

Submission in response to QR 2016 Access Undertaking Review
Event

22 October 2019



1 Executive Summary

This submission is made on behalf of Yancoal Australia Limited (**Yancoal**), in its capacity as operator of the Cameby Downs mine, located on Queensland Rail's (**QR**), West Moreton rail network, in relation to:

- (a) QR's submission of 22 September 2019 proposing variations to the West Moreton and Metropolitan tariffs which apply under the current access undertaking (the **QR Tariff Submission**); and
- (b) QR's reference train service draft amending access undertaking (**DAAU**).

The QR Tariff Submission claims two 'Review Events' have arisen, namely:

- (a) the change to the reference train through the inclusion of an additional wagon; and
- (b) the reduction in train services contracted by New Hope,

and seeks to make the DAAU conditional upon the QR Tariff Submission (i.e. only providing the productivity improvement of an additional wagon where QR achieves the tariff increases sought).

However, Review Events do not provide an automatic entitlement to increase tariffs. Under QR's access undertaking they are required to be considered appropriate by the QCA. However, Yancoal considers it is clearly not appropriate for the QCA to approve the tariff increases sought in the QR Submission. In particular:

- (a) the proposed increased reference tariffs raise exactly the same affordability concerns that are raised by QR's submissions in respect of the reference tariffs to apply in the 'low volume' scenario under the 2020 draft access undertaking (the **2020 DAU**);
- (b) QR has provided no proposal in relation to loss capitalisation or any other mechanism to appropriately resolve that affordability issue;
- (c) QR has not sought to separate the impacts of the two purported Review Events to allow it to be determined whether the changes proposed to be made reflects either of the changes in circumstance;
- (d) QR appears to have simply assumed that it is entitled to an increased tariff on the basis of a simple formulaic division of QR's same revenue amount across the reduced volume, without even addressing the adverse consequences of the higher charge, and has clearly not demonstrated the appropriateness of the increase; and
- (e) Yancoal considers it is clearly not appropriate for the volume risk arising from New Hope's difficulty in obtaining regulatory approvals for New Acland Stage 3 to be principally borne by Yancoal (as the remaining producing mine) while QR is entirely insulated – which would be the outcome if the QR Tariff Submission was approved.

Accordingly, Yancoal's firm view is that the variations proposed in the QR Submission should not be approved by the Queensland Competition Authority (**QCA**).

2 Reference Train Service DAAU

Yancoal has been working with QR and Aurizon in relation to increasing productivity on the West Moreton line in recent years and fully supports the additional wagon being included in the reference train as a small incremental step towards improving the efficiency of the line.

Consequently, Yancoal supports the permanent commitment to longer trains being recorded in the access undertaking as proposed in the DAAU.

However, given the manner in which QR has submitted the DAAU together with the submission to increase the West Moreton Tariffs due to the reduction in train path usage by New Acland Mine, it

appears that QR is attempting to condition the permanent implementation of longer trains on receiving materially increased tariffs for the West Moreton Network.

Yancoal does not agree that the productivity improvement that would result from the implementation of longer trains should be conditional on (or necessitates) a change in the reference tariff as proposed by QR.

Yancoal is supportive of the change in reference train characteristics, but not on the condition of approving the proposed unaffordable and inappropriate tariff variations, which are discussed further below in section 5.

3 Requirements for Tariff Changes Based on a Review Event

The QR Submission falls to be considered by the QCA in the context of Clause 5.4 of Schedule D of QR's access undertaking, which sets out the threshold requirements for a reference tariff variation based on a Review Event to be approved.

In particular, to approve QR's proposed reference tariff variations in these circumstances, the QCA must be satisfied that:

- (a) the Review Event has occurred;
- (b) the variation has been calculated as if all other Reference Tariffs were also being recalculated due to the occurrence that caused the Review Event;
- (c) the variation reflects the cost impact on QR resulting from the relevant Review Event; and
- (d) the variation is appropriate after having regard to the *Queensland Competition Authority Act 1997* (Qld) (**QCA Act**), including the factors listed in section 138(2) of the QCA Act.

Each of QR's claims in relation to Review Event as the basis for increases in reference tariffs are considered against these requirements below.

4 Reference Train Service – Review Event

Yancoal does not agree that the addition of a wagon to the Reference Train Service automatically constitutes a 'Review Event' or at least one which meets the requirements for approval noted above. A variation to the Reference Train Service may constitute a 'Review Event' if a proposal is made to QR which '*requires a variation to the Reference Tariff to accommodate productivity or efficiency improvements to their Above Rail Services.*'

QR has provided no explanation of how the change in the Reference Train Service 'requires a variation to the Reference Tariff' (such as any information on how maintenance or operational costs would vary with the additional wagon or any evidence that any access holder has changed the number of paths they have contracted or intend to utilise on the basis of the longer reference train being utilised).

QR has proposed an increase to the AT₂ component of the Metropolitan Network Reference Tariff which is directly proportional to the increase in train weight following the addition of a wagon. Yancoal struggles to see how an increase in train weight should result in an increase to the component of the Reference Tariff that is imposed on a per train path basis, when costs would not be expected to vary in that manner.

We note that in relation to the West Moreton Network, QR has submitted that 'The New Reference Train Service commencing 1 January 2020 slightly offsets the reduction, increasing the total GTKs per train service'. However, no further detail has been provided which would allow Yancoal to understand how the increased train length has been factored into the new proposed West Moreton Network Tariffs.

Accordingly, Yancoal considers that QR has not reasonably demonstrated, and the QCA cannot be reasonably satisfied, that it is appropriate to make changes to reference tariffs on the basis of the change to the reference tariff service.

5 Reduction in Volume Forecasts - Review Event

5.1 Regulatory Requirements for Review Event Based Variations

The QR Submission states that a 'Review Event' entitling them to a revision of the Reference Tariffs has arisen as New Hope's reduced volume of contracted access rights is 'a material change in circumstances'.

As the volumes are redacted for confidentiality in the public version of the QR Submission, and Yancoal has no way of verifying New Hope's contracted access levels, Yancoal cannot comment on whether the Review Event has occurred or whether QR's new volume forecasts are reasonable.

However, even assuming those are both the case, for the reasons set out below Yancoal cannot see how the QCA could be satisfied that:

- (a) the variations reflect the cost impact on QR resulting from the relevant Review Event; or
- (b) the proposed variation is appropriate.

Accordingly, Yancoal considers the QCA is bound not to approve the variations proposed in the QR Submission.

5.2 Cost impact of the Review Event

The QR Submission provides no indication of how, in calculating the proposed revised tariffs, QR has reflected the decrease in its costs from the lower operating and maintenance cost (relative to the allowances assumed by the QCA in the build of the existing tariff) that should arise from the decrease in volumes.

While Yancoal appreciates that some of QR's costs are fixed, some reduction over the balance of the access undertaking's term in incremental operating and maintenance costs arising from a reduction in volumes, and potential deferral of sustaining capital investments would be expected.

As the QR Submission provides no information on how such a reduction in cost was taken into account in calculating the proposed reference tariffs, Yancoal considers that the QCA cannot be satisfied that the proposed variations reflect the cost impact on QR resulting from the relevant Review Event.

5.3 Appropriateness

Section 138(2) factors

Clause 5.4 of Schedule D of QR's access undertaking requires that for a Review Event based reference tariff variation to be approved, the variation must be appropriate after having regard to the QCA Act, including those factors listed in section 138(2) of the QCA Act.

The factors in section 138(2) QCA Act, which the QCA is therefore required to have regard to in considering the tariff variation are:

- (a) the object of Part 5 of the QCA Act, being to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets;
- (b) the legitimate business interests of QR (as the owner and operator of the service);
- (c) the public interest, including the public interest in having competition in markets;

- (d) the interests of persons who may seek access to the service;
- (e) the effect of excluding existing assets for pricing purposes;
- (f) the pricing principles mentioned in s 168A; and
- (g) any other issues the QCA considers relevant.

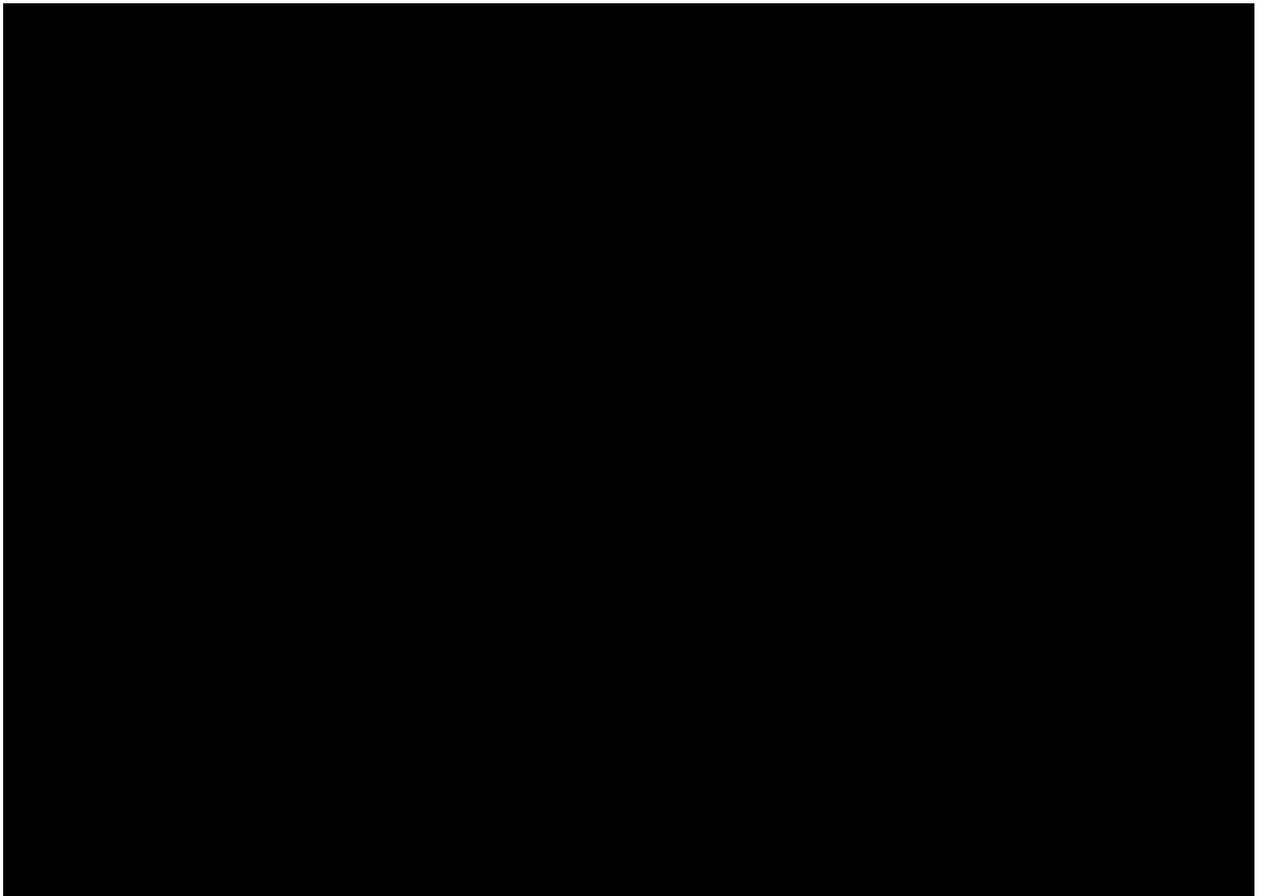
The QR Submission does not provide any explanation of the application of those factors. Rather, it simply appears to assume that QR is automatically entitled to recover the same revenue based on the lower volumes, despite the fact that the outcome of that is a substantial jump in tariffs for West Moreton coal customers, which will lead to substantial adverse consequences.

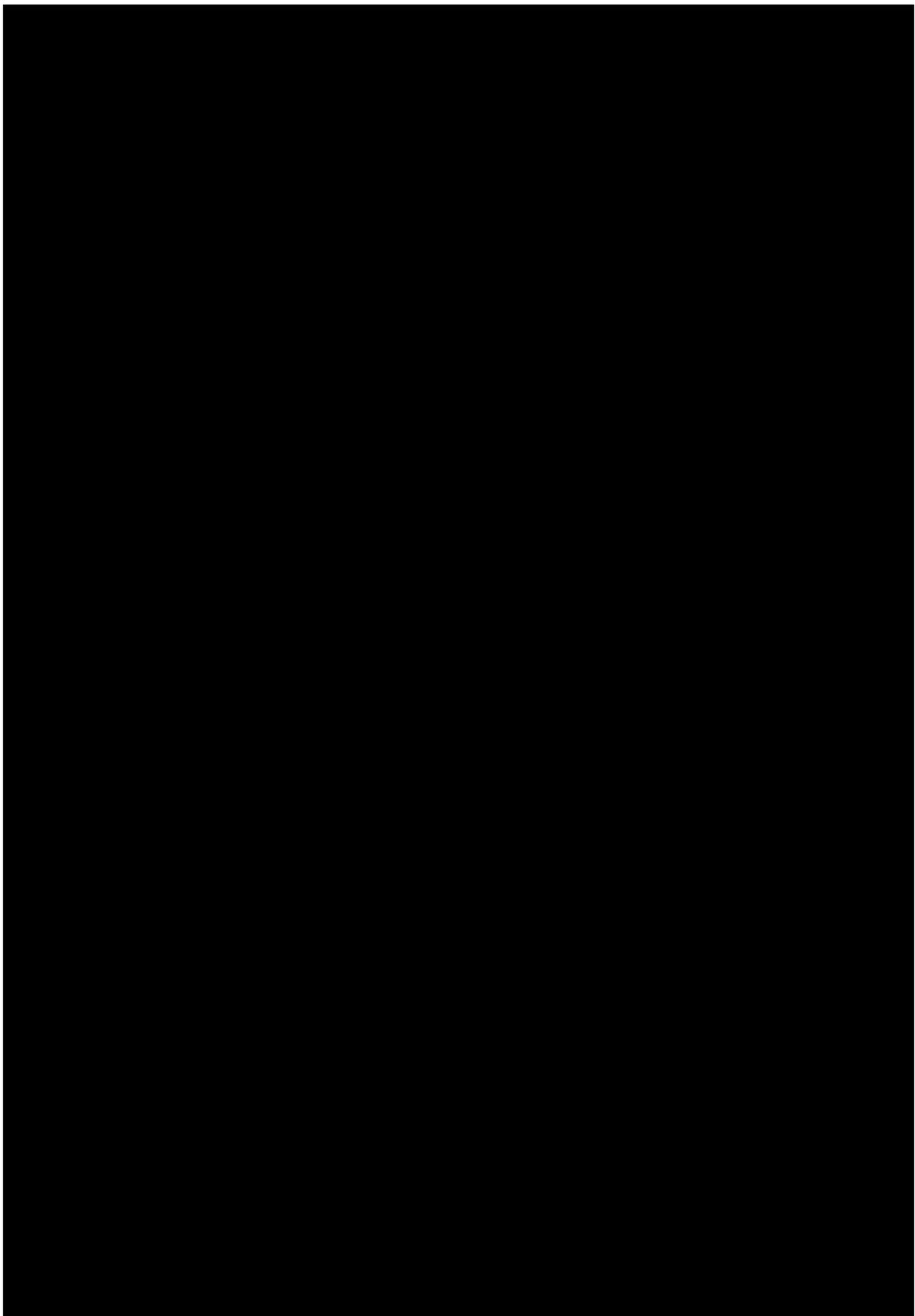
Relevance of Affordability

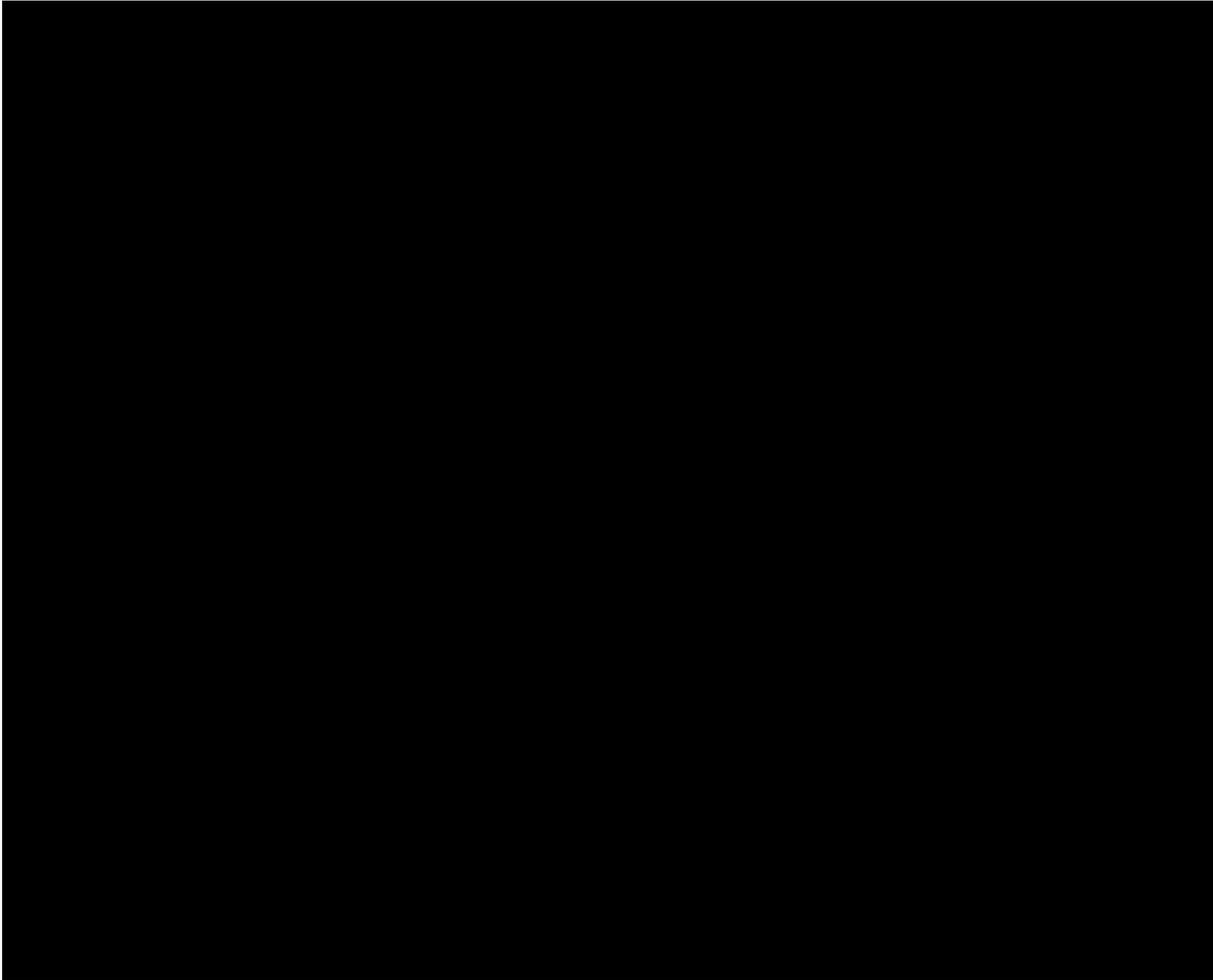
As Yancoal noted in its most recent collaborative submission on the 2020 DAU, the current West Moreton tariffs provide a reasonable estimate of the limit of affordability for West Moreton coal users. Increases above that as a result of a reduction in forecast tonnages (whether as a result of QR's proposals in the QR Submission or the 2020 DAU), require serious consideration of the affordability of the resulting tariff, and the consequences for access holders and access seekers if tariffs are set at an unaffordable level.

As discussed in Yancoal's most recent submission on the 2020 DAU, Yancoal also considers that QR has significantly over-stated the ability to pay of West Moreton coal miners.

In particular, Yancoal's previous submission noted:







Application of the section 138(2) factors in relation to this Review Event

As required by clause 5.4 of Schedule D of QR's current access undertaking, Yancoal has sought to consider how the factors in section 138(2) QCA Act would apply in this context.

When those factors are properly considered, it is clear that they do not lead to it being appropriate to approve tariffs well above the level that is affordable for continuing users.

Factor to be had regard to	Reference tariff increase is inappropriate because:
Object of Part 5 QCA Act	<p>The increase in prices well above the level that is affordable for Cameby Downs, is highly likely to discourage efficient utilisation of the West Moreton network.</p> <p>Even if it did not result in the immediate cessation of mining at Cameby Downs – it would be highly likely to disincentivise ad-hoc path usage and delay any future investment in West Moreton coal projects (most relevantly being the expansion of Cameby Downs or New Hope's future investment in the New Acland Stage 3 Project) at least until the next undertaking where stakeholders currently expect (based on the QCA Draft Decision) that a loss capitalisation regime will be implemented in the event of low volumes eventuating.</p> <p>The longer New Acland Stage 3 Project is delayed, presumably the less likely it becomes that the investment will occur, as remobilisation becomes more expensive.</p>

	<p>Accordingly, Yancoal is concerned that the proposal increases the risks of volumes not recovering and the West Moreton network and coal projects effectively becoming a stranded investment.</p> <p>Outcomes of that nature are clearly inconsistent with the object of Part 5 of the QCA Act.</p>
Legitimate interests of QR	<p>Yancoal acknowledges that QR has a legitimate interest in maintaining a certain amount of revenue. However, the legitimacy of maintaining revenue cannot be assessed in isolation to the affordability of the resulting price and the consequences for both customers and QR.</p> <p>In this context where a purist approach to revenue maintenance results in a material spike in prices at the very time when volumes are low and customers are most economically vulnerable (due to the cyclical nature of their profitability), such that the price rise presents real threats to the prospects of volume returning, Yancoal considers it is not clear this increase is actually in QR's long term interests.</p> <p>In any case, this factor needs to be balanced against the other factors in section 138(2) QCA Act, which weigh against approval of the tariff increases.</p>
Public interest	<p>Consistent with previous QCA analysis, the promotion of investment in the West Moreton coal industry is in the public interest, given the substantial positive regional economic impacts such projects generate, both directly through employment, royalties and exports and indirectly through greater spending in the region.</p> <p>It is therefore clearly not in the public interest for the tariff to be set at a level that threatens the economic viability of Cameby Downs, and hinders the chances of future increases in volumes (whether from New Acland or an expansion of Cameby Downs)</p> <p>Consistent with previous QCA analysis, it is also in the public interest to provide regulatory certainty to stakeholders. Significant price increases of the magnitude QR is proposing, late in the regulatory period in the absence of a new undertaking, at a time of falling coal prices are clearly inconsistent with providing an appropriate level of regulatory certainty.</p> <p>If this variation is approved, Yancoal will be particularly wary of future investment in this network given that it will effectively be wholly exposed to volume risk of other users in a way that is not the case for its Hunter Valley and central Queensland mining operations (while QR seeks to remain wholly insulated).</p>
Interests of access seekers	<p>Access seekers clearly have an interest in the tariff being at levels that make access to the West Moreton network affordable such that they can justify efficient investment in new West Moreton coal projects.</p>
Effect of excluding existing assets	<p>It is clear that excluding existing assets through optimisation would make the tariff more affordable than that proposed by QR.</p> <p>However, in the absence of optimisation, some other mechanism needs to be implemented to ensure tariffs remain affordable and don't rise to the point of hindering future investment and any prospect of volume recoveries.</p>

Section 168A QCA Act Pricing Principles	Yancoal acknowledges that the pricing principle including that charges should 'generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved'. However, as the QCA concluded in determining the tariffs under the existing access undertaking, that principle is merely one factor that needs to be weighed against each of the other section 138(2) factors, with the QCA determining the appropriate balance.
Other relevant issues	The QCA has previously recognised that the interests of existing access holders are generally a relevant factor. In this case, there is a real risk that an unaffordable tariff brings an earlier end to production at New Hope's New Acland mine (where Yancoal assumes that profitability will already be diminishing as volumes reduce), and/or results in earlier than anticipated cessation of operations at or closure of Yancoal's Cameby Downs mine.

It follows from the above, that based on balancing those factors, it would inappropriate to simply increase the tariffs as QR is proposing.

5.4 Potential Solutions – Optimisation or Revenue Deferral

Yancoal considers that there are realistically two possible solutions to the low volumes now forecast, which will produce an appropriate tariff, being optimisation or some form of revenue deferral.

Yancoal considers that cost reduction is also important (and should be part of efficiently managing the rail system in an environment of low volumes), but considers that incremental cost reductions alone will not make the tariff affordable (particularly given the limited remaining term of this undertaking in which such reductions could be achieved).

Optimisation should be considered given the vast amount of surplus capacity which will exist. Whether the QCA should impose optimisation is presumably a feature of the QCA's view about the potential for volumes recovering in the future.

However, if optimisation is not adopted, Yancoal strongly considers the only way to achieve an appropriate and affordable tariff is a loss capitalisation structure.

Given volumes would presumably not return during the remaining term of the current access undertaking, for a loss capitalisation structure to be appropriate, it would need to envisage capitalisation of losses during the whole remainder of the term of the current undertaking, but with a view those losses are then taken into account and, subject to optimisation becoming more appropriate, recovered during the term of subsequent access undertakings (to the extent future volumes sufficiently recover to allow that to occur through a tariff at an affordable level).

In that regard, Yancoal notes the QCA's proposals in the Draft Decision on the 2020 DAU, and continues to have the view noted in the submissions on that Draft Decision, and considers those equally apply here.

6 Conclusion

Based on the analysis above Yancoal:

- (a) supports the change to the reference train service – but not where it is made conditional on approving the tariff variations proposed in the QR Submission;

- (b) questions whether a Review Event has, in fact, occurred as a result of the change to the reference train service; and
- (c) in any event, considers that it would not be appropriate for the QCA to approve the tariff variations proposed in the QR Submission, particularly given increases are proposed to levels well above what is affordable for West Moreton coal users.

Please do not hesitate to contact Mike Dodd of Yancoal Australia Limited if you have any queries in relation to this submission.