



Charles Millsteed
Director – Economic Regulation
Queensland Competition Authority
GPO Box 2257
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30 September 2015

Dear Charles,

Stakeholder notice - short term transfer mechanism

Aurizon Network Pty Ltd (Aurizon Network) provides this submission in response to the Queensland Competition Authority's (QCA's) Stakeholder Notice issued on 16 September 2015 concerning Aurizon Network's 2014 Draft Access Undertaking (2014DAU). The Stakeholder Notice addresses the responses to the Supplementary Draft Decision on the Capacity Transfer Mechanism (Draft Decision)¹.

Background and rationale

Aurizon Network developed the short term transfer mechanism in response to requests from its customers for greater short-term flexibility.

After detailed consultation, Aurizon Network decided in conjunction with its customers to develop a trial, stand-alone short-term transfer mechanism:

- To substantiate actual demand for short-term transfers;
- To minimise cost and complexity, by designing a mechanism which fits within existing rules, processes and IT systems; and
- With criteria designed to ensure the mechanism was used for legitimate purposes only, while at the same time ensuring the criteria do not adversely impact on the utilisation of the mechanism (and therefore, on the substantiation of actual demand for short-term transfers).

¹ QCA Supplementary Draft Decision, Aurizon Network 2014 Draft Access Undertaking: Capacity Transfer Mechanism, 30 April 2015

Aurizon Network submitted this transfer mechanism on a voluntary basis.

The purpose of the short term transfer mechanism is to “fill the gap” for customers to enable flexible contractual alignment in the planning environment. Aurizon Network and customers specifically designed the short term transfer process to be a completely new and separate process from the existing rights of relinquishment and transfer under access agreements. Having a separate process to the existing mechanism serves to:

- ensure Aurizon Network could manage requests for a short term transfer in a timely and efficient manner and
- test the proposed short term transfer process for practicality, independent of and without impacting the existing transfer mechanism.

Aurizon Network believes that the short term transfer mechanism proposed in its Discussion Paper² is an appropriate basis on which to introduce flexibility in management of access rights. In addition, the mechanism proposed was ‘largely supported’³ by the Queensland Resources Council (QRC), whose submissions on the Discussion Paper did not raise any major concerns with the proposal. This agreement was further confirmed in a meeting between the QRC, QCA and Aurizon Network on 26 June 2015.

The QCA’s Draft Decision rejected Aurizon Network’s proposal and instead proposed to substantially amend the transfer mechanism contained in the 2014DAU for any type of transfer (short or long term). The QCA’s proposed mechanism does not work within existing rules, processes and IT systems, is more complex, more costly, and (as it is untested) may result in further, unanticipated opportunities for the “gaming” behaviour which forms the basis for the QCA’s Stakeholder Notice.

Accordingly, Aurizon Network welcomes the opportunity to respond to the Stakeholder Notice, and in particular to demonstrate why its proposal appropriately balances cost, complexity, efficiency and (in seeking to minimise gaming behaviour) integrity.

While Aurizon Network has included responses below, it still has a concern regarding the lack of clarity and information provided by the QCA. In a number of questions, the QCA is asking what would be more appropriate than the criteria proposed by Aurizon Network in the Discussion Paper. Aurizon Network does not consider that the QCA has sufficiently demonstrated why Aurizon Network’s proposal is not appropriate, especially given the level of consultation and agreement from customers regarding the content of the Discussion Paper.

Response to Stakeholder Notice

In submitting this response, Aurizon Network seeks to provide information to address all questions contained within the QCA’s Stakeholder Notice. For ease, these questions are repeated below.

² Aurizon Network 2014 Draft Access Undertaking, Discussion Paper on potential short term transfer mechanism, 19 December 2014

³ Supplementary Draft Decision – Capacity Transfer Mechanism - Queensland Resources Council, 15 June 2015, page 1

1) Please provide examples of previous transfers or hypothetical examples of transfers that you would not undertake if the transfer was subject to the pricing mechanism outlined in decision 4.1 of our Draft Decision. In your response please provide sufficient details of:

- a. the additional costs of the transfer in the absence of the proposed pricing mechanism**
- b. the additional costs of the transfer if it were subject to the proposed pricing mechanism, and**
- c. the revenue forgone if you had not entered into the transfer.**

Aurizon Network remains committed to facilitating transfers of access rights requested by access holders which will ultimately ensure efficient use of the rail network. The current two year “free transfer” under the 2010 Access Undertaking (2010AU), and the proposed “free transfers” under the short term transfer mechanism benefits access holders by responding to changes in demand for railings without additional cost attributed to that flexibility.

During FY2015, Aurizon Network processed 29 access requests relating to the transfer of access rights. Of these access requests, 10 were executed into an access agreement, 12 are still being negotiation, five are waiting the access seeker to action and two were cancelled by the access seeker. Of the access requests executed or still being negotiated (total of 22 in FY2015) 19 have a transfer fee of zero.

In Aurizon Network’s experience, especially in the current market environment, any additional costs for a transfer can inhibit a negotiation. In most cases, Aurizon Network deals with rail operators as the access holder for access rights, not directly with the end customer. This arrangement results in Aurizon Network not having any visibility on whether or not these transfers would have proceeded if they were being priced in-line with the QCA’s Draft Decision.

2) Please provide examples of 'gaming' behaviour that may occur.

The two key “gaming” behaviours relevant to short-term transfers are:

- a. Transferring access rights to shorter hauls with no intention of using them; and
- b. “Shifting” large portfolios of access rights to suit prevailing market conditions, at the expense of other system users.

Aurizon Network’s has responded to these equally below:

- a. Longer to shorter

This would occur where access rights are moved from a longer haul to a shorter haul, minimising both access charges payable and take or pay due. Where the access rights are transferred to a shorter haul that are actually used, Aurizon Network will receive the full access charge (AT1 – AT4 plus AT5 and EC where electric services are operated) for that shorter haul. This could result in additional revenue if the transferred paths are used, assuming that without the transfer the access rights would have only counted towards take or pay (AT1 – AT4) revenue. However, where access rights are transferred to a shorter haul and are not used, Aurizon Network will receive a lower amount of take or pay revenue on the shorter distance than it would have without the transfer.

It is in the interests of all access holders to minimise this type of gaming behaviour, however maintaining a mechanism which leads to an increase in flexibility and utilisation of access rights where the transferee has a demand for the capacity. In order to address this concern, Aurizon Network proposed the criteria of demonstrating that the transferee has an ability to load trains. This is further discussed in response to Question 5.

b. Portfolio shifting

Aurizon Network proposed the maximum of 25% of access rights in any financial year criteria as a limit on access holders using the short term transfer mechanism to move significant portions of access rights. Aurizon Network proposed the 25% maximum as a proxy for three months of access rights (effectively a quarter of the year). A percentage test is objective, and aligns with existing processes, meaning that the test can be more readily tracked and monitored than a timeframe-based test for transfers, especially if the transfers are only for a portion of an access holder's access rights during that period.

Where an access holder has a requirement to transfer greater than 25% of access rights in any financial year, they have the 'existing transfer mechanism' within the standard access agreements to facilitate this request. The existing transfer process allows Aurizon Network to undertake a detailed capacity assessment and determine any financial impacts on other access holders. This is discussed further in response to Question 7.

3) Please provide any comments on whether Aurizon Network's proposed 85% requirement will identify and stop any 'gaming' behaviour identified in your response to question 2.

To ensure that all access holders are treated equally and that there could be no suggestions of bias, Aurizon Network submitted an objective measure to ensure that the proposed mechanism prevented gaming from occurring. The 85% criteria was an objective measure and will satisfy this requirements. Having an objective measure provides certainty to access holders on fair treatment to all access holders.

Aurizon Network proposed the 85% level to align with the existing provisions around resumption of access rights. In this case, if an access holder does not use 85% of access rights, where there is alternative demand, Aurizon Network could resume these rights and resell to another access seeker. Consequently, this resumption provision has been considered as a precedence of a relevant measure of utilisation of access rights resulting through a short term transfer.

4) Please provide comments on alternatives to Aurizon Network's proposal [85% requirement] that you consider more appropriate. Please provide illustrative examples in your response.

Aurizon Network's concern is whether the proposed transferee will actually utilise the rights under a short term transfer.

As an alternative, Aurizon Network considers that an assessment of the train load out would provide a natural, physical constraint on transfers. It would provide an objective assessment of the likelihood that train services would operate.

Each mine load out has a specified maximum number of trains per day which are able to be loaded. Where an order for a proposed short term transfer is received, Aurizon Network could complete a simple confirmation against the maximum number of trains that the transferee mine

load-out can handle. Where it is confirmed that the transferred rights will result in an exceedance of the load out capabilities, Aurizon Network could decline the transfer.

Aurizon Network is prepared to substitute the 85% utilisation of transferred access rights criteria for an alternative if that measure meets the objective of the short term transfer mechanism being a simplistic, cost effective and utilised process.

5) Please provide any comments on whether the requirement to demonstrate ability to load a train will identify and stop any 'gaming' behaviour identified in your response to question 2.

As outlined in Question 2, Aurizon Network's main concern is whether the proposed transferee actually intends to use the access rights granted to them under a transfer.

Aurizon Network considers that the train load out provides a natural, physical constraint on gaming transfers. It provides an objective assessment of the likelihood that train services are actually going to operate. Each load out will have a specified maximum number of trains per day which are able to be loaded. Aurizon Network would agree up front this maximum number, which would also then provide an early indication to access holders of whether the proposed transfer will go ahead.

6) Please provide comments on alternatives to Aurizon Network's proposal [demonstrate ability to load a train] that you consider more appropriate. Please provide illustrative examples in your response.

Aurizon Network would be willing to remove the 85% requirement as discussed in response to Questions 3 and 4 as long as the requirement to demonstrate the ability to load a train is retained.

Aurizon Network considers this criteria provides a clear, objective rationale for Aurizon Network to decline a transfer where the number of trains needed to operate is in excess of the maximum. In this manner, it removes any potential disputes around rejection of a transfer.

7) Please provide comments on alternatives to Aurizon Network's proposal [25% of TSEs, coal traffic only, same reference tariff] that you consider more appropriate. Please provide illustrative examples in your response.

As discussed in response to Question 2, the 25% of access rights limit provides Aurizon Network an opportunity to assess impacts on the system of transfers beyond this level. For transfers of more than 25% of total access rights for the year, Aurizon Network would assess these under the standard process for transfers contained in access agreements. Aurizon Network considers this a workable approach for the initial implementation of the short term transfer mechanism. This would be considered as part of the periodic review to be completed after implementation.

As outlined in Aurizon Network's response to QCA Draft Decision⁴, Aurizon Network did not include non-coal traffic in the short term transfer process as the process is designed to deal with coal supply chain dynamics, for example cargo assembly operation of coal export terminals. In addition, due to the nature of non-coal traffic, it is unlikely they would be able to

⁴ Response to QCA Supplementary Draft Decision on 2014 Draft Access Undertaking – Capacity Transfer Mechanism 29 May 2015, page 9

be transferred without causing disruptions to timetables, and also result in pricing/revenue allocation issues.

Providing flexibility for transfers to occur across reference tariff groups raises a number of additional pricing issues:

- The allocation of revenue received from the transferee between reference tariff groups would need to be considered.
- In the case where the transferor is paying substantially higher reference tariffs than the transferee, the loss of revenue may be substantial.

It is possible that allocation mechanisms for revenue from a short term transfer across reference tariffs could be agreed in future. At this time, given the requirement for additional administrative controls, and also mechanisms to deal with potential substantial revenue losses, Aurizon Network believes that this should not be considered in the initial implementation of the short term transfer mechanism.

8) Please provide comments on the appropriate definition of common destination. Please provide illustrative examples in your response.

Aurizon Network's proposed common destination referred to the same unloading facility as the transferor's access rights. The rationale for this was to limit the requirement for capacity assessments to be undertaken within the 48 hour timeframe granted to Aurizon Network to approve or deny the transfer request.

Aurizon Network would consider broadening of this criteria to be a destination within the same port precinct, subject to a mechanism being agreed to enable Aurizon Network to still address any capacity concerns within the required timeframe for notifying the access holder whether the transfer request will be granted. For example, similar to the load out facility capability, Aurizon Network, in consultation with access holders and terminal operators, could determine the maximum number of trains per day through each facility, and if the access rights to be transferred fit within this limit it would be agreed.

9) Please provide comments on the extent to which 'gaming' behaviour identified in your response to question 2 will continue under the pricing mechanism outlined in decision 4.1 of our Draft Decision and why this would be the case.

Aurizon Network and stakeholders agreed on the pricing mechanism proposed in Aurizon Network's Discussion Paper (being a zero transfer fee). Aurizon Network and stakeholders were comfortable with this approach.

The pricing mechanism outlined in the QCA's draft decision 4.1 is contrary to the objectives of Aurizon Network's customers. In the Draft Decision, the QCA sort to not only introduce effectively a fee for transfers under the short term transfer mechanism, but also wound back the two year free transfer which the QCA previously supported and approved through the 2010AU:

"The Authority has considered stakeholders' comments in relation to short-term transfers and, in particular, agrees in principle that it would be beneficial, and promote

*whole-of-coal-chain supply objectives, if fees for short-term transfers were relaxed under all access agreements.*⁵

The Draft Decision did not demonstrate how the proposed pricing mechanism would improve efficiency of operation of the network relative to Aurizon Network's proposal. In addition, Aurizon Network considers there is the potential for the QCA's proposal to create a whole new framework for transfers which in itself could potentially become misused.

As outlined in Aurizon Network's response to the Draft Decision⁶, and below for Question 10, Aurizon Network considers there are a number of practical issues with this proposed pricing mechanism.

10) Please provide comments on the practical requirements of adopting the pricing mechanism outlined in decision 4.1 of our Draft Decision, the impact these may have and why. Please provide illustrative examples in your response.

Aurizon Network believes there are a number of practical issues associated with implementing the QCA's pricing mechanism. For example:

- Contractual variations (requiring the consent of each access holder) would be required to ensure the different charge for the transferred services are reflected. This could result in disputes around the derivation of the access charge.
- In pricing further transfers, if the access rights to be transferred are already subject to a transfer price, there would need to be pricing principles agreed in regards to what price the new transferee should pay. This could lead to additional disputes in developing access charges for transfers of access rights. In the environment where transfers are being sort to be approved within 48 hours, this could cause additional costs and delays for both Aurizon Network and the access holder.
- In the train ordering and scheduling environment, both Aurizon Network and the access holder would need to have systems/mechanisms in place to record which train services operated are original contracted services and which are transferred services. This would result in additional costs, and also increase administration time required to manage the process. Aurizon Network proposed Maximum Allowable Revenue submission in December 2014, does not contain any provisions for these additional costs.
- In both billing and take or pay, both Aurizon Network's and access holders billing systems and processes would require material changes to ensure the invoice each month accurately reflects the access rights used, and the services count towards the correct usage for take or pay (as it would be based on two different access charges). Aurizon Network proposed Maximum Allowable Revenue submission in December 2014, does not contain any provisions for these additional costs.
- In reporting, potential for increased compliance risks due to billing errors. This would increase costs to Aurizon Network. Aurizon Network proposed Maximum Allowable Revenue submission in December 2014, does not contain any provisions for these additional costs.
- In generating reference tariffs, additional complexity in determining assumptions for gtk and ntk forecasts. This would increase costs to Aurizon Network. Aurizon Network

⁵ QCA Final Decision QR Network's 2010 DAU, September 2010, page 138

⁶ Response to QCA Supplementary Draft Decision on 2014 Draft Access Undertaking – Capacity Transfer Mechanism 29 May 2015, page 17

proposed Maximum Allowable Revenue submission in December 2014, does not contain any provisions for these additional costs.

In summary, Aurizon Network believes the short term transfer mechanism as proposed in the Discussion Paper remains an appropriate starting point for introduction this new, more flexible method of facilitating transfers of access rights for access holders. The intention is to put in place a simple, functioning short term transfer mechanism. Over time, as both Aurizon Network and access holders become more familiar with the process, it may be possible to make incremental changes.

Furthermore, Aurizon Network has not been provided sufficient evidence from the QCA in its Draft Decision as to why the proposed mechanism, or the existing transfer processes in access agreements is not appropriate and why it required wholesale changes to be made.

Aurizon Network does not consider any information contained in this submission is confidential, and may be considered a public document. Aurizon Network looks forward to further engagement with the QCA and stakeholders leading to the finalisation of the 2014DAU to ultimately establish an approved access undertaking.

If you have any questions on this matter please contact Belinda Pryor on (07) 3019 5003.

Kind regards,



Jon Windle
Vice President - Regulation
Aurizon Network