26 February 2016

Professor Roy Green
Chairman
Queensland Competition Authority
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Dear Professor Green,

Aurizon Network's 2014 Draft Access Undertaking - Response on Queensland Competition Authority's Consolidated Draft Decision

BHP Billiton Mitsubishi Alliance (BMA) welcomes the opportunity to provide a submission on the Queensland Competition Authority's (QCA) Consolidated Draft Decision (CDD) on Aurizon Network's Draft 2014 Access Undertaking (2014 DAU).

In general, BMA supports the QCA's decision not to approve the 2014 DAU and considers, overall, the CDD amended 2014 DAU provides greater transparency, more balanced terms and conditions and retains aspects of the current undertaking, where appropriate. BMA has considered the arrangements in its capacity as an access holder and rail operator (and holder of a Train Operating Agreement (TOA)) on the central Queensland Coal Network (CQCN).

BMA supports the comments made by the Queensland Resource Council (QRC) in its submission to the QCA on the CDD. Further comments BMA makes in respect of particular aspects of the QCA's proposed amendments are contained in Attachment 1 to this submission.

BMA is hopeful the way forward will see the timely completion of the UT4 assessment process and a re-evaluation of the undertaking approval process more generally.

Promoting the most efficient use of the existing coal network

A key theme of the CDD is to 'support the productive use of the existing CQCN capacity' and to ensure 'all elements are working together', from capacity management and pricing, to access agreements, for this to occur.[1] BMA strongly supports this objective, particularly at a time when coal producers are undertaking extreme measures to improve productivity and competitiveness in current coal market conditions.

Since the global financial crisis, coal prices have been at an all-time low and downward pressure on coal prices is expected to continue. For coal producers, expanding or undertaking costly initiatives to increase output and margins is not an option in this environment.

[1] December 2015, QCA Consolidated Draft Decision (Vol 1): viii

As such, the focus is, and has to be, on productivity – finding different and better ways to maximise the use of existing assets and resources to enable production increases (thereby lowering the cost per unit rate).

Similarly, expanding the below-rail network or incurring increased costs to maximise throughput is currently, and likely to continue to be, an unattractive option for coal producers. As such, when it comes to regulatory framework, the focus must turn to putting in place arrangements that, as a whole, support the efficient use of existing CQCN infrastructure and promote coal supply chain co-ordination.

BMA supports a transparent and workable transfer mechanism

The short-term transfer mechanism plays an important role in the day to day operations of mining companies. Arrangements that facilitate short-term transfers have benefits for coal producers – in maximising the use of their existing below-rail entitlements and providing flexibility to manage supply chain variables (e.g. mine production variability and port requirements). It also has overall network benefits – in maximising the use of existing CQCN infrastructure and improving coal supply chain alignment.

The QCA has aimed to streamline and simply the transfer arrangements in order to reduce unnecessary costs and complexity for both Aurizon Network and access holders. While BMA does not oppose the transfer provisions, it is not clear whether the QCA's amendments have in fact achieved this purpose:

- *separate processes* – BMA supports having separate processes for short-term transfers and permanent transfers of access rights. While there may normally be benefits in combining similar processes to reduce administrative costs and complexity, BMA does not believe short-term transfers and permanent transfers are similar processes. The two serve a very different purpose and combining them only increases complexity (and therefore administration) rather than improving it;
- *zero fee period* – BMA supports having a fee-free period for short-term transfers, but considers a 3 month period is too short. It would require some transfers to be renegotiated repeatedly, which reduces certainty for industry and increases administrative costs (of which Aurizon Network's administrative costs would be passed back to miners). If QCA is minded to retain the 3 month period, BMA considers including provision for the 'roll-over' of transfers (up to a maximum limit) may be a useful way to alleviate some of these concerns;
- *gaming* – BMA does not believe maximising the use of existing contractual entitlements necessarily means gaming is occurring. While the QCA was not clear on whether it considered gaming occurred or not, it said there was a clear incentive for companies with larger portfolios to shift railing needs to the least-cost option. BMA blends coal from different mines to produce a range of saleable products. As such, it is not a viable option for BMA to work from the starting assumption of selling products from particular mines in a bid to reduce its take-or-pay liability. To maintain the viability of all mines in its portfolio, BMA uses coal from all of its mines (subject to unforeseen events (e.g. weather)) to meet customer product and blend requirements. Short-term transfers assist BMA to manage inevitable mis-alignment between mine production to customer (port) requirements;
- *reporting regime* – BMA supports the use of a reporting regime to inform future assessments, if information on actual transfers will assist in developing a regime that meets stated goals and the needs of parties using it;

- *price arrangements* – if the undertaking ultimately requires a fee for short-term transfers over 3 months, BMA questions whether it is correct to assume cost socialisation of any short-term transfer fee should not occur in some instances (i.e. where the transferred rights are used and the fee results from a long to short haul transfer). While BMA does not consider the QCA is bound to previous decisions (including the two year fee-free approach applied under UT3 arrangements), BMA considers socialisation of the fee is:
  - consistent with the regulatory regime we operate in; and
  - does not adversely affect existing access holders given the amount is likely to be minimal and there are broad interests in unused capacity being used rather than not.

Regarding the pricing arrangements, BMA notes that between UT2[2] and UT3[3] there was a shift to a revenue cap regime and then to a system pricing approach. These steps grouped customers together (by system) for the purpose of pricing and revenue recovery – i.e. prices are determined for all mines in the system and any revenue differentials based on individual variations in actual tonnages are used to determine the system revenue cap adjustments. The adjustment is then applied to future system tariffs for all system users such that, the under/over railing of any particular mine over the course of the regulatory period is spread over all system users.

Given this, it is not clear why in this instance of transfer fees, the focus of revenue differentials at a customer level is deemed 'inequitable'. This form of 'cost spreading' to account for customer volume differentials was contemplated by, and already occurs, in the pricing and revenue arrangements we currently have. In addition, if it means the difference between a train path being used or not, there is a system benefit to it being used (maximising use of existing capacity and increasing actual tonnage throughput). If more tonnes are railed by individual mines, the more likely it is system volume forecasts (and therefore system revenue caps) will be achieved. This reduces not only the likelihood of take-or-pay obligations being triggered for all customers, but also the chance of tariff increases for all customers resulting from revenue cap adjustments in future.

Where arrangements can benefit all users of the network, it would be a shame if an assessment of possible winners and losers at the extreme micro level was the cause for rejecting its implementation.

Encouraging and taking account of productivity improvements

The QCA has aimed to include arrangements that provide greater transparency of capacity on the CQCN and promote increased co-ordination of coal supply chain participants. BMA considers the amendments made will help achieve these objectives. In particular, BMA supports arrangements included in the 2014 DAU that provide for developing a baseline capacity estimate on the CQCN (and for annual reviews of it thereafter) and requirements for Aurizon Network to participate in coal supply chain coordination efforts and adopt operational changes where it can reasonably recover the costs of doing so under the undertaking.

At the same time, the coal industry (including BMA as both a mine, train and port operator) has been striving to improve productivity and reduce costs, but it is fair to say, more needs to be done to materially improve and sustain levels of productivity for the industry to remain competitive in the global market (**Box 1**).

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[2] The access undertaking relating to the regulatory period between 2006 to 2010
[3] The access undertaking relating to the regulatory period between 2010 to 2014 (extended and applicable until the approval of UT4).

Box 1: BMA coal train initiatives

BMA Rail is a standalone coal rail haulage operation that commenced railings in 2012. BMA Rail currently services some of BMA's northern mines, railing to BMA's export terminal at Hay Point. BMA Rail has implemented (and continues to work on) a number of initiatives to drive productivity improvements and achieve sustainable operational efficiencies, including the longer train initiative (discussed below).

BMA Rail has also initiated and co-ordinated the formation of the Operators Forum with various relevant parties operating on the CQCN, including Aurizon Operations and Pacific National. This forum encourages information sharing and collaboration from all participants in implementing and ultimately achieving productivity improvements via train operations across the network.

Longer train initiative

BMA Rail researched a number of ways to increase its throughput and lower per unit costs within the boundaries of its current operations on the CQCN. Using longer trains was an initiative designed to take advantage of technological advances in the size of locomotives and increase tonnages hauled within the capabilities of the existing loading and unloading infrastructure (and with lower capital investment relative to other options like expanding the network).

In order to implement this initiative, BMA Rail prepared plans and sought approval to commence a trial of these trains on the network. This trial was successful, and led to more broad adoption of longer trains by other train operators on the network. It has also achieved the goal of increasing throughput and lowering haulage costs (on a net tonne basis).

Train operators, including BMA Rail, have adopted the use of longer trains on the CQCN. This has the effect of increasing track availability on the network because at any given tonnage, the number of trains required to haul the tonnes is less (given increased payloads). Increasing track availability on the network has potential benefits for:

- access seekers and holders:
  - meeting capacity demands with the existing CQCN infrastructure and potentially delaying unnecessary and costly expansions;
  - potentially reducing the number of contracted train paths not provided (from existing entitlements) due to various causes (network maintenance and other forms of above and below-rail factors);
  - freeing up paths for transfers that could have otherwise required additional capacity;
- Aurizon Network:
  - reducing train paths used on the network provides more paths for network requirements that can be used without affecting existing contracted entitlements;

- ability to accommodate new capacity requests using existing infrastructure in a timely manner and without expansion.

Aurizon Network can update parameters used to determine system operating plans, available capacity (including baseline capacity), cycle times and average below-rail transit times (a trigger for capital expenditure), as well as benefit from increased flexibility in scheduling its own below-rail operational requirements, e.g. maintenance possessions.

BMA also notes the QCA has sought to update parameters to reflect operational improvements in diesel versus electric trains and, as a result, has removed the diesel multiplier (an input used in determining reference tariffs).

While the 2014 DAU allows Aurizon Network to account for any efficiency gained by updating relevant parameters, and the QCA has updated parameters to reflect operating reality, BMA is concerned the same flexibility is not accorded to access holders, despite having played an important role in developing, implementing and achieving the initiatives:

- no scope to waive relinquishment fee – the QCA has not accepted it is appropriate to include provisions for waiving relinquishment fees where additional paths are created via operational productivity improvements;
- provisions within the SAAs – the QCA has not accepted inclusion of provisions that would allow for the reduction in train paths (either by Aurizon Network or the access holder) where the operational parameters have changed due to productivity increases (i.e. increased payloads).

BMA urges the QCA to revisit these positions so access holders can recognise productivity benefits able to be captured across other aspects of the regulatory arrangements.

BMA also notes capturing these benefits will become increasingly important as access holders seek to implement further productivity improvements and Aurizon Network’s participation in supply chain initiatives may result in the adoption of operational changes (as proposed by the QCA in the CDD). As it stands, the 2014 DAU now contemplates Aurizon Network recovering the cost of such initiatives via the undertaking, but there are no corresponding mechanisms (such as those described above) allowing access holders to account for operational changes affecting their contractual entitlements without penalty.

As operational changes and practices evolve, there are likely to be corresponding changes to a range of factors in the undertaking that effect calculations under the undertaking, as well as access holders’ entitlements under contracts, e.g. reference train characteristics, train length, loading and unloading times, cycle times etc. Also, as stakeholders strive for productivity improvements and efficiencies to make better use of existing assets (including the CQCN), it is the inputs that will change (and hopefully improve) in response to these initiatives. All of these factors will affect inputs in the undertaking and which are used for a range of calculations concerning capacity, capital expenditure requirements, reference tariff determination, actual revenues collected and adjustment amounts required. Unless there is flexibility to update these factors and reflect real changes in the operating environment, outputs determined based on these parameters will be misleading. Careful consideration needs to be given to the interlinkages between input parameters, outputs and the regulatory regime in order to cater for future requirements, while balancing the interests of all parties.

While BMA generally supports the CDD, there are areas impacting the efficient operation of the whole of supply chain that should be reassessed. BMA has highlighted some broad concerns with particular aspects of the CDD, but believes further consideration is necessary going forward so that efforts to incrementally simplify and improve the undertaking over time do not leave an undertaking that is different, but equally as unwieldy and complex as what it was before.

If you have any queries or require further information, please feel free to contact Ruchi Gupta on 07 3329 2348.

Yours sincerely

Geoff Streeton

Head of Business Development
BHP Billiton Mitsubishi Alliance

Attachment 1

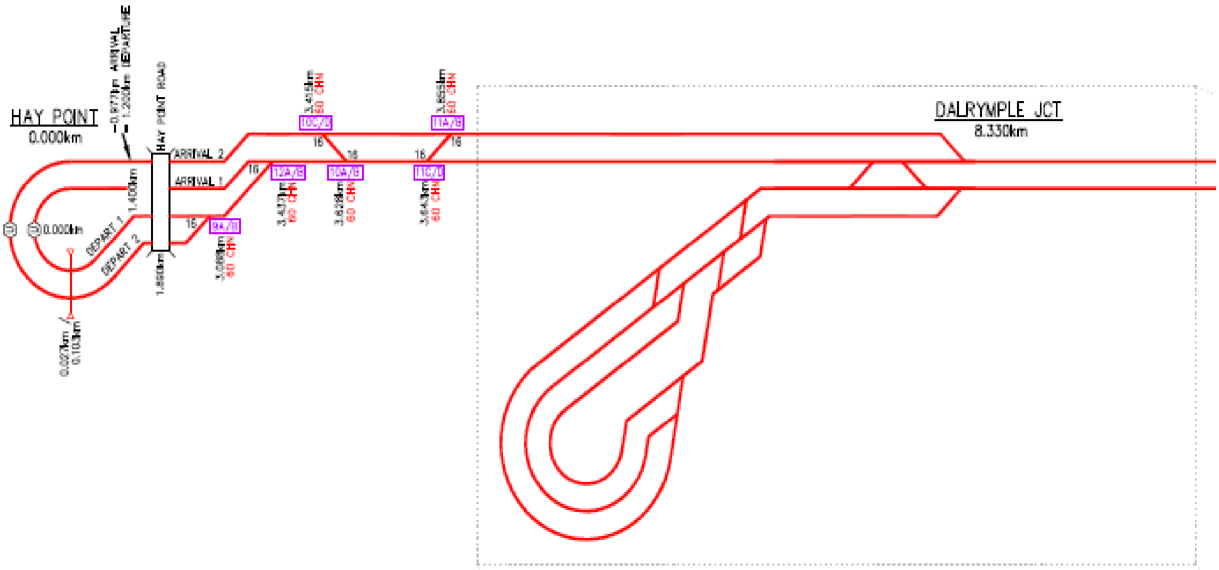
BMA generally supports the Queensland Resource Council's (QRC's) submission. In addition, BMA makes the following comments on specific aspects of the QCA's CDD.

Table 1: Comments on specific aspects of the CDD	
Access	
Access Agreements	Incorporating clauses from the agreements (such as transfers and relinquishments) into the undertaking – while BMA understands the concept of including such provisions in the access arrangements, certainty of contractual terms are of key importance from a risk perspective, particularly given the long term nature of the access contracts. BMA cannot accept arrangements that lock in access rights over the long term, but increase the uncertainty and risks of using them throughout the life of the contract.
Deed	Proposal to change the train operating agreement (TOA) to a deed (TOD) – BMA does not support this change. If it creates additional administrative complexities (for BMA or parties' it contracts with) it may impact the ability of parties to make necessary changes to agreements that are time critical.
Capacity	
Short-term Transfers	In addition to the comments raised in the body of this submission, BMA provides the following circumstances where QCA's transfer fee proposal would impact transfer decisions made by BMA. BMA notes this is the same example provided to the QCA prior to its release of the CDD. Example 1 – Riverside / Goonyella mine. This is a single mine with two separate load outs. BMA uses transfers between to manage fluctuations in demand for respective Ports and coal type (blending). The load outs service multiple coal Systems and ports. Transfer fees would increase the cost of managing this variability and, in turn, place additional cost pressures on BMA in an already declining coal market. Example 2 – Norwich Park mine. BMA entered into long term contractual arrangements to haul coal from this mine however railings cannot commence until infrastructure enhancements are made. BMA has relied on being able to transfer these rights until railings are able to commence at Norwich Park. Transfer fees would again increase the cost of managing this variability and, in turn, place additional cost pressures on BMA in an already declining coal market.
	Transfers within the same port precinct – under the QCA's CDD, Aurizon Network must affect a short-term transfer within 2 business days if certain criteria are met (Category A), or longer (as specified), if other criteria is met (Category B and C). BMA does not consider transfers between port precincts should be entirely discounted from occurring under Category A (and able to be effected without extended assessment). In particular, Hay Point and Dalrymple Bay coal Terminals are in close proximity to one another (see Figure A on the following page). A mine servicing either one of these ports would have the same capacity (including mainline) requirements.
Mechanism for review of transfer process	The UT4 process has been complex and time consuming for all parties. This has been exacerbated by new mechanisms being presented for consideration, despite stakeholders having spent considerable time and resources in developing and agreeing positions on existing ones. The short-term transfer mechanism is one such process. In future, BMA considers it would be more cost and time effective to use industry supported positions as a starting point, with subsequent amendments made as appropriate to ensure future access seekers' rights are not adversely affected having not been party to the development of such processes.
System	BMA supports the QCA's amendments allowing for updates to the SoP (if required)

Operating Plans (SoPs)	in conjunction with the arrangements for capacity assessments.
Schedule G	Network Management Plan – BMA notes the QCA has removed provisions relating to Train Service Entitlement (TSE) reconciliation (cl. 8.2(c)(iii), Schedule G). BMA considers these provisions should be reinstated as they assist access holders to manage mine production variability on a weekly basis.
Pricing and Maximum Allowable Revenue	
Pricing arrangements	Expansion pricing – BMA does not oppose the QCA's approach to expansion pricing at this time. Expansion pricing has proven to be a complex task and, as seen in the example of pricing for WICET, can be difficult to determine and controversial. Nonetheless, BMA believes further development of the arrangements is necessary to provide clearer guidance and certainty on the treatment of pricing for expansions in future. At the same time, consideration needs to be given to the broad pricing approach and cost / risk sharing regime, as incremental changes (to account for specific groups of customers and their circumstances) appear to be resulting in similar arrangements to those under UT2 (i.e. a more complex cluster based pricing approach).
Diesel capacity multiplier	BMA supports the removal of the diesel capacity multiplier. It is important that, where possible, inputs used to determine pricing (and other) arrangements reflect current information where possible so as to provide appropriate signals to users of the cost of access on the below-rail network.
Adjustment charge	BMA notes the particularly complex nature of the reconciliation required given UT4 timings and will require reconciliation via revenue caps and adjustment charges. BMA would support an approach that minimises the impact on access holders – i.e. by smoothing revenues (or tariffs) to avoid significant reference tariff changes.
Caval Ridge pricing	BMA reiterates its support of the QCA's approach to pricing for this train service. Pricing based on the 2010 pricing principles were used to inform investment decisions and, in the interests of certainty, it is important these be used to determine the ultimate pricing arrangements that apply.
Ballast undercutting allowance	BMA accepts the QCA's (upward) revised the ballast allowance on the basis of the higher level of scrutiny and independent assessment undertaken since its MAR draft decision. BMA would not support any further increases to the ballast allowance and continues support the QCA improving transparency around Aurizon Network's ballast expenditure (both actual and forecast).
Maximum Allowable Revenue	Modelling approach – BMA accepts the QCA's approach to mid-year timing to calculate reference tariffs. Given Aurizon Network invoices and collects revenues throughout the year, it is appropriate for financial modelling assumptions to be based on a proxy that best reflects this.
WIRP pricing	BMA supports the cost allocation and pricing approach the QCA as applied for train services to Wiggins Island Coal Export Terminal. Where operational benefits cannot be appropriately identified, BMA does not support the socialisation of expansion costs.
Other Matters	
Standard User Funding Agreement (SUFA)	BMA supports the timely approval of SUFA arrangements so that, going forward, industry has the option to undertake major expansions in a timely manner.

Figure A

The line diagram below shows the proximity between DBCT and HPCT, highlighting the fact that transfers between these ports from the same origin should be easily accommodated and able to be effected under Category A of the QCA's transfer mechanism.



Source: Excerpt from Aurizon Network's published line diagrams[4]

[4] December 2015, Aurizon Network: Review of Rail Infrastructure and Line Diagrams for central Queensland Coal Region: Sheet 11 of 16.