

Dalrymple Bay Coal Terminal User Group

2015 Draft Amending Access Undertaking

Supplementary Submission to the Queensland Competition Authority – Responses to Further Issues Raised by DBCTM

28 September 2016



1 Background

In response to an initial undertaking notice issued by the Queensland Competition Authority (**QCA**) on 23 June 2015, on 12 October 2015 DBCT Management Pty Ltd (**DBCTM**) lodged a draft access undertaking (the **2015 DAU**) to replace the current access undertaking.

The QCA invited submissions on the 2015 DAU and, following consideration of submissions received from stakeholders, issued its draft decision on 19 April 2016 (the **Draft Decision**).

The users of the Dalrymple Bay Coal Terminal (**the DBCT User Group**), provided a submission on 8 July 2016 in response to the Draft Decision, and have subsequently provided supplementary submissions in relation to debt risk premium issues and estimation of gamma.

On 3 August 2016, the QCA published QCA Staff Questions for Stakeholders (the **QCA Questions**). In addition to providing responses to the QCA Questions, DBCTM also provided a separate submission on issues that were not raised in the QCA Questions (**DBCTM Additional Submission**).

This supplementary submission responds to the additional issues raised by DBCTM in the DBCTM Additional Submission to ensure that the DBCT User Group is afforded procedural fairness in respect of those matters. The DBCT User Group is, of course, keen to ensure that the consideration of the 2015 DAU is finalised swiftly, and has therefore been conscious of confining this submission to solely responding to the DBCTM Additional Submission and not using this submission to raise new issues.

As it does not restate in their entirety previous submissions the DBCT User Group has made on the issues under consideration in respect of the 2015 DAU, it should be read together with each of the previous submissions made by the DBCT User Group during the 2015 DAU process including:

- (a) the DBCT User Group Submission dated 24 November 2015;
- (b) the DBCT User Group Supplementary Submission dated 22 January 2016;
- (c) the DBCT User Group Submission dated 8 July 2016;
- (d) the DBCT User Group Submission on debt risk premium dated 21 July 2016;
- (e) the DBCT User Group Submission on gamma dated 22 August 2016; and
- (f) the DBCT User Group Submission in response to the QCA Questions dated 30 August 2016.

2 Update on contract profile

The DBCTM Additional Submission sets out an 'update' on the contract profile of the Terminal. DBCTM claims that the short-term risk of non-renewals 'support the view that DBCTM's risk profile over the upcoming regulatory period is higher than that of the regulatory period to which the 2010 AU applies'.

The DBCT User Group reiterates its previous submissions that the DBCT Users have very strong incentives to exercise renewal options for the reasons set out in the DBCT User Group Supplementary context.

With respect to DBCTM's submissions regarding the Peabody 2017 – 2021 business plan, the DBCT User Group notes that the reduction in the expected metallurgical coal sales by Peabody over the period between 2016 and 2017 is a natural consequence of its stated intention to divest, sell or suspend non-strategic assets. Sales forecasts produced by Peabody are clearly not

reflective of the likely tonnage produced by any mining operation that it has sold or divested (which would continue to be throughput for the Terminal). In fact:

- (a) the recent reopening of the Isaac Plains mine following its sale by Vale to Stanmore;
- (b) the sale of Clermont by Rio Tinto to a Glencore and Sumitomo owned company; and
- (c) the sale of Anglo American's 70% stake in Foxleigh to Taurus Fund Management,

clearly indicates that sales and divestments of assets by DBCT Users (including temporarily suspended operations) does not mean that the throughput will reduce over a regulatory period. It is the economic viability of the mine that is relevant.

Further, the DBCT User Group continues to consider that even a DBCT User closing a mine will have reason to keep the capacity on foot with the ability to divest a mine with infrastructure capacity in place. There is nothing in the Peabody announcement that indicates that any of its divestment, sales or closure processes would operate any differently.

With respect to DBCTM's submissions about Rio Tinto's contracted rail and port capacity, the DBCT User Group notes the following:

- (a) The DBCT User Group reiterates its previous submissions, including its submissions made in response to the QCA Questions, that the existing contractual arrangements (such as the AAPT-GAPE access agreements) do not demonstrate competition between the Terminal and other ports.
- (b) The announcement by Rio Tinto of the onerous contract provisions relating to its contracts at AAPT-GAPE does not in any way represent a new form of competition for the Terminal. The AAPT-GAPE access agreements were entered into in 2010, and it is widely known that there has been excess capacity in the GAPE system for a number of years. Rio Tinto, and other AAPT-GAPE users with excess capacity, have had standing incentives to offload that capacity. The announcement by Rio Tinto does not change these incentives, and it is apparent to the DBCT User Group that the surplus capacity on the AAPT-GAPE system has not posed any threat of competition to DBCTM to date. That is because of many of the issues mentioned in previous DBCT User submissions (many of which are not solved by any discounted trading of AAPT-GAPE capacity that has already been contracted – i.e. physical infrastructure constraints, blending requirements, existing long term take or pay commitments other users have).

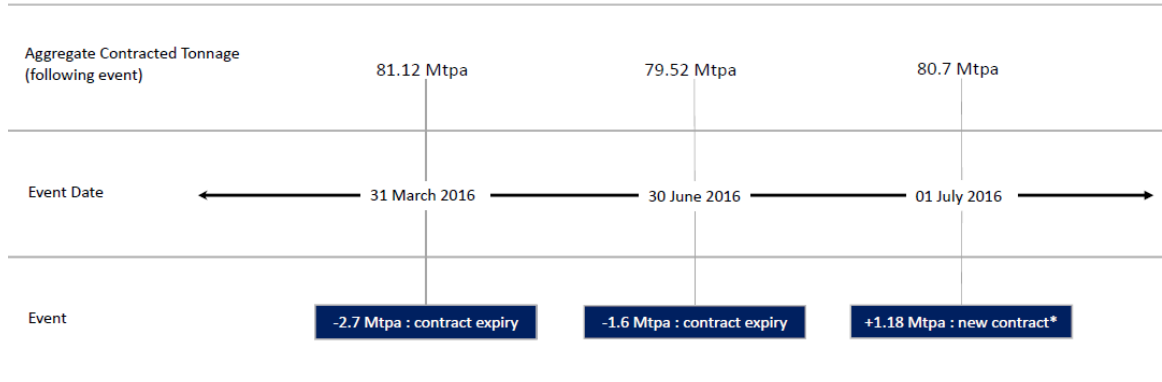
Nothing in the DBCTM Additional Submission indicates why a routine announcement by Rio Tinto would have any impact on market forces or competition between ports. The DBCT User Group considers that DBCTM's submission that this announcement may indicate increased demand risk for DBCTM to be misrepresentative of pre-existing market dynamics, and entirely unsubstantiated by its submission.

With respect to the uncontracted tonnage currently available at the Terminal, and the tonnage that will become available in 2017, the DBCT User Group notes that the revenue cap form of regulation and socialisation across the continuing users of the Terminal makes DBCTM completely immune from that capacity not being contracted for any interim period until it is recontracted. As such, the DBCT User Group does not consider that the available uncontracted tonnage has any meaningful impact on the risk profile of the DBCTM over the next regulatory period.

By way of an example of how this has operated in practice, the DBCT User Group notes that, based on information previously provided to the DBCT User Group by DBCTM, a new contract was entered for 1.18 mtpa of capacity commencing 1 July 2016 (which DBCTM had advised was

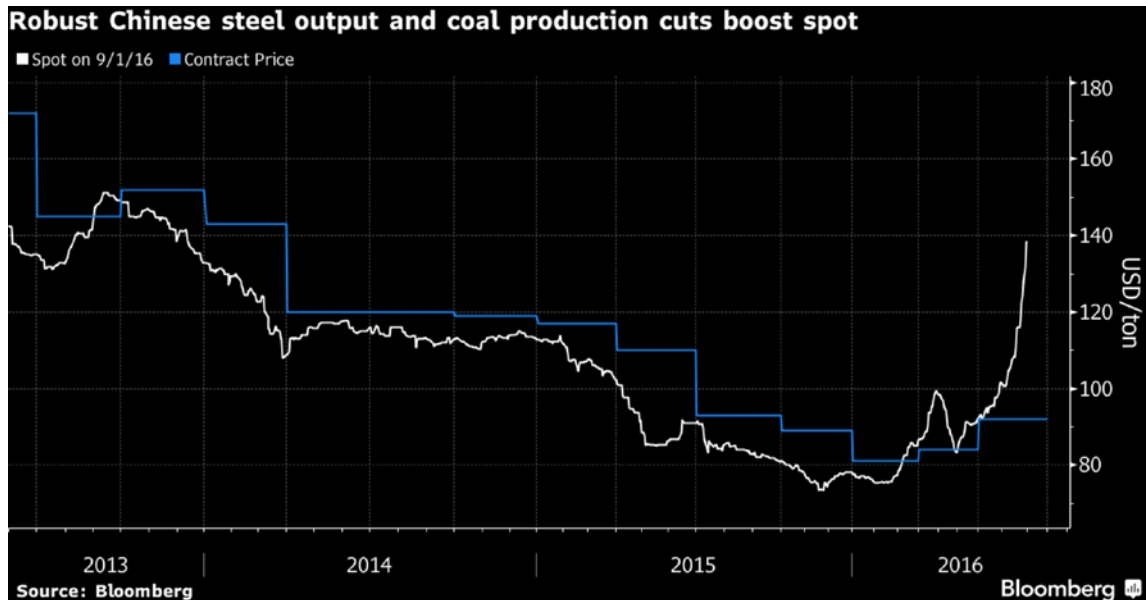
available from 1 July 2013). Through the revenue cap the costs of that capacity were effectively socialised in the 3 years until it was recontracted, such that DBCTM was insulated from any risks arising from it not being contracted.

DBCT contracted capacity timeline



- Notes
- *1.18 Mtpa contract is subject to satisfaction of a condition precedent
 - Assumes available capacity isn't recontracted

The reasoning set out above reflects the DBCT User Group's view irrespective of coal price measured at any particular instant. However, for completeness and in the face of continuing assertions by DBCTM about their risk profile, the DBCT User Group notes there has also been a sustained rise in metallurgical coal prices. The data from Bloomberg shown below in relation to hard coking coal prices is indicative of the type of sustained recovery in pricing that has occurred during the period in which the 2015 DAU has been before the QCA for consideration:



In conclusion, the DBCT User Group strongly considers that none of the submissions made by DBCTM in relation to its 'updated' contract profile indicate any change in the risk profile of DBCTM (or justify any change to the QCA's Draft Decision).

3 Ring-fencing issues

The DBCT User Group maintains its previous position with respect to ring-fencing at the Terminal.

3.1 Ring-fencing provisions

Although the DBCT User Group notes that the proposed Brookfield-Asciano transaction is not proceeding in the form originally proposed, it continues to consider that the proposal of the transaction demonstrates the clear risks of vertical integration by DBCTM and its related entities at the Terminal. Nonetheless, the DBCT User Group acknowledges that the extent of ring-fencing requirements that are necessary where the transaction is not proceeding is different than if the vertical integration of the Terminal had been allowed to occur by the ACCC and other regulators. This is precisely why the DBCT User Group submitted drafting reflecting a compromise position between the position set out in the QCA's decision on the Ring-Fencing DAAU, and the position in the 2010 DAU.

The 2010 DAU mechanisms were demonstrated to have failed in respect of the Brookfield-Asciano transaction, as they left the QCA powerless to require resubmission in response to the QCA's final decision on the Ring-Fencing DAAU. It is therefore appropriate to provide protections for the prospects of increased vertical integration during the next regulatory period.

The DBCT User Group continues to support the drafting positions provided in its submission in response to the QCA Draft Decision (though accepts that minor and inconsequential amendments may be appropriate where, for example, defined terms have been deleted and should be replaced with equivalent terms in the drafting).

3.2 Terminal Regulations

The DBCT User Group maintains its previous submissions with respect to the Terminal Regulations, including supporting the drafting proposed in response to the QCA's Draft Decision. The DBCT User Group continues to agree with the view expressed by the QCA in its Ring-fencing DAAU draft decision that it is appropriate for the QCA to retain a role in resolving disputes under the Terminal Regulations.

The DBCT User Group sought to amend the QCA's proposed drafting to reflect the status of the proposed Brookfield-Asciano transaction by removing references to rail operators in consideration of amendments to the Terminal Regulations.

As discussed above, the DBCT User Group considers that the Brookfield-Asciano transaction demonstrated the real potential for issues of vertical integration to emerge during a regulatory period. On that basis, it considers the drafting proposed by the QCA to be eminently reasonable, and provide appropriate protections to all users of the Terminal without creating significant or inappropriate regulatory burden on DBCTM.

The DBCT User Group does not consider that the QCA's proposed drafting would provide 'disproportionate and unnecessary' control over the terminal regulations as DBCTM now alleges. This is particularly the case given it is the DBCT Users and the operator of the Terminal who engage with the Terminal Regulations on a day to day basis. The DBCT User Group emphatically rejects DBCTM's claim that creating a mechanism by which users may appeal withholding of consent by DBCTM empowers those users to 'force consent' through the dispute process. The DBCT User Group considers it entirely appropriate that DBCT Users be able to refer a dispute to the QCA in the event that DBCTM withholds its consent, and the QCA is satisfied as set out in the drafting of section 6 of both the QCA's and the DBCT User Group's proposed drafting (i.e. the withholding of consent was inappropriate).

The DBCT User Group notes DBCTM's advice that it does not wish to be removed from the Terminal Regulations amendment mechanism. We note that the drafting proposed in the DBCT User Group's previous submissions did not reflect such a position.

Further, the DBCT User Group does not agree with DBCTM's assertions that the QCA's proposed amendments would leave DBCTM unable to meet its contractual and legal obligations. In that regard the QCA notes that in order for DBCTM to give consent (or for the QCA to overturn a refusal to provide consent) to amendment, the criteria in section 6(e)(1) to (4) must be satisfied. Those criteria, most relevantly ensure that:

- (a) amendments are not inconsistent with the undertaking or access agreements; and
- (b) amendments are 'reasonably necessary for the operation of the Terminal in accordance with applicable laws and regulatory standards, Good Operating and Maintenance Practice or any costs or obligations imposed are justified by the efficiency benefits arising from those costs or obligations'.

The DBCT User Group finds it very difficult to understand how the second of those tests (from clause 6(e)(4)) could ever be satisfied where the amendments would, using DBCTM's example from the DBCTM Additional Submission, leave it in breach of dust emissions under its environmental approvals.

As such, the DBCT User Group urges the QCA to retain its proposed ring-fencing drafting, with the minor amendments proposed by the DBCT User Group in its previous submission.

3.3 Coal Supply Business and Trading SCB

The DBCT User Group is willing to accept the proposed acknowledgement that a related body corporate of DBCTM has an existing interest in a Trading SCB which is a Supply Chain Business.

The DBCT User Group otherwise continues to support the drafting provided in its submission in response to the QCA's Draft Decision as the most appropriate mechanism to resolve concerns regarding vertical integration, the Trading SCB and DBCTM. As noted above, the proposed Brookfield-Asciano transaction (and the QCA's inability to require compliance with its final decision on the Ring-fencing DAAU) demonstrated that it is unworkable to rely on 'dealing with it at the time' as the method for resolving issues arising from increased vertical integration during the next regulatory period.

4 Other matters

4.1 Responsibility for Acts or Omissions of the Operator

With respect to DBCTM's submissions regarding responsibility for acts or omissions of the operator, the DBCT User Group maintains its previous submissions and continues to support its previously proposed drafting. If there is a concern about the existing Operations and Maintenance Contract not allowing this, then the DBCT User Group would be comfortable (given the identity, ownership and nature of the current operator) with the subcontracting under that agreement being specifically carved out of the proposed obligation in clause 4(b)(1)).

4.2 Notional Contracted Tonnage

The DBCT User Group maintains its previous submissions, and welcomes DBCTM's acknowledgment that the 'Revenue Cap' calculation in section 2, Part A, Schedule C of the 2015 DAU be amended to take into account the revised Notional Contracted Tonnage definition. The DBCT User Group continues to believe that its proposed drafting is the most appropriate way to address this necessary change.

The DBCT User Group continues to note that a number of its members consider they are currently being asked for security when they are clearly of good standing, credit worthy and financial substance. Unjustified and strategic requests of that nature, timed to occur in conjunction with the regulatory process, should not be allowed to influence the QCA's regulatory decisions.

4.3 Minor Drafting Clarification

The DBCT User Group is supportive of the drafting clarification proposed by DBCTM in section 6.3 of the DBCTM Additional Submission.