
Peabody Energy Australia
Submission in response to the QCA draft
recommendation re declaration of DBCT

11 March 2019

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1 Executive summary

- 1 Peabody Energy Australia (**Peabody**) welcomes this opportunity to respond to the QCA draft recommendation in relation to its review of the declaration for the Dalrymple Bay Coal Terminal (**DBCT**) (**Draft Recommendation**).
- 2 Peabody is a member of the DBCT User Group, and supports the detailed submissions made by the User Group in relation to the Draft Recommendation. This brief submission is intended to supplement the User Group's submission, by providing additional information and comments which reflect Peabody's specific circumstances. In particular, we are able to provide further specific information and comments reflecting our experience in using the Hay Point supply chain, to support the QCA's analysis.
- 3 Peabody supports the conclusions reached by the QCA on each of the declaration criteria.
- 4 Our key comments on the Draft Recommendation are as follows:

- (a) **The market in which the DBCT coal handling service is provided.** Peabody supports the conclusion ultimately reached by the QCA on the scope of the relevant market – that within the Goonyella system there are no effective substitutes for the DBCT coal handling service. This is consistent with Peabody's own experience, as explained in this submission. In particular, Peabody observes significant cost differences between shipping coal to DBCT and other terminals, such as the Abbot Point Coal Terminal (**APCT**). Peabody also considers that the DBCT coal handling service is distinct from services offered at other terminals, particularly in relation to blending capability.
- (b) **Meeting foreseeable demand.** We consider that the QCA's estimate of foreseeable demand in the relevant market is likely to be overstated. This is because the "high case" forecast prepared by the QCA's consultants (MMI) does not reflect commercial reality, at least insofar as it relates to Peabody projects. We consider that the appropriate forecast of foreseeable demand is either the MMI "base case" or the WoodMacKenzie forecast prepared for the DBCT User Group. On either of these forecasts the existing facility is capable of meeting foreseeable demand, without expansion.

However we note that, even based on the QCA's highly conservative forecast of foreseeable demand, an expanded DBCT is clearly the least cost option for meeting this demand. Thus, criterion (b) is comfortably satisfied on any reasonable view of foreseeable demand.

- (c) **Promoting competition in the coal tenements market.** Peabody agrees with the QCA that, in the absence of declaration, there is likely to be a material distortion of competition in the coal tenements market in the Hay Point catchment area. This is consistent with Peabody's experience in considering new coal tenements in the Hay Point catchment area, which always involves an assessment of the likely terms of access at DBCT. In the absence of declaration, we expect that any 'new entrant' in this market will be at a significant competitive disadvantage.
- (d) **Promoting the public interest.** We also agree with the QCA that, on balance, declaration would promote the public interest. Declaration provides stability, certainty and transparency around the future operation of the Hay Point supply chain and the terms of access to DBCT. This will in turn support efficient investment across the supply chain, including in the market for coal tenements. Peabody considers that the administration and compliance costs associated with declaration (which are paid by Peabody and other users) are far outweighed by the benefits of increased stability, certainty and transparency brought about by declaration.

- 5 Peabody thanks the QCA for the opportunity to comment on the Draft Recommendation, and we look forward to further constructive engagement in relation to the declaration reviews.

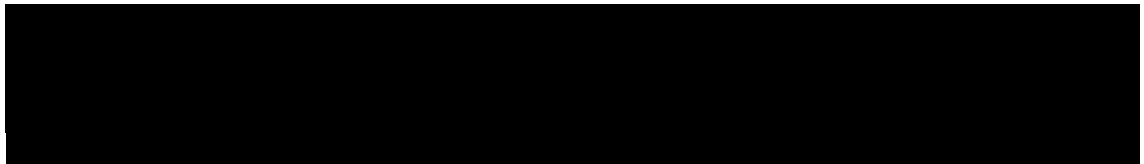
2 The relevant market

- 6 Peabody supports the approach to market definition adopted in the Draft Recommendation. The QCA's approach is appropriately focused on the extent to which other terminals provide a competitive constraint on DBCT.
- 7 Peabody also supports the conclusion ultimately reached by the QCA – that within the Goonyella system there are no effective substitutes for the DBCT coal handling service. This is consistent with Peabody's own experience, as explained below.
- 8 In the remainder of this section, we provide further information which supports the QCA's conclusions regarding the lack of available substitutes for the DBCT coal handling service, for mines operating in the Goonyella system.

2.1 Superior blending capability at DBCT

- 9 As noted in the Draft Recommendation, DBCT is able to offer blending options at the terminal.¹ DBCT offers homogenous blending on a consistent basis that caters to a wide variety of end customer requirements, and allows users to increase the value and saleability of their product range.
- 10 The DBCT blending options are a distinct market offering. Comparable blending options are not available at other terminals such as RGTanna, WICET or APCT.
- 11 At DBCT, coal is generally railed on a just in time basis to suit the cargo assembly nature of the terminal operation whereby the inloading and outloading operations of product are closely linked. The nature of this terminal operation, which is governed by the DBCT terminal regulations generally provides for loading on a dual (2) reclaim basis. This process in turn allows homogenous blending and blending of discreetly assembled stockpiles for each shipment

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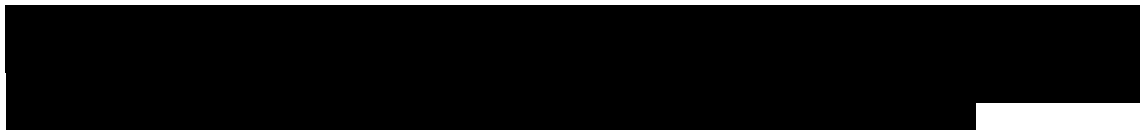
Peabody is able to achieve a variety of blending options that while in accordance with the Terminal Regulations, would not be possible at other ports such as RGTanna, WICET or APCT due to the nature of their handling operations.

- 13 By way of comparison, blending at RGTanna is by use of bulldozers pushing coal from large stockpiles into a coal-valve. While blending is available, it is not necessarily possible to maintain the same homogenous blending as with two reclaimers. The biggest difference is that, at RGTanna, the last coal on is generally the first coal off, whereas a stockpile at DBCT can be reclaimed by means of full bench lengths (top to bottom) or south-north and top-to bottom (effectively reducing length in smaller benches).

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¹ Draft Recommendation, pp 19-20.

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2.2 Cost differential between DBCT and Abbot Point

- 17 The QCA has sought to independently model its own cost estimates for mines in the Goonyella system to transport coal to other coal handling terminals, relative to transporting coal to DBCT. While noting the cost estimates provided by the DBCT User Group, the QCA says that it has not seen the detailed assumptions or underlying data that underpin these calculations.
- 18 While different to the DBCT User Group estimates, the QCA's estimates support the same conclusion – that the average supply chain cost for a mine in the Goonyella system to access DBCT is substantially cheaper than that for accessing other terminals.
- 19 This conclusion is consistent with Peabody's own experience at the Middlemount mine. Peabody has previously noted that DBCT is a more proximate terminal and a significantly lower cost option for Middlemount, and that the only reason that coal is transported from this mine to APCT is that, at the time the mine was being developed, there was no clear pathway for provision of capacity at DBCT but there was a clear offer of capacity at APCT.
- 20 Table 1 below shows the cost of exporting coal from Middlemount through APCT and DBCT². As can be seen, the supply chain cost of exporting through APCT is approximately double the cost of exporting through DBCT. This further supports the QCA's conclusion regarding the relative cost of using different terminals for mines in the Goonyella system.

Table 1: Supply chain cost for Middlemount of accessing alternative coal terminals (\$ / tonne)

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2.3 Costs of switching between rail systems

- 21 In addition to significantly higher rail and port charges, switching between rail systems brings additional infrastructure costs for users.

² Costs are correct as at May 2018 when supplied to the DBCT User Group advisors and formed part of the weighted average price analysis undertaken by PWC. The cost structure as at March 2019 is not materially different with a similar magnitude of difference between the 2 coal Terminals of DBCT and APCT.

- (a) Mine infrastructure costs
- 22 The QCA has invited further information regarding mine investment costs associated with switching between rail systems and terminals.
- 23 Peabody has previously noted that, in order to facilitate delivery to an alternative port, investment would be required at its mines to reconfigure parts of the rail network. For example, a mine that is configured to export through DBCT is likely to have a standard east facing rail turnout. If the mine were to switch to exporting through APCT, a turnout with the ability send trains north to APCT is required to facilitate efficient delivery on a consistent basis. While Middlemount's location on the Dysart branch line of the Goonyella system alleviates this requirement, the mines of Coppabella and North Goonyella would require additional infrastructure. We have not developed detailed costing for such investments, since Peabody has never seriously considered switching from one terminal to another. However we estimate that these investment costs would be material, and would vary depending on the site and its proximity to the main-line and other infrastructure, such as roads.
- 24 In addition, reconfiguration can reduce capacity from a particular mine, as re-configured trains or a change in traction type may be required. For example, whereas electric trains are used for export through DBCT, only diesel trains can operate on the APCT (Newlands network). In addition these trains are smaller in nominal size (7000t vs 10500t for a DBCT service on the Goonyella network) and as such are more expensive of a A\$/tonne.
- (b) Differences in rail system costs and charging structures
- 25 The cost comparison presented in Table 1 above shows that switching between rail systems (in that case switching from Goonyella to GAPE / Newlands) can lead to significantly higher above and below-rail charges.
- 26 Switching between rail systems can also lead to differences in how rail charges are structured, and consequently different incentives for how the rail system is used.
- 27 A recent example of this is Aurizon Network's proposal for different approaches to recovery of electrification costs in the Goonyella and Blackwater systems.³ Under the Aurizon Network proposal, the threshold for socialisation of electrification costs would be materially different in these two systems, leading to different incentives for use of electric trains. The proposal for different thresholds reflects different market dynamics in these two systems – in particular, different traction cost differentials and different levels of utilisation of electric infrastructure across the two systems.

2.4 Constraints on DBCTM in the relevant market

- 28 Peabody agrees with the QCA that, apart from declaration and ongoing regulation by the QCA, there are no effective constraints on DBCTM exercising market power.
- 29 Peabody does not consider that, in the negotiation of access terms, terminal users (or prospective users) would be in a position to exercise countervailing power. As explained above and in the DBCT User Group submissions, the cost of switching to an alternative terminal would be very significant. Consequently, any threat by a prospective user to switch would not be credible.
- 30 Peabody also agrees with the QCA's view on the DBCTM proposed access framework. Under the proposed access framework there would be considerable discretion available to DBCTM in setting access terms and conditions of access. The proposed access framework would therefore not provide an effective constraint on DBCTM's ability to exercise market power. In short, the proposed framework should not be seen as a substitute for effective regulatory oversight.

³ Aurizon Network, 2018 Electric Traction Draft Amending Access Undertaking Submission, November 2018.

3 Meeting foreseeable demand at least cost (criterion (b))

31 Peabody supports the submissions of the DBCT User Group in relation to foreseeable demand and the ability of DBCT to meet this demand at least cost.

32 For reasons set out below and in the DBCT User Group submission, we consider that the QCA’s estimate of foreseeable demand in the market is likely to be overstated. However, even based on this relatively high estimate of foreseeable demand, the QCA finds that DBCT can satisfy this demand at the least cost, compared to two or more terminals.

33 Therefore we consider that, if anything, the QCA’s analysis is likely to be conservative, in the sense that it will understate the case for satisfaction of criterion (b). We consider that criterion (b) is comfortably satisfied, on any reasonable estimate of foreseeable demand.

34 In this section, we provide specific comments in relation to the QCA’s demand forecasts, insofar as these are impacted by demand from Peabody mines. More comprehensive comments on the QCA’s criterion (b) analysis are set out in the DBCT User Group submission.

3.1 Foreseeable demand

35 Peabody supports the QCA’s use of independent experts to review the forecasts of demand for the relevant market prepared by HoustonKemp for DBCT Management. The DBCT User Group has previously raised concerns with the HoustonKemp demand forecasts. It was because of these concerns that the DBCT User Group commissioned WoodMacKenzie to prepare independent forecasts, based on information as to the likely demand for services at DBCT from individual projects.

36 However Peabody has some concerns regarding the assumptions underpinning the “high case” forecasts prepared by the QCA’s consultants, MMI. A number of these assumptions do not reflect commercial reality.

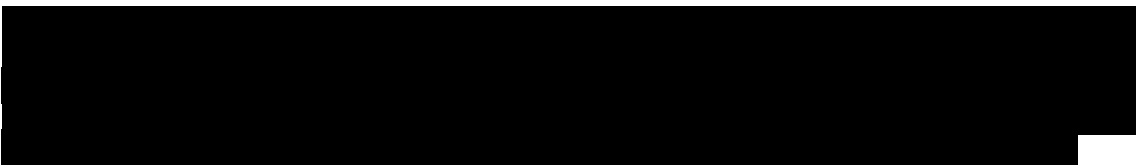
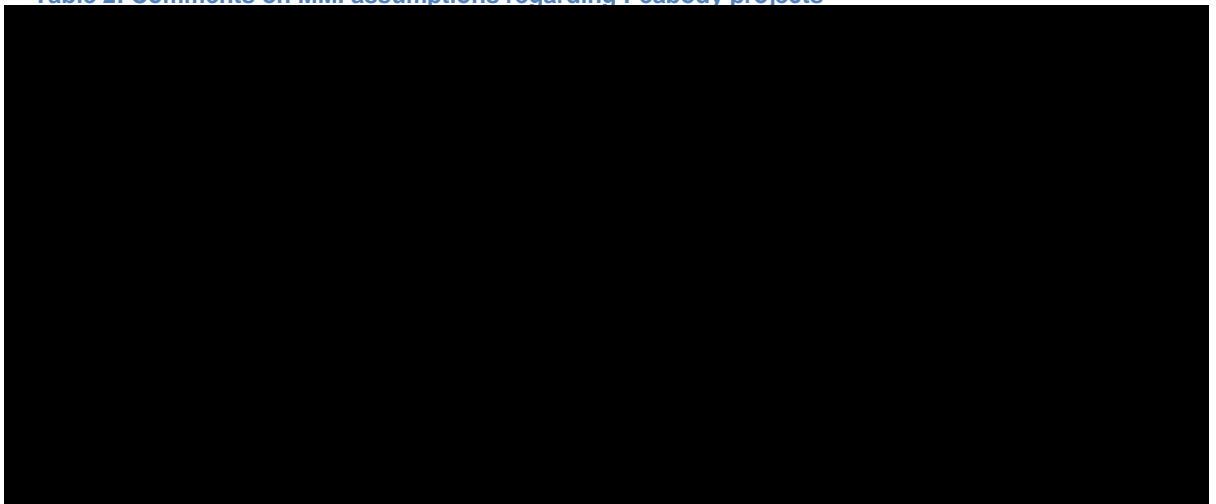

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Table 2: Comments on MMI assumptions regarding Peabody projects



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- 38 Given that the assumptions underpinning the MMI “high case” do not appear to reflect commercial reality, we consider that no weight should be placed on the “high case” forecasts. If the MMI advice is to be adopted by the QCA, the “base case” forecasts should be used for all years.
- 39 Alternatively, Peabody would be content for the WoodMacKenzie forecasts (submitted by the DBCT User Group) to be relied on for the QCA’s criterion (b) analysis. Peabody considers that these forecasts are robust and reflect the best available independent information as to demand from mines in the Goonyella system over the declaration period. We note that while the granular detail within an annual basis (mine-by-mine detail) could be debated the overall demand for each year appears materially robust.

3.2 Meeting foreseeable demand

- 40 Peabody agrees with the QCA’s approach to assessing the ‘cost’ of meeting foreseeable demand. In particular, we agree that under criterion (b), the relevant ‘cost’ is the total cost of meeting demand (including any sunk costs), not just the incremental cost to society. The amended criterion (b) calls for application of a ‘natural monopoly’ test, which necessarily involves consideration of sunk costs. On the other hand, the previous form of criterion (b) which was considered by the Tribunal in *Pilbara*⁴ invoked consideration of whether it was ‘economic’ to duplicate a facility – arguably a different form of assessment, more focused on incremental costs of duplication versus expansion.
- 41 In any event, we consider that in the present case this is somewhat academic. For reasons set out above, we consider that the appropriate forecast of foreseeable demand is either the MMI “base case” or the WoodMacKenzie forecast. On either of these forecasts the existing facility is capable of meeting foreseeable demand, without expansion.
- 42 Even based on the QCA’s highly conservative forecast of foreseeable demand, an expanded DBCT is clearly the least cost option for meeting this demand.
- 43 Criterion (b) is therefore comfortably satisfied, on any reasonable view of foreseeable demand.

4 Promoting competition (criterion (a))

4.1 Effect in the coal tenements market

- 44 Peabody agrees with the QCA that, in the absence of declaration, there is likely to be a material distortion of competition in the coal tenements market in the Hay Point catchment area. This distortion is likely to arise due to a disparity in the terms of access to DBCT as between ‘incumbent users’ (i.e. those with existing access rights) and those needing to acquire capacity at DBCT.

⁴ *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2.

4.2 Peabody's future participation in the coal tenements market

45 The QCA notes that Peabody seems to have potential replacement production tenements with throughput estimates exceeding 4mtpa. On this basis, the QCA concludes that Peabody may not seek coal tenements for exploiting under the terms of its existing agreement.⁵

46 At this stage, it should not be assumed that Peabody will not seek new coal tenements nor that it will be economical within the period of the declaration to 2030 to develop and operate its existing non-producing tenements. While Peabody is currently assessing options based on its current tenement holdings, and in recent times has been a seller of Tenements (such as Olive Downs South), this is no indication that Peabody will not seek new tenements in the future.

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48 With existing long term capacity rights at DBCT, Peabody is able to take advantage of assets that fit into a long term production profile. In considering new tenements, Peabody takes into account the extent to which it can exploit existing access rights at DBCT, and the value of those existing access rights. Indeed in the absence of declaration, Peabody considers that it would have a natural advantage in competing for new tenements, to the extent that it can exploit existing access rights at DBCT.

49 However Peabody recognises that, despite the position of value to be gained in the coal tenements market by virtue of its existing access rights, removal of declaration would create broader long term risks. Removal of declaration would create uncertainty as to the future terms of access for any new capacity which Peabody may require. More broadly, declaration promotes greater stability, certainty and transparency around the operation of the Hay Point Port supply chain, and therefore provides a greater overall benefit to Peabody.

5 State significance and the public interest (criteria (c) and (d))

50 Peabody supports the QCA's conclusions on criteria (c) and (d).

51 We note that DBCTM does not dispute that the facility is significant, having regard to its size and economic importance. As previously noted, we consider that there can be little debate about this.

We also agree with the QCA that, on balance, declaration would promote the public interest. As noted above, declaration provides stability, certainty and transparency around the future operation of the Hay Point supply chain and the terms of access to DBCT. This will in turn support efficient investment across the supply chain, including in the market for coal tenements. Compared to the benefits of efficient investment in, operation and use of infrastructure across this supply chain, the costs of administration and compliance with the access regime are likely to be small. In any event, such costs are ultimately paid by users such as Peabody, through access charges and the QCA levy. Peabody considers that the administration and compliance costs it bears are far outweighed by the benefits of increased stability, certainty and transparency brought about by declaration.

⁵ Draft Recommendation, p 89.