DBCT 2015 DAU

Response to QCA's Draft Decision

8 July 2016

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EXECUTIVE SUMMARY

DBCTM welcomes the opportunity to explain its key concerns in response to the QCA's draft decision on the DBCT 2015 DAU. The approach adopted by DBCTM is to avoid re-prosecuting arguments that the QCA has already dealt with.

This response focuses on issues that have material consequences for DBCTM's future revenues and risk profile. DBCTM has paid particular attention to new evidence that has emerged since its original submission of the 2015 DAU.

DBCTM's response to the QCA's draft decision has four main themes:

- DBCTM considers that the return on equity proposed for DBCTM in the decision is too low.
- DBCTM proposes an improved approach for calculating expected inflation.
- DBCTM seeks clarification of the QCA's position on gamma and the market risk premium.
- DBCTM proposes that the QCA's decision criteria for expansion-pricing applications should be broadened.

EQUITY BETA

DBCTM considers the QCA's draft position on the equity beta is a material departure from the approach adopted in its previous decisions on DBCTM's DAUs (see section 4.8.1 of this response). Moreover, it is not consistent with recent developments in DBCTM's risk profile.

The QCA has reduced DBCTM's equity beta from the level that DBCTM believed would continue so long as DBCTM's risks did not decrease. DBCT contends that, rather than having decreased, its risks have increased over the period since the original equity beta was set. Hence, the QCA's draft proposal will not allow DBCTM to earn a return on equity that is consistent with its current risk profile.

1) Increase in revenue risk

DBCTM contends that the draft decision gives inadequate weight to the increase in downside revenue risk that DBCTM has experienced as prospects for the coal-export sector have declined.

The regulatory framework provides some downside protection for DBCTM, just as it limits DBCTM's ability to participate in coal-sector upside. There are two main instruments providing downside protection:

a) The first instrument is the take-or-pay contracting arrangement at DBCT. The limitation of this arrangement is that the typical 10-year contracts collectively do not cover the full life of the terminal. Hence, DBCTM depends heavily on the willingness of existing access holders to renew contracts at expiry, or for new access seekers to take up relinquished capacity. As demonstrated in sections 1.1.3 and 4.8.2 of this response, DBCTM currently faces serious risks with respect to capacity renewal and re-contracting.

b) The second instrument is DBCTM's ability to socialise lost revenue across its remaining contracted capacity. This instrument can fail if customers that account for large shares of DBCTM's contracted capacity default. This can lead to an increase in access charges for remaining customers to a level that makes the continued utilisation of DBCT uneconomic. In sections 1.1.1 and 4.8.2, DBCTM notes that one of its largest customers (Peabody) is in danger of default.

2) Competition from other ports

DBCTM has strong evidence to demonstrate that it faces materially greater competition than it did when DBCT was originally declared for regulated access, and since its 2010 AU was approved.

As explained in sections 1.1.2 and 4.8.2, the Goonyella Abbot Point Expansion (GAPE) connecting the Goonyella and Newlands rail systems has made it technically feasible for Goonyella mines to access the Adani Abbot Point Terminal (AAPT).

Not only is this access technically feasible, some DBCT User Group companies have in fact entered into 15-year access agreements at AAPT. The capacity covered by these agreements is equivalent to approximately 25% of DBCT's nameplate capacity.

In section 1.1.2, DBCTM explains that future competition will be based on access charges for expansions, not charges for existing infrastructure. The QCA's medium- and long-term outlook for coal exports at DBCT is positive. If this outlook materialises, expansions will be necessary. DBCTM's ability to compete with AAPT will depend on the relative expansion costs of the Goonyella-DBCT and GAPE-AAPT options, and also on AAPT's expansion-pricing practices.

3) Relative risks of DBCTM and Aurizon Network

DBCTM demonstrates that it faces greater risk than Aurizon Network, the other principal infrastructure provider in the Central Queensland Coal Network that the QCA regulates.

As explained in section 4.8.3, Aurizon Network faces lower risks than DBCTM because:

a) Aurizon Network's biggest customer is a related-party coal haulier (Aurizon Operations). It is widely accepted that vertical integration of this type inhibits the regulator's ability to constrain the network provider's monopoly power.
b) Aurizon Network is not constrained to accept regulated conditions for undertaking infrastructure expansions and extensions. This has allowed Aurizon Network to remove relatively risky investment activities from the regulatory scope and to obtain superior access conditions from users of its expansion infrastructure.

4) The Port Services Agreement

DBCTM contends that the main role of the PSA is to impose public-interest constraints on DBCTM (see sections 1.1.4, 4.8.3 and 11.2).

DBCTM interprets the PSA as an instrument designed to address the principal-agent problem that arises when governments privatise major infrastructure facilities. It provides important guidance to the QCA about the view that the government took about public-interest issues when it decided to lease the terminal to private enterprises.

Consistent with this role, the PSA imposes on DBCTM obligations to invest on regulated terms and to avoid discriminating between different classes of access holders. These obligations deny DBCTM options for risk reduction that are available to Aurizon Network.

Most of the discussion of the PSA in the QCA's draft decision relates to DBCTM's business interests. Hence, DBCTM contends that the QCA should assign the appropriate weight to the PSA when considering public-interest issues in assessing the 2015 DAU.

Because of these factors, DBCTM proposes that the QCA should exercise its regulatory judgement to retain DBCTM's equity beta at the same value as approved in 2005 and 2010.

EXPECTED INFLATION

DBCTM submits that the QCA's current approach to adjusting for inflation in the annual revenue requirement (ARR) building blocks gives rise to some inconsistencies. DBCTM demonstrates that, in the current market, the QCA's approach would reduce the real return that DBCTM earns on the RAB below what is implied by market expectations of inflation.

Section 8.4 shows that estimates of expected inflation made using current forecasts from the Reserve Bank of Australia (RBA) imply that real yields on five-year government bond rates are negative. In this section, DBCTM argues that there is sufficient liquidity in the indexed bond market to allow reliable market-based estimates of expected inflation to be made by comparing the yields on nominal and indexed bonds. Such estimates do not imply negative real bond yields. DBCTM proposes that the QCA should adjust DBCTM's ARR for inflation using market-based expectations derived from bond yields, rather than expectations based on RBA forecasts.

ISSUES FOR CLARIFICATION

1) Gamma

DBCTM considers that the QCA has given insufficient regard to the views of the Australian Competition Tribunal (the Tribunal) concerning the estimation of the "gamma" parameter in setting post-tax equity returns. This parameter measures the extent to which Australia's dividend-imputation scheme advantages investors in Australian regulated infrastructure businesses.

Section 4.9 of this response explains that, in its *PIAC-Ausgrid* decision, the Tribunal canvassed all of the issues in dispute between DBCTM and the QCA concerning the estimation of gamma. The Tribunal ruled that the method currently favoured by the QCA is inappropriate in the Australian regulatory framework.

DBCTM acknowledges that the QCA is not formally bound by the Tribunal's rulings but notes that the QCA has appealed to the authority of the Tribunal in other matters. DBCTM seeks to understand why the QCA continues to use gamma-estimation methods that the Tribunal has ruled inappropriate.

2) The market risk premium

DBCTM considers that the QCA's methods for estimating the market risk premium have implausible implications.

DBCTM acknowledges that the estimation of the general market risk premium is controversial. Other infrastructure providers have disagreed with the QCA on this issue for some years. DBCTM's original submission raised similar concerns with the methodology.

DBCTM has chosen not to re-prosecute the arguments that it has previously put to the QCA. Rather, section 4.7 of this response summarises the implications of the QCA's methods that DBCTM considers are implausible representations of investors' behaviour in capital markets.

DBCTM seeks the QCA's opinion about whether the QCA's preferred methodology has these implications. To the extent that the QCA agrees that its methods have the suggested implications, DBCTM seeks the QCA's views on why it regards the implications as plausible representations of capital-market behaviour.

EXPANSION PRICING

DBCTM supports the QCA's proposed case-specific approach to determining the pricing of access to expansions of the terminal's capacity. However, section 11.2 of this response confirms that DBCTM has been formally advised by DBCT Holdings that the QCA's proposed "incremental-up" approach to expansion pricing is inconsistent with the non-discrimination provisions of the PSA.

In view of this, DBCTM may propose a departure from the "incremental-up" approach when lodging applications for expansions that would increase average access costs for the terminal as a whole. DBCTM has proposed broadening the QCA's decision criteria for its consideration of such departures. The proposed amendments are consistent with decision criteria used by the QCA in other contexts and with the QCA Act.

1 INTRODUCTION

DBCTM has structured its response to correspond to the structure of the QCA's draft decision.

1.1 OVERARCHING ISSUES

In section 1.3 of its draft decision, the QCA canvasses four overarching issues, namely:

- the outlook for the coal market
- competition between ports
- evergreen contracts
- pricing of terminal expansions.

The first three of these provide important context for DBCTM's responses to risk-related issues, especially its equity beta. They are discussed in subsections 1.1.1 to 1.1.3.

DBCTM's response to the QCA's expansion-pricing decision is to support the QCA's proposal that the substantive issues should be resolved on a case-by-case basis in the context of specific expansion proposals (see section 11 of this response). DBCTM therefore does not propose to discuss this further as an overarching issue.

DBCTM does, however, regard the interpretation of its Port Services Agreement (PSA) as an overarching issue that provides important context for many of its responses, especially equity beta and differential pricing. This additional issue is discussed in subsection 1.1.4.

1.1.1 COAL MARKET

Since DBCTM submitted its 2015 DAU in October 2015, investors' views of the coal market and the financial results for some DBCT users have had material consequences on DBCTM's prospects. These consequences include:

- continuing evidence that market conditions for the coal sector are weak[1] and the deteriorating credit ratings of DBCTM's customers. Almost all of DBCTM's customers have lower credit ratings than they did at the time the QCA approved the 2010 AU
- Moody's[2] downgrading of DBCT Finance's credit rating to Ba2 status with a negative outlook (equivalent to a BB), which reflects a sub-investment grade rating and is considered 'speculative'. This reflects a two-notch downgrade[3] since the 2015 DAU submission
- Peabody Energy Corporation (Peabody) filing for Chapter 11 bankruptcy protection in the USA. Peabody's Australian entities account for a large share (over 20%) of DBCTM's contracted volumes. DBCTM's credit rating assumes that no counterparty default occurs
- Peabody Australia reporting losses of $2.7 billion for calendar year 2015[4]
- [redacted] banking institutions declining to participate in DBCTM's recent refinance. Reasons cited for not participating included regulatory risk, coal-sector weakness and Peabody's financial position. DBCTM has provided evidence on this to the QCA on a confidential basis.

DBCTM considers that the current state of the market, combined with the current level of competition that has emerged, implies that the regulatory arrangements may not be able to provide DBCTM with

[1] See http://www.abc.net.au/news/2016-06-07/big-miners-in-trouble-as-mining-boom-gains-wiped-out/7484908
[2] Moody's Investor Service, 25 May 2016, DBCT Finance Pty Ltd, Update following draft regulatory decision
[3] From investment grade Baa3, BBB- equivalent
[4] See http://www.abc.net.au/news/2016-06-02/peabody-australia-coal-company-loses-nearly-3-billion/7471748

the degree of downside protection that was intended when the arrangements were initially established. DBCTM's experience with the recent refinance also suggests that revenue cap regulation, which provides some downside protection, has been ineffective at insuring against the risks present in the market.

1.1.2 COMPETITION BETWEEN PORTS

The QCA's draft decision sought further feedback from DBCTM on whether other coal export terminals can compete with DBCT. [5]

DBCTM has market-based evidence that demonstrates at least one of the Queensland ports, the Adani Abbot Point Terminal (AAPT)[6], can compete with DBCT. This section discusses:

- evidence that competition already exists
- that future competition depends on expansion infrastructure (not only existing infrastructure)
- DBCTM's response to the QCA's summary of the DBCT User Group's comments[7].

COMPETITION ALREADY EXISTS

In December 2011, Aurizon Network commissioned the Goonyella Abbot Point Expansion (GAPE) infrastructure. This allows Goonyella mines access to AAPT. Aurizon Network's 2012 GAPE DAAU to the QCA noted:

> *The GAPE expansion was initiated for two reasons – to alleviate capacity pressures on the Goonyella rail and port infrastructure and to utilise the expansion of the Abbot Point Coal Terminal. [Aurizon Network] worked with alliance partners … to deliver the GAPE project on behalf of five foundation customers; QCoal, Rio Tinto Coal, BMC, Middlemount Coal and Lake Vermont Resources.* [8]

DBCTM notes that three of the five foundation GAPE customers are currently part of the DBCT User Group:

- Middlemount Coal, which is owned by Peabody and Yancoal
- BMC
- Rio Tinto Coal (for Clermont mine, which has since been sold to Glencore, also part of the DBCT User Group).

DBCTM also notes that the Jellinbah Group's Lake Vermont mine is in the Goonyella coal system. Prior to contracting with AAPT, Lake Vermont was a contracted customer at DBCT.

Publically available research[9] on AAPT's financial prospects was published in June 2015. This research includes information on access agreements that users have with AAPT. DBCTM considers it inappropriate for the DBCT User Group[10] to contend that there is no economic or practical evidence of competition from other terminals, since:

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[5] QCA draft decision on 2015 DAU: 230

[6] DBCTM notes that the Wiggins Island Coal Export Terminal (WICET) and BMA's Hay Point Coal Terminal facility can technically compete with DBCT for volumes. However, DBCTM has focussed on AAPT, given competition from this facility has actually resulted in DBCTM losing contracted capacity it would have otherwise secured.

[7] QCA draft decision on 2015 DAU: 228-9 (see Table 25)

[8] See page 5 of http://www.qca.org.au/getattachment/1f208641-4dfd-429b-96e7-921547aac7b0/QR-Network-GAPE-Submission.aspx .

[9] See page 5 of https://www.fiig.com.au/docs/default-source/research-attachments/adani-abbot-point-terminal-research-report---9-june-2015-(r).pdf?sfvrsn=2 .

[10] DBCT User Group's submission on the 2015 DAU: 10

- the User Group's chair company (Peabody, via Middlemount Coal) has a 15-year port access agreement (which commenced in mid-2012) at AAPT for 3 mtpa
- BMC/BMA has a 15-year port access agreement (which commenced in late 2011) at AAPT for 4 mtpa and a 3 mtpa access agreement that expires in 2016
- Rio Tinto (via Queensland Coal) has a 15-year port access agreement (which commenced in mid-2013) at AAPT for 11 mtpa. Rio Tinto Coal subsequently assigned 1.5 mtpa of its access rights to Glencore.

In total, DBCT User Group companies have contracted up to 21 mtpa of capacity at AAPT via GAPE. This is equivalent to almost 25% of DBCT's nameplate capacity. In addition, Lake Vermont, which is a Goonyella mine but not a member of the DBCT User Group, has 6 mtpa contracted at AAPT.

The evidence clearly demonstrates that several Goonyella mines were willing to contract for AAPT-GAPE capacity under long-term take-or-pay port and rail access agreements, noting the port access agreements are for 15 years. DBCTM also notes that the rail access agreements would have been subject to Aurizon Network's GAPE access conditions. These Goonyella mines were willing to underwrite the GAPE investment under access conditions presumably more favourable to Aurizon Network than those that the QCA approved for Aurizon Network's 2010 access undertaking.

The evidence also shows that the abovementioned DBCT User Group companies considered the risk surrounding coal prices insufficient to offset the risk of contracting under 15-year port-access agreements at AAPT. Otherwise, they would not have entered into those access agreements. Whether the coal price was 'high' or 'low' at the point of making the investment decision is irrelevant. What matters is that such decisions demonstrate that competition from AAPT is a genuine threat to DBCT.

DBCTM acknowledges that users' decisions to contract at AAPT rather than DBCT were not primarily price-based. AAPT secured capacity from DBCT's Goonyella catchment because DBCTM was still completing its expansion and there was considerable new demand. That demand would have preferred to come to DBCT but AAPT could bring it to market quicker. Total infrastructure costs for Goonyella miners at AAPT were in the range of $25 to $30/t and only about $15/t at DBCT. But the users still chose AAPT because they had no certainty as to the timing of expansions at DBCT.

FUTURE COMPETITION IS BASED ON EXPANSION INFRASTRUCTURE

The QCA[11] notes Wood Mackenzie's forecasts indicating that Australian coal export volumes are expected to increase at a compound annual growth rate (CAGR) of 1.1% from 2015 to 2035. If the market evolves according to the QCA's expectations, coal-export growth through the Hay Point area should see port access agreements renewed and capacity expansions required.

In this scenario, DBCTM will be competing with AAPT not only for existing capacity tranches. Since capacity at both terminals would be fully (or almost fully) contracted, medium- and long-term competition will be based on access charges for expansion infrastructure.

DBCT's current low-cost status is relevant only when there is spare capacity in the existing terminal (e.g. when coal prices are 'low' and capacity is freed up by existing users relinquishing capacity at the end of their access agreements). But this low-cost status is not relevant for establishing whether DBCTM can compete with AAPT for securing volumes for expansion infrastructure. In times of 'favourable' coal prices, users' supply-chain decisions will be driven by a combination of ports' ability to provide expansion infrastructure expeditiously and the associated terms of access.

Where ports are comparable on the timing of their ability to deliver new capacity, the deciding factor is likely to be the terms of access (e.g. access charges, proportion of take-or-pay contributions and length of access agreement). One of the key components of this decision will be the access charge.

[11] QCA draft decision on 2015 DAU: 121

Relative access charges for the expansion capacity will depend on relative expansion costs and the pricing regimes applied.

DBCTM notes that the QCA's draft decision proposes to constrain DBCTM to adopt an 'incremental up/average down' pricing approach, while AAPT may not be subject to the same constraint. This could mean that access to incrementally priced expansions at DBCT will not be competitive with access to expansions at AAPT, even if expansion costs at DBCT are lower than AAPT's.[12]

A new user's terminal choice will also depend on below- and above-rail charges (and the terms of those access and haulage agreements). Aurizon Network's below-rail network (including the Goonyella and GAPE systems) is capacity constrained.[13] Therefore, new users will have to consider *expansion prices* that will apply to Aurizon Network's infrastructure. The cost relativities of the Goonyella and GAPE expansions will influence a user's terminal choice. The risk of per-tonne costs being higher for the Goonyella expansion than for GAPE increases the competitive pressure DBCTM faces from AAPT.

DBCTM does not support the QCA's position that there is "limited potential for competition between ports".[14] DBCTM has demonstrated that competition between AAPT and DBCT is feasible, has already occurred and will depend on the timing and pricing arrangements for future port and rail expansions.

CONSTRAINTS ON DBCT USERS CHANGING PORTS

The QCA[15] has sought DBCTM's views on competition-related issues that the DBCT User Group raised. DBCTM's main concern is that the QCA has assessed the state of competition between DBCT and other port terminals on the basis of *existing* assets only.

As canvassed earlier, if the QCA's preferred medium- to long-term outlook for metallurgical coal exports at DBCT is realised, the appropriate price comparison is between prices for access to expansion infrastructure at DBCT and potentially competing ports, not prices for access to existing infrastructure. Table 1 below addresses the QCA's queries.

Table 1: DBCTM's responses to QCA's queries on competition between ports

Constraint	QCA summary of DBCT User Group's positions	DBCTM's response
Cost differences	Being a regulated, brownfield terminal, with large economies of scale means services at DBCT are provided at lower prices than at other Queensland coal export terminals.	The fact that Peabody, BMA/BMC, Rio Tinto Coal and the Jellinbah Group contracted AAPT capacity for some of their Goonyella mines shows they considered doing so to be commercial. Moreover, those port access agreements are for 15 years. The relevant comparison is not between existing access charges at DBCT and AAPT. Rather, the relevant comparator is the access charge for expansion infrastructure at the ports.
Insufficient terminal capacity	No guarantee that sufficient capacity will be available at other terminals at the relevant time.	This is true for any export terminal. As noted above, given the QCA's preferred outlook for coal exports, future competition will be based on expansion capacity. If more subdued prospects for coal exports eventuate, it is likely that excess capacity will emerge at ports generally.

[12] Page 64 of DBCTM's supporting submission for the 2015 DAU explained how different expansion-pricing approaches between DBCT and AAPT could lead to a socially inefficient expansion occurring.

[13] See page 116 of http://www.qca.org.au/getattachment/a02c8fcc-267b-4c2f-a969-5a15a4df9e46/Aurizon-Network-Explanatory-materials-The-2013-Und.aspx

[14] QCA draft decision on 2015 DAU: 9

[15] QCA draft decision on 2015 DAU: 230

Constraint	QCA summary of DBCT User Group's positions	DBCTM's response
Multi-cargo and coal blending	Multi-cargo arrangements, in which different coal products from different producers are loaded into different holds in the same vessel, make it preferable for coal producers to ship through DBCT. Customers are able to specify blended coal products, a process which must take place at a single terminal. A change in export terminal for a mine would adversely affect possible blending options.	The fact that Peabody, BMA/BMC, Rio Tinto Coal and the Jellinbah Group took out 15-year access agreements for AAPT capacity for some of their Goonyella mines shows they considered it commercial to do so. A lack of blending capability at other port terminals was not a sufficient deterrent for them to be locked into 15-year agreements.
Rail cost differences	DBCT is the closest multi-user terminal to all mines in the Goonyella system. For most mines, the additional distance to alternative terminals, and the associated below-rail access and above-rail haulage costs, would make exporting through other terminals unviable.	The fact that Peabody, BMA/BMC and the Jellinbah Group contracted GAPE capacity for some of their Goonyella mines evidences they considered this option commercial. Moreover, those users were willing to contract under the access conditions that Aurizon Network required to build GAPE.
Insufficient below-rail capacity	There is insufficient capacity on parts of the below-rail network to allow switching to occur on a long-term basis for any material volumes, without rail network expansions. The surplus capacity that exists is typically fully contracted, and would require the trading of access rights with a haulage operator or another producer, or prior relinquishment by one of those entities.	Aurizon Network's below-rail network is capacity constrained. If contracted throughput increases beyond current levels, it is likely that below-rail expansions will be required in both the Goonyella and GAPE coal systems. DBCTM notes that the cost of triplicating the Connors Range ($800m in 2018)[16] for the Goonyella system is higher than the cost for constructing the Collinsville Deviation, passing loops and duplications (up to $280m in 2018)[17] for the Newlands/GAPE system. This cost difference may threaten DBCTM's ability to compete with AAPT for expansion volumes.
Rail network differences	The Goonyella system can accommodate both electric and diesel locomotives, whereas only diesel stock can use the Newlands system to APCT. If rail and port access could be acquired, there would be limits to what rail haulage providers with electric stock could do to switch to the Newlands system without passing on substantial costs to users.	The fact that Peabody, BMA/BMC and the Jellinbah Group contracted GAPE capacity for some of their Goonyella mines is evidence that they considered that option commercial, despite the diesel-only GAPE and Newlands networks. Above-rail haulage agreements for shorter trains and diesel-only traction were not a sufficient deterrent for some Goonyella users to contract for capacity at AAPT. Moreover, those users were willing to contract under the access conditions that Aurizon Network required to build GAPE.

[16] Aurizon Network's 2015 Network Development Plan: 43

[17] Aurizon Network's 2015 Network Development Plan: 27, 43. This includes the costs of: passing loops at Teviot Brook, Newlands Junction and Station Creek; and duplications from Buckley to Armuna and Binbee to Briaba.

Constraint	QCA summary of DBCT User Group's positions	DBCTM's response
Capital investment in mine specific rail infrastructure	For some mines, material capital investment would be required to reconfigure the turn-out from the mine's rail loop in order for coal to be hauled in a different direction.	In relation to volumes that will require below-rail expansions, the capital investment for turn-out changes is likely to be immaterial relative to sharing the costs of expanding the Goonyella or GAPE systems. In addition, capital investment for turn-outs will be relevant only for Goonyella mines along the mainline and North Goonyella branchline that do not currently use GAPE. Mines along the South Goonyella and West Goonyella branchlines will not need to invest in turn-out changes. This is because the points on the network at which trains servicing those mines have to switch directions already have bi-directional turn-outs. DBCTM notes that volumes along the South Goonyella and West Goonyella branchlines account for more than half of DBCTM's contracts.
Restraints on substitution from long-term take-or-pay	Rail haulage and access agreements are typically set on at least a 10-year take-or-pay basis. Switching terminals is a choice that arises at the point of re-contracting, and when re-contracting aligns with the terms of the DBCT User Agreement.	In general, users would have sought to align their rail and port access agreements. At the point of contract expiry, those users would have the choice of using Goonyella-DBCT and/or GAPE-AAPT. In addition, if the QCA's preferred outlook is for coal exports to grow at DBCT, then *additional demand* from existing users and *new demand* from new users is more relevant than establishing where renewing access holders' volumes go.

1.1.3 EVERGREEN CONTRACTS

The QCA[18] invited stakeholders to comment on the issue of evergreen contracts (i.e. the ongoing right to renew an access agreement).

DBCTM considers its prospects for fully contracting DBCT over the upcoming regulatory period are limited. Since June 2014, no users have expressed interest in renewing their access agreements. Key examples are:

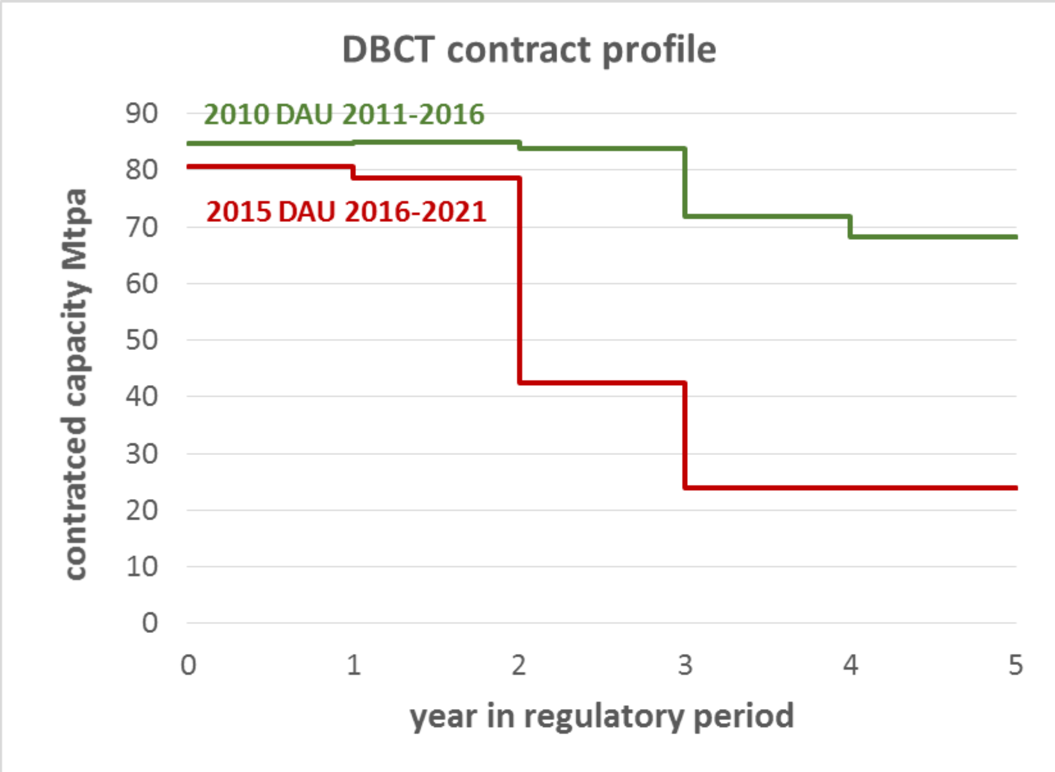
- On 1 April 2016, a DBCT customer relinquished capacity of 2.7 mtpa. As of 1 July 2016, no other user has expressed interest in this relinquished capacity, despite DBCTM having sought expressions of interest for it from January 2016. A further 1.6 mtpa has been relinquished by another customer. This too has been put on the market but no other user (or access seeker) has yet shown interest in securing it.
- Another user has advised that it will not renew its 2.0 mtpa contract from 1 July 2017. This user confirmed that it would seek to meet its future capacity needs through the secondary market for access. This suggests that some users are confident that other customers are looking to offload capacity, reinforcing DBCTM's views that short-term prospects of DBCT being fully contracted are not promising.

[18] QCA draft decision on 2015 DAU: 12

Based on the evidence above, 4.3 mtpa is uncontracted from the beginning of 2016-17 and it is likely that 6.3 mtpa will be uncontracted from 2017-18. If this trend persists, a further 36.2 mtpa may not be renewed in 2017-18.

DBCTM notes that users who have contracts for the 36.2 mtpa have not yet signalled any intent to renew their contracts. Assuming they do not renew, and no user secures the 6.3 mtpa available from 2017-18, 50% of DBCT's nameplate capacity would be uncontracted in 2018-19. Figure 1 shows the contract-profile drop off over the 2015 DAU regulatory period and compares it with the situation DBCTM faced at the time of the 2010 AU.

Figure 1: Contract-profile drop off



Note: Green represents years 2011-12 to 2015-16, red represents 2016-17 to 2020-21

If 50% of capacity remains uncontracted in 2018-19, access charges would effectively double. Depending on the coal-price direction over the next few years, such a change in the access charge could have a materially adverse effect on DBCT users. While DBCTM does not submit that 50% of its contracted capacity will fail to be renewed in the next few years, it faces the prospect that its users could significantly reduce their take-or-pay obligations by way of:

- renewing only a portion of their contracted capacity
- managing *ad hoc* capacity requirements through the secondary market for access.

DBCTM also notes any increase in the number of users that default or choose not to renew their agreements would lead to further access charge increases, which could result in unsustainable prices for remaining customers. This would exacerbate DBCTM's asset-stranding risk.

In addition, DBCTM notes Figure 1 does not recognise that Peabody Australia could default in the near future, given the $2.7 billion loss reported for calendar year 2015 and Peabody Energy Corporation's

Chapter 11 bankruptcy protection application.[19] Hence, asset-stranding risks are a genuine and immediate concern for DBCTM.

DBCTM considers the QCA's draft decision has relied too heavily on its preferred outlook on the medium- and long-term prospects of the metallurgical coal industry in Australia. In DBCTM's view, the QCA's decision has not considered that the short-term risks DBCTM faces are sufficient to threaten DBCTM's prospects in the medium- and long-term market.

1.1.4 PORT SERVICES AGREEMENT

Most of the discussion of the PSA in the QCA's draft decision relates to DBCTM's business interests. DBCTM contends that the PSA should be understood primarily in the context of the public interest, not of DBCTM's business interests.

The main rationale for the original public ownership of major infrastructure facilities is the view that they should be run in the public interest. The rationale for then privatising the facilities derives from operational efficiency considerations, not from any retreat from the view that they should be run in the public interest. But when the State sells (or leases) the facilities, it creates a principal-agent problem – how can it ensure that the new private owners (its agents) will prosecute its (the principal's) objectives? The main role of the PSA is to address this problem.

Consistent with this role, the PSA imposes conditions on DBCTM to ensure that its conduct is compatible with the public interest. The PSA does not allow DBCTM to circumvent the requirements of the QCA but it does provide important guidance to the QCA about the view that the government took about public-interest issues when it decided to lease the terminal to private enterprises.

For example, the PSA imposes on DBCTM obligations to invest on regulated conditions and not to discriminate in its access pricing between different classes of access holders. These obligations are not imposed on regulated entities by the Australian competition law (or any other law). Other infrastructure providers that the QCA regulates – Aurizon Network, in particular – do not operate under the same constraints as those imposed on DBCTM by the PSA.

The obligation-to-invest requirements of the PSA prevent DBCTM from removing investment in terminal expansions and major extensions from the QCA's regulatory oversight (see section 4.8.3 of this response). The non-discrimination requirements restrict DBCTM's options in relation to pricing access for expansion users differently from existing users (see section 11.2).

LEGAL ADVICE

DBCTM's legal advice is that section 138 of the QCA Act does not give the QCA the power to impose provisions in the access undertaking that are inconsistent with the PSA. DBCTM contends that it cannot be the case that the Parliament intended section 138 to allow the QCA to impose a condition which is inconsistent with an agreement entered into at the time the asset was acquired from the State and which DBCTM has no right to amend. Only the most extreme of scenarios could justify the QCA deciding to amend an undertaking in such a way as to put the infrastructure owner in breach of pre-existing bona fide contractual provisions imposed by the State.

[19] See ABC News 3-Jun-16 *Peabody Australia coal company loses nearly $3b in 2015, notes risk from parent's bankruptcy* http://www.abc.net.au/news/2016-06-02/peabody-australia-coal-company-loses-nearly-3-billion/7471748

1.2 STRUCTURE

DBCTM's response to the QCA's draft decision is structured as follows:

- Chapter 2: Legislative framework
- Chapter 3: Scope and administration
- Chapter 4: Rate of return
- Chapter 5: Depreciation
- Chapter 6: Remediation allowance
- Chapter 7: Corporate overheads
- Chapter 8: Terminal Infrastructure Charge and Modelling
- Chapter 9: Ring-fencing matters
- Chapter 10: Negotiation Framework and Capital Processes
- Chapter 11: Differential pricing
- Chapter 12: Other matters.

2 LEGISLATIVE FRAMEWORK

DBCTM notes the QCA's decision-making is guided by the factors in section 138(2) of the QCA Act. DBCTM has been mindful of this in preparing its response to the QCA's draft decision.

DBCTM notes the QCA's position on its legislative framework under the QCA Act. DBCTM does not make any comment on the QCA's position, other than to the extent specifically mentioned elsewhere in this response.

3 SCOPE AND ADMINISTRATION

DBCTM notes the QCA’s views on the undertaking’s scope and administration.

3.1 PROPOSALS RELATING TO THE RING-FENCING DAAU

DBCTM notes the QCA’s views on the October and November ring-fencing DAAUs. DBCTM’s response in relation to ring-fencing is set out in section 9 of this response. Sections 12.3 to 12.6 of this response also explain other drafting amendments DBCTM has proposed for ring-fencing.

3.2 TERMINATING DATE OF THE ACCESS UNDERTAKING

DBCTM notes the QCA’s views on the terminating date of the access undertaking.

3.3 REVIEW OF THE ACCESS UNDERTAKING

DBCTM notes the QCA’s views on this matter.

4 RATE OF RETURN

This section sets out DBCTM's response on the QCA's draft decision on DBCTM's rate of return.

4.1 OVERVIEW OF DBCTM'S RESPONSE

DBCTM considers that its regulated rate of return should be based on:

- a risk-free rate (RFR) of 1.82%, consistent with the QCA's methodology
- a debt risk premium of 2.71%, consistent with the QCA's methodology
- an interest rate transaction swap cost allowance of 15.9 basis points per annum
- an equity beta of 1.0
- a gamma of 0.25.

Using the QCA's proposed 6.5% market risk premium (MRP), the resultant regulated rate of return would therefore be 6.21%.

DBCTM is not proposing a specific alternative to the QCA's proposed MRP. Instead, section 4.7 of this response proposes that the QCA should review the implications of its current method for setting the MRP.

4.2 OVERVIEW OF WACC PROPOSALS

DBCTM notes the overview that the QCA's draft decision provides on DBCTM's WACC proposal.

4.3 FRAMEWORK ISSUES

DBCTM notes the framework issues the QCA has raised in section 4.3 of its draft decision.

4.4 RISK-FREE RATE

4.4.1 QCA DRAFT DECISION

The QCA has proposed a five-year period for setting the RFR.

4.4.2 DBCTM'S RESPONSE

DBCTM has no further comment on this matter.

DBCTM submits that over the relevant WACC averaging period, the five-year approach yields a RFR of 1.8242%. DBCTM notes that Incenta's June 2016 debt risk premium (DRP) report for the QCA is broadly consistent with this result.[20]

> **DBCTM Response 4.1**
>
> **DBCTM proposes a risk-free rate of 1.8242%.**

[20] For modelling purposes, DBCTM has used 1.8242%. Using the rounded figure (i.e. 1.82%) would understate the ARR.

4.5 CREDIT RATING

4.5.1 QCA DRAFT DECISION

The QCA's draft decision approved DBCTM's proposed benchmark capital structure of 60% and benchmark credit rating of BBB.[21]

4.5.2 DBCTM'S RESPONSE

DBCTM accepts the QCA's draft decision.

> **DBCTM Response 4.2**
>
> **DBCTM accepts the QCA's draft decision on the proposed capital structure of 60% and credit rating of BBB.**

4.6 COST OF DEBT

4.6.1 RISK-FREE RATE

DBCTM's proposal for the RFR is explained in section 4.4 (above).

4.6.2 DEBT RISK PREMIUM

DBCTM accepts the QCA's proposed econometric approach for deriving the DRP. Applying this approach over the relevant WACC averaging period, DBCTM derived a DRP of 2.71%.

During the time DBCTM prepared this response, the QCA published a report from Incenta, which measured the DRP to be 2.65%.[22]

Although DBCTM has accepted the QCA's approach, it is concerned about the QCA's consultants' discretion in sample selection and their ability to modify econometric equations. This subjectivity causes uncertainty around the DRP estimate, since the QCA's consultants can exercise their judgement differently from one regulatory period to the next.

As allowed for by the QCA, DBCTM may provide comments on the Incenta report by the due date of 21 July 2016.

4.6.3 DEBT-RAISING TRANSACTION COSTS

DBCTM accepts the QCA's proposed debt-raising transaction costs of 0.108% per annum.

4.6.4 INTEREST RATE SWAP TRANSACTION COST ALLOWANCE

The QCA has proposed an interest rate swap transaction cost allowance of 11.3 basis points per annum.[23]

[21] QCA draft decision on 2015 DAU: 58
[22] See page 1 of http://www.qca.org.au/getattachment/ab1ec1fe-441c-4a7a-8c82-6ba57a3cb3c4/Incenta-Debt-risk-premium-and-risk-free-rate-(1).aspx
[23] QCA draft decision on the 2015 DAU: 67

The QCA adopted this estimate from a 2014 cost-of-debt report prepared by Incenta for the QCA in relation to Aurizon Network's 2014 DAU. Incenta's advice was based on a market quotation obtained by Evans & Peck in October 2013.[24]

DBCTM'S RESPONSE

DBCTM notes the QCA has relied on an October 2013 market quotation for interest rate swap transaction costs to apply for a regulatory period covering 2016-17 to 2020-21. The use of market quotations must recognise the timing to which those quotations relate.

In the context of DBCTM's regulatory period and the timing of the QCA's draft decision, an appropriate time to have procured a market quotation would have been early 2016. Relying on an October 2013 estimate, in DBCTM's view, is not appropriate.

In addition, DBCTM considers the QCA should have used a base swap:

- **from 10-year fixed rates to 5-year (not 4-year) fixed rates** - DBCTM notes the QCA relied on Incenta's proposed interest rate swap transaction costs for Aurizon Network, whose access undertaking covers a 4-year regulatory period.[25] DBCTM's regulatory period is for five years.
- **for a BBB (not BBB+) entity** - since the QCA's draft decision proposes that DBCTM have a benchmark credit rating of BBB[26], relying on a quotation for a BBB+ entity is not appropriate.

DBCTM (*via* Brookfield Treasury) sought market quotations in June 2016 from three financial institutions[27] for a base swap from 10-year rates to 5-year rates for DBCT Finance Pty Ltd, shown in Figure 2.

Figure 2: DBCTM's proposed interest rate swap transaction cost allowance

Benchmark Swap Costs (Basis Points)		
First Financial Institution	**5 year**	**10 year**
Credit Rating	DBCT Finance Pty Ltd	
Execution Spread	2.25	1.65
Risk Spread (CVA)	2.75	11.90
Benchmark Swap Cost	**18.55**	
Second Financial Institution	**5 year**	**10 year**
Credit Rating	DBCT Finance Pty Ltd	
Execution Spread	2.00	3.00
Risk Spread (CVA)	3.00	8.00
Benchmark Swap Cost	**16.00**	
Third Financial Institution	**5 year**	**10 year**
Credit Rating	DBCT Finance Pty Ltd	
Execution Spread	1.50	1.75
Risk Spread (CVA)	2.00	8.00
Benchmark Swap Cost	**13.25**	
Source: Market Quote obtained by Brookfield Treasury (6-June-2016)		

Source: Brookfield Treasury

[24] Incenta (2014), Aurizon Network: Review of benchmark credit rating and cost of debt and response to stakeholder: 41
[25] QCA draft decision on the 2015 DAU: 67
[26] QCA draft decision on the 2015 DAU: 58
[27] DBCTM can provide to the QCA, on a confidential basis, details of these financial institutions.

The first institution's quotation indicated the cost would be 18.55 basis points per annum; the second quoted 16.00 basis points per annum; and the third quoted 13.25 basis points per annum. The quotation is the sum of the execution spread and risk spread, and priced on the relevant 20-day averaging period applicable to the other time-sensitive components of the WACC. DBCTM notes this approach is consistent with Incenta's report for the QCA.

DBCTM proposes interest rate swap transaction costs of 15.9 basis points per annum, which is the average of the quotations received. DBCTM notes this value is comparable with the DBCT User Group's proposed figure of 15 basis points per annum.[28]

> **DBCTM Response 4.3**
>
> **DBCTM proposes an interest rate swap transaction cost allowance of 15.9 basis points per annum.**

4.7 MARKET RISK PREMIUM

4.7.1 QCA DRAFT DECISION

The QCA has proposed a Market Risk Premium (MRP) of 6.5%.

4.7.2 DBCTM'S RESPONSE

DBCTM notes that the QCA's draft position on the MRP is consistent with all its previous decisions for all entities that it regulates. The QCA has set the MRP to 6.0% or 6.5% in every decision since its inception.

The QCA is correct in applying the same MRP decision to all regulated entities. This is because the MRP is a general-market as opposed to firm-specific parameter in the CAPM.

The QCA's view of the MRP has not varied much over time because the QCA's procedure for estimating the MRP is based on (formal or informal) averaging of four separate estimation methods, three of which (the Ibbotson, Siegel and survey methods) always produce estimates that are more or less time invariant. The fourth (the Cornell method) produces estimates that do vary substantially over time, but seems to have a relatively minor impact on the overall outcome.

DBCTM notes that the QCA's estimation method relies on taking averages of methods that have quite different implications. The figure below illustrates this point.

[28] DBCT User Group's submission on the 2015 DAU: 15

Figure 3: Required market return under DGM-based and Ibbotson-based methods

Source: DBCTM consultant analysis

Figure 3 shows that estimates of the required return on equity for a firm of average risk made using the Ibbotson method for estimating the MRP are dramatically different from estimates made using a dividend growth model (DGM) of the MRP (similar to the Cornell approach). In particular, Ibbotson-based estimates drop sharply with the onset of the global financial crisis (see blue-shaded area in the figure) whereas the DGM-based estimates rise sharply. The Ibbotson-based estimates remain low relative to the DGM-based estimates for most of the subsequent period, including most recently. This is because the Ibbotson approach adds an effectively constant premium to the contemporaneous government bond yields, and since the onset of the global financial crisis (GFC) those yields have fallen to historical lows.

DBCTM infers from these differences that one of the two methods is likely to be the better representation of the way in which the market works. Rather than averaging the results of *representative* and *unrepresentative* methods, DBCTM considers it appropriate for the QCA to decide which of the apparently inconsistent approaches better represents the market. The QCA could then base its regulatory determinations on the approach that it considers most appropriate.

Prior to the Market Parameters decision, the QCA took the median of its four approaches. This means that the DGM only ever received any weight at all if it was in the middle of the other estimates, which is not generally the case. Currently, the QCA does not explain precisely how it distils the four estimates into a single figure. But the fact that the current DGM estimate is substantially above the 6.5% allowance suggests that it receives very little weight. This suggests that the QCA's view is that the DGM method is a poor representation of the market.

DBCTM has a strong view that the Cornell/DGM methods are the better representations of the market. This is because DBCTM considers implausible the following implications of methods that produce time-invariant MRP estimates:

- the allowed return on equity should rise and fall one-for-one with changes in the risk-free rate

- the required return on equity *fell* dramatically during the peak of the GFC – as investors moved funds into government bonds, lowering their yields
- equity capital becomes cheaper and more abundant during financial crises
- the cost of equity capital was higher during the mid-2000s bull market than it was during the GFC
- the cost of equity capital has fallen one-for-one with the decline in government bond yields over recent years and is now at historical lows
- the required return on equity has *fallen* by more than 20% since the Market Parameters decision, over the same period that debt risk premiums have *increased* by over 30%.

DBCTM acknowledges that it has already submitted to the QCA the arguments underlying its views about the MRP[29]. While it still disagrees with the QCA's position, DBCTM is conscious that the QCA might prefer DBCTM does not simply re-prosecute those arguments.

DBCTM does, however, request that the QCA confirm that DBCTM has correctly interpreted the QCA's position and accurately represented the implications of that position. If so, DBCTM will understand that the QCA is comfortable in holding a position with those implications.

DBCTM Response 4.4

DBCTM notes the QCA's proposed MRP of 6.5%. DBCTM requests the QCA to reconsider the implications of keeping the MRP at 6.5%.

4.8 EQUITY BETA[30]

The QCA's draft decision has proposed an equity beta of 0.87, which has been derived from an asset beta of 0.45.[31] DBCTM recognises that the QCA estimates an initial equity beta *via* regression analysis applied to a set of firms that the QCA considers to be comparators for DBCTM. The QCA then exercises its regulatory judgement to:

- account for aspects of DBCTM's risk profile that it believes are not adequately captured by the regression-based estimation procedure
- ensure an appropriate balance between stakeholders' interests, as required by section 138(2) of the QCA Act.

DBCTM has three reasons for proposing amendments to the QCA's draft position:

- The first reason (subsection 4.8.1) is that DBCTM disagrees with the QCA's interpretation of the history of equity beta determinations for DBCTM.
- The second reason (subsection 4.8.2) is that DBCTM can demonstrate that it now faces greater risks than it did in previous regulatory periods.
- The final reason (subsection 4.8.3) is that there are material differences between the way in which the QCA Act's regulatory regime applies to DBCTM as compared to Aurizon Network. The QCA's draft decision does not recognise these differences, nor does Incenta's expert report for the QCA.

Each of these reasons is discussed in turn below. The discussion indicates that it is not possible to draw the conclusion that an equity investment in DBCT today is less risky than it was five or even ten years ago.

[29] DBCTM's supporting submission for 2015 DAU: 32 – 36.
[30] DBCTM has no comment on the QCA's proposed debt beta.
[31] QCA draft decision on 2015 DAU: v

4.8.1 INTERPRETATION OF PREVIOUS EQUITY BETA DETERMINATIONS

In considering whether to invest in regulated businesses, investors must be confident that they understand how the regulatory regime can affect their future cash flows. Hence, the regulator should be clear and consistent in its decisions. It should change its approach only if the change is a rational response to a change in circumstances and a response that investors could anticipate if they are aware of the change in circumstances. Otherwise, investors face regulatory risk that will increase the returns that they will require to invest in regulated assets.

In this context, DBCTM considers the QCA's draft position on the equity beta poses a significant regulatory risk because the position is a material departure from the approach adopted in the QCA's 2005 and 2010 final decisions on DBCTM's DAUs.

2005 DECISION

In its 2005 decision, the QCA approved a WACC of 9.02% and an equity beta of 1.0. It explained that:

> *In reaching this decision, the Authority contemplated adopting a 'two-tier' approach to DBCT's rate of return under which the 8.54% WACC would apply until DBCT is substantively expanded, at which point the WACC would increase to 9.02% (equity beta of 1.0) for the entire terminal. While the Authority believes that this approach may demarcate the different risk profiles of the existing and expansion assets, such an approach introduces uncertainties and unnecessary complexity.*
>
> *As a consequence, the Authority has sought to make a clear and definitive determination on this matter now. For the purpose of assessing financing costs for the opening asset value and the expansion costs to 60 mtpa, the Authority has used a WACC of 8.54%. For the purpose of assessing reference tariffs* ***into the future****, the Authority has used a WACC of 9.02%. In doing so, the Authority believes that this WACC provides DBCT Management with an adequate incentive to expand the terminal, particularly as it gives DBCT Management the return it sought for taking on the greater risks associated with any major expansion of DBCT. However,* ***in the event that the terminal is not substantively expanded, the Authority will reassess the equity beta at the next regulatory review****.* [32] *(Emphasis added)*

The first quoted paragraph signals the QCA's unwillingness to embrace a "complex" system in which the WACC varies over time according to an entity's investment cycle. The QCA considered that the "complex" system would leave stakeholders uncertain about future WACCs and future access charges.[33]

The second quoted paragraph explains how the QCA decided to avoid complexity and to make a "*clear and definitive determination on this matter now*" by establishing a single WACC to apply to all DBCTM assets from the time of the decision. The QCA regarded this WACC as sufficient to provide DBCTM with an "*adequate incentive to expand the terminal*" and the "*return it sought for taking on the greater risks associated with any major expansion of DBCT*". The only limitation in the paragraph on the period over which DBCTM will be allowed to use the approved WACC in setting prices is "*in the event that the terminal is not substantively expanded*".

On this basis, DBCTM interpreted the QCA's 2005 decision as indicating that the QCA would continue to set WACC on the basis outlined in the 2005 decision so long as DBCTM expanded the terminal (which it did) and stood ready to undertake any subsequent expansions at the regulated WACC (which has been its position).

In consequence, DBCTM has undertaken the investments as set out in Figure 4 and Table 2.

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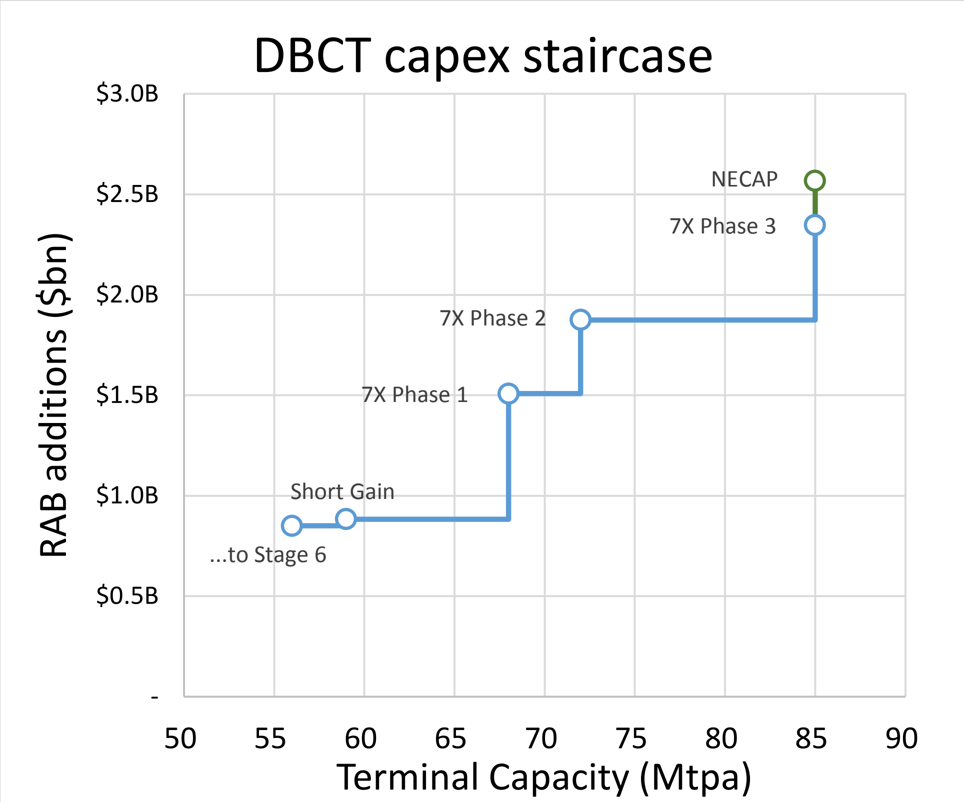
[32] QCA draft decision on DBCTM's 2004 DAU: 150

[33] DBCTM notes this complex system is similar to Dieter Helm's split-cost-of-capital concept, about which the QCA published a discussion paper in 2013. See: http://www.qca.org.au/getattachment/2ec54eab-9065-4d67-8662-68b426fe316b/Split-Cost-of-Capital.aspx.

Figure 4: DBCTM's capex investments since August 2006



Source: DBCTM regulatory model

Table 2: Additions to DBCTM's RAB from August 2006 to June 2016

Expansion	Commissioned	Timing	RAB addition ($m)	% of RAB
As-sold to Stage 6	June 2003	Before QCA's 2005 final decision	850.0	35
Short Gain	August 2006	After QCA's 2005 final decision	33.3	1
7X Phase 1	March 2008		624.6	26
7X Phase 2/3 Step A	December 2008		366.8	15
7X Phase 2/3 Step B	June 2009		472.1	19
Post 7X NECAP	Up to June 2015		220.7	9
RAB roll-forwards	Up to June 2015		(126.2)	-5
Current Opening RAB (2016-17)			**2,371.1**	**100**

Source: DBCTM roll-forward model

As shown above, investments accounting for approximately two thirds of the value of DBCTM's current RAB have been undertaken since the QCA's 2005 decision on beta.

2010 DECISION

There was nothing in the QCA's 2010 decision that indicated there would be any change to the approach adopted in 2005.

The QCA approved the 2010 access undertaking's WACC proposal on the basis that it:

> *"…was part of the negotiated package of arrangements agreed by users."*[34]

The QCA did note that DBCTM:

> *"…has used a methodology … that is not consistent with the Authority's current WACC methodology."*[35]

However, the 2010 AU adopted the same beta as the QCA had adopted in its 2005 decision, and the QCA did not take the opportunity to foreshadow a return to a basis other than that approved for the 2005 and 2010 decisions. This was despite the fact that by then the expansions contemplated in the 2005 decision were fully commissioned and in steady state operations. Hence, investors in DBCTM would have taken no signal from the 2010 decision to indicate that their previous assessment of regulatory risk was unrealistic or that the approach to determination of its WACC was likely to change.

CONCLUSION

DBCTM's investors' interpretation of the 2005 and 2010 decisions was that DBCTM would retain the equity beta inherent in its WACC so long as there was no material change in the risk profile of the expanded asset. As argued in section 1.1 of this response, DBCTM can demonstrate that the risk profile of the asset has since deteriorated, not improved.

The QCA's 2015 draft decision is to adopt a different basis for setting DBCTM's WACC. An implication of the QCA confirming its draft decision would be that investors in DBCTM would have to factor substantially higher degrees of regulatory risk into their *future* investment decisions and/or that DBCTM would have to explore options to withdraw from its current commitment to undertake investments at the regulated WACC. However, withdrawal from the commitment to invest at the regulated WACC is problematic from the point of view of the Port Services Agreement (PSA) that DBCTM signed as a condition of its primary lease of the facility[36].

DBCTM notes the following concerns relevant to the consistency of the QCA's draft position with section 138(2) of the QCA Act:

- With respect to section 138(2)(c) relating to DBCTM's legitimate business interests, DBCTM considers that the QCA's proposed reduction of the equity beta will increase the perceived regulatory risk facing the future investments of DBCTM.
- With respect to section 138(2)(d) relating to the public interest, DBCTM believes that the perceptions of the increase in risk would not be quarantined to DBCTM alone. Because the QCA has presented no evidence that DBCTM's systematic risk has declined, the QCA's proposed change will also be likely to increase the level of regulatory risk perceived by other regulated infrastructure providers. This is especially the case since (as shown in the next section) there is good evidence that DBCTM's systematic risk has increased.

[34] QCA final decision on 2009 DAU: iii
[35] QCA final decision on 2009 DAU: iii
[36] The last point is explained in more detail in subsection 4.8.3.

4.8.2 CHANGES IN DBCTM'S RISK PROFILE

DBCTM considers it now faces more commercial risk than it did in the 2005 or 2010 access undertaking periods. In this context, the QCA's proposed reduction of the equity beta is not consistent with DBCTM being able to earn a *return on investment commensurate with the regulatory and commercial risks involved*. This seems inconsistent with sections 138(2)(c) and (g) of the QCA Act.

Three main factors underlie the increase in DBCTM's commercial risk:

- Increased downside revenue risk
- Increased potential (and actual) competition with other ports
- Recent behaviour of ratings agencies and potential financiers.

INCREASED DOWNSIDE REVENUE RISK

The regulatory regime, combined with take-or-pay provisions in users' access agreements, limits DBCTM's downside risk, just as it curbs DBCTM's ability to press for participation in coal-sector upside. However, this downside protection can fail in the event of a major downturn in the coal-export market that leads to a significant share of DBCT users failing to renew their contracts or defaulting through bankruptcy.

The QCA's draft decision allows DBCTM to socialise revenue shortfalls, but the long-term effectiveness of this arrangement is limited by the danger that escalating access charges can threaten the viability of remaining customers.

DBCTM cites three pieces of evidence to support its contention that its downside revenue risk has increased:

- The first is that recent sharp falls in coal export prices have substantially impaired the profitability of DBCTM's customers. In June 2016, PricewaterhouseCoopers (PwC) estimated that the world's 40 largest mining companies made a collective loss of US$27bn in the 2015 calendar year.[37] PwC further estimated that the correction in commodity prices has wiped US$297bn off the top 40 miners' collective market value. PwC concludes that this decline in market capitalisation has erased all of the gains accumulated during the commodity boom of the previous decade. Due to the consolidated nature of DBCTM's customers' accounts, it is impossible to quantify the exact impact of falling coal prices on the profitability of DBCTM's source mines. However, actions by the Peabody US parent, discussed further below, and the decision of the Anglo group to divest itself of all the operations using DBCT, sends a clear and concerning signal to current and future investors in DBCTM.
- The second is that DBCTM can no longer be confident that access agreements will be renewed when they expire, or that capacity relinquished by a user whose access agreement has expired will readily be taken up by another user. For example:
  - in January 2016, a user with an access agreement for 2.7 mtpa of capacity due to end on 31 March 2016 decided not to renew the agreement[38]. In April 2016, a user with an access agreement for 1.6 mtpa of capacity due to end on 30 June 2016 decided not to renew the agreement. To date, no other users have expressed interest in securing any of the 4.3 mtpa of available capacity.[39]

[37] See http://www.abc.net.au/news/2016-06-07/big-miners-in-trouble-as-mining-boom-gains-wiped-out/7484908
[38] At both users' requests, DBCTM extended the contract renewal notification dates by nine months.
[39] DBCTM notes that AAPT users must renew their contracts three years prior to expiry. (See page 7 of https://www.fiig.com.au/docs/default-source/research-attachments/adani-abbot-point-terminal-research-report---9-june-2015-(r).pdf?sfvrsn=2) . Hence, AAPT has less contract renewal risk than DBCTM.

 - notice for the extension of another user's 2.0 mtpa contracted capacity was due by 30 June 2016 (12 months prior to contract expiry). The user has decided not to renew this contract. Thus, an additional 2.0 mtpa will remain uncontracted as of 1 July 2017

- The third piece of evidence is that Peabody Energy Corporation (PEC), the parent company of one of DBCTM's largest customers by volume and number of mines, has recently filed for Chapter 11 bankruptcy protection in the USA. DBCTM contracts with several entities that are owned (either wholly or partially) by PEC. PEC's bankruptcy protection application increases the risk attached to DBCTM's prospects of recovering access charges from these entities. In the worst-case scenario in which all the PEC entities default within the next two years, recovery of lost revenue by socialisation would require a TIC increase that could be sufficiently large to threaten the viability of remaining customers in the current coal-sector environment.

INCREASED COMPETITION WITH OTHER PORTS

As highlighted in section 1.1.2 of DBCTM's response, it is now technically feasible for coal companies that have historically shipped through DBCT to ship through other ports that they could not previously access. This has made the services that DBCTM provides subject to *potential* competition, even if it does not currently face active competition in the current economic climate. For example, since the commissioning of Aurizon Network's GAPE in late 2011, it has been technically feasible for Adani Abbot Point Terminal (i.e. AAPT) to compete with DBCT for Goonyella mines' volumes.

The DBCT User Group asserts that DBCT does not face competition from other ports because access to DBCT is currently cheaper than access to other terminals. It attributes DBCT's cost advantage to the fact that DBCT is a regulated brownfield terminal with large economies of scale.

However, the market evidence is that Goonyella mines have already contracted for capacity at AAPT. Three members of the DBCT User Group – Peabody (Middlemount Coal mine), BMC and Rio Tinto's Clermont (now sold to Glencore) – entered into 15-year port access agreements at AAPT since 2011. Together, these agreements account for capacity of up to 25% of DBCT's total contracted capacity.[40]

RATINGS AGENCIES AND FINANCIERS

DBCTM has recently suffered downgrades of its credit ratings by ratings agencies and has experienced significant difficulty in obtaining refinance.

In its March 2016 report on DBCT, Moody's stated:

> *"Given the material challenges facing the coal sector, we consider that DBCT's financial leverage and debt coverage metrics are no longer consistent with an investment-grade rated issuer, even if DBCT was geared at its benchmarked regulatory gearing level of 60%."*[41]

Several of DBCTM's major customers have been subject to similar ratings downgrades. The figure below gives a snapshot of DBCTM's major customers and compares their credit ratings over the period from the time of the 2010 AU to the present. This indicates that there have been 15 rating downgrades but only one upgrade in the period (see figure below).

[40] See https://www.fiig.com.au/docs/default-source/research-attachments/adani-abbot-point-terminal-research-report---9-june-2015-(r).pdf?sfvrsn=2.

[41] See page 3 of Moody's Investor Services Credit Opinion for DBCT Finance Pty Ltd., Update Following Draft Regulatory Decision (May 2016).

Figure 5: Comparison of 2016 and 2010 credit ratings of DBCTM's customers

Current Parent Company	Long Term Issuer Ratings					
	Moody's		S&P		Fitch	
	2010	2016	2010	2016	2010	2016
Rio	A3	Baa1	BBB+	A-	A-	A-
BHP	A1	A3	A+	A	A+	A+
Vale	Baa2	Ba3	BBB+	BBB-	BBB+	BBB
Peabody	Ba1	Ca (WR)	BB+	D	BB+	D
Anglo	Baa1	Ba3	BBB	-	BBB+	BB+
Glencore	-	-	BBB	BBB-	-	-
Mitsui	A2	A3	A+	A	-	-
Sumitomo	-	A1	A	A-	A	A

Downgraded	15
Stable	4
Improvement	1
No rating	4

Source: Published ratings as documented by Brookfield Treasury

In March 2016, DBCTM (*via* Brookfield) sought participation from [redacted] institutions for its refinance. [redacted] were willing to participate. The main reasons cited by the other institutions for declining to participate were: the state of the steel and coal sectors; DBCTM's and its customers' credit ratings; regulatory risk; and concerns around Peabody's financial viability.

DBCTM's experience in the debt capital markets in 2016 sits in stark contrast to the last time it refinanced significant tranches of debt in 2011 and 2012. At that time, DBCTM chose to raise debt finance in the US private placement (USPP) market where each of DBCTM's offers was substantially oversubscribed. In 2011 for example, DBCTM entered the market seeking AUD$300m of capital and received offers totalling in excess of US$1.7bn. In preparing for the 2016 refinance, however, DBCTM received a consistent message from its US noteholders that they were not in a position to support any further capital raising. DBCTM instead chose to raise short-term (five-year) debt in the domestic bank market which is less than ideal for a large-value, long-life infrastructure asset[42].

DBCTM's experiences in the debt capital markets highlight the increased risk it faces, compared to 2005 and 2010. The debt markets' assessment of the increased risk of lending to DBCTM contrasts with the QCA's draft decision, which suggests that DBCTM's risks have decreased. It would be incongruous for debtholders to perceive increased risk and for equity holders to perceive reduced risk, as is implied by the QCA's draft decision.

CONCLUSION

DBCTM faces increased downside revenue risk and increased potential and actual competition from other ports relative to the situation prevailing when the 2005 and 2010 access undertakings were approved. In addition, ratings agencies and potential financiers now assess DBCTM to be riskier than it was previously.

DBCTM contends that all of these risk increases are market-related and hence relevant to DBCTM's equity beta. This is very clear in the case of increased demand risk and the views of ratings agencies and potential financiers. It is also the case that the impact of additional competition bears more heavily on DBCTM in market downturns when the prices of coal and other commodities are depressed.

In this context, DBCTM notes that the QCA's proposed reduction of the equity beta does not recognise the increased commercial risks DBCTM is facing relative to the 2005 and 2010 access undertaking periods and will not enable DBCTM to earn a return on equity commensurate with the regulatory and commercial risks involved. These concerns are relevant to the consistency of the QCA's draft position with sections 138(2)(c) and (g) of the QCA Act.

[42] This experience is not unique to DBCTM. For example, BHP has experienced similar difficulties: http://www.afr.com/business/mining/bhp-billiton-struggles-to-get-newcastle-coal-export-terminal-financing-20160623-gpqoyp

4.8.3 COMPARISON BETWEEN DBCTM AND AURIZON NETWORK

In discussing its setting of DBCTM's asset beta at 0.45, the QCA notes, among other justifications, that:

> *"This is the same as the asset beta proposed for Aurizon Network – which is subject to similar regulation by the same regulator, and operates in the same coal chain, as DBCTM."*[43]

In DBCTM's view, however, there are material differences in the extent to which the regulatory system constrains DBCTM relative to Aurizon Network.

The first difference is that Aurizon Network is vertically integrated (i.e. it has a major related-party customer that is not subject to economic regulation) whereas DBCTM is not vertically integrated. It is widely accepted that vertical integration provides a regulated monopoly infrastructure provider opportunities to exercise its market power by favouring its unregulated related-party infrastructure user relative to third-party users. Moreover, it is also widely accepted that behavioural undertakings (e.g. ring-fencing commitments) are ineffective in dealing with this. Most recently, vertical-integration issues were the ACCC's main reason for opposing Brookfield's acquisition of Asciano (particularly its Pacific National business)[44].

The second difference is that, building on its understanding that the QCA cannot require regulated entities to invest (at least, not at their own cost), Aurizon Network has effectively split its cost of capital. DBCTM understands that Aurizon Network has confined the application of its regulatory access conditions (including WACC) to its established RAB and has secured different (presumably more favourable) conditions from users to compensate it for the risks of undertaking significant expansions. As an example, DBCTM understands that Aurizon Network undertook its GAPE and WIRP investments on the basis of access conditions negotiated with users, not on the basis of the regulated conditions specified in its access undertaking[45].

As noted above, expansions at DBCT have always been undertaken at the regulated WACC. DBCTM interprets its PSA with DBCT Holdings as requiring this on public-interest grounds[46].

According to the PSA:

> [redacted]

The PSA also precludes DBCTM from discriminating between the interests of existing and prospective users:

> [redacted]

In particular, it requires DBCTM to levy charges at a common rate for comparable services:

> [redacted]

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[43] QCA draft decision on 2015 DAU: 97

[44] See: http://www.accc.gov.au/media-release/accc-decides-not-to-accept-brookfield%E2%80%99s-proposed-undertakings

[45] The QCA's response to this (formulated at the time that QR was privatised) was to require a user-funding option to be included in Aurizon Network's 2010 access undertaking. This was to limit the extent to which Aurizon Network could employ investment-hold-up tactics to extract returns from expansion users in excess of the regulated return on equity. But practical arrangements to activate the user-funding option have yet to be agreed in Aurizon Network's 2010 access undertaking.

[46] DBCTM's interpretation of the PSA as a public-interest instrument is discussed in section 1.1.4 (above).

[47] PSA, clause 11.1

[48] PSA, Schedule 3, clause 3(b)

[49] PSA, Schedule 3, clause 3(a)

When an integrated terminal undergoes an expansion, and capacity cannot be differentiated upon the expansion's completion, the service being offered to existing users and expansion users is comparable. This requirement of the PSA would prevent DBCTM from seeking a higher return on equity for the expansion relative to that for the existing infrastructure.

DBCTM's obligations to invest are a significant feature of the PSA:

> [redacted]

In addition to other (unspecified) remedies for which DBCTM might be liable, the PSA allows DBCT Holdings to step in and make investments that DBCTM has failed to make. In this circumstance, DBCT Holdings can recoup its costs from DBCTM and charge a 10% margin on those costs.

The PSA allows DBCTM to avoid the obligation to invest[51] if the claimed costs of the investment would not be approved by the QCA. However, the PSA does not seem to allow DBCTM to avoid that obligation on the grounds that it requires a return on equity in excess of the regulated return.

The PSA requires DBCTM to consult "in good faith" with users on any proposed modification of its usual investment obligations. Proposals requiring returns on equity in excess of the regulated return are likely to encounter strong user resistance. Because the QCA Act does not allow the QCA to require Aurizon Network to invest on regulated terms, the QCA has no power to respond to user resistance to the terms that Aurizon Network might demand for network expansions.

In summary, the PSA provides, at best, only very limited opportunities for DBCTM to invest at rates of return on equity higher than its regulated rate[52].

CONCLUSION

The differences between DBCTM and Aurizon Network with respect to vertical integration and willingness and obligation to invest at the regulated return on equity represents a material difference in the *practical application* of the QCA's regulatory regime to the entities. The *average* return on equity that Aurizon Network realises from *all* its activities exceeds its regulated return on equity. Neither the QCA in its 2015 draft decision nor Incenta in its advice to the QCA recognise these differences when they rely on comparing Aurizon Network with DBCTM to justify their proposed setting of DBCTM's asset beta.

The activities to which the price-setting aspects of the regulatory regime apply in the case of DBCTM include, at any point in time, access to expansions of the facility as well as access to the existing facility. In contrast, Aurizon Network has substantially de-risked its regulated business by insisting that conditions for access to major expansions are more favourable to Aurizon Network than regulated conditions.

Under current arrangements, Aurizon Network's regulated return on equity is not the appropriate comparator to DBCTM's. Rather, a more appropriate comparator would be a weighted average of Aurizon Network's regulated return on equity and the return on equity implied by the access conditions that Aurizon Network has secured for GAPE and WIRP. While details of these latter rates are not available to the public or to the QCA, it is clear that they must imply returns in excess of Aurizon Network's regulated return on equity.

DBCTM accepts Incenta's and the QCA's conclusion that Aurizon Network is, to a limited extent, a relevant comparator for DBCTM. But DBCTM concludes that the comparison implies that DBCTM's regulated return on equity should exceed that allowed for Aurizon Network.

[50] PSA, clause 11.4
[51] PSA, clauses 2.4 and 11.8
[52] Details of the relevant provisions of the PSA are in confidential Appendix A.

4.8.4 OVERALL CONCLUSION

The QCA's draft decision to reduce DBCTM's equity beta from 1.0 to 0.87 is inconsistent with the commitments implicit in the QCA's 2005 and 2010 decisions and the increases in risk that DBCTM has experienced since those decisions. The regulated return on equity that DBCTM will receive if the draft decision is confirmed will not be commensurate with DBCTM's current risk profile, as is required by the QCA Act.

In DBCTM's view, the most appropriate way for the QCA to ensure that DBCTM's regulated return on equity reflects its current risk profile would be to use its regulatory discretion to retain DBCTM's equity beta at its current level of 1.0.

> **DBCTM Response 4.5**
>
> **DBCTM proposes the QCA exercise its regulatory judgement to retain DBCTM's equity beta at its current level of 1.0.**

4.9 GAMMA

4.9.1 QCA'S APPROACH

DBCTM contends that the QCA's methodology for determining gamma overestimates the value of Australia's tax-imputation scheme to the shareholders of DBCTM's benchmark efficient firm. This reduces DBCTM's ARR relative to what it would be were it to reflect the actual value of imputation credits to shareholders.

The basic problem with the QCA's approach is that it avoids the use of market data in estimating the value of imputation credits to shareholders (the *utilisation rate*). This is inconsistent with the way in which other WACC parameters are estimated. The QCA's approach also contains an error with respect to estimating the *distribution rate*.

With respect to both rates, the Australian Competition Tribunal (the Tribunal) has recently ruled that the approach adopted by the AER since 2013 (and followed by the QCA in its draft decision on the 2015 DAU) is inappropriate in the Australian regulatory framework.

4.9.2 UTILISATION RATE

The fundamental issue upon which the Tribunal ruled in its February 2016 *PIAC-Ausgrid* case was whether gamma should be interpreted as:

- the value to shareholders of distributed imputation credits (in which case estimates of the utilisation rate would be based on market prices, like other WACC parameters); or
- the proportion of credits that are available for redemption (in which case estimates of the redemption proportion would be required).

Prior to 2013, all regulators (including the QCA) had always interpreted gamma as the market value of imputation tax credits. In its December 2013 Guideline, the AER announced that it intended to redefine gamma in terms of the proportion of imputation tax credits that might be redeemed. In its 2014 Market Parameters decision, the QCA adopted the AER's redefinition of what gamma should mean. Hence, instead of estimating the value of credits to investors using market data, the QCA now relies on estimates of the proportion of credits that are available for redemption.

In the *PIAC-Ausgrid* case, the Australian Competition Tribunal explicitly rejected the AER's "conceptual re-evaluation" (on which the QCA now relies) and held that gamma must be interpreted as the value of credits to investors and not as the proportion of credits that can be redeemed:

We consider that, by placing most reliance on the equity ownership approach and effectively defining the utilisation rate as the proportion of distributed imputation credits available for redemption, the AER has adopted a conceptual approach to gamma that redefines it as the value of imputation credits that are available for redemption. This is inconsistent with the concept of gamma in the Officer Framework for the WACC.[53]

…the Tribunal does not accept the AER's approach that imputation credits are valued at their claimable amount or face value (as it said in the Final Decisions: the measure is what can be claimed). The value is not what can be claimed or utilised.[54]

…the Tribunal considers the use of market studies to estimate the value of imputation credits is consistent with the methods used to calculate other parameters of the costs of debt and equity from market data.[55]

Thus, the Tribunal decided that the AER had estimated the wrong thing – a redemption proportion instead of a value – and directed the AER to re-make its decision with a gamma of 0.25 instead of the 0.4 estimate that the AER had proposed. The 0.25 estimate is a value estimate based on market prices, and is the estimate that had been used prior to the AER's "re-evaluation."

The QCA's draft decision relies on the "equity ownership" approach to estimate the proportion of imputation credits that might be redeemed. This involves estimating the proportion of Australian equity that is owned by resident investors. The equity ownership approach was singled out for special criticism by the Tribunal:

The AER's equity ownership and tax statistics approaches consequently make no attempt to assess the value of imputation credits to shareholders…The Tribunal considers these approaches to be inconsistent with a proper interpretation of the Officer Framework.[56]

The Tribunal considers that the equity ownership approach overstates the redemption rate. We agree with the Network Applicants' submission that "even on the AER's own definition of theta (focussing on potential utilisation by eligible investors), equity ownership rates are above the true maximum possible figure for theta[57]*".*[58]

The Tribunal was very clear that it is not enough to simply look at the number of credits that might be redeemed – it is also necessary to determine the *value* to investors of the credits that they redeem:

…it is necessary to consider both the eligibility of investors to redeem imputation credits and the extent to which investors determine the worth of imputation credits to them.[59]

4.9.3 DISTRIBUTION RATE

In the Australian regulatory setting, the long-standing approach to estimating the distribution rate in the gamma formula is to use data from the Australian Tax Office (ATO) on total credits created and total credits distributed. The relevant ATO data supports an estimate of 0.7.

In its 2014 Market Parameters decision, and subsequent decisions, the QCA relies on estimates of the distribution rate from data relating to 20 large Australian listed companies – predominantly multinationals with significant foreign-sourced income[60]. This reflects a view that the ATO data is less reliable than audited company data.

In addressing this specific issue in the recent *PIAC-Ausgrid* case, the Tribunal noted that:

[53] PIAC-Ausgrid, Paragraph 1100.
[54] PIAC-Ausgrid, Paragraph 1081.
[55] PIAC-Ausgrid, Paragraph 1097.
[56] PIAC-Ausgrid, Paragraph 1095.
[57] Note that, in the technical literature, the utilisation rate is conventionally denoted "theta".
[58] PIAC-Ausgrid, Paragraph 1093.
[59] PIAC-Ausgrid, Paragraph 1061.
[60] Lally, 2014

> *The Networks Applicants say that the AER should not have relied on an estimate of the distribution rate for listed equity in estimating the distribution rate because it was likely to be unrepresentative of the distribution rate of the benchmark entity. This is because a large proportion of listed companies are multinational firms with foreign profits which will generally have an incentive [or ability] (by virtue of generating foreign-sourced income) to distribute a higher proportion of imputation credits. In contrast, the benchmark entity, by definition, is an entity with 100 percent Australian income.*[61]

The Tribunal then rejected the AER's reasons for placing weight on an estimate that was dominated by multinationals and determined that the long-standing approach of estimating the distribution rate using ATO data for all companies should be maintained:

> *…the Tribunal is of the view that it is appropriate to follow past practice.*[62]

This supports DBCTM's contention that the QCA's approach focusses on producing a *good* estimate of the *wrong* thing.

Moreover, the view that the ATO data is unreliable was rejected by the Tribunal in the *PIAC-Ausgrid* case:

> *The distribution … was estimated with a cumulative payout ratio approach which uses Australian Taxation Office (ATO) Franking Account Balances (FAB) statistics to calculate the proportion of imputation credits generated (via tax payments) that have been distributed by companies since the start of the imputation system. There is no dispute about this definition or the reliability of the ATO FAB data used to determine the distribution rate.*[63]

To be consistent with the Tribunal's ruling, the QCA should adopt the standard value of 0.7 for the distribution rate, rather than the 0.84 proposed in the draft decision.

4.9.4 REGULATORY PRECEDENT

The QCA acknowledges the importance of considering regulatory precedent in determining gamma:

> *In arriving at a preferred estimate of gamma, the QCA has considered a range of information, including:*
>
> *(a) the evidence and arguments presented by the AER in its Rate of Return Guideline (AER, 2013d; 2013e)*
>
> *(b) the views expressed by the Tribunal and supporting evidence in its recent decisions on gamma (ACT, 2010a; 2010b; 2011)*[64]

References to decisions of the Australian Competition Tribunal in the QCA's draft decision on the 2015 DAU and the decision on Market Parameters relate only to decisions up to 2011.

From the above quote, it is also clear that the QCA has been influenced by the AER's "conceptual re-evaluation" of gamma procedures in its 2013 Rate of Return Guidelines.

In its February 2016 decision in the *PIAC-Ausgrid* case, the Tribunal rejected the AER's "conceptual re-evaluation" as inconsistent with the Officer framework for defining gamma and, in particular with the definition of gamma in the National Electricity Rules. The QCA's approach is essentially in line with the AER's "conceptual re-evaluation".

The QCA does not provide complete reasons for its gamma position within the draft decision. Instead it states that:

[61] PIAC-Ausgrid, Paragraph 1105.
[62] PIAC-Ausgrid, Paragraph 1106.
[63] PIAC-Ausgrid, Paragraph 1032.
[64] QCA's final decision on Cost of Capital Market Parameters: 90.

> *"Full details of our analysis for estimating the gamma parameter are set out in our market parameters decision."*[65]

However, the Market Parameters decision, which, as noted above, acknowledges the importance of considering other Tribunal precedents, pre-dates the Tribunal's 2016 *PIAC-Ausgrid* decision and hence makes no reference to it.

DBCTM does not understand the basis on which the QCA concludes that:

> *"… there is nothing in the Tribunal's reasoning that demonstrates that our approach to estimating gamma is inappropriate."*[66]

Indeed, it would be difficult for the QCA to reach this conclusion unless it regards the role of gamma in its regulatory framework to be materially different to the role of gamma in the regulatory framework to which the Tribunal refers.

The QCA has dismissed the relevance of the Tribunal's *PIAC-Ausgrid* utilisation-rate ruling on the basis that the Tribunal embarked on one task (estimating the market value of imputation credits) whereas the QCA is performing a different task (estimation of the proportion of credits that might be redeemed). DBCTM considers that the QCA's dismissal is inappropriate. The Tribunal specifically considered the question of which of the two tasks is the appropriate one in the regulatory context. It concluded that the AER had performed the wrong task – the regulatory framework requires an estimate of the *value* of imputation credits but the AER (and QCA) have estimated something else.

The Tribunal also supported the use of ATO data to estimate the distribution rate and ruled that the alternative approach of relying on data for large listed multinationals was inappropriate.

In DBCTM's view, to argue that the Tribunal decision does not apply to QCA determinations, the QCA must establish that its regulatory framework differs in a material way to the framework under which the AER operates. Given that the QCA Act mirrors quite closely the Australian *Competition and Consumer Act 2010*, it seems unlikely that such a material difference exists.

4.9.5 CONCLUSION

With respect to gamma, the Australian Competition Tribunal has recently decided that the Australian regulatory framework requires a market value estimate of the utilisation rate. It has also decided that the distribution rate is better estimated from ATO data on total credits created and total credits distributed, rather than on data from a sample of large listed companies that includes multinationals. The Tribunal's view is that 0.25 is the appropriate value for gamma under the Australian regulatory framework.

While acknowledging that the QCA is not formally bound by the Tribunal decision, DBCTM notes that the Tribunal considered and rejected all the arguments upon which the QCA relies to justify the 0.47 value proposed in the draft decision on the 2015 DAU. Hence, DBCTM submits that the QCA should adopt the Tribunal's preferred value for gamma of 0.25.

DBCTM notes that the table of regulatory estimates set out in the QCA's draft decision[67] is out of date and that no regulator has adopted a gamma above 0.25 since the Tribunal's decision. A gamma of 0.25 is the current estimate adopted by the Australian Competition Tribunal, IPART and the Economic Regulation Authority of Western Australia.

Finally, DBCTM notes that the Tribunal's decision has been appealed to the full Federal Court. This is an appeal on legal issues only, not on the merits of the decision.

[65] QCA draft decision on 2015 DAU: 98
[66] QCA draft decision on 2015 DAU: 108
[67] QCA draft decision on 2015 DAU: 107. See Table 13.

DBCTM Response 4.6

DBCTM maintains that the most appropriate value for gamma is 0.25.

4.10 CONCLUSION—WACC

The table below shows the implications of DBCTM's proposed revised parameters on its WACC.

Table 3: WACC parameter summary

Parameter	*DBCTM's 2015 DAU proposal*	*DBCT User Group submission*	*QCA draft decision*	*DBCTM's Response*
Averaging period ending	21/08/15	21/08/15	30/10/15	31/05/16
Risk-free rate	2.8%	2.17%	2.10%	1.82%
Market risk premium	8.0%	6.5%	6.5%	6.5%*
Asset beta[68]	NA	0.43	0.45	NA
Equity beta	1.0	0.81	0.87	1.00
Gamma	0.25	0.47	0.47	0.25
Capital structure (% debt)	60%	60%	60%	60%
Credit rating	BBB	BBB	BBB	BBB
Debt risk premium (raw)	2.32%	2.32%	2.68%	2.71%
Debt issuance costs	0.108%	0.108%	0.108%	0.108%
Interest rate swap costs	NA	0.150%	0.113%	0.159%
Total debt risk premium	2.43%	2.58%	2.90%	2.98%
Cost of debt	5.23%	4.75%	5.00%	4.80%
Cost of equity	10.8%	7.47%	7.76%	8.32%*
Equity premium	8.0%	5.27%	5.66%	6.50%*
WACC premium (above RFR)	4.66%	3.67%	4.00%	4.39%*
WACC	**7.46%**	**5.84%**	**6.10%**	**6.21%***

**These values are dependent on the QCA's final decision regarding MRP.*

DBCTM proposes that if the QCA resolves to retain 6.50% for the MRP, DBCTM's WACC should be set at 6.21%. If the QCA decides to change its MRP setting, the WACC should be adjusted accordingly.

[68] DBCTM does not propose an asset beta value.

5 DEPRECIATION

This section sets out DBCTM's response to the QCA's draft decision on the method for calculating depreciation.

5.1 OVERVIEW

DBCTM proposed a weighted average mine life (WAML) approach for calculating depreciation, based on marketable reserves.[69]

On this basis, DBCTM proposed a depreciation period of 25 years to apply from 1 July 2016. This translates to an end-of-depreciation period of 30 June 2041.

5.2 DEPRECIATION

5.2.1 QCA'S DRAFT DECISION

The QCA has refused to approve DBCTM's proposed WAML approach for depreciation.[70] The QCA's draft decision stated:

> *While we accept the Australian coal market is currently experiencing short-term difficulties, given the evidence provided, including expert evidence, we are not persuaded that DBCTM has demonstrated that its asset stranding risk has increased materially:*
>
> *- The sound economic fundamentals of the Queensland metallurgical coal industry, which includes those firms in the DBCT catchment, position the industry as being on the low part of the international cost curve and able to withstand significant and protracted coal market downturns.*
>
> *- Economic barriers (e.g. additional railing costs) and practical barriers (e.g. lack of below-rail capacity) prevent users from transferring capacity to alternative terminals, which severely limits competition from other ports and gives DBCT substantial monopoly power.*
>
> *- Estimates of the medium and long-term supply of coal to DBCT suggest an expected Terminal life of (at least) 40 years as at 2015.*[71]

The QCA concluded that the end of DBCT's economic life (i.e. June 2054) should determine the appropriate reference point for measuring depreciation. This end-date effectively results in no change to the depreciation period from the 2010 AU.

5.2.2 DBCTM'S RESPONSE

Asset stranding is a major issue for access providers, as evidenced by customers at WICET filing for administration[72] and Aurizon Network's application for alternative pricing arrangements for electric and diesel traction in the Blackwater system[73]. While take-or-pay contracts provide some revenue protection, they cannot insulate access providers from a situation where contracts are not renewed and infrastructure charges increase to a point that threatens the viability of remaining users.

[69] DBCTM's supporting submission for the 2015 DAU: 27
[70] QCA draft decision on 2015 DAU: 128
[71] QCA draft decision: 128
[72] See http://www.wicet.com.au/irm/PDF/1079/Costblowoutscauseshipmentdelay
[73] See http://www.qca.org.au/getattachment/fb27d745-dcdb-41aa-b7f3-7ca35f0dc05c/Draft-Decision-on-Blackwater-Electric-Traction-DAA.aspx

This has become a significant concern for DBCTM, especially in light of events such as Peabody Australia (one of DBCTM's largest customers) recording a loss of $2.7 billion in the last calendar year and PEC (its parent company in the USA) filing for Chapter 11 bankruptcy protection.[74]

One way of mitigating asset-stranding risk is by reducing the period over which the value of assets is returned to investors (i.e. the period for the return of capital). The QCA did not accept the 2015 DAU's proposed WAML approach because it considered DBCTM's asset-stranding risk has not increased materially since the 2010 AU. However, as discussed in sections 1.1 and 4.8 of this response, DBCTM's risk has increased materially because of:

- the genuine threat of competition that exists from AAPT. DBCTM notes several Goonyella mines have contracted for 15-year port access agreements via GAPE since its last access undertaking
- 6.3 mtpa of capacity not being renewed by access holders. This capacity has not been taken up by other parties. The contract-profile 'drop off' for DBCTM is markedly different from that in the 2010 AU, and demonstrates that DBCTM's short-term risks are considerable.

In consideration of the above, DBCTM considers there is merit in shortening the depreciation period and wishes to propose an alternative approach for the QCA's consideration.

ALTERNATIVE APPROACH FOR THE QCA'S CONSIDERATION

DBCTM proposes that the end of its lease for DBCT with the State Government (i.e. DBCT Holdings) should be the reference point for measuring depreciation. DBCTM considers managing asset-stranding risks in accordance with information that is *certain* reflects a balanced outcome between an access provider and its customers.

DBCTM notes the QCA's consultant (Resource Management International) holds different views from DBCTM's consultant (i.e. Wood Mackenzie) on how a WAML should be determined. DBCTM's alternative approach of relying on information that is certain eliminates the need to address differences in opinion between consultants.

DBCTM's lease with DBCT Holdings ends on 15 September 2051. As noted above, the QCA's current view is that DBCT's economic life ends on 30 June 2054.

There is no certainty that the lease will be extended. However, the QCA's draft decision implicitly assumes that DBCTM will extend its lease (noting that this would have to be a 49-year extension option) to recover the remaining RAB value from 15 September 2051 to 30 June 2054. Without this assumption, DBCTM would not be able to recover its return of capital on the RAB over the last three years.

As it approaches the lease-end date, DBCTM will have to consider whether taking on the obligations associated with a 49-year extension (e.g. investment obligations in the PSA) is in its business interests. This is an important commercial decision as, per discussion in other parts of this response, these obligations are significant. Accordingly, it is not appropriate for the QCA's assumption to be that DBCTM will extend its lease; there is, as discussed above, no certainty the lease will be extended.

If DBCT's economic life is the reference point for calculating depreciation, there is a risk DBCTM may not recover its return of capital on assets over the September 2051 to 30 June 2054 period. This would be inconsistent with the pricing principles and DBCTM's legitimate business interests (ss. 138(2)(g) and (c) of the QCA Act).

What is *certain*, however, is that the lease ends on 15 September 2051.

[74] http://www.abc.net.au/news/2016-06-02/peabody-australia-coal-company-loses-nearly-3-billion/7471748

On that basis, it is more appropriate for the depreciation reference point to be September 2051 rather than June 2054. For revenue-modelling simplicity, DBCTM proposes to use June 2051 as the depreciation reference point. DBCTM considers its proposed approach to be consistent with the pricing principles and DBCTM's legitimate business interests (ss. 138(2)(g) and (c) of QCA Act).

5.2.3 CONCLUSION

DBCTM proposes the remaining asset life be the lesser of:

- an asset's remaining useful life; or
- the number of financial years to June 2051 (end date of DBCTM's lease with DBCT Holdings).

DBCTM's Response 5.1

DBCTM proposes the remaining asset life be the lesser of:

(a) an asset's remaining useful life; or
(b) the number of financial years to June 2051.

5.3 DEPRECIATION OF SPARES

DBCTM supports the QCA's position on the depreciation of spares. The QCA rightly points out that:

> *… if we maintained our position in the 2006 AU, DBCTM would receive the return on capital component of its investment in spares but not its return of capital. We consider this is not an appropriate outcome as, consistent with the pricing principles, DBCTM should receive a return that is at least enough to meet the efficient costs of providing access (s. 168A(a)).*[75]

As highlighted earlier in DBCTM's response, recovering investment costs, particularly via the return of capital, is important for managing DBCTM's asset-stranding risks.

DBCTM also supports the QCA's position to keep the asset life at 15 years for spares.

DBCTM's Response 5.2

DBCTM supports the QCA's position on the depreciation of spares.

5.4 RESIDUAL VALUE OF INITIAL ASSETS

In the final decision on the 2006 DAU, the QCA required that initial assets would have a 2.5% residual value.[76] The QCA's view was that assets have a salvage value at the end of their economic life. The 2.5% residual-value assumption does not apply to assets that have been included in the RAB after the 2006 AU came into effect.

In its 2015 DAU submission, DBCTM proposed that the residual value of initial assets be updated from 2.5% to 0% from 2016-17 onwards.[77] This would allow DBCTM to recover its full return of capital associated with the relevant assets.

[75] QCA draft decision on 2015 DAU: 31
[76] QCA draft decision on 2004 DAU: 158 (final decision upheld draft decision)
[77] QCA draft decision on 2015 DAU: 163

5.4.1 QCA'S DRAFT DECISION

While the QCA did not approve the DBCTM's 2015 DAU proposal to update the residual value of initial assets in the RAB from 2.5% to 0%, it encouraged DBCTM to amend this proposal to address the DBCT User Group's concerns with respect to double counting.[78]

5.4.2 DBCTM'S RESPONSE AND REVISED PROPOSAL

In DBCTM's view, the Review Event provisions[79] in the 2015 DAU (and all previous access undertakings) already address the users' concerns with respect to the potential for double-counting. The relevant Review Event refers to the *"...sale of assets comprised in the Terminal during the preceding 12 months"*.[80]

As part of the Review Event, the RAB and reference tariff are adjusted to reflect DBCTM's net proceeds from selling assets. [81] DBCTM cannot retain the net proceeds of the sale of any terminal asset, as those proceeds must be deducted from the RAB. The following examples provide assurance to users that DBCTM has complied with its obligations:

- The RL1 Insurance Settlement approved in 2011 included scrap proceeds of $54k.[82]
- The SR1 Replacement Project approved in 2014 included scrap proceeds of $250k.[83]

DBCTM considers the 2015 DAU and DBCTM's demonstrated compliance with the relevant Review Event provisions adequately address stakeholders' concerns regarding double-counting.

DBCTM therefore retains its proposal to update the residual value of initial assets from 2.5% to 0% from 2016-17 onwards.

> **DBCTM's Response 5.3**
>
> **DBCTM has addressed the double-counting issues raised in the draft decision, and retains its proposal to update the residual value of initial assets from 2.5% to 0% from 2016-17 onwards.**

78 QCA draft decision on 2015 DAU: 172
79 2015 DAU, Schedule C Part A Section 4(f)(2)
80 2015 DAU, Schedule H, definition of Review Event e(3)
81 2015 DAU, Schedule C, cl. (f)(ii)
82 See http://www.qca.org.au/getattachment/0511d0f2-4a11-4c1a-aec5-8650703915fd/Decision-RL1-Insurance-Recovery.aspx
83 Refer http://www.qca.org.au/getattachment/2fea4dd7-65b6-416f-97f6-80c18e911700/Letter-of-approval.aspx

6 REMEDIATION ALLOWANCE

This section sets out DBCTM's response to the QCA's draft decision on the annual remediation allowance.

6.1 QCA'S DRAFT DECISION

The QCA proposed an annual remediation allowance of $5.7m[84] based on:

- a remediation cost estimate of $389.69m (Q4, 2015). The QCA sought advice from Turner and Townsend (T&T) on producing this estimate
- a 38-year term to remediation (i.e. to 2054, consistent with the QCA's position to use DBCT's remaining economic life to measure depreciation).

6.2 DBCTM'S RESPONSE

DBCTM's response on the QCA's position is set out as follows:

- interpretation of the PSA's remediation requirements
- site remediation cost estimate
- term to remediation
- annual remediation allowance
- conclusion.

6.2.1 INTERPRETATION OF THE PSA'S REMEDIATION REQUIREMENTS

DBCTM's obligations related to remediation and rehabilitation are set out in clauses 1.1 and 22 of the PSA.

PSA REMEDIATION REQUIREMENTS AND LEGAL INTERPRETATION

Clause 1.1 of the PSA defines 'rehabilitate' to mean, [redacted].

DBCTM considers the requirement for it to remediate the land to a particular standard (being the natural state and condition prior to any development or construction activity) should be interpreted as it is written.

Clause 22.4 of the PSA states that:

[redacted]

DBCTM's legal advice is that on the PSA's proper construction, clause 22.4(b) does not reduce the standard to which DBCTM must rehabilitate the premises. Rather, the clause imposes certain

[84] QCA draft decision on 2015 DAU: vi

obligations on DBCTM to follow while undertaking its remediation of the onshore and offshore land to the standard defined in clause 1.1 of the PSA.

T&T INTERPRETATION OF PSA REMEDIATION REQUIREMENTS

Upon reviewing the PSA's remediation requirements, T&T considered that:

> *In the event of site closure, the likely rehabilitation work scope will be to return the site to a safe and stable condition, appropriate for the likely (open land) use. This complies with the industry standard of "return of disturbed land to a stable and productive condition". Although the lease states there is an obligation to "remediate the Onshore Land and Offshore Land to its natural state and condition as existed prior to any development or construction activity having occurred on the Premises",* ***clause 22.4 of the PSA goes on to state "(b) Rehabilitate in accordance with DBCT Holdings' reasonable conditions and requirements."***
>
> *This reasonable conditions clause is significant as it is likely to preclude any requirement to rehabilitate to a higher standard than is required for open space.* [85] (emphasis added)

DBCTM's legal advice is that T&T's interpretation does not draw the important distinction between:

- the manner in which DBCTM may be directed by DBCT Holdings to undertake the relevant rehabilitation works (per clause 22.4(b)), and
- the state in which the premises must exist upon completion of remediation works (per clause 1.1).

DBCTM notes therefore, that T&T has interpreted clause 22.4(b) as allowing DBCTM to rehabilitate to a standard lower than that defined under clause 1.1. T&T's interpretation makes an assumption which is not express or implied in the clause.

6.2.2 SITE REMEDIATION COST ESTIMATE

In its original submission, DBCTM submitted a factored approach for estimating site-remediation costs, whereas T&T has adopted a first principles approach. DBCTM acknowledges the limitations of its factored approach and supports T&T's first principles approach (which the QCA has accepted).

In light of legal advice, DBCTM proposes that the first principles approach is used to estimate the costs of remediating the site to the standard required to comply with the PSA. DBCTM considers that doing so could result in T&T's cost estimate increasing by 10-20%.

6.2.3 TERM TO REMEDIATION

Consistent with its position on depreciation, DBCTM proposes a 35-year term to remediation.

As discussed in section 5 of this response, there is no certainty that the lease DBCTM has with DBCT Holdings, which ends in September 2051, will be extended. Retaining the reference point for depreciation at June 2054 creates a risk the DBCTM will not earn a return of capital on the RAB from September 2051 to June 2054. To address this risk, the reference point for depreciation should be consistent with end date of the lease. For revenue-modelling simplicity, DBCTM has proposed that June 2051 be the reference point for measuring depreciation.

If the lease is not extended, it is reasonable to assume that DBCT Holdings will request that DBCTM rehabilitate the facility upon conclusion of the lease. Accordingly, DBCTM proposes a term to remediation that aligns with the depreciation reference point.

[85] T&T Report For Review of proposed DBCT site rehabilitation: 19

6.2.4 ANNUAL REMEDIATION ALLOWANCE

DBCTM's revised remediation proposal includes:

- a site-remediation cost estimate of $389.69m (Q4, 2015), subject to the QCA's response on the cost of revised remediation requirements
- a 35-year term to remediation
- maintaining cost escalation for the cost estimate at 2.5% per annum[86].

Using a WACC of 6.21%, DBCTM estimates an annual remediation allowance of $6.4m.

6.2.5 CONCLUSION

The table below summarises DBCTM's revised remediation proposal and compares it with the QCA's draft decision.

Table 4: Revised remediation proposal

Allowance parameter	QCA draft decision	DBCTM revised proposal
Interest rate	6.10% (QCA-approved indicative WACC)	6.21%
Term to remediation from 2016	38 years (economic life)	35 years (end of lease)
Cost of remediation (Q4, 2015)	$389.69m (T&T estimate)	$389.69m* (subject to the QCA's response on the cost of the revised remediation requirements)
Annual remediation charge	$5.7m	$6.4m* (subject to the QCA's final decision on relevant parameters)

DBCTM obtained Finity's advice in updating the annual remediation allowance (see Appendix B).

DBCTM Response 6.1

DBCTM proposes a revised annual remediation allowance of $6.4m. This is subject to the QCA's final decision on relevant matters.

86 This is consistent with the mid-point of the RBA's target inflation band over the long term (i.e. 35+ years). DBCTM notes this differs from its proposal for inflation (1.45%) for the upcoming regulatory period (see section 8.3 below).

7 CORPORATE OVERHEADS

This section set out DBCTM's response on the QCA's draft decision on corporate overhead costs.

7.1 QCA'S DRAFT DECISION

The QCA has proposed a corporate overheads allowance of $7.23m per annum in 2016-17, indexed annually for inflation over the regulatory period.[87]

The QCA based this estimate on the third method (i.e. benchmarking) that DBCTM's consultant had proposed.

7.2 DBCTM'S RESPONSE

DBCTM has no further comment on the corporate overheads allowance.

Based on the QCA's draft decision, DBCTM submits a corporate overheads allowance of $7.23m per annum in 2016-17, indexed annually by 1.45%[88] over the regulatory period.

DBCTM Response 7.1

DBCTM proposes a revised corporate overheads allowance of $7.23m per annum in 2016-17.

[87] QCA draft decision on 2015 DAU: 154
[88] As proposed in section 8.3 of this response

8 TERMINAL INFRASTRUCTURE CHARGE AND MODELLING

This sections sets out DBCTM's response on RAB and ARR modelling. A summary of DBCTM's response is provided below in Table 5 below.

Table 5: DBCTM's response to QCA draft decision on modelling inputs and pricing assumptions (2015 DAU)

Input/assumption	DBCTM proposal	QCA draft decision	DBCTM response to QCA's draft decision
WACC	7.46%	6.10%	6.21%
Remaining useful life of the Terminal	25 years from 1 July 2016, based on weighted average mine life approach.	Refused to approve. Maintained remaining useful life of Terminal at 38 years.	DBCTM proposes using the end-of-lease period (i.e. June 2051).
Annual site remediation fee	$12.8m	Refused to approve. Estimated $5.7m.	$6.4m (subject to the QCA's final decision on relevant parameters)
Reduce residual value of initial assets to zero	Eliminate the 2.5% residual value assigned to some initial assets.	Refused to approve, but suggested how DBCTM proposal could be enabled.	Eliminate the 2.5% residual value assigned to some initial assets, noting that stakeholders concern on double-counting are already addressed by the 2015 DAU (see section 5.4).
Working capital allowance	Calculate based on 45 rather than 30 debtor days.	Refused to approve. Proposed to maintain 30 debtor days currently applied.	QCA's decision noted and accepted.
Corporate overhead allowance	Increase to $8.2m, compared to $6.1m allowed in 2015-16.	Refused to approve. $7.23m, based on 'bottom up' approach.	QCA's decision noted and methodology accepted.
Amortise spares from initial asset base.	Depreciate spares included in the initial asset base over the next 15 years.	Approved DBCTM's proposal.	QCA's decision noted and accepted.
Expected vs. outturn inflation	Adopt expected inflation to calculate return of and on capital.	Refused to approve, pending further investigation.	Use Indexed Bond Approach to determine expected inflation. Align outturn inflation with expected inflation.

8.1 QCA'S DRAFT DECISION

DBCTM notes the QCA's draft decision.[89]

8.2 STAKEHOLDERS' SUBMISSIONS

DBCTM notes the QCA's description of stakeholder submissions.[90]

8.3 DBCTM'S RESPONSE

8.3.1 RAB ROLL-FORWARD (2010–11 H2 TO 2015–16)

DBCTM agrees with the QCA's position on the RAB roll-forward.

8.3.2 BUILDING BLOCKS (2016-17 TO 2020-21)

DBCTM proposes revising the RAB roll forward on the following basis:

- Indexation based on 1.45% per annum (see section 8.4)
- Nominal depreciation based on the lease end date (see section 5.2).

Table 6: DBCTM's revised RAB ($m)

Item description	2016–17	2017–18	2018–19	2019–20	2020–21
Opening RAB	2,371.1	2,320.8	2,269.2	2,216.8	2,163.8
Indexation	34.3	33.6	32.9	32.1	31.3
Nominal depreciation	84.6	85.2	85.3	85.1	86.3
Closing RAB	**2,320.8**	**2,269.2**	**2,216.8**	**2,163.8**	**2,108.9**

DBCTM's revised proposal for the ARR and TIC is set out in the table below.

Table 7: DBCTM's revised proposal for ARR and TIC ($m)

Item description	2016–17	2017–18	2018–19	2019–20	2020–21
Return on asset	144.0	141.0	137.8	134.7	131.5
Return of asset (depreciation)	82.1	82.7	82.8	82.5	83.7
Less indexation	(33.3)	(32.6)	(31.9)	(31.2)	(30.4)
Corporate overheads	7.2	7.3	7.4	7.5	7.7
Regulatory levy	0.1	0.4	0.4	0.4	2.0
Remediation fee	6.4	6.4	6.4	6.4	6.4
Net tax allowance	17.9	17.9	17.9	17.9	18.0
ARR[91]	**224.3**	**223.0**	**220.8**	**218.2**	**218.8**
Reference tonnage (mtpa)	80.700	78.700	78.700	78.700	78.700
TIC ($/tonne)	**2.7799**	**2.8342**	**2.8062**	**2.7731**	**2.7804**

[89] QCA draft decision on 2015 DAU: 156-173
[90] QCA draft decision on 2015 DAU: 156-173
[91] Totals may not add correctly due to rounding.

RETURN ON CAPITAL

DBCTM’s revised WACC proposal is outlined in the table below.

Table 8: DBCTM's revised WACC assumptions

Parameter	DBCTM's 2015 DAU proposal	DBCT User Group submission	QCA draft decision	DBCTM’s Response
Averaging period ending	21/08/15	21/08/15	30/10/15	31/05/16
Risk-free rate	2.8%	2.17%	2.10%	1.82%
Market risk premium	8.0%	6.5%	6.5%	6.5%*
Asset beta	NA	0.43	0.45	NA
Equity beta	1.0	0.81	0.87	1.00
Gamma	0.25	0.47	0.47	0.25
Capital structure (% debt)	60%	60%	60%	60%
Credit rating	BBB	BBB	BBB	BBB
Debt risk premium (raw)	2.32%	2.32%	2.68%	2.71%
Debt issuance costs	0.108%	0.108%	0.108%	0.108%
Interest rate swap costs	NA	0.150%	0.113%	0.159%
Total debt risk premium	2.43%	2.58%	2.90%	2.98%
Cost of debt	5.23%	4.75%	5.00%	4.80%
Cost of equity	10.8%	7.47%	7.76%	8.32%*
Equity premium	8.0%	5.27%	5.66%	6.50%*
WACC premium (above RFR)	4.66%	3.67%	4.00%	4.39%*
WACC	**7.46%**	**5.84%**	**6.10%**	**6.21%***

**These values are dependent on the QCA's final determination of MRP.*

WORKING CAPITAL

DBCTM accepts the QCA’s decision on the working capital allowance.

OPERATING EXPENDITURE

DBCTM sets out its revised operating expenditure proposal in the table below.

Table 9: DBCTM's revised operating expenditure proposal ($m)

Item description	2016–17	2017–18	2018–19	2019–20	2020–21
Site remediation	6.4	6.4	6.4	6.4	6.4
Corporate overheads	7.2	7.3	7.4	7.5	7.7
Regulatory levy	0.1	0.4	0.4	0.4	2.0
Total opex	**13.7**	**14.1**	**14.2**	**14.3**	**16.1**

RESIDUAL VALUE OF INITIAL ASSETS

As discussed in section 5.4, DBCTM has addressed the issue of double-counting raised in the draft decision relating to the residual value of initial assets. DBCTM therefore retains its proposal to update the residual value of initial assets from 2.5% to 0% from 2016-17 onwards.

TAX PAYABLE

DBCTM supports the QCA's approach for the calculation of net tax payable.

8.4 INFLATION

8.4.1 OVERVIEW

In calculating the return on capital, a *nominal* WACC is applied to the RAB. This includes compensation to DBCTM for the fact that inflation will erode the real value of the RAB over the regulatory period. At the end of each year, the RAB is indexed to reflect actual (outturn) inflation during the year. To avoid double compensation for inflationary erosion of the RAB, the ARR building blocks include annual deductions representing the amount by which the QCA expects inflation to erode the real value of the RAB.[92]

This creates a problem if the expected inflation rate used in calculating the inflation deduction in a particular year is not well aligned with the inflation expectation implicit in the nominal WACC. If the deduction expectation exceeds the implicit WACC expectation, DBCTM will be *undercompensated* for inflation in that year. However, if the deduction expectation is lower than the implicit WACC expectation, DBCTM will be *overcompensated*.

This will not matter over the regulatory period as a whole so long as the rate used for the annual indexation of the RAB is the same as the rate used in calculating the inflation deduction. But this is not the case if outturn inflation is used to index the RAB, as proposed by the QCA.

8.4.2 QCA'S DRAFT DECISION

In its draft decision, the QCA has adopted an expected inflation rate of 2.50% for ARR modelling purposes[93]. This is the midpoint of the RBA's target inflation band.

Separately, the QCA refused to approve DBCTM's proposed approach to apply the expected inflation rate to index the RAB, rather than the outturn rate. However, the QCA indicated it would consider further submissions on this issue.

8.4.3 DBCTM'S RESPONSE

DBCTM's response is set out as follows:

- Expected inflation in RBA forecasts
- Expected inflation implied in the nominal WACC
- Market observation of expected inflation
- RAB indexation
- Regulatory precedent.

[92] QCA draft decision on 2015 DAU: 166 (see Tables 30 and 31).
[93] QCA draft decision on 2015 DAU: 145

EXPECTED INFLATION IN RBA FORECASTS

In its original submission in October 2015, DBCTM included an expected inflation rate of 2.5% which was consistent with forecasts contained in the RBA's Statement of Monetary Policy for August 2015. However, the RBA's Statement of Monetary Policy for May 2016 indicated that inflation below the target range would persist until at least 2018, with a high level of uncertainty as indicated in the charts below[94]. DBCTM therefore submits that the expected inflation proposal of 2.5% is no longer a valid representation of the RBA's views, and consequently, DBCTM proposes to revise the estimate for expected inflation to apply for the 2016-2021 regulatory period.

Figure 6: Key information from the RBA's Statement on Monetary Policy 2016

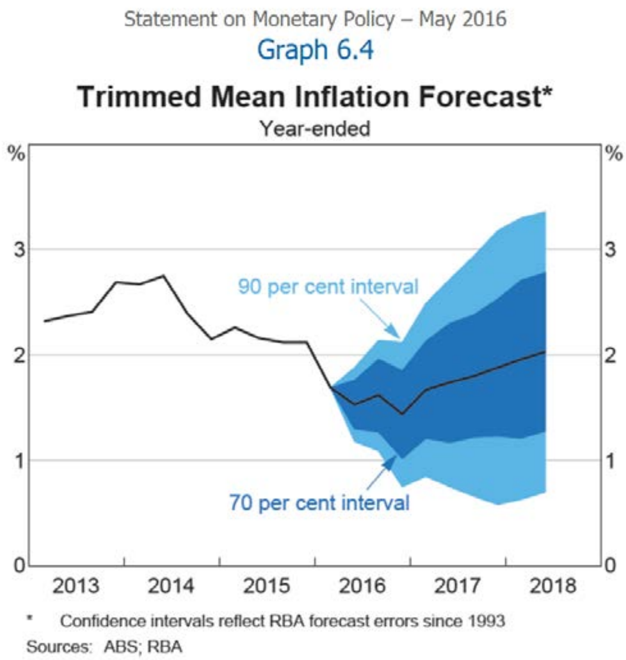


Table 6.1: Output Growth and Inflation Forecasts(a)

Per cent

	Year-ended					
	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
GDP growth	3	2½–3½	2½–3½	2½–3½	2½–3½	3–4
CPI inflation	1.7	1	1–2	1½–2½	1½–2½	1½–2½
Underlying inflation	2	1½	1–2	1½–2½	1½–2½	1½–2½
	Year-average					
	2015	2015/16	2016	2016/17	2017	2017/18
GDP growth	2½	2½	2½–3½	2½–3½	2½–3½	2½–3½

(a) Technical assumptions include A$ at US$0.75, TWI at 62.5 and Brent crude oil price at US$47 per barrel; shaded regions are historical data

Sources: ABS; RBA

[94] RBA Statement of Monetary Policy (May 2016) Graph 6.4 and Table 6.1

The table below shows the calculation of the expected inflation rate from the most recent RBA forecasts over the term of the risk-free rate. This approach uses Consumer Price Index (CPI) forecasts from the RBA's most recent Statement on Monetary Policy. Where explicit CPI forecasts are not provided, the midpoint of the RBA inflation target range of 2-3% is used. The expected inflation rate is then estimated using the geometric mean of these annual forecasts. Using this approach, for the five-year term of the 2015 DAU, the expected inflation rate is estimated at 2.00%.

Table 10: Forecast inflation rates from RBA's Statement on Monetary Policy May 2016

Current QCA approach for estimating expected inflation	Period	Rate
First 3 years from midpoint of the CPI inflation from the RBA Statement of Monetary Policy Table 6.1 Output Growth and Inflation Forecasts issued in May-16	Jun-16	1.00%
	Jun-17	2.00%
	Jun-18	2.00%
Subsequent 2 years based on the midpoint of RBA long-term inflation target range of 2% to 3%	Jun-19	2.50%
	Jun-20	2.50%
Geometric average		**2.00%**

EXPECTED INFLATION IMPLIED IN THE NOMINAL WACC

An expected inflation rate is implicit in the nominal risk-free rate component of the WACC. The QCA determines the nominal risk-free rate by taking a 20-day average of the yields of five-year Australian government nominal bonds. The draft decision calculated this rate to be 2.10%. Based on a 20-day average up to 31 May 2016, the rate calculated is 1.82%.

It is clear that together with the risk-free rate of 1.82% included in the nominal WACC, the expected inflation rate of 2.50% proposed in the QCA draft decision implies a negative real rate of interest on five-year government bonds. If this is considered implausible, it must be that the inflation expectation implicit in the WACC is lower than 2.50%. It follows that the QCA's calculation of the inflation deduction currently results in DBCTM being undercompensated for inflation. Even with the updated expected inflation rate of 2.00%, a negative real risk-free rate is still implied.

MARKET OBSERVATION OF EXPECTED INFLATION

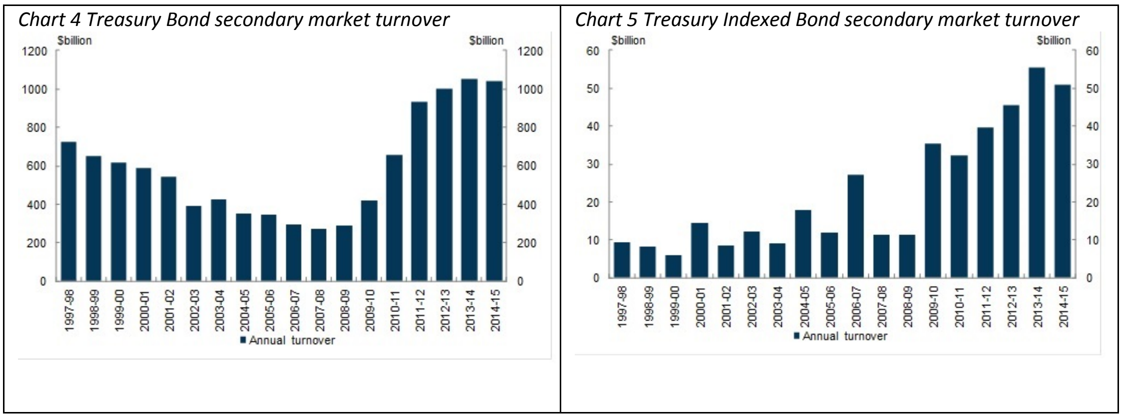
An alternative to the current QCA approach would be to infer market expectations of inflation by comparing yields on nominal and indexed five-year Treasury bonds *via* the Fisher equation (the Indexed Bond Approach). Currently, this yields an expected inflation rate of 1.45%[95] for the regulatory period. In turn, this implies a 0.37% (1.82% - 1.45%) real risk-free rate. DBCTM regards this as a much more plausible proxy for the inflation expectation implicit in the nominal WACC than either the QCA's draft decision of 2.50% or the 2.00% based on the updated RBA forecasts. As noted above, both of the RBA forecast-based estimates imply negative real risk-free rates.

One common objection to relying on indexed-bond data in drawing market inferences is that the indexed-bond market has insufficient liquidity to allow robust inferences. But DBCTM considers that this does not apply in current circumstances. Recent evidence from the Australian Office of Financial Management (AOFM) – which controls the $400 billion Australian Government Securities program – indicates that liquidity is currently strong for Treasury Indexed Bonds:

> *Financial market liquidity has a range of interpretations, however one indicator of liquidity is turnover in the secondary market. Charts 4 and 5 show the evolution of total secondary market turnover from 1997-98 through to 2014-15. In 2014-15, turnover was around $1 trillion for Treasury Bonds … and $50 billion for Treasury Indexed Bonds ... Strong liquidity is attractive to investors and reflects favourably on a sovereign bond market.* [96]

[95] Based on interpolation of RBA bond data available at http://www.rba.gov.au/statistics/tables/xls/f16.xls . Calculations are included in the DBCT ARR model submitted to the QCA.
[96] AOFM *Annual Report 2014-15* (September 2015), Part 2 Operations and Performance

Figure 7: Indicative liquidity in Treasury Bond market



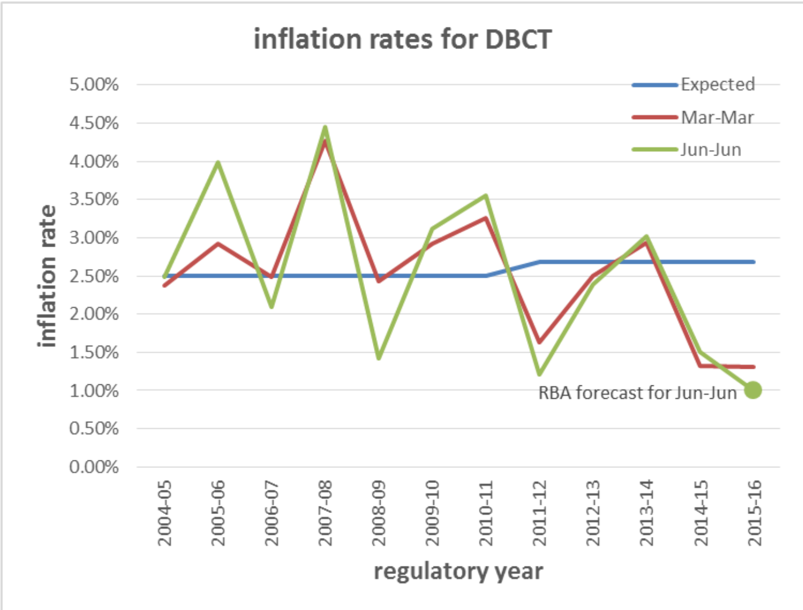
Accordingly, DBCTM proposes that the inflation deduction in the ARR building blocks should be based on an expected forecast inflation rate of 1.45%.

RAB INDEXATION

As noted in section 8.4(1) above, the current practice of using the outturn inflation rate for annually indexing DBCTM's RAB cannot guarantee that DBCTM will be appropriately compensated for the effects of inflation over the regulatory period as a whole. Moreover, it creates uncertainty about future reference tariffs, both for DBCTM and its access holders/seekers. DBCTM notes that the outturn inflation rate is the only parameter of the annual ARR roll forward process that has not been determined at the beginning of the regulatory period.

A subsidiary difficulty is that the March-March outturn rate is not a very accurate proxy for the theoretically preferred June-June rate.

Figure 8: Comparing March-March outturn inflation rate with the June-June rate



For these reasons, DBCTM proposes that the RAB should be indexed using the expected inflation rate that is used in calculating the annual inflation deductions in the ARR, rather than annual March-March outturn rates. For consistency with the expected inflation rate proposed for the inflation deduction in the ARR building blocks, DBCTM proposes that the expected inflation-indexation rate should be 1.45%, derived from the indexed-bond method.

REGULATORY PRECEDENT

DBCTM provides the following additional support for the Indexed Bond Approach:

(1) The expected inflation rate estimated from the RBA forecasts does not correspond well with the Indexed Bond Approach for the 2015 DAU, unlike the experience with the two previous decisions. This inconsistency (as highlighted in the table below) indicates a lack of reliability.

Table 11: Comparison of risk-free rates and inflation rates

Item	2006 AU	2010 AU	2015 DAU
Term of risk-free rate	10-year	10-year	5-year
Nominal risk-free rate (from Treasury Nominal Bonds)	5.84%	5.08%	1.82%
Expected inflation rate (using RBA Approach)	2.50%	2.69%	2.00%
Real risk-free rate (using Fisher equation)	3.26%	2.33%	(0.17%)
Real risk-free rate (from Treasury Indexed Bonds)	3.24%	2.44%	0.37%
Expected inflation rate (using Indexed Bond Approach)	2.52%	2.57%	1.45%

(2) The Indexed Bond Approach is consistent with the approach adopted by other regulators, for example ERAWA for Western Power[97], Essential Services Commission of South Australia (ESCOSA)[98] for SA Water.

(3) The Indexed Bond Approach has been used in the past by the QCA for its regulated entities. In its final determination for the regulation of electricity distribution in 2001 the QCA noted:

> *The Authority's preferred approach is to measure inflation as the difference between the nominal bond rate and an inflation indexed bond rate over the same period (that is utilising the Fisher equation). The benefit of such an approach is that it delivers a forward looking estimate of inflation rather than an historic measure. This method is also consistent with the approach adopted by other regulators. In addition, it should represent a measure consistent with the term of the nominal risk-free rate. To apply ex-post measures of CPI as suggested by the QSU (2001) would lead to a mismatch between the measure of inflation and the term of the risk-free rate.*[99]

(4) The Indexed Bond Approach was proposed by the QCA to potential lessees of DBCT:

> *… inflation has been estimated by calculating the difference between the nominal commonwealth 10 year bond and the commonwealth indexed bond with a similar term...* [100]

The Indexed Bond Approach has been approved by the QCA for use on DBCT in the past, in particular implicitly as part of the WACC(3) determination process for 7X Phase 1, Phase 2/3 Step A and Step B, altogether comprising $1.5 billion of expansion assets commissioned as recently as 2009-10. These expected inflation rates applied from the commissioning date of the assets until the end of the 2006 AU regulatory period.

8.4.4 CONCLUSION

DBCTM proposes to use the Indexed Bond Approach instead of the current 'RBA based' approach, which overestimates the rate. DBCTM proposes an expected inflation rate of 1.45%, calculated using the Indexed Bond Approach.

[97] ERAWA *Explanatory Statement for the Rate of Return Guidelines* (December 2013) para 997
[98] ESCOSA *Advice on a regulatory rate of return for SA Water—Final advice* (February 2012): 9
[99] QCA *Regulation of Electricity Distribution* (May 2001): 108
[100] QCA *Statement of Regulatory Principles – Dalrymple Bay Coal Terminal* (February 2001): 13

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(1) DBCTM proposes an expected inflation rate of 1.45%, calculated using the Indexed Bond Approach.

(2) DBCTM proposes that annual indexation of the RAB should be conducted using the fixed expected inflation rate (1.45%) rather than variable annual March-March outturn rates.

8.5 OTHER MODELLING ISSUES

Both the QCA and DBCTM maintain separate ARR models for DBCT. Over time, minor discrepancies have arisen.

8.5.1 QCA'S DRAFT DECISION

The QCA noted a number of modelling issues, and indicated it would consult with DBCTM and review any proposed changes to address those issues.[101]

8.5.2 DBCTM'S RESPONSE

Following the release of its draft decision, the QCA consulted with DBCTM in relation to the variance between the models. DBCTM's position is as follows:

- **Tax expense** – DBCTM has agreed with QCA staff to exclude the working capital allowance from the RAB total[102] used in calculating net tax payable going forward.
- **Depreciation** – In DBCTM's original submission, its ARR model rounded the RAB for depreciation calculations to accommodate the proposed WAML approach. Since DBCTM is no longer proposing the WAML approach, it has reinstated its previous method for determining depreciation.

[101] QCA draft decision on 2015 DAU: 173
[102] This is the sum of the Opening RAB and the working capital allowance.

9 RING-FENCING MATTERS

This subsection sets out DBCTM's response on ring-fencing matters.

9.1 QCA'S DRAFT DECISION

The QCA's mark-up of the 2015 DAU includes comprehensive ring-fence provisions drafted on the basis that there is a vertical-integration issue relevant to DBCT Management. That is, DBCT Management has related entities that compete with third-party businesses that access the port (in particular, above-rail operators).

The QCA's drafting is based on the drafting that DBCTM originally proposed. DBCTM had proposed this drafting at a time when it was likely that a related entity of DBCTM would hold a controlling interest in Pacific National. Pacific National currently provides above-rail services to DBCT. In its mark-up of the 2015 DAU, the QCA proposed changes to DBCTM's drafting to reflect stakeholder concerns about DBCTM's vertical-integration relationship with Pacific National. The effect of those changes, together with DBCTM's original drafting, is to create detailed and comprehensive ring-fencing provisions addressing the cross-ownership between DBCTM and Pacific National.

Prior to the QCA's draft decision being published, the participation of Brookfield (which ultimately holds the controlling interest in DBCTM) in the acquisition of Asciano fundamentally changed. In particular, the acquisition of Asciano (if it proceeds at all) will be undertaken in two parts.

The first part will be an acquisition of Asciano's ports and stevedoring business. This has no connection to DBCT or the DBCT coal chain. The second part will be the acquisition of Pacific National. Brookfield will not participate in the acquisition of Pacific National at all. The effect of the above is that the vertical-integration issues which triggered DBCTM's drafting and the QCA's drafting no longer exist.

In light of the change in the proposed structure of the acquisition of Asciano, the QCA has proposed three ring-fencing options:

- Option 1 is to remove the ring-fencing drafting and revert to the requirement contained in the 2010 AU that DBCTM will submit ring-fencing drafting if conflicts arise in the future.
- Option 2 is the retention of the comprehensive ring-fencing drafting, but making its operation conditional upon vertical integration occurring (if it ever occurs).
- Option 3 is a middle ground. It includes limited ring-fencing provisions that are similar to, but more developed than, the ring-fencing provisions in the 2010 AU.

9.2 DBCTM'S RESPONSE

DBCTM has consulted the DBCT User Group as well as Aurizon Network. DBCTM and the DBCT User Group have exchanged ring-fencing drafting and discussed that drafting at meetings. Based on DBCTM's discussions with these stakeholders, the most prudent path forward is Option 3.

In DBCTM's view, reverting to the 2010 AU's ring-fencing drafting (i.e. Option 1) would not address the concerns that the DBCT User Group has about the trading business or Aurizon Network's concerns about confidentiality at a board level. To maintain confidence in the regulatory framework, a more developed form of ring-fencing is required relative to that contained in the 2010 AU. However, Option 2 is not warranted in light of the revised Asciano acquisition structure.

DBCTM's drafting of Option 3 is included in the mark-up of the 2015 DAU attached to this submission. As is noted above, DBCTM's drafting incorporates consultation with relevant stakeholders.

9.2.1 EXPLANATION OF DBCTM'S DRAFTING

DBCTM's ring-fencing drafting is explained in four parts.

Firstly, section 9.1 of the 2015 DAU obliges DBCTM to submit a DAAU to the QCA if a vertical-integration issue arises. Under DBCTM's drafting, DBCTM is obliged to comply with amendments that the QCA proposes. This creates a tighter process than is provided for in the QCA Act. The circumstances which trigger the need to propose amendments are broad. DBCTM is obliged to submit a DAAU if DBCTM or any of its related bodies corporate acquire an interest, directly or indirectly, in a coal mine, rail haulage business or below-rail infrastructure. This is a broader test than that in the Aurizon Network access undertaking.

Secondly, section 9.2 of the 2015 DAU addresses discrimination and is not triggered by vertical integration. It:

- prohibits DBCTM from engaging in conduct that prevents or hinders access
- prohibits unfair differentiation between access seekers and access holders
- operates to regulate DBCTM when dealing with the trading business and also more generally.

Thirdly, section 9.3 of the 2015 DAU obliges DBCTM to procure an undertaking from any related business (and not just Brookfield Port Capacity Pty Ltd) that engages in secondary trading of DBCT capacity. The form of the undertaking is provided for in schedule I to DBCTM's 2015 DAU.

Schedule I is given as a deed poll and is in favour of the QCA, access seekers and access holders. It:

- prohibits a trading business from engaging in conduct that prevents or hinders access
- prohibits unfair differentiation between access seekers and access holders
- includes robust confidentiality obligations
- includes a complaint and audit process.

Fourthly, section 9.4 of the 2015 DAU addresses a specific concern raised by Aurizon Network. DBCTM has a minority shareholder, BcIMC, which (if the Asciano transaction proceeds) may be a minority shareholder in Pacific National. For clarification, there will not be any relationship between Brookfield, DBCTM or Pacific National. A BcIMC executive is currently a director on DBCTM's board. To address any perceived conflict of interest, DBCTM has proposed that each board member execute a confidentiality deed poll. In this poll, DBCTM proposes that each board member: agrees to not disclose the confidential information obtained in her/ his role as a director; and acknowledges that confidential information cannot be passed on to a business connected with the DBCT coal chain.

DBCTM Response 9.1

DBCTM's proposed drafting for ring-fencing is included in the 2015 DAU.

10 NEGOTIATION FRAMEWORK AND CAPITAL PROCESSES

This section sets out DBCTM's responses to the QCA's positions on the negotiation framework and capital processes.

10.1 OVERVIEW

DBCTM's response on the negotiation framework and capital processes covers:

- length of access agreements (10.2)
- access transfer provisions (10.3)
- funding provisions (10.4)
- funding agreements (10.5)
- non-expansionary capital expenditure (NECAP) and whole-of-life (WOL) cost tests (10.6).

10.2 LENGTH OF ACCESS AGREEMENTS

10.2.1 QCA'S DRAFT DECISION

The QCA did not accept DBCTM's proposal to increase the access term from 10 years to 15 years for expansion infrastructure.

The QCA instead considered it appropriate for DBCTM to have the option to seek non-standard terms to a conditional access agreement, so DBCTM can address cost and risk issues associated with expansion infrastructure that was differentiated.[103]

10.2.2 DBCTM'S RESPONSE

DBCTM maintains its view that 15-year access agreements are appropriate for expansion infrastructure. DBCTM has demonstrated in this response that the risks it now faces are greater than those in the past (i.e. since the approval of the 2006 AU and 2010 AU). The reasons for DBCTM's view include:

- competition with AAPT being a genuine threat (section 1.1.2)
- evidence of capacity not being re-contracted at DBCT over the upcoming regulatory period (section 1.1.3)
- the risk that expansion users, in the context of differentially priced expansions, could switch usage to the pre-expansion infrastructure if excess capacity subsequently emerges at that infrastructure (section 11.2).

Taking into account the reasons described above, DBCTM considers that the risks associated with expansion infrastructure warrant 15-year access-agreement terms, especially for differentially priced expansions. In forming its position, DBCTM notes that AAPT negotiated 15-year access agreements with some users in the Goonyella system (see section 1.1.2).

DBCTM supports the QCA's draft decision to allow DBCTM to apply non-standard terms to conditional access agreements. This flexibility will be important for DBCTM in managing the risks associated with investing in expansion infrastructure, especially where the infrastructure is differentially priced.

[103] QCA draft decision on 2015 DAU: 192

10.3 ACCESS TRANSFER PROVISIONS

10.3.1 QCA'S DRAFT DECISION

The QCA considered that the 2015 DAU should:

- provide certainty on the assessment timeframe DBCTM will apply to access transfer requests, including where DBCTM is required to execute a user agreement with the proposed transferee
- outline the assessment criteria DBCTM will apply to all access transfer requests
- identify the dispute resolution processes available to users and proposed transferees adversely affected by a DBCTM decision to not approve an access transfer request.[104]

10.3.2 DBCTM'S RESPONSE

DBCTM recognises the benefits that transfers have for its customers, particularly from the perspective of managing take-or-pay obligations. Access transfers involve DBCTM, a transferor (i.e. the party transferring its access rights to another party), and a transferee (i.e. the party receiving the transferor's access rights).

DBCTM supports a transfer process that does not adversely affect its risk profile. Accordingly, DBCTM's main concern is that contracting with the transferee should not result in DBCTM's risk profile being adversely affected, relative to contracting with the transferor.

DBCTM's response on access transfers is structured as follows:

- Assessment timeframes
- Assessment criteria
- Dispute resolution.

While DBCTM has outlined its views on the above matters in this response, it has not proposed drafting amendments for the 2015 DAU or 2015 SAA. DBCTM would be willing to meet QCA staff to provide feedback on their legal advisors' implementation of the relevant drafting.

ASSESSMENT TIMEFRAMES

In DBCTM's view, the constraints for addressing access transfer requests relate to:

- establishing the transferee's creditworthiness
- the ability and willingness of the transferee to provide security (e.g. bank guarantees). DBCTM's experience has been that negotiation of security can protract the timeframes for considering and finalising a transfer request
- whether the request is for a short-term transfer (i.e. less than 12 months) or long-term transfer (more than 12 months).

DBCTM proposes one timeframe for short-term transfers and another for long-term transfers. The table below shows DBCTM's proposed timeframe for short-term transfers.

[104] QCA draft decision on 2015 DAU: 195

Table 12: Assessment timeframe for short-term transfers

Responsible party			Action	Prescribed timeframe (business days)
DBCTM	Transferor	Transferee		
✓	✓	✓	Initial assignment discussion	1
		✓	Provision of financial information	5
✓			Assessment of financial information	10
✓		✓	Security negotiation	15
✓	✓	✓	Negotiation and preparation of paperwork	10
✓			DBCTM director execution	5
	✓	✓	Transferor and transferee execution of contract	5
Total				**51**

DBCTM considers that having about 50 business days to assess and approve a short-term transfer would be appropriate.

In comparison with short-term transfers, long-term transfers come with greater financial obligations and can present greater risk to DBCTM if adequate credit protection is not obtained. This can result in longer durations for undertaking financial assessments and negotiating security. The table below shows DBCTM's proposed timeframe for long-term transfers.

Table 13: Assessment timeframe for long-term transfers

Responsible party			Action	Prescribed timeframe (business days)
DBCTM	Transferor	Transferee		
✓	✓	✓	Initial assignment discussion	1
		✓	Provision of financial information	5
✓			Assessment of financial information	15
✓		✓	Security negotiation	30
✓	✓	✓	Negotiation and preparation of paperwork	15
✓			DBCTM director execution	5
	✓	✓	Transferor and transferee execution of contract	5
Total				**76**

DBCTM considers that having about 75 business days to assess and approve a long-term transfer would be appropriate.

DBCTM notes that the proposed timeframes may appear lengthy to stakeholders. In practice, the finalising of transfers can take longer (e.g. 24 months) than the timeframes DBCTM has proposed in this response. This arises when a transferee's view of its creditworthiness is significantly different from what DBCTM assesses that creditworthiness to be, which can lead to a protracted negotiation. In this context, DBCTM considers the proposed timeframes above are reasonable.

ASSESSMENT CRITERIA

As noted above, DBCTM's main concern is that contracting with the transferee may be riskier than doing so with the transferor. DBCTM's ability to measure that risk can be difficult if the transferee has not previously shipped through DBCT.

DBCTM has proposed criteria that seek to maintain DBCTM's risk profile, while not being too onerous such that a transferee's access to DBCT is frustrated. The proposed criteria are:

- The transferee should demonstrate its ability to meet the financial obligations under the transferor's SAA. The transferee's preparedness to provide DBCTM with adequate credit protection is a key consideration.
- The transferee must demonstrate it has rail-related agreements to transport its coal to DBCT.
- The transferee must agree to be bound by the terminal regulations and other relevant regulations and agreements required to ship through DBCT.
- If the transferee has previously shipped through DBCT, it should have demonstrated a commitment to:
  - complying with the terminal regulations, other relevant regulations and agreements associated with shipping through DBCT
  - the safe, efficient and sustainable operation of DBCT.

DISPUTE RESOLUTION

The table below sets out DBCTM's proposed dispute-resolution process for transfers. A dispute can be triggered when the prescribed timeframe for any one of the steps nominated in Table 12 and Table 13 are exceeded.

Table 14: Dispute-resolution process for transfers

Action	Days prior to taking action
Transfer negotiation exceeds prescribed timeframe	n/a
Executives meet to resolve	14
If not resolved, issue is referred to QCA for arbitration	14
Total	**28**

DBCTM considers that a key principle for guiding the arbitration process is that DBCTM's risk profile should not be adversely affected if contracting with the transferee.

10.4 FUNDING PROVISIONS

10.4.1 QCA'S DRAFT DECISION

The QCA sought feedback on whether access seekers should have the right to fund an expansion if DBCTM has been relieved of its obligation *via* clause[105] 12.7 of the 2015 DAU to undertake the relevant expansion.[106]

The QCA has also proposed definitions for FEL1, FEL 2 and FEL3 feasibility studies. [107]

[105] "Clauses" and "sections" are used interchangeably when referring to provisions in the DAU and SAA
[106] QCA draft decision on 2015 DAU: 199
[107] See schedule H of QCA's proposed mark-up of 2015 DAU

10.4.2 DBCTM'S RESPONSE

RELIEF FROM OBLIGATION TO EXPAND

Clause 12.7 of the 2015 DAU provides that DBCTM can seek approval from DBCT Holdings not to undertake an expansion that is considered unreasonable and uneconomic.

Clause 12.7 reflects one of the provisions of the PSA.[108] As discussed elsewhere in this submission, the PSA imposes public-interest constraints on DBCTM. If DBCT Holdings considers an expansion to be unreasonable and uneconomic, then the expansion should not go ahead because it is not in the public interest. In DBCTM's view, access seekers should not have the right to fund expansions that DBCT Holdings considers not to be in the public interest.

DEFINITIONS OF FEL STUDIES

DBCTM does not support the QCA's proposed definitions for FEL studies.

Each expansion project has different drivers and objectives. Depending on the nature of an expansion project, the scope and deliverables for each FEL study can vary significantly. Including detailed definitions of FEL studies in an access undertaking does not provide the flexibility that DBCTM requires when investigating expansion options.

DBCTM acknowledges that the QCA is seeking greater certainty for stakeholders in relation to the process for assessing the viability of an expansion. However, the QCA's proposed approach is unlikely to support this objective because it:

- imposes unnecessary costs on DBCTM's customers, in relation to FEL-study outputs that those customers may not want or value
- does not provide DBCTM with the opportunity to negotiate with users about the scope and deliverables for each FEL study. This is particularly the case with the QCA's proposed definitions for the FEL 2 and FEL 3 studies.
- does not capture financial-related outcomes (e.g. bankability) that would be sought as part of a FEL 3 study, noting that the complexity of the study will depend on the risk profile of access seekers and the expected pricing method.

DBCTM does not expect to disagree with its users on what FEL studies should cover, nor has such disagreement happened in the past. DBCTM also notes that the DBCT User Group's submission on the 2015 DAU did not raise concerns about the definitions of FEL studies.

In this context, DBCTM notes that the QCA's final decision on Aurizon Network's 2014 DAU provided that Aurizon Network and stakeholders could seek to arrange alternative processes and definitions for the baseline capacity assessment. The QCA said this approach was consistent with the principles of a negotiate-arbitrate model.[109]

Accordingly, DBCTM proposes maintaining the definition of FEL studies in the 2015 DAU.

[108] PSA, clause 11.8
[109] QCA final decision on Aurizon Network's 2014 DAU: 16, 33

10.5 FUNDING AGREEMENTS

10.5.1 QCA'S DRAFT DECISION

The QCA considered it appropriate for DBCTM to:

- provide an ability for access seekers and users to lodge access disputes on the template funding agreement (TFA)
- negotiate with access funders in accordance with the TFA, unless otherwise agreed (and subject to there being no disputes about the TFA).[110]

10.5.2 DBCTM'S RESPONSE

DBCTM proposes that access seekers only have the right to refer a dispute on the TFA to the QCA. As access seekers are the parties that ultimately fund the expansion via their access charges, the rights of access holders are only relevant to the extent they are also access seekers.

DBCTM also proposes that a dispute only be triggered when 60% of the relevant access seekers (by proposed contracted volumes) wish to dispute the TFA. It is important that TFA disputes only be addressed if a majority of access seekers have concerns. DBCTM notes that similar forms of this requirement are applied in relation to expansion approval process in its 2010 AU (and in reviews of Aurizon Network's capacity assessments). DBCTM is willing to accept the requirement to negotiate with parties in accordance with the TFA, if the 60% requirement above is implemented.

10.6 NECAP AND WHOLE OF LIFE COST TESTS

10.6.1 QCA'S DRAFT DECISION

The QCA accepted DBCTM's positions regarding NECAP and WOL cost tests.[111]

10.6.2 DBCTM'S RESPONSE

DBCTM supports the QCA's draft decision, and notes that the WOL-related elements of the decision are consistent with the requirements of the QCA Act.[112]

[110] QCA draft decision on 2015 DAU: 199
[111] QCA draft decision on 2015 DAU: 207-209
[112] QCA draft decision on 2015 DAU: 209

11 DIFFERENTIAL PRICING

This section outlines DBCTM's response to the QCA's draft position on differential pricing.

11.1 QCA'S DRAFT DECISION

The QCA has maintained its 'incremental up/average down' approach as the default for the pricing of terminal expansions.

Where there is an 'incremental up' outcome, the QCA proposes to consider socialising the expansion's costs where 'exceptional circumstances' exist and to consider several factors in doing so. This amounts to a case-by-case approach for deciding whether to socialise or differentiate an expansion that increases average costs.

The QCA's proposed drafting on its 'incremental up/average down' approach is as follows:

> *In assessing whether or not Differentiation should apply in respect of a proposed Terminal Capacity Expansion, the following principles shall apply:*
>
> *(a) where Socialisation of a Terminal Capacity Expansion would decrease the Reference Tariff for users of the Existing Terminal, the Terminal Capacity Expansion should be treated as forming part of the Existing Terminal, such that a single Reference Tariff and Annual Revenue Requirement shall apply to the Existing Terminal (including the Terminal Capacity Expansion) (a Socialised Expansion).*
>
> *(b) where socialisation of a Terminal Capacity Expansion would increase the Reference Tariff for users of the Existing Terminal (a Cost Sensitive Expansion), subject to Section 11.13(c), the Terminal Capacity Expansion should be treated as a separate Terminal Component, with its own Regulated Asset Base, Reference Tariff and Annual Revenue Requirement (a Differentiated Expansion Component).*
>
> *(c) A Cost Sensitive Expansion may be treated as forming part of the Existing Terminal (and therefore, not treated as a Differentiated Expansion Component) where exceptional circumstances exist that justify Socialisation. In determining whether there are exceptional circumstances, consideration shall be given to:*
>
> *(1) the materiality of the increase in the Existing Terminal's Reference Tariff that would be affected by socialising the Cost Sensitive Expansion;*
>
> *(2) the extent to which assets or infrastructure the subject of the Cost Sensitive Expansion will operate wholly or partly, in an integrated way with the Existing Terminal or as a stand-alone development;*
>
> *(3) the extent to which the Cost Sensitive Expansion is likely to benefit users of the Existing Terminal (for example, such as through higher efficiency, reliability or flexibility of the Existing Terminal); and*
>
> *(4) any differences in the risks of providing Access to users of the Existing Terminal in respect of additional Terminal Capacity created by the Cost Sensitive Expansion.* [113]

DBCTM's position on the QCA's drafting is set out below.

[113] QCA's proposed mark up of 2015 DAU, clause 11.13, p. 72.

11.2 DBCTM'S RESPONSE

As noted above, the QCA has proposed a case-by-case approach for deciding whether to socialise or differentiate an expansion that increases average costs.

DBCTM anticipates applying to the QCA for a departure from the default in the case of the majority of 'Cost Sensitive' expansions. The principal reason is that DBCTM has been advised by DBCT Holdings that the adoption of differential pricing would be inconsistent with the PSA.[114]

DBCTM also contends that differential pricing would be inconsistent with established regulatory practice in the QCA's previous DAU decisions for DBCT, and that no material change in circumstances has emerged to justify a change from the uniform average-cost pricing agreed to in the first DBCT access undertaking (2006 AU). Uniform average-cost pricing has been applied to all expansions since the 2006 AU.

DBCTM's main concern with the QCA's draft decision on differential pricing is to ensure that the factors set out in clause 11.13(c) (see subsection above) are sufficiently wide to allow the QCA to consider the arguments that DBCTM may advance in seeking to depart from the QCA's default 'incremental-up' approach.

DBCTM supports the QCA's case-by-case approach subject to four primary amendments:

- The QCA should remove the adjective 'exceptional' from the first and second sentences of clause 11.13(c). DBCTM does not understand how the circumstances referred to are exceptional in any sense other than that they are deemed sufficient to justify a departure from the QCA's default.
- the factors that the QCA proposes to consider should be broader than those set out in clause 11.13(c). DBCTM is concerned that the factors set out in the QCA's current drafting are too narrow to allow the QCA to consider some arguments that DBCTM is likely to advance in support of departures from the 'incremental-up' approach.

  In particular, DBCTM proposes the list of factors should also account for:

  - the possibility that expansion users could switch usage to the pre-expansion infrastructure should excess capacity emerge there subsequently
  - the complexity associated with allocating costs of future O&M and NECAP activities between expansion and existing users
  - whether the services that the expansion infrastructure provides are functionally equivalent to the services that the existing infrastructure provides
  - other factors not currently anticipated. DBCTM considers it reasonable for the QCA to acknowledge that the factors listed in clause 11.13(c) are not exhaustive. This would be achieved by adding a final factor to be considered, reading "any other factors that the QCA considers relevant". DBCTM notes that clauses of this type are used in the QCA Act[115] and in previous QCA decisions to ensure that the QCA has adequate discretion to consider stakeholder views.
- the QCA's current drafting of clause 11.13(c) should be modified to remove the apparent implication that a 'Cost Sensitive' expansion will either be wholly differentiated or wholly socialised. As acknowledged in clause 11.13(c)(3), 'the extent to which the Cost Sensitive Expansion is likely to benefit users of the Existing Terminal' is a relevant factor. It could justify a cost sharing arrangement between existing and expansion users.

[114] See letter from DBCT Holdings to DBCTM (Appendix D), dated 15 March 2016.
[115] See, for example, Section 138(2)(h).

- the words 'Reference Tariff' in the QCA's current drafting should be replaced with 'Access Charge'. This is to accommodate the possibility that capital investments can reduce operating costs, implying that the appropriate metric for deciding on differential pricing should be the total access charge (i.e. TAC). See the subsection below for a more detailed discussion.

11.3 USE OF TOTAL ACCESS CHARGES, NOT REFERENCE TARIFFS

As discussed immediately above, the QCA's draft decision proposes that the 'incremental up/average down' approach be based on the impact on the existing *reference tariff*[116] of including expansion costs in DBCTM's RAB.

The reference tariff is the TIC, which includes DBCTM's capital costs, corporate overheads and site-remediation costs. However, it does not include the costs of operating and maintaining DBCT. DBCTM considers that the appropriate metric for deciding on differential pricing should be the entire existing cost of providing the declared service.

The declared service is the handling of coal at DBCT.[117] The cost of coal-handing services includes the costs of operating and maintaining DBCT. DBCTM submits that the effect of the expansion on the TAC, which includes all relevant charges, is the appropriate metric upon which the QCA should decide whether an expansion's costs are socialised or differentiated.

DBCTM notes that its current handling charges (HCF and HCV) are similar in value to the TIC expected to apply from the start of the upcoming regulatory period. One implication of using TAC is that an expansion might be socialised when it would have been differentiated if using the TIC. This may occur when an expansion reduces average handling costs for all users, such that the TAC decreases despite a TIC increase.

11.4 DBCTM'S PROPOSED DRAFTING

DBCTM has proposed the following drafting amendments to the 2015 DAU:

- DBCTM has not included the requirement[118] for DBCTM to apply to the QCA for a price ruling on how an expansion should be priced within 20 business days after completion of a FEL 2 study. In DBCTM's view, it would be inappropriate to submit a price ruling application before DBCTM has submitted a Terminal Capacity Expansion application. Accordingly, DBCTM proposes to apply for a price ruling as part of its Terminal Capacity Expansion application.[119]
- DBCTM has, consistent with its position in section 11.3 of this response, proposed:
  - removing the "exceptional" circumstances requirement from the Expansion Pricing Principles in section 11.10(b)[120]
  - including further factors[121] relevant to the QCA's determination of the pricing methodology
- DBCTM has amended references to 'Reference Tariff' to instead be 'Access Charges' in section 11.10(b).

As a simplification and readability measure only, DBCTM has proposed a new Schedule J. This schedule contains drafting that applies only in the event that an expansion component is differentially priced.

[116] 2015 DAU mark-up, cls. 11.13(a)-(b)
[117] QCA Act, s. 250(1)(c)
[118] See section 5.12 of the QCA's mark-up of the 2015 DAU
[119] See section 12.5 of DBCTM's mark up of the 2015 DAU
[120] In DBCTM's mark up of the 2015 DAU
[121] DBCTM's proposed drafting has also sought to clarify the intent of clause 11.13(c)(4) in the QCA's 2015 DAU mark-up

The drafting that remains in the body of the revised 2015 DAU is relevant only to the determination as to how a future expansion of DBCT, if any, would be priced. Once it is determined by the QCA that a future expansion is to be “Differentiated” (to use the language of the revised 2015 DAU), the access undertaking is amended in accordance with Schedule J.

DBCTM Response 11.1

DBCTM’s proposed drafting for differential pricing is included primarily in section 11 and Schedule J of the revised 2015 DAU.

12 OTHER MATTERS

This section sets out DBCTM's views on other matters.

12.1 REPORTING

DBCTM has proposed amending the QCA's mark-up of section 10.2(i) of the 2015 DAU to acknowledge that DBCTM should not be obliged to publicly report on matters which are subject to a confidentiality obligation.

It would be unreasonable to require DBCTM to disclose confidential information.

12.2 AMENDING THE DEFINITION OF NOTIONAL CONTRACTED TONNAGE

12.2.1 QCA'S DRAFT DECISION

The QCA has accepted the 2015 DAU's proposed definition of notional contracted tonnage (NCT).

12.2.2 DBCTM'S RESPONSE

DBCTM welcomes the QCA's acceptance of the 2015 DAU's proposed NCT definition.

Socialising revenue lost as a result of default by, or insolvency of, an access holder enables DBCTM to continue to earn a return on and of all capital invested. Not ensuring that DBCTM can do this would be inconsistent with the QCA Act's pricing principles, as the QCA highlighted in its draft decision:

> *In the absence of the proposed change to the NCT definition, DBCTM may not have an opportunity to recover its efficient costs of providing the declared service should an access agreement be terminated early. We consider such an outcome is inconsistent with the pricing principle in section 168A(a) of the QCA Act.*[122]

As implied above, a shortcoming of the 2010 AU's NCT definition is that DBCTM is not able to recoup the access charges an access holder would have paid, had that access holder not defaulted or become insolvent.

The 2015 DAU's NCT definition sought to address this shortcoming by allowing DBCTM to socialise the 'revenue lost' *after* the defaulting or insolvent access holder's user agreement is terminated. However, the revised NCT definition does not account for the revenue lost *before* termination of the user agreement. In particular, the definition does not allow DBCTM to recover access charges from:

- the beginning of the period to which an access holder's unpaid invoice applies; and
- the date at which the access holder has its access agreement terminated by DBCTM.

This period is 104 days at a minimum, but would likely be longer if the access holder disputes[123] the notices to remedy or suspend.

DBCTM invoices its access charges in arrears on 30-day terms. If an access holder fails to pay an invoice by its due date, DBCTM would have already provided 60 days of services to that access holder. At that juncture, DBCTM can issue a notice to remedy.[124] The access holder has 30 days to address that notice, noting that DBCTM is still obliged to provide services to the access holder over that period.[125]

[122] QCA draft decision on 2015 DAU: 257
[123] Clause 15 of the SAA
[124] Clause 14.1 of the SAA
[125] Clause 14.1(a) of the SAA

If the access holder fails to remedy the non-payment within 30 days, DBCTM can issue a notice to suspend. This provides an access holder 14 days' notice of DBCTM's intent to terminate the agreement.[126] At the end of the 14-day notice period, DBCTM can issue a notice of termination (effective immediately).

DBCTM proposes to seek a revenue cap adjustment process to account for unpaid access charges before the user agreement's termination date. DBCTM notes that Aurizon Network's 2010 access undertaking allows Aurizon Network to apply for a revenue cap adjustment when total actual revenue for a year falls short of system allowable revenue.[127]

DBCTM would determine the net losses incurred due to the access holder's non-payment prior to the termination of the user agreement. Consistent with the Review Event process in the 2015 DAU, DBCTM would seek QCA approval of the net-loss calculations and the proposed adjustment of the subsequent year's revenue cap. This approach will ensure DBCTM earns its return on and of capital, while avoiding a significant one-off true-up invoice[128]; this addresses any 'bill shock' that DBCTM's customers may experience.

Net-loss calculations would account for security deposits, bank guarantees and/or other measures that have offset the unpaid access charges, in order to address any revenue over-recovery concerns the QCA may have with DBCTM's proposal.

DBCTM notes that it can only seek to improve its credit protection (e.g. bank guarantees, parent company guarantees) when it consents to a new contract or to a change in counterparty for an existing contract. DBCTM is only entitled to request security if it is satisfied that the incoming counterparty is unlikely to be able to meet the financial obligations of the contract. DBCTM cannot seek additional security when the ownership of an existing contractual counterparty changes. Despite DBCTM's concerted efforts over the last year, it remains in dispute with five of its seven customers about requests for improved credit protection.

DBCTM has proposed drafting for the QCA's consideration in the definition of 'Review Event' in the revised 2015 DAU.

DBCTM Response 12.1

(1) DBCTM supports the QCA's acceptance of the 2015 DAU's definition of Notional Contracted Tonnage.

(2) DBCTM proposes a revenue-cap adjustment process to account for under-recovery of revenue relating to access charges between:

- **(a) the beginning of the period to which an access holder's unpaid invoice applies; and**
- **(b) the date at which the access holder has its access agreement terminated by DBCTM.**

12.3 SECTION 3 OF THE ACCESS UNDERTAKING

12.3.1 QCA'S DRAFT DECISION

DBCTM has engaged DBCT Pty Ltd (the Operator) to provide the whole of the operation and maintenance services at DBCT. DBCT Pty Ltd is owned by a substantial majority of DBCT users.

[126] Clause 14.2 of the SAA

[127] Part B, Schedule F, clause 3.2

[128] A true-up invoice would involve a one-off recovery of the net losses from other users. This may lead to 'bill shock'. DBCTM's proposal to amend the subsequent year's revenue cap would, however, spread the net-loss amount over a 12 month period.

The QCA's proposed changes to section 3 of the 2015 DAU are largely based on the ring-fencing changes proposed by DBCTM as a part of the Asciano transaction. Entrenching the Operator was perceived to be a key mitigant to the conflict issues created by vertical integration. Accordingly, section 3.2 of the QCA's mark-up of the 2015 DAU provided, among other things, that:

- DBCTM must maintain the Operating and Maintenance Contract (OMC) or a similar operating contract with a company that is owned by a majority of the users
- DBCTM be prohibited from terminating the OMC, other than where this contract would be replaced by substantially the same operating contract with a company that is owned by a majority of the users
- DBCTM be prohibited from amending or varying the OMC without approval.

In light of the fundamental change in the structure of the Asciano transaction (which is further described in section 9 of DBCTM's response), the QCA has sought feedback from stakeholders on whether the changes to section 3 of the 2015 DAU continue to be warranted.[129]

12.3.2 DBCTM'S RESPONSE

DBCTM's position is that none of the changes to section 3 in the 2015 DAU are appropriate, as discussed below.

Section 3 of the QCA's mark-up of the 2015 DAU minimises DBCTM's contractual freedom in respect of the OMC. DBCTM cannot address performance issues in respect of the Operator without QCA approval. This is despite the fact that operations at DBCT are ultimately DBCTM's risk.

Section 3 also practically entrenches DBCT Pty Ltd as the Operator of DBCT during the term of the undertaking. The QCA's changes to section 3 of the 2015 DAU remove any bargaining power which DBCTM could have. There is no other majority owned user company that DBCTM could contract with. The effect of the QCA's changes to section 3 is to make DBCTM captive to DBCT Pty Ltd. DBCTM does not consider this outcome appropriate.

In light of the change to the Asciano transaction, the reasons for seeking to constrain DBCTM's freedom in respect of the OMC no longer exist. It is not sufficient that the users (who on this point have a vested interest) wish to entrench the role of the Operator. That is not the commercial arrangement that DBCTM entered into when it purchased DBCT or when it recently renegotiated the OMC.

DBCTM therefore contends that the QCA's proposed changes to section 3 of the 2015 DAU are not appropriate. However, DBCTM recognises that DBCT users would like greater certainty around what happens if the OMC is terminated or expires. DBCTM's proposed drafting in respect of section 3 of the 2015 DAU attempts to address some of these concerns.

[129] QCA draft decision on 2015 DAU: 179

12.4 SECTION 4 OF THE ACCESS UNDERTAKING

12.4.1 QCA'S DRAFT DECISION

Section 4 in the 2010 AU was brief and acknowledged that DBCTM would provide coal-handling services at DBCT. The QCA has expanded section 4 in three ways, namely to:

- oblige DBCTM to provide the services in accordance with the undertaking, the user agreements and the terminal regulations
- acknowledge that DBCTM can subcontract coal-handling services a DBCT
- make DBCTM responsible for the acts and omissions of its subcontractors, including the Operator.

12.4.2 DBCTM'S RESPONSE

In DBCTM's view, the QCA's amendments to section 4 unintentionally and unreasonably change the risk profile agreed to under the user agreements and OMC. Should the QCA's final decision entrench the tenure of the Operator, it may be necessary to renegotiate the OMC. These negotiations would need to address the asymmetry in bargaining power between the incumbent Operator and DBCTM, and would need to be completed prior to DBCTM submitting a complying 2015 DAU.

The standard access agreement acknowledges that DBCTM is not liable for the acts and omissions of the Operator, other than to the extent (and then limited to the extent) that DBCTM can recover monies from the Operator.

The Operator has a very favourable risk profile, by industry standards, in the OMC. The OMC also provides the Operator with a high degree of autonomy.

Imposing on DBCTM obligations to provide the services in accordance with the user agreements and to be wholly liable for the acts and omissions of the Operator is inconsistent with the liability regime provided for in the user agreements and the OMC. The QCA's changes would give a user a right to sue DBCTM under section 4 on an unlimited basis and not through the agreed regime in the user agreements.

DBCTM does not consider this outcome to be an appropriate balance of the section 138(2) matters in the QCA Act. Accordingly, the QCA's changes to section 4 do not appear necessary. The obligation to provide the services best belongs in the user agreements themselves.

12.5 SECTION 6 OF THE ACCESS UNDERTAKING

12.5.1 BACKGROUND

Section 6 sets out a process to deal with amendments to the terminal regulations. It:

- limits the matters that the terminal regulations can relate to (being operational matters)
- obliges DBCTM to consult in relation to amendments
- specifies the circumstances in which DBCTM may consent to amendments to the terminal regulations
- provides users with a process to dispute amendments to the terminal regulations together with a binding outcome from the QCA.

12.5.2 QCA'S POSITION

The QCA has expanded section 6. In particular, it has proposed a regime for users to dispute a decision by DBCTM to consent to amendments to the terminal regulations and a dispute process under which the QCA can require DBCTM to consent or not to an amendment to the terminal regulations.

12.5.3 DBCTM'S RESPONSE

DBCTM does not consider that any of the QCA's amendments are appropriate (other than the acknowledgement that the terminal regulations are to relate to operational matters and that DBCTM will ensure that the terminal regulations are publically available). That is because the underlying reasons for the amendments (being the vertical integration issues created by the Asciano transaction) no longer exist. The process to amend the terminal regulations has worked effectively since the first access undertaking was approved. No concerns have ever been raised by the users or Aurizon in respect of the process to amend the terminal regulations (other than in respect of the Asciano transaction).

The QCA's amendments to section 6 are not required because the current process in relation to the terminal regulations provides adequate protection to the users. The only party that can propose amendments to the terminal regulations is the Operator (amendments are not proposed by DBCTM). DBCTM may not consent to amendments to the terminal regulations where they do not operate equitably. That test protects the two users that are not shareholders in the Operator.

The QCA's amendments to section 6 provide the users with disproportionate and unnecessary say over the terminal regulations. In particular, section 6 would provide the users with the ability to propose amendments to the terminal regulations and force consent through the dispute process. There is no reason to justify a change from the position that both DBCTM and the Operator should consent to the amendment.

Further, DBCTM notes that the QCA's amendments create conflict created between section 6 of the 2015 DAU and all existing user agreements. The drafting of section 6 should acknowledge that DBCTM cannot be required to consent to an amendment to the terminal regulations (including through a QCA decision) if to do so would put it in breach of a user agreement entered into before the date of the undertaking. This drafting is not reflected in DBCTM's mark-up of the access undertaking because DBCTM's position is that all of the QCA's proposed changes to section 6 should not be accepted (other than the acknowledgement that the terminal regulations should only relate to operating matters).

12.6 OTHER SECTIONS OF THE ACCESS UNDERTAKING

DBCTM has not accepted the QCA's proposed amendments to:

- Section 1.2 and Schedule E (clauses 10 and 11) – this is because the amendments relate to the ring-fencing arrangements. Section 9 of this response explains that these amendments are no longer necessary because of the change in the structure of the Asciano transaction.
- Section 1.7 – This is because these changes relate to differential pricing provisions which DBCTM propose to include as a new Schedule J to the 2015 DAU.

12.7 2015 SAA

DBCTM seeks two key changes to the Standard Access Agreement (SAA), namely that:

- the provision relating to terminal regulations should be modified to reflect the QCA's final decision on the 2015 DAU's terminal-regulation provisions (clause 3.6)

- a change of control of a user should be treated as an assignment (which requires consent). Without protection against a change of control, DBCTM could be exposed to a change in user without DBCTM having a say over who that new user is (clause 12.3).

DBCTM has also proposed alternative drafting for the following sections:

- in clause 20 (Options) DBCTM has retained the 15 year access agreement term before the option applies (in lieu of the 10 year term proposed by the QCA).
- also in clause 20, DBCTM has amended subclause (e) so that if it calls for the early exercise of an option to extend the user agreement to determine whether an expansion is required to accommodate access applications and the user exercises its option to extend, then the exercise of the option is final. The QCA had proposed amending the clause in the way that the Users have requested in the past. However, if DBCTM accepts the amendment, the Users would be able to "take back" the early exercise of an option to extend, even if DBCTM has based a decision to expand on the exercise of the options. Also, the clause is not workable as drafted, as it will not be possible for DBCTM to enter an access agreement with an access seeker within the 90 day period as required if all users exercise their options to extend (resulting in no spare capacity to offer).
- DBCTM has not accepted the proposed change to clause 29(b), which would mean that DBCTM is only permitted to ask for additional security for a materially increased risk that the user will cease to be of good financial standing where the agreement concerns access to a Differentiated Expansion Component. This change was included in square brackets by the QCA and its intent is unclear. Under the current user agreements, DBCTM has the right to request additional security if in its opinion, there is a material increase in risk that any user will cease to be of good financial standing.
- DBCTM has not accepted the changes in Schedule 3 (including the "Standards for Services" amendments which were the same changes as the QCA made to Schedule E of the DAU).
- in schedule 9, DBCTM has amended:
  - the definition of "Agreement Revision Date" to refer to the QCA's decision on whether an expansion is to be differentiated or socialised under section 12.5(h) of the AU rather than section 5.12 (necessary for the definition to be consistent with the amendments to the DAU)
  - the definition of "Existing Terminal" to refer to the definition now in Schedule J of the DAU.
- DBCTM has not accepted the QCA's amendments to the definition of "Terminal Regulations" (the definition remains the same as the definition proposed in the DAU).

APPENDIX A: RELEVANT PROVISIONS IN THE PSA

This appendix has been removed

APPENDIX B: UPDATE FROM FINITY ON ANNUAL REMEDIATION ALLOWANCE

File Note

From Mark Hurst and Danielle Casamento

Date 1 July 2016

Subject Annual Remediation Charge | Revised Results

Introduction

Finity Consulting (Finity) have been asked to update our estimate of the annual charge required to fund Dalrymple Bay Coal Terminal Management's (DBCTM) potential future obligation to remediate the Dalrymple Bay Coal Terminal site. This is being assessed as part of its five yearly review by the Queensland Competition Authority (QCA), under the *Queensland Competition Authority Act 1997* (the QCA Act).

The current Access Undertaking (AU) expires on 30 June 2016 with the next AU applying for the five year period 2016/17 to 2020/21.

This note follows from our previous advice as documented in our report titled 'Review of Dalrymple Bay Coal Terminal Remediation Charge' dated 24 September 2015 and is in response to QCA's Draft Decision dated April 2016.

Results

Nature of estimates

We note the nature of the estimates shown in this file note is unchanged from our previous advice. More specifically, estimates are net of tax, include an allowance for inflation, take into account interest at the specified WACC rate and assume that there will be no major future developments to the DBCT.

Approach

Our annuity based approach is unchanged from the previous review. However, we have assumed DBCTM recovers the total annual redemption allowance on average in the middle of each year rather than at the beginning of each year. This is in response to QCA's proposal documented in Section 6.5 'Timing of payment each year' of the Draft Decision.

Assumptions

Our revised estimate of the annual remediation charge is dependent on several base case assumptions:

- The rate of inflation – assumed to be 2.5% per annum. This is the CPI rate that the RBA targets over the long term [no change to previous advice].

- The applicable interest rate – assumed to be 6.21% per annum. This is the future WACC rate used to accrue the sinking fund, and our estimated annual remediation charges, to the year of remediation. This compares to a WACC rate of 6.10% per annum recommended in QCA's Draft Decision [7.46% per annum in previous advice].
- Timing of remediation – assumed to be in 35 years' time from 30 June 2016. This corresponds to 30 June 2051, three months prior to the termination of DBCTM's terminal lease agreement with the Queensland Government. This assumption has been adopted for modelling purposes as requested by DBCTM. The QCA recommended a time to remediation of 38 years related to the economic life of the terminal. It is our understanding that DBCTM request that the QCA consider their recommendation for a 35 year term, as a 38 year term is beyond the timeframe of the current lease agreement [mean term of 32 years in previous advice].
- Cost of remediation - assumed to be $389.69 million in December 2015 dollars as assessed by Turner & Townsend. This cost is equivalent to $395.53 million in current 30 June 2016 values [$847 million in 30 June 2016 dollars in previous advice].
- Size of the current notional sinking fund – calculated to be $20.8 million as at 30 June 2016. This compares to a notional sinking fund of $21.3 million at the previous review. We have maintained our previous approach of accruing the current annual remediation allowance of $952,710 at 9.02% per annum from 2005 to 2010 and 9.86% per annum from 2010 to 2015. However, we have now assumed remediation charges are collected on average half way through the year rather than at the beginning of the year.

Summary of Results

Our estimates of the annual remediation charge under the base case and alternative scenarios (as provided by DBCTM) are shown in Table 1. For each scenario, we have shown the underlying assumptions and the total estimated costs at the time of remediation.

Table 1 – Summary of results

	Base Scenario	Scenario 1 (Longer Term to Remediation)	Scenario 2 (10% Increase in Estimated Costs)
Total Estimated Costs ($m, June 2016 values)	395	395	434
Inflation Rate	2.5%	2.5%	2.5%
Interest Rate	6.21%	6.21%	6.21%
Number of Years until Remediation	35	38	35
Total Estimated Costs ($m, at time of Remediation)	936	1008	1030
Annual Remediation Charge ($m)	**6.4**	**5.5**	**7.1**
Multiple of Current Remediation Allowance	7	6	8

The above table shows that:

- Our Base Case scenario results in $6.4 million per annum remediation charge. This is 7 times the current remediation charge of $952,710.

- Increasing the term to remediation to 38 years (Scenario 1) gives an estimated annual remediation charge of $5.5 million. A term to remediation of 38 years from 30 June 2016 corresponds to remediation date of 30 June 2054, consistent with QCA's view of the economic life of the terminal as stated in the Draft Decision.
- Increasing the total estimated costs of remediation by 10% to $434 million in June 2016 values (Scenario 2) gives an annual remediation charge of $7.1 million. The increased cost assumes QCA re-estimates the remediation cost to comply with technical requirements of the Port Services Agreement (PSA), which Connell Hatch has estimated could be around an additional 10%.
- These estimates compare to:
  - our previous proposed annual remediation allowance of $12.8 million. Our revised annual remediation allowance under the base case is $6.2 million lower than our previous estimate, largely due to a lower cost to remediate the site and a shorter term to remediation.
  - a proposed annual remediation allowance of $5.7 million recommended by the QCA; assuming an interest rate of 6.10% per annum and a term to remediation of 38 years.

Over time, at each regulatory reset, the annual remediation charge should be reviewed to take into account the latest available information regarding interest rates as well as timing and cost of remediation.

Reliance's and Limitations

We have relied on the accuracy and completeness of all data and other information (qualitative, quantitative, written and verbal) provided to us for the purpose of this advice. We have not independently verified or audited the data but we have reviewed it for general reasonableness and consistency. It should be noted that if any data or other information is inaccurate or incomplete, we should be advised so that our advice can be revised, if warranted.

It is not possible to estimate the annual amount needed to remediate the DBCT with certainty. As well as difficulties in knowing the timing and cost of remediation, outcomes remain dependent on future events, including legislative, political, environmental, social and economic forces. In our judgement, we have employed techniques and assumptions that are appropriate, and the conclusions presented herein are reasonable, given the information currently available. However, it should be recognised that the annual amount required will likely deviate, perhaps materially, from our estimates.

This advice has been prepared for the sole use of DBCTM for the purpose stated in the Introduction. It is not intended, nor necessarily suitable, for any other purpose. Members of Finity staff are available to answer any queries, and the reader should seek that advice before drawing any conclusions or any issues in doubt. The report should be considered as a whole.

We understand that DBCTM may wish to provide a copy of this advice to the QCA. Permission is hereby granted for such distribution on the condition that the entire report, rather than any excerpt, is distributed. No other use of, or reference to, this report should be made without prior written consent from Finity Consulting, nor should the whole or part of this report be disclosed to any other person.

Third parties, whether authorised or not to receive this report, should recognise that the furnishing of this report is not a substitute for their own due diligence and should place no reliance on this report or the data contained herein which would result in the creation of any duty or liability by Finity to the third party.

APPENDIX C: LETTER FROM DBCT HOLDINGS ON DIFFERENTIAL PRICING

This appendix has been removed