



25 August 2016

Mr John Hindmarsh  
Chief Executive Officer  
Queensland Competition Authority

Dear Mr Hindmarsh

**Response to QCA staff questions the DBCT 2015 DAU**

On 3 August 2016, QCA staff released a paper that sought stakeholder submissions on issues relating to DBCTM's 2015 DAU. These issues cover:

- Differential pricing
- Treatment of inflation
- Non-expansionary capital expenditure
- Competition between ports
- Independence of the Operator
- Terminal Master Plan.

Attached is DBCTM's response to those issues.

Please contact me or Jonathan Blakey if you have any related queries or require more information on DBCTM's submission.

Yours sincerely



Anthony Timbrell  
Chief Executive Officer  
**DBCT Management**

DBCT MANAGEMENT



**Response to QCA staff questions on DBCT 2015 DAU  
25 August 2016**

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## INTRODUCTION

This submission sets out DBCTM's response to questions that QCA staff have raised since receiving stakeholder views on the draft decision on the 2015 DAU. The structure of DBCTM's response is as follows:

- (1) Differential pricing
- (2) Treatment of inflation
- (3) Non-expansionary capital expenditure
- (4) Competition between ports
- (5) Independence of the Operator
- (6) Terminal Master Plan.

QCA staff have sought comments from stakeholders on the appropriateness of DBCTM's proposals to:

- include additional criteria in clause 11.13(c) of the 2015 DAU for the QCA to consider when assessing an expansion pricing application
- base the assessment of the 'incremental up/average down' approach on the impact on the total access charge (TAC), rather than the Terminal Infrastructure Charge (TIC)
- include a new schedule to the 2015 DAU, which contains the specific negotiation clauses for implementation during the regulatory period if the QCA determines that an expansion component is to be differentially priced.

DBCTM recognises that the primary purpose of QCA staff's queries is to seek feedback from users on new proposals that DBCTM included in its response to the draft decision. DBCTM notes that it may respond to any feedback that opposes the thrust of its proposals. In the meantime, DBCTM explains further its rationale for the proposals, and addresses each of the three dot points above in turn.

### 1.1 ADDITIONAL CRITERIA IN CLAUSE 11.13(C)

As discussed in its 8 July submission, DBCTM interprets the QCA's draft decision as allowing expansion-pricing arrangements to be determined on a case-by-case basis.

DBCTM recognises that the QCA has a preference for an 'incremental up/average down' approach as the default. However, DBCT Holdings has confirmed that differential pricing would be inconsistent with the PSA. Hence, DBCTM anticipates making a case for average-cost pricing for expansions that increase average costs (i.e. Cost Sensitive Expansions<sup>1</sup>).

DBCTM's proposed amendments to clause 11.13(c) are designed simply to ensure that DBCTM will not be precluded from making its case for average-cost pricing. The rationale for introducing these clauses is as follows:

- **whether the services provided by Cost Sensitive Expansions are functionally equivalent to the services provided by existing infrastructure** – DBCTM considers functional equivalence to be relevant in the context of the requirement in the PSA<sup>2</sup> that DBCTM should levy charges at a common rate for 'comparable services' at DBCT.
- **the possibility that access holders using the Cost Sensitive Expansion could switch usage to the existing infrastructure, should capacity become available at the existing infrastructure** – if spare capacity becomes available at the existing infrastructure when access agreements for the "cost sensitive" infrastructure expire, there is a risk that access holders using the Cost Sensitive Expansion could move their volumes to the existing infrastructure, threatening the financial viability of the expansion.
- **the complexity associated with allocating future operating and maintenance costs and/or NECAP between the Cost Sensitive Expansion and the existing infrastructure** – allocating costs of future O&M and NECAP activities between users of the Cost Sensitive Expansion and users of the existing infrastructure can be very complex, particularly for an integrated facility. As indicated in the QCA's draft decision, a costing manual would be required<sup>3</sup>. DBCTM understands that the QCA has faced this issue in assessing Aurizon Network's 2014 DAU, particularly in allocating costs between WIRP

<sup>1</sup> **Cost Sensitive Expansion** has the meaning given in Section 11.10(b)(2) of DBCTM's submitted 2015 DAU

<sup>2</sup> PSA, Schedule 3, Access Principles, clause 3(a)

<sup>3</sup> QCA draft decision on 2015 DAU: 241

and non-WIRP users.<sup>4</sup> DBCTM's concern is therefore not theoretical; it is a live and controversial issue.

- **any other factor that the QCA considers relevant** –DBCTM reiterates that the inclusion of this factor is consistent with the decision-making criteria in the QCA Act and other QCA decision criteria to ensure that the regulator has adequate discretion to consider legitimate stakeholder concerns.

## 1.2 USE OF TOTAL ACCESS CHARGE FOR DIFFERENTIAL-PRICING TEST

DBCTM's proposal recognises that it is the total access charge (TAC), rather than the reference tariff (i.e. TIC), that dictates the effects of the expansion on the business interests of non-expanding users.

DBCTM's investment incentives should recognise any positive (or negative) externalities that investments have on handling costs for non-expanding users. Accordingly, the sum of capital and operating costs (TAC) should be the metric for applying the differential-pricing test. The TIC does not capture all relevant costs.

## 1.3 INTRODUCTION OF SCHEDULE J

The proposed new Schedule J has no bearing on what expansion pricing arrangements should apply. It relates only to provisions that apply in the event that the QCA requires an expansion to be priced differentially.

The content of Schedule J mirrors the material that is included elsewhere in the QCA's mark-up of the 2015 DAU in the draft decision. DBCTM has proposed collating these provisions in a new schedule for ease of readability only.

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<sup>4</sup> QCA's final decision on Aurizon Network's 2014 DAU, Volume III, *Pricing & tariffs*: 202-207

## 2 TREATMENT OF INFLATION

QCA staff have sought comments from stakeholders on the appropriateness of DBCTM's proposals to:

- adopt the expected inflation rate to calculate inflation on the opening RAB value each year, instead of outturn inflation
- change the method used to calculate expected inflation from the 'RBA approach' to an 'indexed bond approach.'

### 2.1 USING EXPECTED INFLATION FOR RAB INDEXATION

There are three inflation rates that are relevant for addressing the QCA's queries. These are the inflation rates:

- implicit in the nominal WACC (*via* the five-year government bond rate)
- used for the ARR deduction each year
- used for RAB indexation at the end of each year.

DBCTM's position is that the inflation rate used for the ARR deduction should match the inflation rate implicit in the nominal WACC. If these rates are different, then DBCTM would not be appropriately compensated for inflation on a year-to-year basis.

In its response to the draft decision, DBCTM noted it would be appropriately compensated over the regulatory period if the inflation rates for the ARR deduction and RAB indexation match.<sup>5</sup> To clarify DBCTM's position, this is true only if the regulatory period coincides with the whole economic life of assets in the RAB (i.e. the period over which the assets are depreciated).

The 'NPV=0 principle' ensures that DBCTM is appropriately compensated for its investments. DBCTM notes that the QCA considers that the NPV=0 principle achieves an appropriate balance of the factors in section 138(2) of the QCA Act.<sup>6</sup>

#### 2.1.1 INFLATION EXAMPLE

This subsection provides an example to illustrate the configuration of inflation rates required to ensure that the NPV=0 principle holds over various periods. It demonstrates two propositions:

- If the inflation rate used for RAB indexation does not match that for the ARR deduction, the NPV=0 principle will not be satisfied.
- If the inflation rate used for RAB indexation matches that for the ARR deduction, but differs from the inflation rate implicit in the nominal WACC, DBCTM is appropriately compensated *over the life of the RAB* (i.e. NPV=0 principle is satisfied). However, DBCTM would not be appropriately compensated over the regulatory period.

<sup>5</sup> DBCTM response to QCA's draft decision on 2015 DAU: 42, third paragraph of section 8.4.1

<sup>6</sup> QCA's final decision on Aurizon Network's 2014 DAU, Volume IV, Maximum Allowable Revenue: 205

Figure 1 shows a base case in which all three of the inflation rates listed at the beginning of Section 2.1 are aligned.

**Figure 1: Inflation rates in WACC, ARR deduction and RAB indexation all set at 1.5% (base case)**

Assumptions		Year	1	2	3	4	5	6	7	8	9	10
Opening RAB (\$)	100	<b>RAB roll-forward</b>										
Regulatory period (years)	5	Opening RAB	100.0	91.4	82.4	73.2	63.7	53.9	43.7	33.3	22.5	11.4
Life of RAB (years)	10	Inflation	1.5	1.4	1.2	1.1	1.0	0.8	0.7	0.5	0.3	0.2
Nominal WACC & discount rate	10%	Less Depreciation	(10.2)	(10.3)	(10.5)	(10.6)	(10.8)	(10.9)	(11.1)	(11.3)	(11.4)	(11.6)
Inflation implicit in WACC:	1.5%	Closing RAB	91.4	82.4	73.2	63.7	53.9	43.7	33.3	22.5	11.4	-
Inflation rate for ARR deduction:	1.5%	<b>ARR</b>										
Inflation rate for RAB roll-forward:	1.5%	Return on Capital	10.0	9.1	8.2	7.3	6.4	5.4	4.4	3.3	2.3	1.1
End-of-year depreciation = (Opening RAB + Inflation)/Remaining Life		Return of Capital	10.2	10.3	10.5	10.6	10.8	10.9	11.1	11.3	11.4	11.6
No mid-year discounting		Less Inflation	(1.5)	(1.4)	(1.2)	(1.1)	(1.0)	(0.8)	(0.7)	(0.5)	(0.3)	(0.2)
		ARR	18.7	18.1	17.5	16.8	16.2	15.5	14.8	14.1	13.3	12.6

  

PV of ARR over regulatory period	66.55
PV of ARR over asset life	100.00

In this case, the compensation for inflation provided through the nominal WACC is exactly offset by the inflation deduction from the ARR *on an annual basis*. Hence, DBCTM infers that the same must be true over the five-year regulatory period. Figure 1 shows that the PV of the ARRs over the five-year regulatory period is \$66.55 (using the nominal WACC of 10% as the discount rate). Note that the PV of the ARRs over the life of the RAB is \$100, which is equal to the initial RAB value, thus satisfying the NPV=0 principle.

Figure 2 shows a case in which the inflation rate for the ARR deduction is 2.5% but the rate implicit in the WACC and the rate used for RAB indexation are both 1.5%.<sup>7</sup>

**Figure 2: Inflation rates in WACC and for RAB indexation are 1.5%; for ARR deduction, rate is 2.5%**

Assumptions		Year	1	2	3	4	5	6	7	8	9	10
Opening RAB (\$)	100	<b>RAB roll-forward</b>										
Regulatory period (years)	5	Opening RAB	100.0	91.4	82.4	73.2	63.7	53.9	43.7	33.3	22.5	11.4
Life of RAB (years)	10	Inflation	1.5	1.4	1.2	1.1	1.0	0.8	0.7	0.5	0.3	0.2
Nominal WACC & discount rate	10%	Less Depreciation	(10.2)	(10.3)	(10.5)	(10.6)	(10.8)	(10.9)	(11.1)	(11.3)	(11.4)	(11.6)
Inflation implicit in WACC:	1.5%	Closing RAB	91.4	82.4	73.2	63.7	53.9	43.7	33.3	22.5	11.4	-
Inflation rate for ARR deduction:	2.5%	<b>ARR</b>										
Inflation rate for RAB roll-forward:	1.5%	Return on Capital	10.0	9.1	8.2	7.3	6.4	5.4	4.4	3.3	2.3	1.1
End-of-year depreciation = (Opening RAB + Inflation)/Remaining Life		Return of Capital	10.2	10.3	10.5	10.6	10.8	10.9	11.1	11.3	11.4	11.6
No mid-year discounting		Less Inflation	(2.5)	(2.3)	(2.1)	(1.8)	(1.6)	(1.3)	(1.1)	(0.8)	(0.6)	(0.3)
		ARR	17.7	17.2	16.6	16.1	15.5	15.0	14.4	13.8	13.1	12.5

  

PV of ARR over regulatory period	63.38
PV of ARR over asset life	96.00

In this case, on an annual basis, the inflation deduction for the ARR exceeds the compensation for inflation provided by the WACC. Moreover, because the RAB is indexed at the same rate as that implicit in the nominal WACC, there is no offset in subsequent years for the under-compensation that occurs in any particular year. The NPV=0 principle does not hold over the life of the RAB — the PV of ARRs over this period is only \$96: less than the initial asset value of \$100. This confirms the example's first proposition that the inflation rate used for the RAB indexation must match that for the ARR deduction for the NPV=0 principle to hold.

It is also the case that the PV of the ARRs over the five-year regulatory period (\$63.38 in Figure 2) is less than the appropriate amount (i.e. \$66.55) identified in the base case.

<sup>7</sup> If it is assumed that the outturn inflation rate is correctly predicted by the inflation rate implicit in the nominal WACC, this is like the QCA's current position.



Figure 3 shows the case in which the inflation rate used for the ARR deduction and the rate used to index the RAB are both 2.5%, which is greater than the 1.5% rate implicit in the nominal WACC.

**Figure 3: Inflation rates for ARR deduction and RAB indexation match at 2.5%, but are higher than inflation rate (1.5%) implicit in nominal WACC**

Assumptions		Year	1	2	3	4	5	6	7	8	9	10
Opening RAB (\$)	100	<b>RAB roll-forward</b>										
Regulatory period (years)	5	Opening RAB	100.0	92.3	84.1	75.4	66.2	56.6	46.4	35.7	24.4	12.5
Life of RAB (years)	10	Inflation	2.5	2.3	2.1	1.9	1.7	1.4	1.2	0.9	0.6	0.3
Nominal WACC & discount rate	10%	Less Depreciation	(10.3)	(10.5)	(10.8)	(11.0)	(11.3)	(11.6)	(11.9)	(12.2)	(12.5)	(12.8)
Inflation implicit in WACC:	1.5%	<b>Closing RAB</b>	<b>92.3</b>	<b>84.1</b>	<b>75.4</b>	<b>66.2</b>	<b>56.6</b>	<b>46.4</b>	<b>35.7</b>	<b>24.4</b>	<b>12.5</b>	-
Inflation rate for ARR deduction:	2.5%	<b>ARR</b>										
Inflation rate for RAB roll-forward:	2.5%	Return on Capital	10.0	9.2	8.4	7.5	6.6	5.7	4.6	3.6	2.4	1.2
End-of-year depreciation =	(Opening RAB + Inflation)/Remaining Life	Return of Capital	10.3	10.5	10.8	11.0	11.3	11.6	11.9	12.2	12.5	12.8
No mid-year discounting		Less Inflation	(2.5)	(2.3)	(2.1)	(1.9)	(1.7)	(1.4)	(1.2)	(0.9)	(0.6)	(0.3)
		<b>ARR</b>	<b>17.8</b>	<b>17.4</b>	<b>17.1</b>	<b>16.7</b>	<b>16.3</b>	<b>15.8</b>	<b>15.4</b>	<b>14.9</b>	<b>14.3</b>	<b>13.7</b>
<b>PV of ARR over regulatory period</b>	<b>64.87</b>											
<b>PV of ARR over asset life</b>	<b>100.00</b>											

In this case, the NPV=0 principle does hold over the life of the RAB. Indexing the RAB at a rate that exceeds the rate implicit in the nominal WACC offsets the under-compensation implied by the use of a similarly high rate to make ARR deductions. However, the PV of the ARR over the five-year regulatory period (\$64.87) is less than the appropriate amount (i.e. \$66.55) identified in the base case. In this case, DBCTM would be under-compensated over the regulatory period. This confirms the example's second proposition.

To promote the objective of DBCTM being appropriately compensated over a regulatory period, the best approach is to provide an estimate of expected inflation that is market-reflective and plausible (i.e. in line with the inflation rate implicit in the nominal WACC). In that respect, DBCTM considers the "indexed bond approach" to be more appropriate than the "RBA approach". The next subsection discusses this.

In DBCTM's view, the QCA's proposal in the draft decision could amount to making ARR deductions using an inflation rate (2.5% based on the draft decision, or 2.0% based on the RBA approach) that is high relative to the rate implicit in the WACC (1.45%, based on the indexed bond approach)<sup>8</sup> and relative to the outturn rate that is used to index the RAB.

## 2.2 INDEXED BOND APPROACH

DBCTM maintains its view that the indexed bond approach is superior to the RBA approach to estimating expected inflation.

The RBA approach<sup>9</sup> employs the RBA's target inflation rate for later years in multi-year forecasts, not the RBA's actual expectations of inflation. DBCTM notes that the RBA's retiring governor has recently observed that it is unlikely that the inflation rate will return to the target in the foreseeable future. Moreover, the RBA's latest Statement of Monetary Policy (August 2016) reinforces this view.<sup>10</sup>

<sup>8</sup> DBCTM derived the 1.45% from the indexed-bond approach. See pages 42-46 of DBCTM's submission on draft decision

<sup>9</sup> The RBA has not provided forecasts further out than December 2018 (see August 2016 Statement of Monetary Policy).

DBCTM understands that the RBA approach adopts the target inflation band (2%-3%) in the years thereafter. Therefore, the RBA approach is based on a mix of forecast inflation and aspirational RBA inflation targets.

<sup>10</sup> See Table 6.1 in <http://www.rba.gov.au/publications/smp/2016/aug/pdf/statement-on-monetary-policy-2016-08.pdf>.

As discussed in its response to the draft decision, DBCTM considers that liquidity in the indexed-bond market is currently sufficient to support use of the indexed bond method to estimate inflationary expectations. It notes that other regulators have adopted this approach for estimating inflation.<sup>11,12</sup>

A further advantage of indexing the RAB using a forecast of the inflation rate rather than the annual outturn rate is that access holders and seekers will have greater *ex ante* certainty about the access charges to apply through the regulatory period. DBCTM considers this to be consistent with promoting the principle of certainty in contractual arrangements, which the QCA's draft decision discusses.<sup>13</sup>

## 2.3 SUMMARY

If the inflation rate for the ARR deduction does not match the inflation rate for RAB indexation, DBCTM could be under- or over-compensated *over the life of the RAB*. This would be inconsistent with the NPV=0 principle, which the QCA supports. DBCTM therefore proposes to align the inflation rate for the ARR deduction with that for RAB indexation. DBCTM maintains its position that expected inflation (not outturn inflation) should be used to index the RAB, and also notes that this approach contributes to pricing-related certainty for stakeholders.

To minimise the risk of DBCTM being under- or over-compensated *over a regulatory period*, the estimate of expected inflation should be market-reflective, in line with the rate implicit in the nominal WACC. DBCTM maintains its position that the indexed bond approach is superior to the RBA approach to achieve that objective.

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<sup>11</sup> DBCTM's submission on draft decision: 44,46

<sup>12</sup> Other reasons included that the expected inflation rate of 2.50% proposed in the QCA draft decision (and 2.0% under the RBA approach) implies a negative real rate of interest on five-year government bonds.

<sup>13</sup> QCA draft decision on 2015 DAU: 184

### 3 NECAP

QCA staff noted that:

*The DBCT User Group's submission on the draft decision proposed that, should the QCA be minded to maintain its position on accepting DBCTM's proposal on the approval process for NECAP, then the QCA should require amendment to the DAU to take into account any underinvestment in prudent NECAP when assessing DBCTM's revenue requirements.*

QCA staff seek comments on the appropriateness of formalising this matter in this way.

#### 3.1 DBCTM'S RESPONSE

DBCTM notes that the discussion of NECAP-underinvestment issues in Section 12.3 of the DBCT User Group's submission mostly reiterates views that were previously put to the QCA prior to the draft decision. In DBCTM's view, the submission provides no basis for the QCA to change the position that it adopted in section 10.8 of the draft decision.<sup>14</sup> As noted in Section 10.6 of DBCTM's response to the draft decision, DBCTM fully supports the QCA's draft position on this issue.<sup>15</sup>

Stakeholders agree that DBCTM has clear obligations to ensure that the Terminal continues to be able to provide services according to established standards. DBCTM notes that the PSA<sup>16</sup> already includes a requirement for DBCTM to take account of whole of life costs in optimising its operation of and investment in the Terminal. In view of this and of the limitations under the QCA Act on the QCA's power to require DBCTM to invest at its own cost<sup>17</sup>, DBCTM regards amendment of the DAU in the way proposed by the User Group as unnecessary and inappropriate. DBCTM expanded further on this point in its supplementary submission.<sup>18</sup>

DBCTM notes that, as part of its response to the draft decision, it suggested deleting clause 11(b) from Schedule E of the QCA's mark-up of the 2015 DAU:

*When providing the above Services, DBCT Management must take into account the following factors, where relevant:*

- (1) lowest total whole of life cost;*
- (2) reliability and economy of performance;*
- (3) maximising the effective life of the Terminal; and*
- (4) DBCT Management's non-discrimination obligations under this Undertaking.*

DBCTM's main concern was with factor (3) of this clause. DBCTM regards it as impractical and inappropriate to include this. In DBCTM's view, maximising the Terminal's effective life is likely to be inconsistent with minimising whole of life costs. DBCTM notes that it already has obligations to account for factors (1), (2) and (4) under the PSA.

<sup>14</sup> QCA draft decision on 2015 DAU: 207-209

<sup>15</sup> DBCTM's submission on QCA draft decision on 2015 DAU: 55

<sup>16</sup> PSA, clause 2.2(a) and definition of 'Optimise'.

If requested, DBCTM can provide this information, on a confidential basis, to the QCA.

<sup>17</sup> QCA draft decision on 2015 DAU: 29-30; 208

<sup>18</sup> DBCTM Supplementary Submission on 2015 DAU: 3

## 4 COMPETITION BETWEEN PORTS

QCA staff said that:

*DBCTM's submission on the draft decision suggests that DBCT's 'low cost' status is relevant only where there is spare capacity in the existing Terminal. DBCTM considers this low-cost status is not relevant for establishing whether DBCTM can compete with Adani's Abbot Point Coal Terminal for securing volumes for expansion infrastructure.*

*[The QCA] seeks comments from stakeholders on whether they consider that the competitive drivers relating to expansion tonnage are likely to differ from those relating to existing tonnage.*

### 4.1 DBCTM'S RESPONSE

DBCTM notes that the QCA's draft decision requested additional evidence on the extent to which DBCTM's exposure to competition from other ports has increased.<sup>19</sup> This request allowed all stakeholders ample opportunity to provide material that they thought the QCA should consider in reaching a final decision.

In responding to the QCA's request for another round of feedback, DBCTM seeks to clarify the context in which it emphasised "*competitive drivers relating to expansion tonnage*".

#### 4.1.1 EVIDENCE PROVIDED BY DBCTM AND DBCT USER GROUP TO DATE

In responding to the draft decision, DBCTM supplied evidence of the type the QCA had requested. DBCTM noted that:

- the completion of GAPE has made it technically feasible for Goonyella mines to access AAPT, which was not possible when DBCTM's 2010 AU was approved
- several members of the DBCT User Group have contracts at AAPT for their Goonyella-based mines, which were not in place when DBCTM's 2010 AU was approved. DBCTM contends that this demonstrates the existence of *actual* as well as *potential* competition.
- the extent to which competing ports will be able to match terms offered by DBCTM in the future will depend on expansion costs and expansion-pricing practices, not on current costs and pricing practices.<sup>20</sup>

In comparison, the DBCT User Group's submission makes no mention of its members' access agreements at AAPT and includes the assertion that:

*There continues to be no economic or practical evidence of any such competition from other coal terminals, existing or contemplated.<sup>21</sup>*

In support of this assertion, the User Group's submission offers no new evidence but instead reiterates a number of claims about the current state of relevant parts of the supply chain: claims that it had already made prior to the QCA's draft decision.

#### 4.1.2 SCOPE OF THE QCA'S REQUEST FOR ADDITIONAL FEEDBACK

DBCTM regards the last sentence of the QCA's request for comments on this issue as too narrow. Moreover, it seems to require stakeholders to speculate on future developments in the coal supply chain.

<sup>19</sup> QCA draft decision on 2015 DAU: 230

<sup>20</sup> See section 1.1.2 of DBCTM's July 2016 response to the QCA's draft decision

<sup>21</sup> DBCT User Group submission on QCA's draft decision on the 2015 DAU: 11

DBCTM sees limited value in stakeholders' speculations about future costs, especially when the speculations are being offered with a view to achieving short-term outcomes from the regulatory process. DBCTM seeks clarification of the criteria according to which the QCA intends to assess the credibility of such speculations.

DBCTM contends that the key issue is whether or not DBCT is now exposed to more potential competition than was the case when its previous access undertakings were approved. In DBCTM's view, the evidence provided in its response to the draft decision establishes clearly that this is the case.

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#### 4.1.3 MATERIALITY OF ADDITIONAL COMPETITION

DBCTM considers that a central issue for the QCA's assessment is whether or not this additional competition is material for regulatory purposes. In its response to the draft decision, DBCTM focussed on the relevance of additional competition to the level of demand risk that DBCTM now faces and is likely to face in the future.

In this context, DBCTM observed that the intensity of future competition will depend on *future* costs of exporting through the different ports that are accessible to miners who could also access DBCT. If the medium- to long-term prospects for coal exports are as favourable as the QCA (and other stakeholders) suggest<sup>22</sup>, future costs will depend on expansion costs and expansion-pricing practices at the relevant ports and on the rail infrastructure that connects the mines to the ports.

Another way for the QCA to assess the materiality of the additional competition is to consider the access-declaration criteria from Section 76 (2) of the QCA Act. When the facility was originally declared for access, DBCT was deemed to pass these criteria.

DBCTM contends that DBCT would now be unlikely to pass the "uneconomical to duplicate" access criterion.<sup>23</sup> The AAPT-GAPE combination effectively represents a duplicate for the coal-handling services provided via the DBCT-Goonyella combination.

Following the High Court's decision<sup>24</sup> in the Pilbara case, what would have to be established for DBCT not to pass criterion (b) is that it could be commercially viable for investors to duplicate the coal-export services currently provided by DBCT. The existence of the AAPT-GAPE facility demonstrates not only that investors could regard duplication economical but that they actually did.

DBCTM regards the likelihood that DBCT no longer passes criterion (b) as evidence that the terminal now faces substantially more competitive pressure than was the case when the QCA approved the 2006 and 2010 access undertakings. In DBCTM's view, this implies that it is now exposed to greater demand risk than was previously the case.

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#### 4.1.4 CONCLUSION

In its response to the QCA's draft decision, DBCTM argued that increased competition leading to increased demand risk is one of the factors that justify the QCA approving a regulated rate of return on equity for DBCTM that is greater than the rate proposed in the draft decision. DBCTM contends that it has substantiated its claims that additional competition – actual as well as potential – exists and is material to DBCTM's risk profile.<sup>25</sup>

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<sup>22</sup> QCA draft decision on 2015 DAU: 121

<sup>23</sup> QCA Act, section 76 (1) (b)

<sup>24</sup> See <http://www.austlii.edu.au/au/cases/cth/HCA/2012/36.html>

<sup>25</sup> DBCTM's response to QCA draft decision on 2015 DAU: 26

## 5 INDEPENDENCE OF THE OPERATOR

QCA staff said:

*... the mark-up of the 2015 DAU, that was included in DBCTM's submission on the draft decision, deleted drafting regarding the identity of the Operator and included alternative drafting for the regulatory approval process DBCTM would comply with in the event it decided to exercise its rights under the Operation and Maintenance Contract (OMC) during the regulatory period.*

*DBCTM's submission did not provide reasoning for the nature and scope of its proposed amendments to the scope and administration of the 2015 DAU, beyond referencing that the change in Brookfield's Asciano transaction entitles them to modify the ring-fencing amendments proposed in the draft decision.*

QCA staff seek comments from stakeholders on the appropriateness of DBCTM's proposal to:

- (a) delete proposed drafting in the draft decision regarding the:
  - (i) role and identity of the Operator
  - (ii) regulatory procedures and approval processes DBCTM must comply with prior to changing the Operator
  - (iii) minimum terms to be included in the OMC and Terminal Regulations applying to a new Operator.
- (b) include new regulatory procedures to be followed by DBCTM within 28 days of DBCTM changing the identity of the Operator.

### 5.1 DBCTM'S RESPONSE

DBCTM understand that QCA staff's questions relate to changes that DBCTM proposed for sections 3.3 and 3.4 of the QCA's mark-up of the 2015 DAU.

#### 5.1.1 ROLE AND IDENTITY OF THE OPERATOR

DBCTM acknowledges the importance of ensuring the independence of the Operator and supports the requirement for the Operator to be independent of DBCTM and the Brookfield Group. However, requiring the Operator to be a majority user-owned entity, as proposed in the QCA's drafting,<sup>26</sup> is overly restrictive and would inhibit the ability of DBCTM to undertake a competitive tender process in respect of the operation and maintenance of the Terminal. DBCTM would have no bargaining power in dealing with the Operator or negotiating a new OMC. DBCTM also notes that this could result in competition being reduced in a related market, which is inconsistent with the public interest in having competition in markets (section 138(2)(d) of QCA Act).

Although the existing provisions of the undertaking do not contemplate the Operator being an entity other than a majority user-owned company, this does not mean that an entity not controlled by users should be precluded from being appointed as Operator. However, appointing an independent non-user controlled entity would require amendments to the undertaking having regard to role and identity of the new Operator (for example, to adjust the method of charging of operating costs).

To address this, DBCTM proposed to include a trigger mechanism (including a DAAU) requiring amendments in the event DBCT PL ceases to be the Operator (or there is a change in control of DBCT PL, such that it is no longer a user-owned company).<sup>27</sup> DBCTM considers this approach should alleviate

<sup>26</sup> Clause 3.3(a)(2)(A) of the QCA's mark-up of the 2015 DAU requires, as a default, that more than 50% of the issued shares in the Operator be held by users

<sup>27</sup> DBCTM mark-up (clean version) to QCA's mark-up of 2015 DAU: clause 3.2(b)(3)

concerns raised in the DBCT User Group's submission regarding any possible changes to the identity of the Operator. (See section 5.1.3 below for DBCTM's revised proposal on the timing of the DAAU).

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### 5.1.2 OMC AND TERMINAL REGULATIONS

DBCT considers it inappropriate to include provisions in the undertaking which seek to restrict the terms of the OMC so long as DBCT PL remains as Operator. DBCT PL is a user-owned entity, which gives users sufficient control of the terms of the OMC. To include additional restrictions on DBCTM's ability to negotiate those terms is unnecessary.

DBCTM reiterates that any restrictions which are aimed at entrenching the influence *existing* users have on operation and maintenance arrangements are more appropriately dealt with on a case-by-case basis in light of an actual (rather than hypothetical) change in operator.

Similarly, so long as the Operator is DBCT PL, users have sufficient oversight and control of the Terminal Regulations. If this ceases to be the case (for example, due to a change in Operator), appropriate amendments to the undertaking can be proposed at that time.

DBCTM's proposed drafting in respect of the Terminal Regulations is aligned with the existing form of Standard Access Agreement as approved under the 2010 AU. Altering the Terminal Regulations in the way proposed by the User Group would cause an inconsistency between the undertaking and existing user agreements. Given more robust provisions are not warranted at this time (as the Operator remains a user-controlled company), DBCTM considers the better approach is to avoid creating any such inconsistency.

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### 5.1.3 REGULATORY PROCEDURES FOR CHANGE IN OPERATOR

In its July submission on the draft decision, DBCTM had proposed submitting a DAAU to the QCA within 28 days of DBCT PL ceasing to be the Operator.<sup>28</sup> A new Operator would have to manage the facility immediately after DBCT PL stops being the Operator. However, DBCTM acknowledges that users may value certainty, and being able to comment, on the DAAU's contents *before* the new Operator is appointed.

In that respect, DBCTM recognises that it would be in a position to submit a DAAU before DBCT PL ceases to be the Operator. The notice period under the OMC for terminating DBCT PL as the Operator is [REDACTED]<sup>29</sup>. On this basis, DBCTM proposes to submit a DAAU 12 months prior to DBCT PL's OMC being terminated. The main concern for DBCTM is that the QCA's process for assessing the DAAU, including final approval and implementation, must occur before the new Operator is appointed. DBCTM can meet with QCA staff to discuss alternative drafting for clause 3.2(b) of DBCTM's July 2016 version of the 2015 DAU to give effect to the proposed changes.

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<sup>28</sup> DBCTM mark-up (clean version) to QCA's mark-up of 2015 DAU: clause 3.2(b)(3)

<sup>29</sup> DBCT Operation and Maintenance Contract (2012 Restatement), 1 November 2012, General Conditions for Operations and Maintenance Contract, Clause 6.3 (a)

## 6 MASTER PLAN

QCA staff said:

*DBCTM's submission on the draft decision attached the 2016 Master Plan, as approved by DBCT Holdings. DBCTM intends that this replace the 2009 Master Plan, which was incorporated as Schedule F in the 2015 DAU as a 'placeholder'.*

QCA staff seek comments from stakeholders on the appropriateness of DBCTM's proposal to replace the 2009 Master Plan with the 2016 Master Plan.

### 6.1 DBCTM'S RESPONSE

DBCTM regards the replacement of the 2009 Master Plan with the 2016 Master Plan in the undertaking as a routine administrative matter. DBCTM also notes that stakeholders and the QCA in the draft decision approved DBCTM's proposals concerning master-planning processes.

As noted in section 7 of the 2016 Master Plan<sup>30</sup> (see especially subsection 7.4), DBCTM conducted all the required stakeholder consultation prior to approval of the 2016 Master Plan by DBCT Holdings. This is detailed on the final page of the 2016 Master Plan and includes consultation with:

- Local neighbouring communities – via the Port of Hay Point Community Reference Group (CRG) and DBCT PL's Community Working Group (CWG) meetings since mid-2014 with a detailed presentation given to the CRG in November 2015
- Queensland Department of State Development – October 2015 Briefing
- North Queensland Bulk Ports Corporation - March 2016
- Queensland Department of Transport & Main Roads
- DBCT Access Holders and Access Seekers. DBCT throughput and capacity forum – 12 December 2014, 28 April 2015, 17 March 2016
- Hay Point Services (HPS) via regular Port Liaison meetings
- Aurizon Network (rail network provider) - Quarterly
- Aurizon National and Pacific National DBCT throughput and capacity forum – 12 December 2014, 28 April 2015
- Queensland Department of Environment and Heritage Protection via regular Port Liaison meetings
- Commonwealth Environmental Protection Agency through pre-lodgement discussions and EPBC referral for Zone 4 project.

In addition, DBCTM consulted with DBCT PL at *Throughput Maximisation Team* meetings held on:

- 11 September 2015
- 14 August 2015
- 17 July 2015
- 12 June 2015
- 29 May 2015
- 10 February 2015.

<sup>30</sup> <http://www.dbctm.com.au/files/EOMReports/Master%20Plan%202016.pdf>