30 September 2015

Mr John Hindmarsh
Chief Executive Officer
Queensland Competition Authority
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Dear Mr Hindmarsh,

Submission on short term transfer mechanisms – Stakeholder request for additional information

BHP Billiton Mitsubishi Alliance (**BMA**) welcomes the opportunity to provide a submission in response to the Queensland Competition Authority's (**QCA**) Stakeholder Notice seeking additional information on Aurizon Network's proposed short term transfer mechanism.

BMA operates a portfolio of mines in the northern system. Short term transfer within this portfolio is an important mechanism that BMA relies on to manage its production variability.

In BMA's view, short term transfer mechanisms enable efficient utilisation of track infrastructure while maximising system throughput. In the context of a fully committed network, this is of particular importance to an individual user going forwards; as it is likely that the full cost of any incremental capacity expansions will be borne by the user/s triggering the expansion. It is in the collective interest of Aurizon Network and network users that the regulatory framework has mechanisms in place that support efficient utilisation of below rail infrastructure through flexible and transparent capacity transfer mechanisms from one 'origin-destination" pair to another. This would also support the various objectives under Part 5 of *the Queensland Competition Authority Act* (**the Act**), in particular s138 (2).

In addition to operational efficiency benefits for a portfolio operator, short term transfers should also be the means by which users can efficiently manage the market driven cyclical supply response of mine production within what is otherwise a relatively inflexible, rigid below rail contracting environment. In Australia, and particularly in the resources sector, long term take-or-pay arrangements are common in port and rail contracts. BMA understands the requirement for long term take or pay contracts to underpin Aurizon Network capital investment. However, these take-or-pay contracts may force coal producers to continue production, despite that production being uneconomic as a result of low commodity prices.

The problem of an inefficient market production response by coal producers is exacerbated by the lack of provisions in combining load points when entering into a below rail access agreement, as Aurizon Network's approved undertaking does not allow for any flexibility in this regard. Access agreements are inflexible in their "origin-destination" pairs, and an access agreement specifies the precise tonnages that need to be railed from nominated load points. Production variation, logistics constraints, weather, marketing or customer requirements and production responses to commodity prices are some of the factors that may require an access holder to initiate a short term transfer either within its portfolio or with another third party. Also, productivity benefits overtime could also result in increased system capacity resulting in a need to temporarily capacity transfer.

The inflexibility of the regulatory system is aptly demonstrated from the fact that combining closely co-located load points, for contracting purposes is not permitted even if the load outs are on the same mining lease. Operationally, there may often be a requirement to transfer Trains Service Entitlement (**TSEs**) between co-located load points to effectively manage production variability. However, this would not be encouraged if there was a transfer fee attached to such a transfer as proposed by the QCA in its draft decision. In the absence of a transfer fee, an access holder would have opportunities to manage its contracted entitlements internally, or in collaboration with a third party more efficiently. The current transfer process is also administratively cumbersome, requiring variation to an existing access agreement.

To date, Aurizon Network's access undertaking does not include a mechanism for secondary trading of capacity or contracted access rights. However, Aurizon Network through its access undertaking has always ultimately retained its right to approve or reject a transfer.

The QCA should look at promoting the development of a mechanism that facilitates secondary trading of access rights similar to other regulated infrastructure such as gas pipelines. With the changing regulatory arrangements, and significantly diminished risk profile of Aurizon Network over the past years, such a mechanism would significantly increase productivity and system throughput and enable more efficient supply side responses to changes in commodity prices.

BMA believes that Aurizon Network could play an important role in facilitating the development of an efficient market response by hosting the development of a secondary capacity trading mechanism. Aurizon Network should benefit as the overall system revenue will be higher if a TSE is transferred and utilised when compared to a scenario where the TSE was contracted but left unutilised. This would also promote the objectives of part 5 of the QCA Act by promoting competition. Small producers or mines ramping up production can rely on these mechanisms by avoiding entering into long term contracts that act as barriers to entry.

In its draft decision on the short term transfers mechanism, the QCA has been overly concerned with the loss of revenue as a result of short term transfers and the need to keep Aurizon Network revenue neutral. A short term transfer from a longer haul to a shorter haul may result in a loss of revenue if the effected transfers are not utilised. However, in the event the short term transfers are utilised, the overall revenue earned by Aurizon Network will be more than when a transferor decides to non-utilise the rights and pay take or pay liability instead. Out of the six different components of tariffs only two, AT3 and AT5 are distance based and reduce or increase with distance. Therefore, the loss of revenue in the through transfer in general or transfer from a longer haul to a shorter haul should be more than offset by the access revenue from the use of a shorter haul TSE.

One of the other concerns, which the QCA has highlighted, is the use of the flexible short term transfers provisions by individual users for gaming the take or pay liability by transferring paths from a longer haul to a shorter haul. In BMA's opinion, the likelihood for gaming to occur is very limited particularly over a prolonged period of time. Even if gaming is considered a real risk, it can be easily managed through a simple measure that does not allow repeat transfers where the transferee had previously failed to use the transferred paths. This test in its own should be sufficient enough to prevent any potential gaming. Aurizon Network has proposed a range of mitigating options for preventing gaming. These are:

- Limiting transfers to a maximum of 25% of the TSEs in an access holder's access agreements for a relevant origin destination in any financial year.
- Requirement of written confirmation from a loading facility's operator that the load point is able to accommodate the proposed short term transfers in addition to the contracted access rights.
- Requirement for like for like trains service types.
- Limiting the transfers to services that have charges based on the same reference tariff.

- Requirement to demonstrate that the short term transferee's operator has sufficient capacity to rail 100% of the short term access rights and all other access rights for train services which it operates.

BMA believes that the above requirements are unnecessary and would limit flexibility. The QCA's draft decision to introduce a pricing regime that effectively serves as a transfer fee further acts as a disincentive by adding additional cost to the transfer.

In the Central Queensland Coal Network (**CQCN**), access holders can sell their capacity to other third party access seekers or holders but there is no transparency of available capacity in the short term. Lack of knowledge and easy access to contracted, unutilised capacity could be improved via a transparent, market based mechanism. Besides an approved short term transfer mechanism, the regulatory framework should also provide for a voluntary capacity trading process with the following features:

- A clearing house mechanism for temporary or short term trading of capacity managed by Aurizon Network.
- Aurizon Network as the owner and manager of the below rail track infrastructure would have a natural incentive to encourage capacity trading as it would maximise system revenues.
- The framework for access to mainline should be clear and transparent and dictated by the QCA through Aurizon Network's access undertaking and system rules.
- Aurizon Network can then facilitate operational transfer in collaboration with train operators without the requirement of a contractual amendment.
- Through scheduling and train ordering mechanism the utilisation of access rights can be managed with offsetting adjustment to the TSE consumption in the transferor's access agreement.

The QCA should consider establishing a secondary trading mechanism, in the future, in consultation with industry, and the costs and benefits of any such mechanism would need to be fully assessed.

Before approving any short term transfer provisions, the QCA must ensure that the provisions are sufficiently flexible including ability to transfer paths across systems. There should be no superficial restrictions that prevent maximum utilisation of existing rail infrastructure resulting in improved productivity.

If you have any queries or require further information, please feel free to contact Ruchi Gupta on 07 3239 2348.

Yours Sincerely,

Geoff Streeton

Head of Business Development
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