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19 March 2015

Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane Q 4001

Attention: John Hindmarsh

Dear John

Draft Amending Access Undertaking for Differential Pricing

On behalf of the DBCT User Group (Anglo American, Peabody Energy, Glencore, Rio Tinto Coal Australia, Isaac Plains Coal Management, BHP Mitsui and Vale), please find enclosed our submission in response to the Notice of Investigation: DBCT Management's Draft Amending Access Undertaking for Differential Pricing (DAAU) dated 04 February 2015.

The DBCT User Group appreciates the opportunity to respond to the DAAU and can be available to discuss this submission with the Queensland Competition Authority at a suitable time.

If you have any queries; please contact me on 3334 5628 or John Hedge of Allens on 3334 3171.

Regards

Mark Smith
Chair – DBCT User Group

1 Background

As previously recognised by the Queensland Competition Authority (***QCA***),[1] the Dalrymple Bay Coal Terminal (***DBCT***) has expanded to the point where it is now on the increasing part of its long run average cost curve.

As a result it is anticipated by the current DBCT Users that, if the current approach of socialising costs of expansions continued to be adopted, future expansions are likely to result in substantially higher charges for existing DBCT users.

Differential pricing of expansion was raised by some DBCT Users during the process for consideration of the current DBCT access undertaking (the ***2010 AU***). Those submissions were withdrawn on the condition that Dalrymple Bay Coal Terminal Management Pty Ltd (***DBCTM***) would submit a draft amending access undertaking to introduce differential pricing for terminal capacity to be created by future expansions.

On 3 February 2015, DBCTM lodged a draft amending access undertaking with the QCA concerning that issue (the ***Differential Pricing DAAU***), and on 13 February 2015 the QCA published a series of QCA staff questions (the ***Staff Questions***) on which the QCA particularly invited comment.

The DBCT User Group (consisting of Anglo American, BHP Mitsui, Glencore, Isaac Plains Coal Management, Peabody Energy, Rio Tinto Coal Australia and Vale) is pleased to provide the enclosed submission in relation to the Differential Pricing DAAU.

2 Appropriate principles

The DBCT User Group are supportive of amending the 2010 AU to provide for differential pricing.

2.1 Circumstances in which differential pricing should apply

In particular, the DBCT Users agree with the analysis in the QCA April 2013 discussion paper on access pricing for capacity expansions of rail and port infrastructure which concluded:[2]

> *Because of the importance of the particular circumstances that apply in each case to the pricing of new access capacity, it is not possible to define hard and fast rules that can be applied to price access to any capacity expansion efficiently and fairly. The pricing of access to major capacity expansions will thus need to be decided on a case-by-case basis. However, there are some key propositions that are based on relevant economic efficiency, fairness and governance principles, which can help in arriving at fair, efficient and practical regulatory decisions.*
>
> *The key propositions that apply when capacity is already committed to 'established' users through long-term take-or-pay contracts are as follows.*
>
> *(a) If average costs are decreasing substantially with capacity, adding the expansion costs to the cost base of the established capacity will usually provide an acceptably efficient and fair outcome. An exception would be if foundation customers signed take-or-pay contracts which included a clause that enabled them to pay the price of the lowest cost tranche of capacity.*

[1] Queensland Competition Authority, *Discussion Paper Capacity Expansion and Access Pricing for Rail and Ports*, April 2013 at 20.

[2] Queensland Competition Authority, *Discussion Paper Capacity Expansion and Access Pricing for Rail and Ports*, April 2013 at iv and 28.

(b) *If average costs are increasing substantially with capacity, a separate access price should normally be calculated and charged to those whose capacity underwrites the new tranche of capacity that reflects the average cost of that new capacity.*

...

Although there appears to be some asymmetry in these propositions, they are justified by consideration of what would reasonably be expected to occur in a negotiated contract prior to sunk costs being incurred by either the access provider or the access seeker. These propositions are considered to be perceived as 'fair' to access providers and access seekers and consistent with achieving overall economic efficiency. Clarification of how prices would be set in the context of capacity expansion, as outlined here, is also important for the transparency and credibility of the regulatory governance arrangements.

Accordingly the DBCT User group supports the QCA's general approach of socialising expansion costs where that would reduce tariffs for existing users and applying differential pricing for an expansion where it would otherwise increase tariffs for existing users (which the QCA refers to as 'socialise down/incremental up').

However, the DBCT User group also accepts that there may be special circumstances where a different approach would be justified for a particular expansion. While it may not be possible to exhaustively define those special circumstances, it is appropriate to provide approved principles by which the QCA should assess whether such special circumstances exist.

In seeking to identify the principles which might justify departure from a general socialise down/incremental up approach, the DBCT User group has considered the matters identified in the QCA's decision on the 2010 AU.[3]

The DBCT Users consider that the key factors are:

(a) whether the terminal is really a stand-alone operation that shares none or limited amounts of the facility and provides limited or no benefit to existing users, or a highly integrated development that uses much of the same infrastructure and improves the robustness and operation of the existing terminal; and

(b) the materiality of the cost increase (which goes to the point about what the users and DBCTM would have agreed in a hypothetical scenario before sunk costs were incurred).

Both of those are matters of degree which would need to be considered in the context of a particular expansion.

Accordingly the DBCT User Group proposes that the Differential Pricing DAAU be amended to reflect the following principles:

(a) Where socialisation of expansion costs would result in a decrease in tariffs for existing users, the costs should be socialised (retaining a single regulatory asset base, annual revenue requirement and reference tariff);

(b) Where socialisation of expansion costs would result in an increase in tariffs for existing users, differential pricing should apply to the expansion (via a separate regulatory asset base, annual revenue requirement and reference tariff) except where the QCA considers there are special circumstances that make it appropriate for the costs to be socialised;

[3] Queensland Competition Authority, *Final Decision Dalrymple Bay Coal Terminal 2010 Draft Access Undertaking*, September 2010, at 13.

(c) In determining whether special circumstances exist, such that it is appropriate for differential pricing to apply to an expansion (for which socialisation would increase tariffs for existing users), the QCA must have regard to the following factors:

(i) the extent to which the additional capacity provided by the Capacity Expansion is:

(A) an incremental expansion which involves common usage of many parts of the existing Terminal; or

(B) a stand-alone development which involves common usage of none or limited parts of the existing Terminal;

(ii) the extent to which the expansion benefits existing users (such as through higher efficiency, robustness or flexibility);

(iii) the extent of the increase in costs which would be caused by socialisation;

(iv) any differences in the risks of providing access to the Access Holders in respect of Terminal Capacity created by the Terminal Capacity Expansion;

(v) the position that best reflects what would reasonably be expected to have been agreed in a hypothetical negotiated contract entered prior to sunk costs being incurred by DBCTM or the existing Access Holders; and

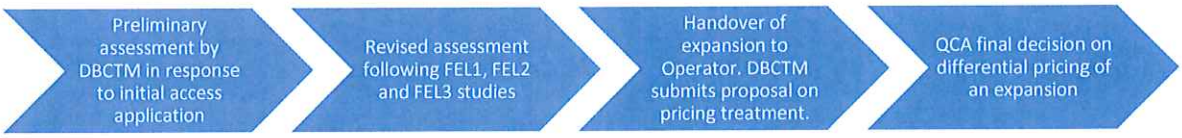
(vi) the object of Part 5 of the *Queensland Competition Authority Act 1997* (Qld).

2.2 Timing for assessment

The Differential Pricing DAAU reflects the QCA making a judgement on differential pricing following handover of an expansion to the Operator.

The DBCT Users consider that is far too late for an assessment of whether differential pricing should apply. If differential pricing is likely, new access seekers need to be advised of that early so that inefficient investment decisions are not made (in terms of development and/or expansion decisions of a mine and related rail access and haulage contracting).

Accordingly, the DBCT Users envisage a process more like the following:



In making the assessments throughout the process, the DBCT User group anticipates that DBCTM would be required to have regard to the principles under which the QCA would make the decision on whether to apply differential pricing (as outlined in section 2.1 of this submission above).

2.3 Treatment of other costs

The Differential Pricing DAAU proposes that differential pricing would apply by way of a separate asset base, annual revenue requirement and reference tariff.

In order to achieve that there would need to be principles providing for how the QCA would allocate:

(a) Future non-expansion capital expenditure (***NECAP***); and

(b) Operating and maintenance costs (***O&M Costs***).

The DBCT Users consider that the appropriate treatment is dependent on whether the expansion is an 'integrated' development (with a significant degree of common usage of existing terminal infrastructure) or a 'stand-alone' development (with no or limited common usage of existing terminal infrastructure).

Where an expansion is:

(a) an integrated development, NECAP and O&M Costs should be socialised through a pro-rata allocation based on tonnage (for NECAP between the existing terminal and expansion regulatory asset base); or

(b) a stand-alone development, NECAP and O&M Costs should be allocated separately based on the extent to which those costs relate to the expansion or the existing terminal.

Such an approach would recognise the likely lower NECAP and maintenance costs attributable to newer stand-alone capital intensive expansions while ensuring that the approach to pricing does not distort the operation of the existing terminal and any heavily integrated expansions.

2.4 Resolution prior to 2015 Access Undertaking

The DBCT Users anticipate that DBCTM will submit a draft access undertaking intended to replace the 2010 AU from 1 July 2016. Clearly as the DBCT User group supports the introduction of differential pricing, they will also support its inclusion in the 2015 access undertaking to be submitted by DBCTM.

However, they are concerned about any suggestion that the issue of differential pricing should be left until then to resolve.

This is an important issue to resolve and one that the QCA has considered on a number of occasions to date (to a limited degree in the 2010 AU process, in the April 2013 discussion paper about expansion pricing and in the draft decision on Aurizon's Network's UT4 access undertaking). There is no reason that it should not be resolved now, and leaving resolution until 1 July 2016 is contrary to the intent of the arrangements between DBCTM and DBCT Users regarding the submission of a draft amending access undertaking on this issue during the term of the 2010 AU.

3 Responses to QCA Staff Questions

Many of the DBCT User group's views on the QCA Staff Questions will be evident from the discussion of the appropriate principles to apply in section 2 of this submission. However, further specific responses to each of the Staff Questions are set out in Schedule 1 to this submission.

4 Other required amendments to the 2010 AU

The DBCT User group is in the process of reviewing the 2010 AU (including the Standard Access Agreement). In the time frame available for submissions to the QCA, it has not been possible to provide a comprehensive list of the other changes required. However, the DBCT

User group is preparing a supplementary submission which will seek to identify the other consequential changes which would be required. The response to the QCA Staff question in section 1.5 of Schedule 1 of this submission provides some initial matters which have been identified in the 2010 AU to date.

If you have any queries in relation to this submission, please do not hesitate to contact Mark Smith of Peabody Energy on 3334 5628 or John Hedge of Allens on 3334 3171.

Schedule 1 - Responses to QCA staff questions

The DBCT Users' responses to the Staff Questions are set out below:

1.1 Role of the QCA

The DAAU provides for the possibility of applying different tariffs to different 'Components' of the Terminal, following a capacity expansion at the DBCT, which is a 'Review Event' requiring DBCT Management to submit a separate DAAU.

Nevertheless, as drafted, the DAAU requires the QCA to initiate decisions, such as whether differential pricing should apply and how capacity should be allocated between components for tariff setting.

QCA staff note this drafting is unlike some other matters in the access undertaking on which the QCA makes decisions following requests from the access provider, such as an application to approve capital expenditure.

Do stakeholders consider DBCT Management's proposal that the QCA (and not DBCT Management) propose differential pricing for expansions reasonable?

Alternatively, considering the negotiate/arbitrate form of access regime established by Part 5 of the QCA Act, do stakeholders consider the form of expansion pricing be left to the parties to negotiate and propose, following a capacity expansion, and for the QCA to make a determination following a request?

As drafted the Differential Pricing DAAU automatically requires the QCA to make a judgement on differential pricing following handover of an expansion to the Operator.

As set out in section 2.2 of this submission, the DBCT User group is concerned that such a process can result in inefficient investment decisions being made by access seekers.

This is not a matter that is well suited to a negotiate/arbitrate regime, as the interests of the existing users will be impacted by the decision that is made. As a result, any negotiation or arbitration would not just be between DBCTM and access seekers wishing to contract expansion capacity, but also need to include existing users. The DBCT User group are conscious that, where the likely costs of the expansion are known, such that the impact of socialised or differential pricing is apparent, there may be real difficulties in reaching an agreed position on the pricing for the expansion.

The DBCT Users therefore consider that it is appropriate for DBCTM to make initial assessments (based on the same criteria the QCA is ultimately required to apply), make a proposal to the QCA following handover of a developed expansion and for the QCA to make the ultimate decision in accordance with criteria set out in the undertaking. Further detail is set out in section 2.2 of the submission.

1.2 Principles governing expansion pricing

DBCT Management's 2010 undertaking sets out the pricing objectives (such as revenue adequacy, incentives for efficient use and equitable treatment) that govern the access charge framework in that undertaking.

Likewise, Aurizon Network in its submission on its 2014 draft access undertaking (2014 DAU) identified principles underpinning its proposed expansion pricing framework. Those principles included that expanding users should generally pay at least the full incremental costs and existing users should not experience a material increase in tariffs as a result of an expansion triggered by expanding users. The QCA's January 2015 draft decision proposed to accept these principles.

In contrast, DBCT Management's differential pricing DAAU does not propose principles or objectives to govern an expansion pricing framework. (a) Do stakeholders consider that DBCT Management's undertaking should provide principles to govern an expansion pricing framework? If so, what principles do stakeholders consider reasonable and why?

As the QCA question indicates, the Differential Pricing DAAU proposes no guidance on:

(a) the circumstances in which the QCA would determine it was appropriate to provide differential pricing (via a different ARR, Revenue Cap and Reference Tariff) for an expansion under the proposed 4(j), Part A Schedule C; and

(b) where they did so, how the differential pricing principles would work beyond having a separate ARR, Revenue Cap and Reference Tariff.

Section 2 of this submission provides the DBCT User Group's proposal regarding the principles which should be applied.

1.3 Rules for implementing an expansion pricing framework

DBCT Management's DAAU requires the QCA to decide whether differential pricing should apply to capacity expansions. This is unlike some other matters where the QCA is required to have regard to a list of criteria in the 2010 undertaking to make a decision, such as criteria for assessing the prudency of expansion as well as non-expansion capital expenditure.

Aurizon Network's 2014 DAU proposed a 'socialisation test' to determine whether to apply a uniform price or a differential price for a capacity expansion. The QCA's January 2015 draft decision accepted the 'averaging down/incremental up' principle embedded in that socialisation test but rejected the way Aurizon Network had proposed to implement it. In its place the QCA proposed to apply a separate tariff with a 'fixed cost' regime to expanding users if an expansion was triggered.

1. Do stakeholders have a view on whether there should be a test or criteria to determine whether differential pricing should apply to an expansion or do stakeholders consider that differential pricing should apply for any capacity expansion? Why?

2. Subject to a response on 3a) what test or criteria do stakeholders consider reasonable and why?

3. Are the circumstances within which the QCA will consider differential pricing for DBCT different to Aurizon Network? Why?

(a) Should there be a test or criteria?

The DBCT User group considers that it is important for both existing users and potential future years to have reasonable certainty about how expansion capacity at DBCT is likely to be priced.

This is important because existing users will be making decisions (such as investing in expansions/extensions of mine life for existing projects) as will potential future users (such as investment in development of a new mine), which will be impacted by the likely cost of access to DBCT.

(b) If so, what test or criteria should be adopted?

The DBCT User group has set out their views on the general test or criteria which should apply in section 2.1 of this submission.

(c) Differences to Aurizon?

The DBCT User group consider the following factors potentially differentiate DBCT from the Aurizon system and worth considering in the context of seeking to determine the appropriate approach for DBCT:

(i) A higher level of certainty exists in the DBCT context that any expansion would increase tariffs if socialised (due to the practically limited expansion possibilities);

(ii) The extent of common infrastructure which would be involved in some possible DBCT expansions is likely to be higher (such as additional stockyard area), whereas for Aurizon the extent of common infrastructure will vary greatly depending on the expansion involved; and

(iii) The take or pay component of charges works differently at DBCT to how it operates in the central Queensland coal network – so that the system trigger issues the QCA was concerned about in the Aurizon Network regime do not apply to DBCT.

1.4 Rules for calculating a differential tariff

DBCT Management's DAAU requires the QCA to determine the differential tariff components including the annual revenue requirement, revenue cap and how contract tonnage will be allocated between expanded and existing capacities.

However, the DAAU does not set out rules for making these determinations. This is unlike the rules set out in Schedule C in DBCT Management's 2010 undertaking for calculating the various tariff components.

1. Do stakeholders have a view on how the tariff components should be calculated in the case of differential pricing of a capacity expansion?

The DBCT User Group has set out its suggested approach in section 2 of this submission.

1.5 Relation with other clauses in the undertaking

DBCT Management's DAAU proposes to amend Sections 5 (negotiation arrangements) and 12 (terminal capacity expansion), and Schedule C (rules for calculating access charges) in the 2010 undertaking.

QCA staff note that the DAAU does not cover other sections in the 2010 undertaking, such as Section 11 (pricing arrangements).

1. Do stakeholders have a view on what sections/schedules in the 2010 undertaking require amendments to give effect to an expansion pricing framework? If so, what amendments do stakeholders consider reasonable and why?

It is clear that the Standard Access Agreement (which forms part of the undertaking under clause 1.4(e)) will need to change in order for differential pricing to operate as intended.

While the Differential Pricing DAAU refers to this ('The changes above will also be reflected in amendments to the Standard Access Agreement') the actual terms of the revised form of the Standard Access Agreement should form part of the Differential Pricing DAAU, to remove uncertainty and future disputes about how such changes would be implemented.

The Negotiation Provisions in Part 5 and provisions like clause 13.1(c) (which allows access seekers to require access agreements to be consistent with the standard access agreement in all material respects) will not work properly unless the Standard Access Agreement is amended to address the potential for differential pricing to apply to future access seekers of expansion capacity.

It is also clear that provisions of the 2010 AU (in addition to those sought to be amended by the Differential Pricing DAAU as submitted by DBCTM) would also need to be amended.

In particular, the DBCT Users consider at least the following changes would be required to the 2010 AU:

2010 AU Clause	Change required
5.2(b)-(c) AU	It would be preferable to clarify how DBCTM should provide information in relation to an expansion (which may be subject to differential pricing) at this stage.
5.10 AU	It should be considered how study costs should be incorporated into the regulatory asset base. Presumably if the expansion does proceed it should go into

2010 AU Clause	Change required
	the regulatory asset base for that expansion component rather than the existing terminal component. Where an expansion does not proceed, it would need to be resolved how FEL 1 and 2 study costs (which DBCTM applies to have included in the regulatory asset base) should be applied.
11.1-11.9	These provisions would need to be carefully reviewed to ensure alignment with the proposed approach to differential pricing.
11.10	The limits on price differentiation will need to expressly recognise any principles in the undertaking regarding differential pricing for expansions as a permitted price differentiation
12.1(p)(1)	It should be clarified that the independent expert's costs should be incorporated into the regulatory asset base for the expansion rather than the existing terminal
12.5(o)	Where DBCTM submits a draft access undertaking of this nature it should presumably set the interim tariff on a basis consistent with DBCTM's assessment at that stage as to whether differential pricing would be applied under the criteria for differential pricing that will be set out in the 2010 AU.
12.10(c)	The provisions regarding inclusion of NECAP will need to deal with how it is allocated between the existing terminal and expansion components. The DBCT Users' proposal in relation to allocation of NECAP is set out in section 2.3 of the submission.
Schedule C	All of the TIC (and related Revenue Cap, ARR and Reference Tariff sections) are based on the existing socialisation approach, which would need to change. It would need to be considered how the Rebate Pool and Increment would be measured.

There are likely to be further consequential changes required (including to the definitions in Schedule H).