



BHP Billiton Mitsubishi Alliance



13 May 2013

Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Malcolm

2013 Draft Amending Access Agreement – GAPE Reference Tariffs

Thank you for the opportunity to respond to Aurizon Network's (AN's) Draft Amending Access Undertaking (DAAU) on the Goonyella Abbot Point Expansion (GAPE) Reference Tariffs. We note this most recent DAAU significantly revises key cost parameters previously contained in its September 2012 GAPE DAAU.

BHP Billiton Mitsubishi Alliance (BMA) and BHP Billiton Mitsui (BMC) endorse the Queensland Resources Council (QRC) submission. We also wish to raise a number of issues we have with the GAPE DAAU.

1. Imperative to ensure regulatory negotiations do not transcend into a “Dutch Auction”

AN conducted both DAAU processes with little to no input from its GAPE customers. The initial draft submitted in September could best be described as an ambit claim, with maintenance costs approximately 80% higher than the costs AN has subsequently re-submitted in this DAAU. Such an outcome:

- underlines the importance of the QCA regulatory process;
- highlights AN's potential gaming of the regulatory process in submitting the original DAAU with theoretically derived higher GAPE costs which were not reflective of expected volumes nor defensible with reference to the incremental costs incurred by the addition of 69km of new track to its existing infrastructure operations; and
- undermines industry's confidence in AN's ability to manage its regulatory obligations in a straight forward way

2. Incentive to Invest in Queensland

The lack of a competitive alternative in the provision of coal rail infrastructure is a significant business risk identified on our Critical Business Risk Register. Uncertainty in the timing, risk and cost of any future investment in the CQCR directly impacts on the commerciality of our mining operations by creating additional hurdle costs and adversely affecting our appetite to invest in Queensland. Such rail investment risks have heightened the impact of the current market environment where we are being required to absorb higher rail infrastructure costs in a market characterised by falling global coal prices. Continued success in our existing operations will critically depend on our ability to remove non-productive costs from our business.

To remain competitive in the global coal market, we are committed to the development of an alternative funding model as a key component of Queensland's rail regulatory framework. It is important QCA recognise the investment threat posed by GAPE styled negotiations and assist industry in delivering a stable and predictable regulatory investment framework which provides a genuine and practical alternative to the terms and conditions being sought by AN.

The investment framework which AN committed to finalise under UT3 included:

- A commitment by AN to finance small scale expansion projects, up to \$300M at the regulatory rate of return.
- Regulatory oversight and approval of Access Conditions sought by AN.
- A framework in which user funding could be provided for larger scale projects where industry or third parties are willing to efficiently invest in the CQCR with appropriate regulatory conditions.
- A detailed 'Extension Process', providing certainty in regard to how expansion projects will be studied, selected and allocated among Access Seekers.

We note, with the original term of UT3 soon coming to an end, that two of these elements (user funding and an extension process) are yet to be developed, while the other two are proposed by AN to be removed from the next UT4. Our experience of the GAPE process demonstrates the importance of an investment framework, comprising all four of the above elements, in order to ensure that the misuse of monopoly power does not delay or, in the current environment, stifle investment in the Queensland coal industry.

Until there is a viable competitive investment alternative to AN in the Queensland coal rail market it is imperative the QCA stringently apply its regulatory powers to ensure AN delivers an efficient, low cost and competitive rail infrastructure service in Queensland.

3. GAPE "Access Conditions"

As GAPE foundation customers we executed commercial agreements with QRNN in 2010 prior to the approval of UT3. Whilst the GAPE commercial agreements were commercially negotiated, GAPE customers did not have the benefit of any of the investment regulatory protections now included in UT3. GAPE customers had no option but to accept AN's commercial terms and conditions in order to grow their coal business in Queensland. One of the terms and conditions in the negotiation process was the requirement for customers to execute stringent confidentiality agreements to participate in the GAPE negotiation process. These confidentiality provisions were then included in the executed GAPE Deed. There is one important disclosure exemption in the confidentiality provisions of the GAPE Deed, namely where disclosure is "lawfully required by the QCA, or in accordance with the Access Undertaking".

Regulatory protections now exist in UT3 which prevent AN from requiring customers to sign confidentiality agreements which removes a customers right to seek QCA review of the non-standard commercial price and risk allocation underpinning any AN proposed CQCR expansion. Given UT3 and the QCA's consideration of the GAPE DAAU, we believe there is a "lawful requirement" for QCA to review the GAPE Deed. This will provide GAPE Deed and GAPE Access Agreement customers with a level of regulatory protection and ensure the interrelationship of the two contracts do not deliver outcomes not anticipated by customers when they executed the GAPE Access Agreement and Deed in early 2010.

It is important to note, that under the GAPE DAAU, there are no restrictions on AN's ability to execute a GAPE Access Agreement with a non-GAPE Deed customer. At the same time, Aurizon has entered into a number Memorandums of Understanding with coal customers to investigate the development of a new, rail line from the Galilee Basin to Abbot Point. It is understood Aurizon is investigating a scenario which would connect this new railway line into the regulated mainline network to utilise the GAPE rail infrastructure and minimise the expansion costs for Aurizon and those coal customers. Accordingly, we believe there is a need for the QCA to ensure:

- Aurizon and/or new customers utilising GAPE cannot obtain an unfair financial advantage compared to access related charges paid by existing GAPE Deed customers;

- The additional risk and cost borne by GAPE Deed customers in underwriting AN's GAPE rail infrastructure (as foundation customers) can be recognised and compensated for in the regulatory framework via the way the QCA might set the reference tariffs to apply to coal volumes above the contracted GAPE Deed capacity .

4. Regulatory Pricing Principles

As part of its review of the GAPE DAAU, we would like to see the QCA endorse the following key regulatory pricing principles:

- Implementation of a hybrid incremental pricing principle for all new expansions in the CQCR;
- Non-expanding customers should not bear any additional costs or risks associated with any new expansions for which:
 - a. they receive no benefit by way of increased tonnage throughput;
 - b. they have no say in the commercial details underpinning the expansion;
 - c. they are not exposed to any operational/capacity risk (eg increased congestion, capacity de-rating) associated with the expansion; and
 - c. AN earns revenue over and above its regulatory return.
- New customers to any infrastructure funded by either the GAPE Deed or Access Conditions under UT3 must not pay access charges less than the access related charges paid by GAPE Deed or Access Conditions customers.
 - a. Under this principle, QCA must set reference tariffs for new GAPE customers to allow for compensation to be payable to GAPE Deed customers for the additional risk and cost incurred prior to the entry of those new customers;
 - a. Compensation of GAPE Deed customers reflects the UT2 pricing principle that when a new customer enters the market, the new customer must share in the financial risks originally borne by the GAPE Deed customers through a contribution to the original costs of that investment.
 - b. The latter approach is reasonable given new GAPE customers will benefit from the financial risks borne by the GAPE Deed customers which have enabled their entry via a relatively risk free extension to the GAPE rail infrastructure.

Adoption of these principles will facilitate greater industry certainty on how new investments will be managed and incorporated into future QCA approved reference tariffs. The proposed regulatory pricing position on new investments will deliver a more stable investment framework for industry, provide existing non-expanding customers with pricing certainty and prevent second phase customers from “free-riding” on back of the risks and costs borne by first mover expanding customers.

We ask the QCA to confirm that the implementation of this pricing approach will be adopted as the regulatory pricing precedent to apply to all future rail infrastructure expansions which are associated with new port developments.

5. Capital Costs for GAPE

AN has summarised its capital costs for the GAPE Infrastructure in the DAAU. We request the QCA review this information on the basis of the efficiency of standard, scope and cost of the GAPE investment.

6. Cost Competitiveness of the Coal Rail Infrastructure Market in Queensland

We note the significant reduction in maintenance and operating costs in this DAAU. We request the Authority to robustly review these costs to ensure AN has appropriately scoped and efficiently costed the revised cost base.

7. Return on Capital

AN has identified it will accept the regulatory rate of return for the GAPE investment. We endorse the use of the regulated rate of return as the basis for pricing new infrastructure which is being included in AN's RAB. However, we do not support AN's proposal that it may seek future changes to the pricing methodology to address potential GAPE asset stranding risks over the longer term. Any additional regulatory protection from the longer term GAPE asset stranding risk (beyond the Schedule A protections) would alter the commercial risk allocation underpinning the original GAPE Deeds, for which GAPE customers are paying an above regulated rate of return.

8. Risk and Insurance Costs for the GAPE Infrastructure

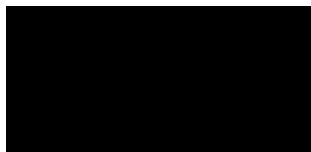
We request the QCA to review its UT3 endorsement of the CQCR risk and insurance costs and identify whether the incremental AN self-insurance costs AN has added to compensate it for the addition of the GAPE infrastructure is an accurate estimate of the marginal cost AN would actually incur for insurance in FY13.

9. Volumes across the GAPE Infrastructure

AN has identified its forecast volumes across the GAPE infrastructure in FY12 and FY13. We request the QCA peer review the tonnage forecasts, particularly in the transitional volumes expected in FY14.

If you have any queries or require more information, please feel free to contact Ms Tanya Boyle on mobile 0459 812257.

Yours sincerely



Neil Buckley
Rail Ports and Infrastructure Department
BHP Billiton Mitsubishi Alliance