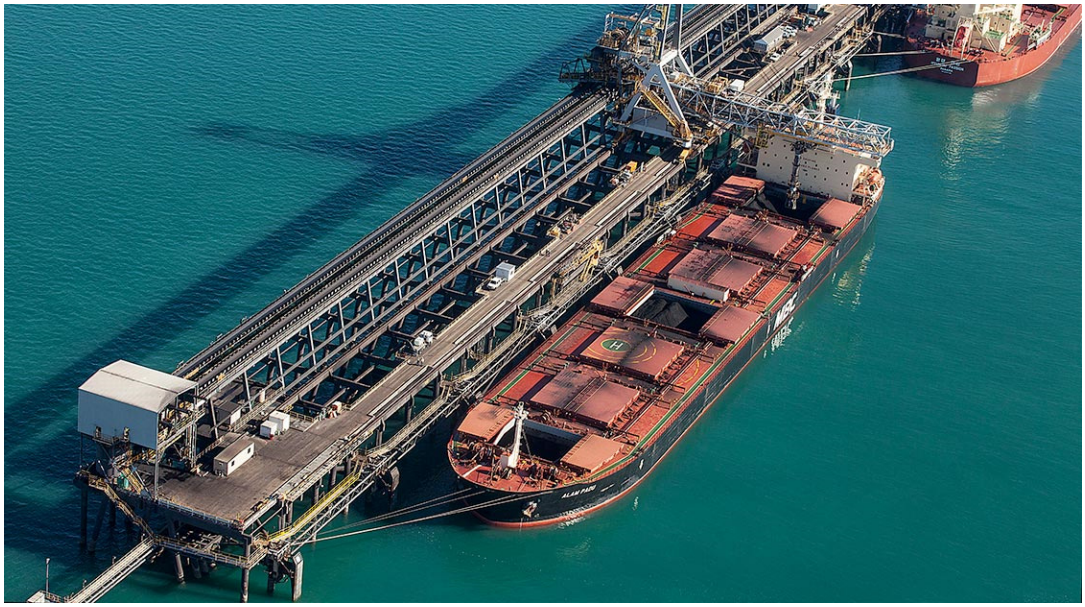
# New Hope Group

## Submission in response to QCA request for further stakeholder feedback on 2019 DBCT Draft Access Undertaking

**22 November 2019**



# 1 Introduction

This submission has been prepared by New Hope Group (**New Hope**). New Hope thanks the Queensland Competition Authority (**QCA**) for the opportunity to provide further feedback on the draft access undertaking prepared by Dalrymple Bay Coal Terminal Management (**DBCT Management**) for the regulatory period beginning 1 July 2021 (**Draft DAU**).

This submission sets out New Hope's further feedback in response to the QCA's stakeholder notice dated 25 October 2019 seeking further feedback from stakeholders in response to the appropriateness of DBCT Management's proposed negotiate arbitrate model (**QCA Notice**). Consistent with New Hope's previous submission dated 23 September 2019, New Hope is firmly opposed to the proposed negotiate arbitrate model proposed by DBCT Management and considers that it should not be approved by the QCA.

New Hope is eager to assist the QCA in its consideration of the Draft DAU and preparation of the interim draft decision, and would be willing to meet with the QCA or other stakeholders to discuss any of the matters set out in this submission.

# 2 Executive summary

In summary, New Hope continues to be of the view that Draft DAU is not appropriate, and should not be approved by the QCA. New Hope is also firmly of the view that the negotiate arbitrate model is fundamentally inappropriate in the circumstances of the DBCT service and should not be approved. New Hope considers this to be the case because:

(1) the approval of the negotiate arbitrate model would undermine regulatory certainty, in circumstances where there has been no change in circumstance that warrants a corresponding change in the fundamental model of regulation of the service at DBCT;

(2) the approval of the negotiate arbitrate model would also undermine regulatory certainty by undermining confidence in future pricing of the service and deter investment in projects and tenements within the Hay Point catchment;

(3) the appropriate assessment for what model of regulation should be applied should not be determined by assigning primacy to commercial negotiations (as DBCT Management asserts), but instead determined through analysis of the underlying factors that lead to one form of regulation being more appropriate than another, and consideration of how the circumstances of the DBCT service compare to those factors;

(4) the QCA is not required to give primacy to commercial negotiations as alleged by DBCT Management and is empowered under the QCA Act to determine that an undertaking model is appropriate for regulating the service at DBCT;

(5) the proposed negotiate arbitrate model would exacerbate asymmetry between access seekers and existing users, despite DBCT Management's claims that the terms would be materially equal;

(6) arbitration is an inappropriate mechanism for regulation in this context as the costs for access seekers will be prohibitively high, timeframes are likely to be significantly extended and outcomes uncertain; and

(7) the willing but not anxious standard is not an appropriate standard to be applied to arbitrations under the Draft DAU.

New Hope is strongly of the view that the negotiate arbitrate model does not appropriately balance the interests of DBCT Management, access seekers and access holders, and instead promotes the interests of DBCT Management to extract monopoly pricing for access to the DBCT service. There is no way to modify a negotiate arbitrate model of regulation to balance the interests of the parties at DBCT – and the best way to balance the interests of DBCT Management, access seekers and access holders is to adopt an undertaking based model of regulation, under which the QCA determines an efficient price for access.

# 3 Background

New Hope Corporation Limited is a majority Australian owned and operated diversified energy company which has been based in South East Queensland for more than 60 years. A subsidiary of New Hope is New Lenton Coal Pty Ltd which is a participant in the Lenton Joint Venture (**LJV**). The Lenton joint venture participants are New Lenton Coal Pty Ltd (90%) and MPC Lenton Pty Ltd (10%) (**MPC**) which is a Formosa Plastics Group (**FPG**) subsidiary. The LJV is seeking to develop an open cut coal resource located within the northern part of the Bowen Basin. The project consists for the most part of the Rangal coal measures, namely the Leichhardt and Vermont seams. There is an existing mining lease on the project, ML70337, which was granted in 2008, with three additional exploration permits for coal extending beyond the mining lease boundary. The Environmental Authority associated with ML70337, allows for mining of up to 2.0 million tonnes per annum (Mtpa) of coal.

The LJV is currently an access seeker at Dalrymple Bay Coal Terminal (**DBCT**) and has applications in the queue at DBCT seeking capacity at the DBCT. As such, New Hope is well-positioned to comment on the Draft DAU as a legitimate access seeker who does not currently hold capacity at DBCT (and therefore is not an existing user of DBCT).

[redacted]

# 4 A negotiate/arbitrate model is inappropriate

## 4.1 The importance of regulatory certainty

New Hope agrees with the QCA's long established principle that regulatory certainty in respect of long-lived infrastructure is in the public interest and is essential to assisting firms in making investment, planning and operational decisions. Regulatory arrangements should be as stable and predictable as possible, while ensuring that each draft access undertaking considered by the QCA is considered on its own merits at the time it is submitted.

As such, while New Hope understands the need to carefully consider DBCT Management's proposal to fundamentally change the framework for regulation of the service at DBCT, it submits that a change should only be approved where there is clear and compelling justification for such a change. New Hope submits that DBCT Management has not provided any such justification. The QCA must not accept that a fundamental change to the regulatory framework at DBCT is appropriate merely because DBCT Management has identified that different services in different markets are regulated in a different manner from the form of regulation applied by the QCA in historical DBCT undertakings. As New Hope indicated in its previous submission, it does not consider that the services regulated

by negotiate arbitrate models identified by DBCT Management (being wheat ports, airports and light handed gas pipeline regulation) are factually or economically analogous to the service provided at DBCT and do not provide compelling regulatory precedent to change the position of the QCA in respect of the regulation of DBCT.

The reconsideration of the declaration of the service at DBCT – in which the QCA determined in its draft decision that declaration should continue – is not a fundamental change of circumstance. Rather it is a continuation of the circumstances that the existing undertaking was developed under – being a declared service that is regulated by the QCA. Undertaking a fundamental change in regulatory approach because DBCT Management considers that its anticipated outcome of the Declaration Review process is unfavourable to its interests or a 'close call' is inconsistent with the preservation of regulatory certainty and the public interest.

Moreover, a shift towards negotiated price and non-price terms of access (rather than a QCA determined tariff) undermines regulatory certainty as access seekers are unable to make longer term investment decisions in dependent markets with the necessary degree of confidence in relation to the likely terms of access. Under the existing regulatory regime, prospective users and access seekers have a high level of confidence that the terms of access, including price, will be objectively and reasonably determined by reference to regulatory precedent. The QCA has significant experience in setting prices and determining risk allocation for the service at DBCT, and even where the price might be higher than users would advocate for in submissions, the involvement of the independent regulator in determining the price ensures that there is a high level of confidence in the appropriateness of the price and terms applied to the service. A decision to move to a negotiate arbitrate model removes this certainty for access seekers and is likely to undermine access seekers' ability and willingness to make investment decisions.

Where access seekers are required to negotiate pricing independently and do not have the assurance offered by an experienced, independent regulator determining an appropriate price for the service, they are less likely to make investment decisions in projects that are dependent on acquiring access to the service. This in turn will dampen competition in dependent markets due to lessened regulatory certainty.

Additionally, New Hope submits that arbitration is not currently a sufficiently credible threat to enable effective and balanced negotiations, partly because of the high degree of uncertainty for users regarding the timing, level of resources and information required for the arbitration process and the likely outcome of any arbitration.[1] This means the outcomes of arbitrations cannot be relied on to constrain the market power of DBCT Management or deliver economically efficient terms of access for the service.

### 4.2 A consideration of the service, not of the competition problem, is the appropriate test

DBCT Management suggests in its submission supporting the Draft DAU that because the competition issue which the declaration of the DBCT service would address was perceived to be narrow, a negotiate arbitrate framework would be appropriate.[2] New Hope submits that framing the decision to apply a regulatory framework around the draft decision made by the QCA in the declaration review is inappropriate, and not in keeping with regulatory precedent. Rather, regulatory precedent suggests that a decision to apply a particular framework for regulation should be responsive to the particular service or infrastructure that is being considered rather than the reason that service is considered to require regulation.

By way of example, services which are subject to a negotiate arbitrate model are generally less standardised services. Where there are more standardised services subject to

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1 See https://www.aemc.gov.au/sites/default/files/2018-03/Richard%20Owens%20-%20Speech%20-%20Gas%20Outlook%20-%201%20March%202018_1.pdf.

2 See DBCT Management 2019 DAU Submission, p 28.

regulation, it is appropriate to apply an ex ante reference tariff. As a general rule, where there are more customised services, a negotiate arbitrate model may be more appropriate.[3] The service at DBCT is a standardised coal handling service with no customisation between users. To the extent that DBCT Management provides some aspects of a coal handling service to some users and not to others (for example, co-shipping or blending), this is not customisation of a service. Rather, such minor differences are more appropriately characterised as minor variations in the application of a very standardised service at DBCT. New Hope rejects DBCT Management's suggested that different services are offered to different users – there is evidently a single coal handling service at the Terminal and minor variations in how users access that service cannot be said to constitute 'different services'.

Regulatory precedent supports the approach for determining the model of regulation by reference to the service. For example, the ACCC determined in 2009 that ex ante price regulation was not required for wheat port access undertakings and instead determined that a negotiate arbitrate model was appropriate. This decision was not made to reflect an assessment of a perceived narrow competition problem – but instead reflective of industry feedback that the key concern for industry participants was discriminatory behaviour by port operators rather than monopoly pricing (which was considered unlikely to occur in the context of the industry). As such, the approach adopted was responsive to the particular circumstances of that industry and infrastructure.[4] The ACCC has since emphasised that this decision was made in the context of the specific industry being considered – not a general statement that one form of regulation is more appropriate for ports generally than another.

The concerns of stakeholders in the Draft DAU are significantly broader than concerns about discriminatory treatment by DBCT Management and include the ability of DBCT Management to extract monopoly prices under a negotiate arbitrate model. As such, while New Hope acknowledges that wheat ports are regulated using a negotiate arbitrate model, it rejects any suggestion that the market power of any wheat port operator is reasonably comparable with the market power of DBCT Management for the provision of the service. This view is supported by the entrance of new market participants providing wheat port services since the introduction of the undertakings in 2009 – whereas there have been no new entrants to compete with DBCT Management or provide a countervailing force to its market power.[5]

It has been acknowledged by regulators that situations of uneven bargaining power, for example where smaller users are not able to meet the costs of potential arbitration, are likely to mean that a negotiate arbitrate model is inappropriate.[6] This is likely to be the case with access seekers at DBCT as those potential users are likely to be unwilling or unable to fund a costly arbitration process against a well-resourced DBCT Management to determine terms of access. Further, the transaction costs of negotiating under a negotiate arbitrate model for the DBCT service are likely to be very high. This is particularly because the costs of availability of information relevant to negotiations are very high – and access seekers would be required to bear these costs themselves. For example, when determining a tariff, access seekers would not have access to any independent information regarding appropriate remediation costs or appropriate levels of maintenance over a pricing period. It

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3 See https://www.aer.gov.au/system/files/AER%20submission%20-%20Review%20into%20the%20scope%20of%20economic%20regulation%20of%20covered%20pipelines%20-%2022%20August%202017._0.pdf.

4 https://www.pc.gov.au/inquiries/completed/access-regime/submissions/submissions-test/submission-counter/sub016-access-regime.pdf

5 See Bulk wheat ports monitoring report, ACCC, 2016-17, for discussion of new entrants in relevant wheat port markets, available here: https://www.accc.gov.au/system/files/Bulk%20Wheat%20Ports%20Monitoring%20report%202016-17.pdf

6 See Margaret Arblaster, ACCC-AER Regulatory Conference 2016: https://www.accc.gov.au/system/files/Presentation%20by%20Margaret%20Arblaster%2C%20Teaching%20Fellow%20in%20Transport%20Economics.pdf.

is possible that access seekers may be able to commission expert reports into these matters to assist their negotiations and bargaining position – but such reports are likely to make entering into negotiations prohibitively expensive. DBCT Management providing its own information does not resolve this concern as that information is unlikely to be independent and is likely to support the positions of DBCT Management. High transaction costs for negotiations under a negotiate arbitrate model is considered by regulators to be an indicia of a service where a negotiate arbitrate model may not be appropriate.[7]

### 4.3 The QCA Act does not require primacy of commercial negotiations in favour of an undertaking

New Hope rejects DBCT Management's submission that the access regime in the QCA Act is predicated on assigning primacy to commercial negotiations, with the threat of arbitrated terms of access providing an incentive for infrastructure providers and access seekers to reach private agreement.[8] It is clear from the application to certify the Queensland access regime that the certification of the QCA Act was based on two pathways for regulation, the negotiate arbitrate model and the access undertaking model.[9] There is no primacy given in the QCA Act to the negotiate arbitrate model – it is clearly intended as a regulatory alternative to voluntary or mandated access undertakings.[10] This position has been well-established, including in the application for certification of the Queensland third party access regime in respect of DBCT.[11]

DBCT Management has asserted in its submission that there is no real room for commercial negotiations within the existing regulatory regime, and that position (combined with the asserted primacy of commercial negotiations under the QCA Act) supports a shift to a negotiate/arbitrate model of regulation.[12] [redacted]

Similarly, New Hope notes that Aurizon Network – which is subject to very similar regulatory arrangements to DBCT Management – engages in negotiations with access seekers regarding terms of access, including in relation to matters such as conditions precedent and insurance requirements.

New Hope also submits that to the extent limited negotiations occur in respect of the terms of the standard access agreement, this is likely to be reflective of the confidence that access seekers have in the appropriateness of risk allocation within the standard approved terms. The QCA having oversight of the standard terms of access gives confidence to access seekers that the terms reflect a fair allocation of risk – which would not exist under a negotiate arbitrate model. For the reasons set out this submission, New Hope is strongly of the view that requiring access seekers to negotiate full terms with DBCT Management to will result in uneconomically high returns to DBCT Management and imbalanced risk allocation between access seekers and DBCT Management (as a monopoly infrastructure provider). This is particularly the case given the information asymmetry that would exist for any access seeker required to negotiate price terms of access with DBCT Management

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7 Ibid.
8 DBCT Management 2019 DAU submission, p 29.
9 See Part 5, Divsions 4 -5 and Division 7 QCA Act, and application for a recommendation on the effectiveness of an access regime in respect of DBCT available here: http://ncc.gov.au/images/uploads/CECTQIAp-002.pdf.
10 Part 5, Divisions 4-5 and Division 7 QCA Act
11 Ibid.
12 DBCT Management 2019 DAU submission, p 11.

(with the asymmetry of information discussed both below and in New Hope's previous submission).

4.4 **Asymmetry for access seekers versus existing users is exacerbated by a negotiate arbitrate model**

Any presumption in favour of light handed regulation assumes equal bargaining power between access provider and access seeker. In practice, it is clear that this is not the case at DBCT. Access seekers do not hold the same level of bargaining power as DBCT Management – and a shift to a regulatory model that presumes this to be the case would be fundamentally misconstrued and harmful to access seekers.

DBCT Management has acknowledged in its submission that the absence of declaration would result in an asymmetry of terms for existing users and access seekers.[13] Further, it acknowledges the QCA's expressed view that such asymmetrical terms are inappropriate.[14]

As set out in New Hope's previous submission dated 23 September 2019, access seekers will face a significant information asymmetry when negotiating terms of access with DBCT Management under the proposed negotiate arbitrate model. Access seekers do not have the same access to information – including knowledge of existing terms and operational experience at DBCT – that existing users have. Requiring access seekers to negotiate with DBCT Management (a monopoly infrastructure owner with incentives to extract the highest possible tariff for use of the service) will exacerbate the uneven playing field between access seekers and existing users.

DBCT Management has asserted that the asymmetry is the problem that the Draft DAU should seek to address. To the extent that DBCT Management's submissions that the access undertaking must be fit for purpose to address the asymmetry experienced by access seekers are accepted, it is nonetheless clear that the Draft DAU fundamentally fails to do so.

Instead, rather than creating a Draft DAU that creates an even playing field between access seekers and existing users, the proposed negotiate arbitrate model exacerbates the barriers to entry for access seekers into the Hay Point catchment tenements market. It also exacerbates the disadvantages experienced by access seekers as compared to existing users. This is for a number of reasons:

(1) The proposed negotiate arbitrate model disincentives entrance into the relevant tenements market because there is no certainty as to terms of access to the service at DBCT – and there are no alternative services that can be reasonably substituted for the service at DBCT.

13 See DBCT Management 2019 DAU Submission, p 17.
14 Ibid.

(2) Certainty of terms is particularly important for access seekers who are developing new projects, as the costs of long term access to exporting product is a key input into the development of a project. Fluctuations in cost can significantly alter the viability of a potential project.

(3) Access seekers do not have the same insight into operational arrangements at DBCT that DBCT Management and existing users enjoy, and do not have access to same information as existing users of the service. For example, existing users are entitled to hold shares in the operator of the service at DBCT, and hold seats on the board. This gives those users a level of insight that access seekers will never have – and necessarily hinders the ability of access seekers to negotiate terms of access as compared to existing users. The costs for access seekers to obtain that information – if it is even possible to obtain that information – are likely to be very high.

(4) The incentives for an access seeker – who does not know how likely a positive outcome would be or what outcomes have been achieved by others negotiating terms of access – to pursue costly and lengthy arbitrations are very low and not a reasonable backstop to protect the interests of access seekers.

(5) Requiring access seekers to engage in a negotiate / arbitrate process while existing users are protected by the terms in existing access agreements is a material asymmetry of terms and there is no guarantee provided in the Draft DAU that the terms achieved through negotiations by an access seeker would be comparable to the terms in existing user agreements.

(6) Existing users will have some continued protection against monopoly pricing through the existing price review provisions of their users agreements. Access seekers clearly do not enjoy this same benefit.

(7) The factors that the QCA would be directed to consider in an arbitration between an access seeker and DBCT Management under the Draft DAU are different to those that would apply to an existing user agreement – which is likely to lead to higher prices for access seekers.

As such, it is clear that even if the terms are notionally the same for existing users and access seekers, the impact of those terms on access seekers and existing users is vastly different. The Draft DAU therefore not address any asymmetry that exists between access seekers and access users – and instead exacerbates these concerns.

For completeness, New Hope also rejects DBCT Management's assertion that the competition problem is appropriately characterised as 'narrow' and therefore does not justify ex ante price regulation. It is a clear competitive harm in a key dependent market for the service that is bounded geographically. Additionally, existing users are only protected insofar as their existing contracts grant them capacity – such that only existing user agreements are protected and users that wished to obtain additional capacity (for expansions of projects) would be treated as access seekers. This means the pool of potential access seekers in the future is large and there are significant number of firms that may face the disadvantages set out above.

4.5 **The willing but not anxious standard is not appropriate**

New Hope submits that the willing but not anxious standard is inappropriate in the context of arbitrated terms of access between access seekers and DBCT Management. This test is almost impossible to apply where there are no alternative services (as the service at DBCT is a monopoly service that has no substitutes). Further, there is no regulatory precedent for applying this standard to a service – rather than an asset or liability. DBCT Management have provided no evidence demonstrating that it would be an appropriate test for valuing a service.

The willing but not anxious standard has been developed in the context of open and contestable markets – for example, where property is compulsorily resumed and a determination of a fair value must be determined. The application of the standard necessarily relies on evidence of other prices in the market which can be referred to by an arbitrator. It is difficult to see how this could operate in the context of DBCT as all prices will have either been determined through arbitration, or determined in the context of commercial negotiations where buyers *are* anxious and there is disproportionate market power. Access seekers do not have alternative sources of port capacity if the service is not made available to them – so where any prices agreed are like to be prices that anxious access seekers negotiating with a monopoly service provider have agreed.

This position sits in tension with the broader application of the willing but not anxious test. For example, the legal precedent developing the meaning of the standard assumes that there is equal bargaining power and knowledge between the two parties to the bargain[15] – which as discussed above, is not the case. There is no liquid or competitive market for the service at DBCT – which means that the standard is not appropriate in the circumstances and is likely to lead to inappropriate outcomes in the context of an arbitration.

The application of such a standard is likely to lead to inappropriately high and inefficient prices being applied to the service, given the disparity of bargaining power between DBCT Management and access seekers and the lack of comparable services and market data.

15 *Spencer v The Commonwealth of Australia* (1907) 5 CLR 418 at 44.