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Dr Malcolm Roberts
Chairman
Queensland Competition Authority
Level 27
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BRISBANE QLD 4000

24 October 2014

Dear Dr Roberts

AURIZON NETWORK'S 2014 DRAFT ACCESS UNDERTAKING

QRC submissions

Glencore Coal provides this letter in relation to the 2014 Draft Access Undertaking ("UT4") submitted to the Queensland Competition Authority by Aurizon Network Pty Ltd. Glencore Coal has been an active participant in the Queensland Resources Council's ("QRC") UT4 working group. Glencore has contributed to the QRC's submissions on UT4 and is supportive of them.

Wiggins Island Rail Project

Introduction

Glencore wishes to respond to the QCA's request for submissions in relation to the Wiggins Island Rail Project ("WIRP"), and also to the submissions by Vale and BHP Billiton Mitsubishi Alliance ("BMA") in relation to WIRP. In due course, Glencore will also be making a separate submission in relation to the QCA's Draft Decision on Maximum Allowable Revenues, and in particular the tonnage forecasts which have been used for WIRP in that decision.

Approach to inclusion of WIRP assets in Blackwater (and Moura) System regulatory asset base

Our understanding is that one key decision which is currently before the QCA in relation to the WIRP assets is to approve their inclusion in the Capital Indicator being used to calculate the Maximum Allowable Revenue for UT4. We would submit that this decision should be based on a reasonable assessment of the likely cost of the WIRP assets, of the date when the WIRP assets will be brought forward to the QCA for approval for inclusion into the Blackwater System and of the likely results of that decision (we will talk about the Blackwater System in this submission, but of course the same arguments apply in relation to the Moura System). It seems to us appropriate to rely on Aurizon Network's estimate of the WIRP costs, provided this is reasonable, and its statement of when it will make the application for the QCA's approval. It also appears to us that the QCA should be able to determine its own likely approach to the request for inclusion of these assets in the regulated asset base. We would expect that this future decision by the QCA will be taken on the basis of the information which would have been reasonable available to Aurizon Network at the time of making its investment decision in relation to the WIRP assets, in accordance with the principles which apply under the current 2010 Access Undertaking and which are proposed to apply under UT4. To do otherwise would reflect a retrospective change in

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regulation which no reasonable regulator could make, particularly given the magnitude of the investments which have been made in reliance on the proper implementation of the current regulatory regime.

The 2010 AU defines the Individual Coal Systems. There is no separate "WIRP" system. The definition of the Blackwater System includes the WIRP infrastructure which has been built along the existing Blackwater lines. Therefore, the decision which must be made is whether or not to accept the WIRP assets into the Blackwater System. We fail to see any mechanism by which a new "WIRP" Individual Coal System could be created under the 2010 AU. Similarly, under UT4 the Coal Systems are exhaustively defined and do not include a separate "WIRP" system. Again, the Blackwater System is defined as one of the Coal Systems and is also defined in such a way as to include the WIRP infrastructure. Again, there is no mechanism for the creation of a new Coal System.

UT4 does include the concept of Expansion Tariffs and sets out the criteria which will apply in respect of the creation of a new Expansion Tariff, at clause 6.2.4(i). Glencore Coal supports the concept of Expansion Tariffs for future expansions to Coal Systems. However, the point at which those criteria are applied is the point at which a Pricing Proposal is made by Aurizon Network in relation to the expansion. The Pricing Proposal is provided to the Access Seekers seeking Access Rights to utilise the expansion as part of the expansion process. The Access Seekers will therefore be aware that an Expansion Tariff will be applied to the expansion prior to contracting for the relevant Access Rights. This point has long passed in relation to the WIRP expansions. The Access Seekers have already contracted for the WIRP capacity and did not do so on the basis of Pricing Proposals which set out a separate Expansion Tariff for the WIRP infrastructure. At the time at which the WIRP users contracted for the Access Rights created by the WIRP expansion, not only was there no Expansion Tariff notified to them, but the concept of an Expansion Tariff did not exist in the Access Undertaking.

Schedule A to the 2010 Access Undertaking contains the provisions which apply to the decision whether or not to incorporate the WIRP infrastructure into the Blackwater System. As set out in paragraph 3.3.1(a)(i), the QCA is only entitled to take into account in its decision the information which would reasonably have been available to Aurizon Network at the time of making its investment decision. The same principle is confirmed in the proposed drafting of Schedule E to UT4, at paragraph 2.3. Therefore, current information in relation to tonnage forecasts will not be relevant to the decision making process. In fact, the listed criteria for the QCA's decision (both under the existing and proposed Access Undertakings) include contracted tonnage, with tonnage forecasts only appearing to be relevant to likely future demand in excess of contracted tonnage (as set out in the definition of "Reasonable Demand"), so it is questionable whether any regard at all should be had to forecasts in relation to contracted tonnage. In any event, at the time that Aurizon Network made its investment decision, the expectation would have been that the WIRP infrastructure would be quickly fully utilised and the 90% utilisation forecasts which have been mentioned by Aurizon Network would have seemed conservative. For the QCA to take the decision on the basis of current tonnage forecasts would be to re-evaluate Aurizon Network's investment decision on the basis of information which was not available to Aurizon Network at the time and to unfairly expose Aurizon Network to optimisation risk, or in the case of WIRP, to expose the WIRP users to that risk.

We would therefore submit that the QCA would be likely to approve a future application by Aurizon Network to include the WIRP assets in the regulatory asset base for the Blackwater system. In any event, the QCA would not be justified in rejecting any such application on the basis of information which would not have been available to Aurizon Network at the time of making its investment decision or on the basis that contracted tonnes are not expected to be used. The likely implications for the Blackwater tariff calculated on the basis of current tonnage forecasts for contracted WIRP tonnes would not be a ground for rejecting the inclusion of the WIRP assets into the Blackwater System. Therefore, we would submit that the QCA should include the WIRP assets within the Capital Indicator for the Blackwater System when calculating the Maximum Allowable Revenue for UT4.

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As is apparent from the discussion above, we consider that the explanation submitted by Aurizon Network in August 2013 in relation to Wiggins Island Rail Project Proposed Revenue and Pricing Treatment is confusing in its approach to the “socialisation” of the WIRP infrastructure in the Blackwater System. In our submission, the likely impact on Blackwater tariffs is not relevant to WIRP since the Expansion Tariff proposals do not apply to WIRP and the impact on tariffs is not a matter which the QCA can take into account in making its decision whether or not to include the WIRP assets within the Blackwater regulated asset base. It appears that this section of the Aurizon Network paper was included for the information of existing Blackwater users.

Volumes for pricing

Leaving aside the question of whether or not to include the WIRP assets in the Blackwater System (and the related decision whether to include the assets into the UT4 Capital Indicator), it is of course necessary to calculate Reference Tariffs. For this purpose, it would be appropriate to use current tonnage forecasts. We note that the QCA has in its Draft Decision on Maximum Allowable Revenue published the forecasts which it intends to use in making its decision. We will be making separate submissions on these forecasts. However, to be clear, the use of current forecasts for this purpose does not mean that it is appropriate to have any regard to these forecasts when making a determination in relation to the inclusion of WIRP assets into the Blackwater System regulated asset base.

Submissions by other stakeholders

The submissions by Vale appear to object to the inclusion of the WIRP assets in the Blackwater System on the basis that optimisation risk, asset stranding risk and credit risk were among the factors which were relied on by QR Network (as it then was) in seeking approval for the WIRP Access Conditions. Vale argues that the acceptance of the WIRP infrastructure into the Blackwater System would be inconsistent with the basis on which the QCA made its decision in relation to the WIRP Access Conditions. In our view, these submissions do not accurately reflect the basis on which the QCA’s decision was made.

The optimisation risk which was referred to as part of the justification for the WIRP fee related to the risk of the QCA not accepting assets into the regulatory asset base. It should be obvious that the risk here is identical whether the QCA accepts the assets into the Blackwater regulated asset basis or somehow insists on the creation of a new WIRP system or the retrospective application of an expansion tariff to the WIRP assets.

The asset stranding risk to Aurizon also remains the same whether or not the assets are in the Blackwater regulated asset base or are in a separate regulated asset base. The risk of future optimisation as the result of asset stranding will depend on whether the assets are physically required to be used. The decision to allocate the assets to one system or another does not affect their necessity to the physical operation of the system or to the risk of their being optimised.

The credit risk referred to in the justification for the Access Conditions is the credit risk of recovery of the WIRP fee, and not the credit risk associated with the general access charges calculated on the basis of the regulated asset base. Again, the decision as to whether to include the WIRP assets into the Blackwater regulated asset base does not change this decision, since the WIRP fee is not socialised in the same way as normal access charges are.

BMA states in its submissions that: “As an existing Blackwater system customer BMA is concerned that there should not be a socialisation of Wiggins Island Rail Project (WIRP) costs within the existing Blackwater and Moura asset bases where this would have the effect of passing on Aurizon Network’s asset stranding, credit or volume risks to existing customers. This is of particular concern where Aurizon Network has apparently extracted addition returns on WIRP from Wiggins Island Coal Terminal (WICET) foundation customers.” As explained above, the addition returns which Aurizon has extracted relate to risks which exist irrespective of the inclusion of the WIRP assets into the Blackwater System, and therefore BMA’s concerns on this basis are groundless. BMA may have concerns about the impact of the inclusion of the WIRP assets into the Blackwater System, but its commercial concerns would not appear

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to us to provide any grounds for the QCA to make a decision in relation to WIRP which is not supported by either the existing or proposed Access Undertakings. Any linkage of the QRC's position on pricing principles for capacity expansions to the WIRP project would be misguided, because as is explained in this submission, the point at which an Expansion Tariff may apply to an expansion under the proposed draft UT4 is when the Pricing Proposal for that expansion is put to the relevant Access Seekers. A determination to apply an Expansion Tariff is not made at the point when the decision is being made on the inclusion of the expansion infrastructure into the regulated asset base. An Expansion Tariff cannot be retrospectively applied to WIRP.

In its submissions, Asciano also takes issue with the inclusion of WIRP infrastructure into the Blackwater System. Its arguments are unclear. It mentions that parties which do not use the infrastructure may end up funding it – which is true, although the WIRP infrastructure generally forms part of the main line which all Blackwater users will use. This argument could apply to any section of line which a particular user does not use – to proceed otherwise would require each segment of track to be treated as a separate system for pricing purposes, which would in our view be needlessly complex. Asciano states that it believes the QCA should consider separate prices for new users and existing users – but it is unclear on what basis it believes that the QCA could retrospectively impose such a regime on WIRP users.

Conclusion

Therefore, while Glencore Coal is supportive of the imposition of Expansion Tariffs to future expansions, this should be on the basis that the Access Seekers wishing to utilise that expansion are provided with this information as part of the Pricing Proposal in relation to the relevant Access Rights. To bring WIRP into this discussion is to confuse the issue, because this project is well past that point. Glencore Coal does not support the use of current information to second guess investment decisions which were committed to on the basis of the best information reasonably available at the time. To do so would be to introduce a high degree of regulatory uncertainty. In the case of WIRP, this would unfairly and retrospectively alter the risks to which the users of WIRP are exposed.

General

Glencore Coal confirms that this letter can be made public.

Should you require any further information or discussion on any aspect of this letter, please feel free to contact me.

Yours sincerely



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