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Dear John,

Supplementary Draft Decision – Capacity Transfer Mechanism

The Queensland Resources Council (QRC) appreciates the opportunity to provide feedback on the Queensland Competition Authority's ("QCA's") Supplementary Draft Decision regarding Aurizon Network's proposed Capacity Transfer Mechanism.

The QRC was largely supportive of the mechanism as proposed by Aurizon Network, with our submission of February 2015 suggesting relatively minor amendments to Aurizon Network's approach.

The QRC understands that the QCA may approve a draft access undertaking only if it considers it appropriate to do so having regard to the S138(2) criteria. We consider that an efficient transfer mechanism is relevant to a number of the S138(2) criteria, particularly S138(2)(a),(d) and (e). We therefore support the QCA's role is seeking to ensure that an efficient transfer mechanism is included in Aurizon Network's next Access Undertaking. However, for the reasons set out in this submission, we maintain the view that the mechanisms proposed by Aurizon Network will deliver substantial benefits, including promoting the efficient use of the infrastructure, while the arrangements proposed by the QCA will deliver more limited benefits.

Given the significant differences in the approaches proposed by Aurizon Network and the QCA, we consider that the issue should now be advanced through face to face consultation involving all stakeholders. We therefore have limited this submission to a selection of key comments, and intend to provide further comments during the proposed consultation process.

The key difference between the proposed approaches of Aurizon Network compared to that of the QCA appears to be in the area of transfer fees. Aurizon Network proposed (and the QRC supported) that no transfer fees should apply in regard to short term transfers. This creates some risks in terms of the effects of lost revenue for other users in the system under the revenue cap arrangements. For this reason, certain protections were proposed by Aurizon Network, including limiting the arrangements to short term transfers, preventing repeat transfers where the transferee had previously failed to use the transferred paths, and limiting the transfers to parties paying the same reference tariff. The QCA proposed to reject this approach, instead requiring the transferee to pay an access charge equal to that of the transferor. Under this arrangement, the proposed protections (including limiting the mechanism to short term transfers) are unnecessary, and so were not included in the QCA's proposed arrangement.

The key consideration for the QCA in reaching this decision appears to have been the risk of a loss of revenue when a transferee has a shorter haul distance than the transferor. In the absence of a transfer fee, it is assumed that there would be a loss of revenue to the system. Under the revenue cap arrangements, this loss of revenue is ultimately recovered from other users in the system. This is true even in a period where volumes exceed forecasts, leading to an excess of revenue, as the extent of the excess will be reduced by the transfer, so the excess revenue handed back to other users through the revenue cap arrangements will be reduced.

While the above risk is real, QRC suggests that:

- A closer examination of this risk reveals a series of mitigating factors, which lead us to the conclusion that this risk is not material for short term transfers.

- Consideration of the benefits of an efficient short term transfer mechanism suggests that the risks to other users are more than offset by the potential benefits.

Risk of revenue loss on transfers to shorter haul:

This risk is offset by a number of factors.

1. AT2 and AT4 tariff components are not dependant on distance, and therefore are not reduced due to a transfer to a shorter haul. AT1 and EC relate to variable costs, such that a reduction in AT1 or EC revenue due to reduced distance will have no impact on other users of the system. The impact on other users is therefore limited to the impact of the reduced distance on AT3 and AT5 revenue.

2. Comparing the tariffs of the transferor with that of the transferee in assessing the revenue loss implicitly assumes that, in the absence of the transfer, the transferor would have utilised the relevant path. Generally, miners will only seek to transfer paths which are in excess of their requirements. In this case, the more valid assumption is that the path, if retained by the transferor, would not be used, and would therefore contribute only take or pay (ToP) revenue. In the case of the transferee, it is reasonable to assume that the transferred path will be used, as a party is unlikely to accept a ToP risk without a reasonable expectation of using the path. Therefore a more valid assessment of the 'revenue loss' involves comparing the ToP revenue which the path would have attracted in the hands of the transferor, with the revenue arising from the usage of the path by the transferee. Under these assumptions, the vast majority of transfers would be expected to <u>add</u> to system revenue, even when the transferee's haul distance is significantly shorter than that of the transferor. The reasons for this are:

    - ToP revenue is often nil in a system due to the system trigger test. In this case, all revenue arising from usage of the transferred path is a benefit to the system.

    - If ToP does apply in the relevant system, then:

- The ToP will not include AT5; therefore all AT5 revenue collected from the transferee is a benefit to the system.

- Where the transferor has a UT2 or UT3 access agreement, the value of ToP collections is often capped, which may result in only a small proportion of the notional ToP being collected. Usage of the path by the transferee will, in this case, provide more revenue than the capped ToP collection.

- Where the transferor has a UT1 access agreement, ToP is limited to approximately 30% of the AT3 and AT4 components. Usage of the path by the transferee will, in this case, provide more revenue than the ToP collection.

The schedule to this submission contains a number of worked examples which quantify the loss of revenue when a transfer to a shorter haul is allowed without payment of transfer fees. The examples shown are from notional hauls in which the transferor is located near the most distant point in the relevant system, while the transferee is located near the loading facility closest to the port. Current reference tariffs are used. The examples show that:

- losses are only likely to arise when it is assumed that the transferor would have used the path (had it retained the path).

- even under this assumption the losses are substantially mitigated by the AT2 and AT4 factors and by the irrelevance of AT1 and EC.

- when it is assumed that the transferor would have otherwise failed to use the path and paid ToP, the transfer will generally result in additional system revenue, rather than a loss of revenue.

Benefits of promoting transfers:

Promoting transfers will encourage efficient utilisation of infrastructure. QRC is concerned that the application of transfer fees on short term transfers will disincentivise transfers and reduce system utilisation. The impacts of this include:

- Lost below-rail revenue, which is ultimately recovered from other users of the system.
- Reduced competition in the coal market.
- Reduced royalties, taxes and employment.
- Lower volumes through coal terminals and ports. Due to the high fixed costs of these operations, unit costs increase at lower volumes. The impact of this increase is often passed to users of the terminal/port.

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Conclusion:

QRC suggests that, having regard to the more detailed analysis of revenue effects set out above and in the attachment, the QCA should, in its final decision, apply less weight to concerns of possible revenue loss on transfers to shorter hauls, and more weight to the benefits of promoting short term transfers. We consider that this will lead to a conclusion that an arrangement broadly along the lines of that proposed by Aurizon Network is appropriate. This includes adopting the protections which were proposed to mitigate the remaining revenue risks, which included limiting the application of the mechanism to short term transfers.

Yours sincerely

Michael Roche

Michael Roche
Chief Executive
Queensland Resources Council

Attachment:

Examples of impacts of transfers to shorter haul

(AT1 and EC excluded as these have no impact on other users)

System	Traction type	Transferor distance	Transferee distance	Access Charge $/t when used by transferee	Possible revenue ($/t) if path retained by transferor				Maximum revenue loss	Maximum revenue gain
					If used	If not used and ToP not triggered	If UT1 TOP triggered	If UT2/3 ToP triggered and not capped		
Blackwater	Electric	350	300	$6.04	$6.65	$0.00	$1.17	$4.40	$0.61	$6.04
Blackwater	Diesel	350	300	$4.12	$4.40	$0.00	$1.17	$4.40	$0.28	$4.12
Goonyella	Electric	270	170	$2.56	$3.36	$0.00	$0.66	$2.45	$0.80	$2.56