QR 2020 DAU – West Moreton Pricing

19 December 2019

Cameby Downs Mine

YANCOAL

兖煤澳大利亚有限公司

Contents

1 Executive Summary

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

It responds specifically to:

(a) the QCA's 'West Moreton coal pricing approach discussion paper' of 24 October 2019 (the ***QCA Paper***); and

(b) QR's submission of 22 November 2019 (***QR Low Volume Tariff Submission***).

1.2 A building blocks price is not affordable

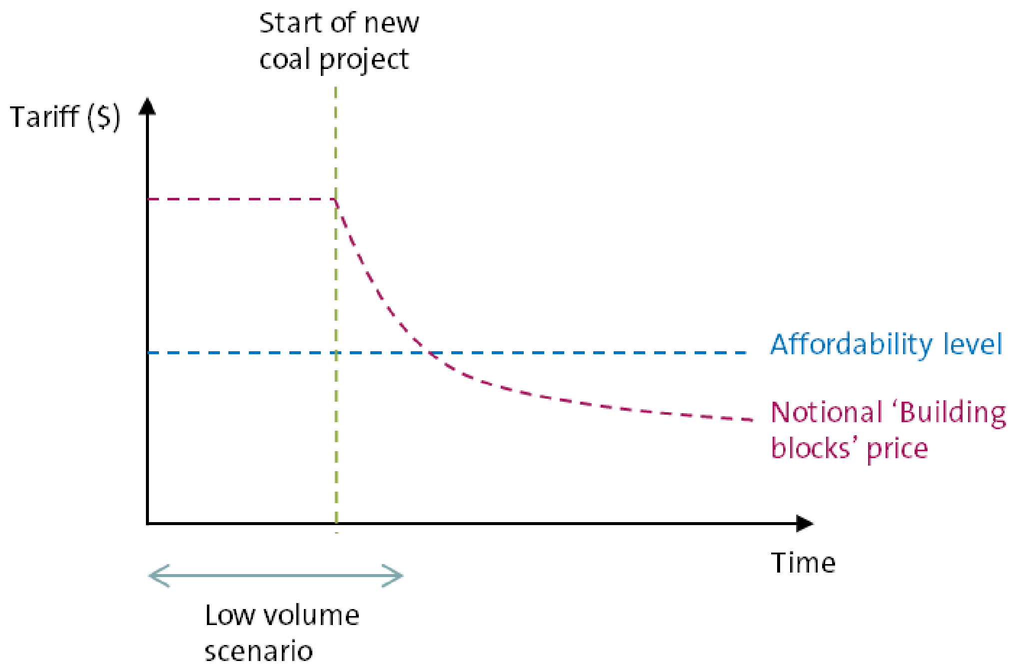
Yancoal has provided views on the issue of the appropriate approach to West Moreton tariffs in the 'low volume' scenario previously, both:

(a) in the process considering QR's 2020 draft access undertaking (the ***2020 DAU***) – including through Yancoal's 11 July and 27 September 2019 submissions made since the QCA's Draft Decision on the 2020 DAU (the ***Draft Decision***); and

(b) in the process considering QR's 'Review Event' and reference train service draft amending access undertaking, including through Yancoal's 22 October 2019 submission.

However, Yancoal acknowledges that the delays in approvals for New Acland Stage 3 have now reached the point where, for at least the initial part of the term of 2020 DAU, it is clear that a 'low volume scenario' will eventuate. It is equally clear that a traditional building blocks approach to determining pricing at that volume would result in tariffs substantially in excess of what is affordable.

There remains hopes of volumes returning part way through the 2020 DAU term and the notional price which would be derived from a building blocks approach thereby returning to below the affordability level (potentially producing a profile like that shown below).



However, it is critical to the prospects of volumes recovering like that in the future, that pricing is set at a level that is affordable for Cameby Downs (as the remaining coal producer) in the meantime.

The QR Low Volume Tariff Submission acknowledges that is the case, such that the main issue the QCA needs to determine in setting the tariff is the level of affordability.

1.3 Commercial negotiations cannot be relied on to produce an affordable tariff

While a negotiate/arbitrate model was raised in the QCA Paper, it is not supported by either Yancoal or the QR Low Volume Tariff Submission (or to Yancoal's knowledge any other stakeholder).

Yancoal is strongly of the view that the only way that an affordable tariff will arise is through the QCA setting a reference tariff at the level of affordability. That is the case as:

(a) Cameby Downs has an existing access agreement which automatically involves QR charging reference tariffs through to [redacted] and

(b) there is no evidence to suggest that QR has the incentive or ability to agree affordable access charges with Cameby Downs or future access seekers.

While, in the abstract, it might be assumed that a monopolist with a low volume outlook might be incentivised to provide an affordable tariff to retain or grow volumes, the evidence does not reflect that being likely to occur. In particular:

(i) while Yancoal's initial submissions in the 2020 DAU process expressed hope that Yancoal would be able to commercially negotiate an affordable tariff with QR in a 'low volume' scenario, attempts to do so have failed;

(ii) both parties have now requested a QCA approved reference tariff instead;

(iii) significant traffic has been lost from the West Moreton network including non-reference tariff grain volumes (for which it has always had pricing discretion) and the Wilkie Creek volumes, without any evident attempt by QR to changes its pricing to retain that volume; and

(iv) QR has now submitted both a review event submission and the QR Low Volume Tariff Submission seeking tariffs well above affordability levels.

1.4 Need to correctly estimate the affordability level

Both Yancoal and the QR Low Volume Tariff Submission support the QCA determining a reference tariff that is affordable for Cameby Downs.

However, the QR Low Volume Tariff Submission asserts that a tariff of $25.72/'000tk is affordable. That is based on some clear misconceptions about the likely profitability of Cameby Downs across the term of the 2020 DAU.

As demonstrated in this submission, when actual cost figures and reliable future revenue projects are utilised, a tariff that reflects prevailing tariff levels is needed to be affordable for Cameby Downs.

1.5 An affordability based tariff needs to be part of an appropriate wider framework

Where an affordability based reference tariff is adopted, Yancoal is willing to support other measures as part of a broader regulatory framework to ensure the approach is appropriate for all stakeholders including:

(a) a limited life loss capitalisation model to provide QR the prospect of recovering the difference between the affordability based tariff and what it would have earned under a notional 'building blocks' price (calculated based on appropriate WACC parameters and a reassessment of cost allowances) once volumes sufficiently recover in a reasonable timeframe; and

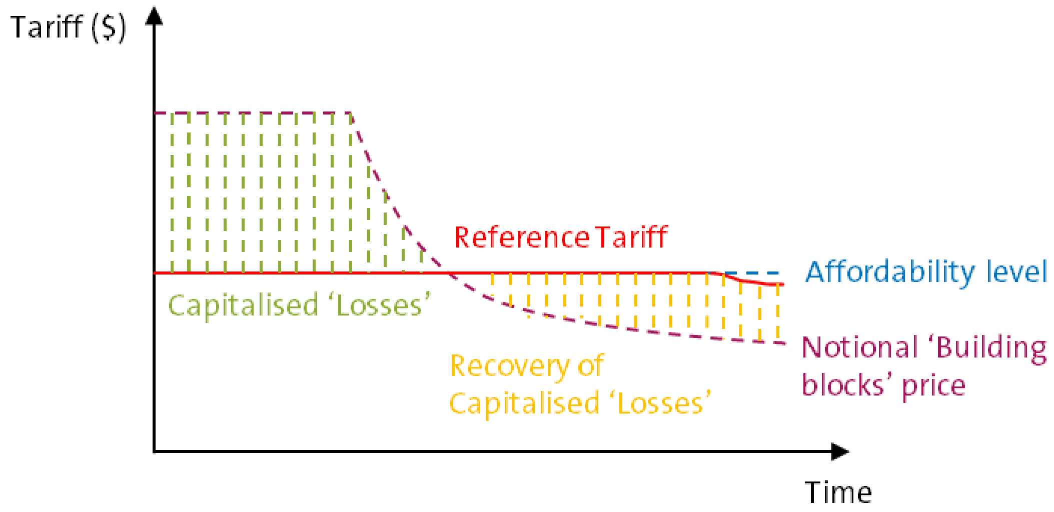
(b) if the QCA considers it appropriate, QR having the ability to negotiate access charges at lower levels for future volumes during the term of the 2020 DAU to enhance the prospects of greater volumes on the network (subject to arrangements that ensure that is appropriately taken into account in the loss capitalisation calculation and done in a way that is equitable for access holders paying reference tariff based charges).

Accordingly, in addition to responding to the QR Low Volume Tariff Submission and the specific questions in the QCA Paper, Yancoal has used this submission to set out, in detail, its proposal for an appropriate tariff regime for the West Moreton system, and how that compares and contrasts to the framework proposed in the QR Low Volume Tariff Submission.

2 Overview of Yancoal's Proposal for Appropriate Tariff Setting

2.1 Reference Tariff and Loss Capitalisation Methodology

Yancoal considers the appropriate West Moreton regulatory price setting would encompass an arrangement like that depicted below (assuming future volumes recover):



Yancoal considers the key characteristics of an appropriate model for West Moreton pricing are:

(a) **a reference tariff that is set at existing tariff levels – as the affordable level for Cameby Downs** (as the remaining West Moreton user). This will be below the pure 'building blocks' based tariff', but is critical to preventing closure of Cameby Downs and keeping alive the prospects of volumes returning in the future;

(b) **a notional 'building blocks' price continuing to be calculated for the purposes of identifying the volume of capitalised 'losses'** (as typically constituted by the difference between the access revenue achieved by QR and that which would have been achieved if the notional 'building blocks' price was charged);

(c) **that notional 'building blocks' price being estimated based on a complete reassessment of**:

(i) **the efficient allowances for operations and maintenance costs based on the lower volumes anticipated**; and

(ii) **the efficient capital expenditure based on the lower volume anticipated**, taking into account the extent to which capital projects should be deferred and the existing regulatory asset base should be optimised;

(d) **an adjustment of the notional 'building blocks' price where volumes on the West Moreton network increase;**

(e) **where volumes recover to the point that the notional building blocks price falls below the affordability level, the reference tariff would stay at the affordability level to allow QR to recover previously capitalised 'losses', subject to:**

(i) **a 5 year limited life capitalisation methodology**, as proposed in the QCA's Draft Decision, to prevent capitalised losses ballooning to unsustainable levels if there is a long period before volumes recover;

(ii) **a maximum 10% cap on the premium that can be recovered above the notional 'building blocks' price** – as part of striking a balance between allowing recovery of capitalised losses and seeking to ensure that a continued affordability based tariff does not disincentivise new investment in future West Moreton coal production; and

(iii) **optimisation of the regulatory asset base to occur if volumes have not materially recovered by the end of the 2020 access undertaking term**.

2.2 Comparison to QR Proposal

To assist in understanding the submissions that follow, the table below sets out Yancoal's understanding of the comparison of Yancoal's position to that proposed in the QR Low Volume Tariff Submission.

First, it is important to note there is some key elements of consensus between QR and Yancoal. In particular, there is clear agreement between Yancoal and QR that:

(a) the appropriate form of regulation is a QCA approved reference tariff – set at a level that is affordable for Cameby Downs; and

(b) given the potential for volume to return, that it is appropriate to include a loss capitalisation methodology.

Yancoal urges the QCA to adopt that approach rather than other alternatives considered in the QCA Paper.

There is obviously a range of differences, particularly in relation to what constitutes an affordable tariff, details of the loss capitalisation methodology, and the appropriate parameters for calculating the building blocks based tariff as summarised below:

Issues	Yancoal position	QR Low Volume Tariff Submission
Form of regulation (reference tariffs vs negotiate/arbitrate)	QCA approved reference tariffs	
How reference tariffs are set (affordability vs building blocks)	Tariffs set at level that is affordable for Cameby Downs	
Affordability level	Prevailing reference tariffs	$25.72/'000 gtk
Loss capitalisation	Loss capitalisation calculated by difference between access charges (based on affordable reference tariff) and notional building blocks based charges	
Limits on loss capitalisation / Optimisation	Limited life capitalisation (depreciated over 5 years as per QCA Draft Decision) Optimisation if volumes have not materially returned by end of 2020 DAU term	No limits on loss capitalisation (to be recovered across multiple terms) No optimisation
Recovery as volumes rise	Recalculation of building blocks price as volume rises. If volumes rise to the point that the building blocks price is below the affordable reference	Draft amending access undertaking to be submitted to revise tariff if volumes >4.1 mtpa Cap on permitted loss recovery premium above building blocks to

	tariff, reference set is set at the lower of the affordability point or building blocks plus 10% loss recovery premium	be set as part of draft amending access undertaking.
Building blocks – Opex, maintenance, capital allowances	Should be fundamentally reviewed, with likely reductions and deferrals given uncertainty of future volume outlook	Minor reductions and deferrals. No major change in asset or operating strategy appropriate given likelihood of volume returning. Estimated annual capitalised losses
Building blocks elements – WACC, allocation of coal	No less favourable than as proposed in the QCA Draft Decision	Other key components as per previous QR submissions
Charges below reference tariff	Willing to support subject to appropriate protections to ensure it reduces / does not exacerbate capitalised losses and is supplemented with measures to preserve equity for existing access holders paying reference tariff based charges	Not specifically addressed in the QR Low Volume Tariff Submission

3 The context of the 'low volume' scenario

In determining the appropriate regulatory framework it is important to be clear about what the 'low volume' scenario actually involves.

3.1 Status of New Acland Stage 3 Project

As is a matter of public record (and as discussed in QR's review event submissions), New Hope has not yet received the mining lease or associated water licence required for it to commence development of the New Acland Stage 3 project.

Yancoal understands that the Oaky Coal Action Alliance has applied for special leave to appeal to the High Court in relation to the latest Queensland Court of Appeal decision in relation to the project, such that further delay in obtaining those approvals is likely.

It is also evident from New Hope's actions, including in granting redundancies, reducing its contracted access rights, being reported to have notified domestic customers it would cease supply from June 2020 and [redacted] that New Hope's coal volumes are now definitely declining.

There would also be anticipated to be a period of time from receiving approvals before first coal production from New Acland Stage 3 would commence (for construction and preparation activities).

Accordingly, Yancoal's understanding is that based on the time it would take for the New Acland Stage 3 project to ramp up to full production levels, it is likely that we are now past the point where, even if the approvals were granted immediately, New Hope would be able to continue material production from its existing mining lease while that project is developed.

The current status of the New Acland Stage 3 project therefore confirms the importance of West Moreton pricing being set in a way which meets the dual purpose of:

(a) being affordable for Cameby Downs for as long as there is no production from New Acland; and

(b) incentivising contracting of future volume for this project if it is developed (or an expansion of Cameby Downs or any other new project).

3.2 Affordability for Cameby Downs is required for the tariff to be appropriate

It follows from the above that a low volume scenario is likely to reflect a 2.1 mtpa production scenario in which, at least for the initial part of the 2020 DAU term, Cameby Downs is the only West Moreton coal mine that remains in operation.

Consequently, the affordability of the access charges *for Cameby Downs* in this scenario is absolutely critical to the economic viability of the West Moreton coal supply chain. If access charges are not affordable for Cameby Downs such that Cameby Downs will cease production, either:

(a) the West Moreton network will close; or

(b) the State will have to fund millions of dollars that are currently commercially funded by coal access rights on the West Moreton and Metropolitan network in order to keep the line open (over $100 million based on QR's most recently published below rail financial statements).

A tariff that is not affordable for Cameby Downs will strand QR's investment in the network and, even if the State kept the line open for the minor use by other traffics, QBH's investment in its Port of Brisbane coal terminal and Aurizon's investment in rolling stock specific to the West Moreton coal haulage task would be stranded. An unaffordable tariff for Cameby Downs is clearly not appropriate in those circumstances.

By contrast, if access charges are affordable such that Cameby Downs will continue production, then it creates the potential for volumes on the line to recover, most likely through an expansion of Cameby Downs and/or New Hope's investment in New Acland Stage 3 project following receipt of approvals.

As a result, appropriateness in a low volume scenario is clearly a function of affordability *for Cameby Downs* – not a tariff derived from a building blocks methodology (that might provide appropriate pricing at higher long term volume levels). The QR Low Volume Tariff Submission confirms QR's agreement with that position, such that this is not anticipated to be contentious.

However, for completeness, further analysis of why an affordability based tariff is appropriate for inclusion in the 2020 DAU having regard to the factors in section 138(2) of the *Queensland Competition Authority Act 1997* (Qld) is included in Schedule 1.

3.3 At an affordability based tariff – Yancoal (not just QR) is bearing risk

The QR Low Volume Tariff Submission notes that, under a loss capitalisation model, QR is taking 'all risk on future demand'.

Yancoal acknowledges that QR is assuming a reasonable degree of risk in relation to future volumes, but that is also clearly appropriate in these circumstances. Yancoal strongly agrees with the conclusion in the Draft Decision on the 2020 DAU that *'it is not reasonable to expect the current customers to have an unlimited obligation to underwrite what is, in effect, Queensland Rail's long-term business development plan*.' It is not appropriate for Yancoal, to bear all of the volume risk of other users which it has no ability to control or mitigate or even respond to in the way QR can (through different pricing approaches, deferring expenditure and reducing operating and maintenance costs).

However, it should not be forgotten that by paying an affordability based tariff, Yancoal is by definition paying a tariff that leaves Cameby Downs as, at best, being a very marginal project until volumes return. In fact, assuming existing tariff levels (which Yancoal is willing to accept as affordable), [redacted].

Yancoal would not invest in a project today based on such an outlook, and the decline in volumes is not an outcome of any act or omission of Yancoal. Accordingly, it is evident that Yancoal is also bearing a significant portion of the volume risk.

4 It cannot be assumed that an affordable tariff will be negotiated

The QCA Paper appears to suggest that a possible approach to achieve an affordability based tariff would be to set a reference tariff based on the traditional building blocks methodology as a ceiling price, with the intention of QR being able to negotiate access charges below that level.

It is noteworthy that neither QR or any other stakeholder has supported that approach.

Yancoal considers it would be flawed to assume that the parties would be able to resolve an affordable tariff through commercial negotiations given the drastic consequences of tariffs not being set at an affordable level.

That follows for three key reasons:

(a) as discussed in the responses to the QCA Questions in Schedule 3, Cameby Downs will contractually be automatically obliged to pay the reference tariff under its existing access agreement;

(b) all past evidence suggests that QR will not have the incentive or ability to negotiate affordable pricing with Cameby Downs or any future access seeker to retain or promote greater volumes on the West Moreton network; and

(c) there is no reason to suggest that position is likely to change in the future.

Further analysis of those reasons is set out in Schedule 2.

5 An affordable reference tariff is preferable to relying on arbitration

The remaining question is whether an affordable tariff is better achieved through a reference tariff (as supported by Yancoal and the QR Low Volume Tariff Submission) or arbitration (as raised in the QCA Paper).

Yancoal considers that an affordability based reference tariff is highly preferable as:

(a) arbitration will introduce unnecessary cost and expense for individual access holders and access seekers (which are highly likely to eventuate given the very low prospects of a commercial resolution based on the evidence discussed in Schedule 2);

(b) a reference tariff will ensure there is affordable pricing for additional access which it would not make commercial sense to arbitrate in respect of (such as ad-hoc services or temporary additional services for a surge in production) – which should be incentivised;

(c) the QCA has already given significant thought to tariff arrangements in this undertaking; and

(d) an affordable tariff will send a much clearer investment signal than a theoretical avenue to reasonable pricing via arbitration.

However, for the reasons set out in Schedule 3, if the QCA was (contrary to both QR and Yancoal's submissions) to consider adopting a building blocks based reference tariff, then Yancoal strongly feels that no reference tariff would be preferable due to the automatic passing through of such an unaffordable reference tariff under Yancoal's existing access agreement.

6 What is the level of affordability for Cameby Downs?

6.1 Cameby Downs affordability

While stakeholders are agreed that the appropriate reference tariff is one set at the level of affordability for Cameby Downs, Yancoal acknowledges there is a material gap between what QR and Yancoal consider reflects that level of affordability.

Yancoal agrees with the QCA's assessment in the Draft Decision that the current tariff levels can be assumed to be economically viable.

However, it strongly considers that further tariff increases above that level will not be affordable, and that the QCA's Draft Decision was correct to conclude:

that the price derived for the high-volume scenario should form the basis of the price at lower volumes as well.

Based on QR's July 2019 submission (referred to in the QR Low Volume Tariff Submission again), QR's view of higher charges being affordable for Cameby Downs is based on:

(a) a projection of the global thermal coal Newcastle FOB (6,000 kCal) price (at $96 AUD), fixed for the entire term;

(b) an assumption that Cameby Downs production can be sold at the level of that index, [redacted]

(c) an assumption of 0.77 USD:AUD exchange rate, fixed for the entire term; and

(d) AME's estimate of Yancoal's costs.

Some of those represent unreasonable assumptions, and relying on those fixed assumptions to set a 5 year affordability level clearly gives rises to the risk that if those assumptions prove to be overly optimistic, the tariff will quickly become unaffordable for Cameby Downs (which has been accepted by all parties and demonstrated in this and previous Yancoal submissions to be inappropriate).

The below graph provides Yancoal's forecast of profitability (being the same graph provided in Yancoal's recent review event submissions), if it is assumed that current tariff levels are accepted as the level of affordability (as proposed by Yancoal).

That graph is based on Cameby Down's actual cost profile and current coal sales revenue projections, rather than a set of artificial assumptions. If anything, the coal sales revenue projections are now looking increasingly bullish as the spot thermal coal price has continued to fall since this data was first provided to the QCA.

It evidences the clear economic challenges presented by even the current tariff levels for Cameby Downs.

[redacted]

As demonstrated, even at prevailing tariff levels, [redacted]

Yancoal has previously submitted that it therefore considers that the prevailing tariff levels (prior to QR's asserted review event) should be regarded as setting the absolute ceiling on the ability to pay of West Moreton users, and that remains Yancoal's view based on the latest cost and revenue projections available to it.

While Yancoal would obviously desperately like the tariffs to be lower [redacted] Yancoal accepts the QCA's view that current tariff levels are 'affordable' in the sense that Yancoal anticipates continuing to produce and continuing railing at that pricing. [redacted]

However, by contrast, if the $25.72/'000 gtk tariff level proposed by QR (or even their lower $21.81/'000 gtk proposal) is assumed, it [redacted] risks a cessation in production.

By definition, a tariff that produces significant sustained losses of that magnitude and risks closure as a result is clearly not affordable or economically viable.

QR has not provide any new information in the QR Low Volume Tariff Submission to demonstrate why the $25.72/'000 gtk tariff is affordable and where, by contrast, Yancoal has provided clear evidence of the losses it would make at prevailing tariff levels (let alone at the tariff level QR proposes), it cannot be appropriate to assume that QR's tariff proposal would be affordable.

6.2 Relevance of QR's cash costs

Even the QR Low Volume Tariff Submission seems to implicitly accept that what QR is really seeking is recovery of its asserted cash costs – not the $25.72/'000 gtk suggested. For example, the QR Low Volume Tariff Submission seeks as a key principle.

An opening reference tariff being set at a level that recovers at least Queensland Rail's 'cash costs' ie. Operating and maintenance costs of providing coal services in any year.

QR then goes on to claim its cash costs would be recovered at a reference tariff level of $21.81/'000 gtk.

Yancoal appreciates that its level of affordability at prevailing tariff levels ([redacted]) is below what QR claims in the QR Low Volume Tariff Submission reflects their cash costs of operations and maintenance costs. However, it is important to note that QR's claims of its cash cost levels are:

(a) based on QR's own view of costs in the context of:

  (i) QR largely rejecting most of the recommendations from the QCA's consultant Systra in relation to how costs could be reduced to more efficient levels; and

  (ii) the QCA not yet having undertaking the required re-evaluation of what constitutes efficient operating and maintenance costs at the 2.1 mtpa now envisaged; and

(b) a direct result of QR having too high a proportion of fixed costs, which would be anticipated to change over time if the decline in volume becomes sustained – such that any deficit will be short lived (as either volumes will recover or an efficient operator would rapidly restructure their cost profile).

Accordingly, Yancoal considers that, properly assessed, QR's prudency and efficient cash costs will be much closer to the affordability level for Cameby Downs.

In addition, Yancoal sees no reason why it is appropriate to set tariffs at a level in which QR is fully recovering its cash costs when Cameby Downs is not. That would result in insulating to a greater degree the party (in QR) that has the greater ability to mitigate its costs and take other actions to facilitate demand, and requiring the party (in Yancoal) which has no way of mitigating or managing volume risks arising from the business of other coal producers to absorb greater losses as a result.

Given the extensive adverse impacts which can arise by over-estimating affordability for Cameby Downs, it is important that there is very clear evidence of affordability of any increase beyond existing tariff levels – and the QR Low Volume Tariff Submission and previous QR submissions do not provide that.

Accordingly, Yancoal considers that even if it was determined that QR's efficient cash costs are at a level which would not be wholly recovered an the affordability level of existing reference tariffs, the existing tariff levels remains the appropriate level for the DAU 2020 reference tariffs.

7 Appropriate Features of Loss Capitalisation Methodology

QCA Question: What features of a loss capitalisation approach are required so that it suits the nature of the West Moreton asset and the market for access?

7.1 Overview

As noted earlier in these submissions, given there is currently reason to believe that volumes may increase during the 2020 DAU term, Yancoal is supportive of implementing an appropriate loss capitalisation methodology.

Yancoal's views remain consistent with the key positions expressed in its 11 July submission:

> *Yancoal is, in principle, willing to support some degree of loss capitalisation.*
>
> *However, Yancoal remains concerned that an inappropriate loss capitalisation methodology has the potential to result in deterring new entry.*
>
> *As the Draft Decision accurately states:*
>
> *unfettered loss capitalisation where volumes remain low could produce an onerous barrier to entry for future access seekers, should the price required for Queensland Rail to recoup a large accumulated loss be more than they are willing to pay … loss capitalisation, if it was to be used for West Moreton, would need to be appropriate constructed to suit the nature of the asset and the market for access.*
>
> *Accordingly, Yancoal is supportive of the QCA's proposal for a limited life capitalisation as an appropriate method of balancing the competing interests of revenue adequacy in the short term and long term facilitation of increase volume, and ensuring that if volumes do not return the capitalised losses are effectively written off.*

In particular, while Yancoal is willing to accept loss capitalisation where there is a reasonable prospect of volume recovering, that needs to be combined with:

(a) a limited life (Yancoal supports the QCA's 5 year accumulation / 5 year depreciation proposal as appropriate), such that if volumes are not recovering, the loss capitalisation does not cause an ballooning level of capitalised losses resulting in a long term 'hang-over' that hinders prospects of volume recovering;

(b) an appropriately calculated building blocks based reference tariff against which the losses to be capitalised are calculated (i.e. based on significantly different cost allowances than would have been provided for higher volumes as discussed in section 8.1 below); and

(c) a recognised end point at which it is determined whether volumes have not sufficiently recovered (Yancoal supports the end of the 2020 DAU term) such that optimisation is appropriate – as this will strongly incentivise QR to facilitate additional volume recovery and prevent the disincentives for future access seekers that would otherwise arise from ballooning uncapitalised losses.

7.2 Ensuring that new volume is not disincentivised

Yancoal's greatest concern with loss capitalisation is that, if it is not implemented in an appropriate way, it will serve as a disincentive for the very volume recovery that a return to a traditionally building blocks calculated tariff (that works for all parties) requires.

A large capitalised loss built up through a delay in volumes returning, or the risk of accelerated future recovery of such losses, has the potential to create a significant chilling effect on investment in West Moreton coal projects. That is the case, because such a large capitalised loss indicates that any new project will receive barely 'affordable' tariffs that will make them at best marginal until the loss is recovered.

There are two requirements to ensure that does not occur.

Firstly, the tariff must be set in a way that is affordable , both initially (i.e. at prevailing tariff levels) and on an ongoing basis. Consequently, when volumes have returned to the point that a building blocks based tariff would fall below the affordability threshold, any premium applied above a building blocks price following volume returning must be capped such that:

(a) the premium does not increase beyond the affordability level – noting the QR Low Volume Tariff Submission appears to accept that position; and

(b) as discussed in section 7.4 below, there is a cap on the premium which can be applied to the notional building blocks tariff – such that existing access holders which have borne the pain of an 'affordable tariff' at some point can share in the relief arising from returning volume.

Second, there needs to be clear mechanisms to prevent capitalised loss being a long term barrier to entry where volumes recover slower than QR is anticipating (or do not recover at all). Yancoal considers this requires:

(c) a 'limited life' to the capitalised losses (with the QCA's 5 year accumulation / 5 year amortisation profile providing an appropriate timeframe aligned to 2 regulatory terms); and

(d) if by the end of the 2020 DAU term volumes have not materially increased, an end to loss capitalisation and optimisation of the regulatory asset base such that a building blocks tariff would become affordable in the future (as in those circumstances it will be clear that there is a sustained decline in demand and optimisation will clearly not be premature).

Without those elements, Yancoal considers that loss capitalisation would be self-defeating and not be appropriate.

Yancoal acknowledges that QR is not supportive of the limited life component of the loss capitalisation methodology. However, the QCA's Draft Decision correctly identifies why that is appropriate here:

> *However, unfettered loss capitalisation where volumes remain low could produce an onerous barrier to entry for future access seekers, should the price required for Queensland Rail to recoup a large accumulated loss be more than they are willing to pay. Loss capitalisation is typically used in the case of lumpy assets such as dams, where there is a reasonable expectation that demand will build over time to a level where the capitalised losses can be recouped.*
>
> *West Moreton has different demand characteristics. Therefore loss capitalisation, if it was to be used for West Moreton, would need to be appropriately constructed to suit the nature of the asset and the market for access.*
>
> *…*
>
> *However, the QCA is also proposing that the capitalised losses have a limited life, to prevent the accumulated amount in the under-recovery account from ballooning to a level at which there is no reasonable prospect of recovery.*
>
> *The balance in the loss capitalisation account would accrue at the WACC. Each under- or overrecovery would remain at full value in the under-recovery account for five years, after which it would be fully depreciated over the next five years. This 10-year life—five-years of accumulation, then five years of 'depreciation'—will help mitigate the accumulation of losses while giving Queensland Rail a reasonable amount of time to find new customers to recover its forgone revenue. The 10-year life would reduce any distortionary inter-generational effects where past costs are borne by future users.*

7.3 Treatment of Additional Revenue

Yancoal is supportive of the QCA's proposal in the Draft Decision that:

> *The loss capitalisation mechanism should be symmetrical, in that any over-recovery (for instance revenue associated with additional paths and government subsidies through the Transport Service Contract (TSC)) should also be placed in this account and accrue at the WACC to offset any subsequent under-recovery. In the event of low volumes, any unrecovered revenue would be capitalised in an under-recovery account.*

While Yancoal notes the statements in the QR Low Volume Tariff Submission that TSC revenue is not received for the provision of coal services, that is not what Yancoal understood the QCA to be suggesting was the basis for this treatment.

Rather, Yancoal understood the QCA to be suggesting that where TSC funding is increased to assist QR with continuing to operate the line that should be taken into account in reducing the capitalised losses (as QR has effectively received that revenue, rather than incurring a loss, just that the revenue has been received from another source).

For the same reasons, Yancoal agrees that any additional revenue from provision of additional coal paths (say ad-hoc paths) above the 2.1 mtpa volume forecast should be taken into account in calculating capitalised losses (after accounting for any incremental operating costs for such services).

7.4 Premiums

The QCA Draft Decision proposed a premium to apply to additional/ad-hoc services and a cap on the premium above the building blocks based tariff that would apply during the period when capitalised losses were being recovered.

Yancoal continues to be strongly opposed to premiums for ad-hoc services of the type proposed in the Draft Decision as they are entirely arbitrary, will provide disincentives for additional volumes when volume should be incentivised and, where the tariff is set at an affordability level, by definition will be likely to make ad-hoc paths unaffordable for coal producers.

Whereas, Yancoal supports the cap on the premium above the notional building blocks based price as continuing an affordability based tariff (which by its nature will make Cameby Downs and other projects paying it marginal) in the long term will be damaging to the prospects of continued investment in the West Moreton coal industry.

Consequently, it is appropriate if volumes recover to that point for there to be a 'sharing' of the benefits of volume recovery between QR (through recovery of capitalised losses) and access holders (through a reduction in tariffs). Yancoal considers a 10% premium will allow a significant amount of recovery of capitalised losses before this benefit sharing approach is triggered, and there is no evident rationale for setting that premium at any higher levels (such as the 15% referred to in the QCA Draft Decision).

Yancoal acknowledges the proposal in the QR Low Volume Tariff Submission that the premium could be set by a subsequent draft access undertaking. However, it appears to Yancoal that there is greater benefit in seeking to provide a level of certainty now such that the focus is on commercially facilitating volumes rather than another regulatory process.

7.5 Conclusions

Accordingly, Yancoal considers that the appropriate features of loss capitalisation would involve:

(a) the difference between actual coal access revenue (with existing users paying an affordability reference tariff) and theoretical building blocks based access charge being calculated periodically;

(b) any net additional revenue (through additional TSC payments or charges for ad-hoc services above 2.1 mtpa) also being deducted from the calculated capitalised losses;

(c) the capitalised losses only being recovered at the point where volume has increased to the point that the theoretical building blocks based charge would fall below the affordability based reference tariff;

(d) from that point, reference tariffs would remain at the affordability based reference tariff, with QR effectively recovering the difference (which would be deducted from the notional capitalised loss) subject to an appropriate cap (which Yancoal considers should be no more than 10%) on how far above the building blocks tariff such an affordability based tariff could become; and

(e) where volumes have not by the end of the 2020 access undertaking term recovered to the point where access charges were resulting in QR recovering notional capitalised losses the West Moreton asset base should be optimised to the point that a building blocks based tariff would be equivalent to the affordability based tariff.

8 Calculating the Ceiling Price

8.1 Costs Allowances and Capex / Tariff Building Blocks

Yancoal notes the indication in the QCA Paper that the QCA is now assessing in more detail the efficient costs of providing access for 2.1 mtpa of coal transportation.

Yancoal considers that such a detailed review is critical and clearly warranted in order for the notional building blocks price to be appropriate given:

(a) with much smaller volumes now envisaged for at least the commencement of the 2020 DAU term, Yancoal anticipates that the prudent approach to capital and operating and maintenance costs would be substantially different to that proposed for a 9.1 mtpa volume forecast as QR initially proposed;

(b) Yancoal (and New Hope) has consistently expressed concerns that

  (i) the costs allowance sought by QR are significantly too high and clearly inefficient; and

  (ii) too high a proportion of the costs allowances sought by QR are claimed to be fixed and do not reduce with lower volumes (with no evident measures having been taken by QR to resolve that despite it becoming increasingly clear that low volumes were a real prospect);

(c) both the QCA and its expert consultant, Systra indicated that a detailed review of prudent capital expenditure and operating and maintenance costs was not undertaken for the 'low volume' scenario; and

(d) Systra made specific recommendations about reductions that should be able to be achieved in a 'low volume' scenario, including recommendations that:

  (i) it would be more efficient to defer some capital works (including bridge replacements and culvert replacement) until there is greater certainty of coal volumes;

  (ii) maintenance and capital expenditure may be able to be deferred through a strategic use of speed restrictions;

  (iii) train control expenditure should be lower in a low volume scenario; and

  (iv) administration and overhead costs should be further reduced.

While the QR Low Volume Tariff Submission provides for some reductions in cost allowances, it represents only minor changes, rejects much of Systra's previous findings and confirms that QR does not intend to change its asset strategy due to a belief that volumes will return in the near future.

If a building blocks price is going to be utilised (even where that occurs on a notional basis to calculate the extent of loss capitalisation), it will be critical to consider the efficiency and prudency approach to costs in the context of the current volume forecast for the 2020 DAU period – both by reference to the specific issues already identified and any further opportunities for deferral of spending and greater efficiencies discovered. A building blocks price which operates on the basis of QR's cost claims is not appropriate as it will artificially inflate the capitalised losses.

8.2 Allocation to coal

Another important part of the notional building blocks based tariff is the allocation of a common network asset base and costs to coal services.

It appears from the QR Low Volume Tariff Submission that QR has continued to apply an allocation based on its previous approach which was rejected in the Draft Decision in favour of an 87 path based allocation.

Given the substantial decline in volumes, it cannot be appropriate to increase the allocation to coal customers (thereby artificially inflating the capitalised losses).

If anything, the decline in volume raises the question as to whether the 87 path allocation is a reasonable approach. The network was not originally designed for coal services, and remains a low payload, inefficient system relative to the fit for purpose coal networks in central Queensland and the Hunter Valley.

Where the reference tariff is an affordability based tariff set at prevailing tariff levels, Yancoal is willing to support a continuation of the QCA's proposed 87 path allocation methodology, noting that that may need to be revisited where there is a sustained reduction in volumes.

8.3 Weighted average cost of capital

QCA Question: If access charges are 'de-coupled' from the reference tariff, does our draft decision approach to estimating WACC appropriately compensate Queensland Rail?

Another important aspect of calculating the notional building blocks based tariff is the appropriate weighted average cost of capital (***WACC***).

Yancoal considers that the issues regarding the appropriate WACC have been well ventilated in previous submissions and the Draft Decision.

As stated in the Yancoal 11 July submission, Yancoal supports the conclusions in the Draft Decision that:

(a) the WACC proposed by QR is inappropriate; and

(b) the WACC should reflect a return that is commensurate with the regulatory and commercial risks involved in providing the reference service (not access to QR's diversified network more generally).

Yancoal expressed concern in its previous submissions that the asset beta and some other inputs were too favourable to QR, due to being at the very top of the range identified by the QCA and its expert consultant, Incenta.

However, where an affordability based tariff is adopted (as Yancoal considers is the only appropriate outcome in low volume scenario circumstances), Yancoal acknowledges that QR will be assuming a higher degree of volume risk than might have been envisaged at the time of Yancoal's previous submissions. Accordingly, for the purposes of calculating the notional building blocks based tariff for the purposes of the loss capitalisation methodology, Yancoal would be willing to support utilising the WACC estimate and inputs proposed in the Draft Decision (subject to the usual time based parameters being recalculated).

Yancoal does not consider that any 'de-coupling' of reference tariffs as discussed in the QCA Paper (assuming it operates on the basis proposed by Yancoal in this submission) involves additional risk for QR that should be reflected in changes to the assessment of the appropriate WACC. If anything it would give QR greater flexibility in relation to setting affordable prices for future access seekers and thereby assist in mitigating their volume risk.

For completeness, Yancoal continues to note that QR retains substantial protections including Cameby Downs having a 100% take or pay contract [redacted] which involves pass through of a reference tariff, and regulatory settings that are likely to give QR the greatest possible opportunity to recover its investments (including through the consideration of measures like loss capitalisation and greater flexibility around access charge setting as is now being considered).

In addition, if the coal price based review event was included (as discussed earlier), that would be an additional regulatory protection that would serve to further mitigate QR's 'under-recovery' to the extent that coal producer's affordability levels will allow.

9 Responses to other QCA Questions

The QR Low Volume Tariff Submission did not directly respond to all of the matters raised in the QCA Paper.

Accordingly, to the extent not directly answered as part of the submissions above, Yancoal has also separately responded to the remaining questions in the QCA Paper below in detail in Schedule 3.

10 Conclusion

Based on the analysis above Yancoal considers it is clear that:

(a) the appropriate reference tariff is one that is affordable to Cameby Downs (as Cameby Downs's continuation is now critical to the prospects of volume recovering and not stranding numerous stakeholders' economic investments); and

(b) to be truly affordable the reference tariff needs to be set at the level of current tariffs.

Accordingly, Yancoal considers the below will provide an appropriate tariff setting:

(c) a reference tariff that is initially set at the level of the prevailing tariff level, as an affordable level for Cameby Downs (as the remaining West Moreton user). This will necessarily be below the pure 'building blocks' based tariff', but is critical to preventing closure of Cameby Downs and keeping alive the prospects of volumes returning in the future;

(d) a notional 'building blocks' price continuing to be calculated for the purposes of identifying the volume of capitalised 'losses' (as typically constituted by the difference between the access revenue achieved by QR and that which would have been achieved if the notional 'building blocks' price was charged);

(e) that notional 'building blocks' price being estimated based on a complete reassessment of:

  (i) the efficient allowances for operations and maintenance costs based on the lower volumes anticipated; and

  (ii) the efficient capital expenditure across the terms based on the lower volume anticipated, taking into account the extent to which capital projects should be deferred and the existing regulatory asset base should be optimised;

(f) an adjustment of the notional 'building blocks' price where contracted volumes on the West Moreton network increase; and

(g) where volumes recover to the point that the notional building blocks price falls below the affordability level, the reference tariff would stay at the affordability level to allow QR to recover previously capitalised 'losses', subject to:

  (i) a 5 year limited life capitalisation methodology to prevent capitalised losses ballooning to unsustainable levels if there is a long period before volumes recover;

  (ii) a cap on the premium that can be recovered above the notional 'building blocks' price (of the lower of a 10% premium or the premium that would take that price to the affordability based price) – as part of striking a balance between allowing recovery of capitalised losses and seeking to ensure that a continued affordability based tariff does not disincentivise new investment in West Moreton coal production; and

  (iii) optimisation of the regulatory asset base to occur if volumes have not materially recovered by the end of the 2020 access undertaking term.

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

Schedule 1

Appropriateness of an affordability based tariff

In assessing appropriateness of the 2020 DAU, the QCA is required to have regard to each of the factors described in section 138(2) of the *Queensland Competition Authority Act 1997* (Qld).

Yancoal strongly considers those factors confirm that (consistent with the submissions of both QR and Yancoal) setting a tariff by reference to affordability is the only appropriate result, as shown below:

Factor to be had regard to	What factor indicates is an appropriate tariff
Object of Part 5 QCA Act	The object of Part 5 is to *promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided*, *with the effect of promoting effective competition in upstream and downstream markets*. Setting prices via a building blocks based methodology with the result that reference tariffs are above the affordability level with no evidence that QR would negotiate affordable tariffs is clearly inconsistent with that object as: • it will threaten the economic viability of the only remaining producer in Cameby Downs, which risks economic stranding of the West Moreton network, Cameby Downs and investments of QBH and Aurizon; • it will disincentive the prospects of greater future use of the West Moreton network, by eliminating the economic viability of a Cameby Downs expansion, New Hope's investment in New Acland Stage 3 (when approvals are obtained) or any other new project in the West Moreton region; and • as a result of the above, the West Moreton network would be likely to be inefficiently underutilised over the remaining term of the undertaking and there will be clear damage to competition in related markets including the West Moreton coal tenements market, the West Moreton coal haulage market and the Port of Brisbane coal handling services market. Only a reference tariff that remains affordable for Cameby Downs, and a regulatory framework that provides the ability for access seekers for non-contracted volumes to negotiate affordable tariffs to incentivise recovery of volumes, will maximise utilisation of the network over the term of the 2020 DAU.
Legitimate interests of QR	Yancoal acknowledges that QR has a legitimate interest in maintaining a certain amount of revenue, and that this factor would typically weigh in favour of a building blocks based price, based on earning a return on the regulatory asset base representing the value of its investment. However, QR itself has recognised in the QR Low Volume Tariff Submission that that is not actually in its interests in these circumstances. In the current circumstances, where a building blocks price is likely to result in a complete elimination of coal volumes, and strand QR's economic investment in the West Moreton network (but potentially still leave QR or the State funding high fixed costs for low volumes of grain and passenger operations), QR's legitimate interests actually favour:

	• an affordable tariff that provides the foundation for returning to a building blocks tariff in the longer term; and • a mechanism to seek to 'make up' lost revenue if volumes recover.
Public interest	Setting reference tariffs at an affordability level is aligned with the public interest as: • consistent with previous QCA analysis, the promotion of investment in the West Moreton coal industry is in the public interest, given the substantial positive regional economic impacts such projects generate, both directly through employment, royalties and exports and indirectly though greater spending in the region, and (as discussed above) an affordability based tariff is required to keep alive the prospects of greater future volumes; • consistent with previous QCA analysis, it is also in the public interest to provide regulatory certainty to stakeholders, and an unanticipated price spike for reasons that the remaining user has no control over (as would be caused by a building blocks based price in the context of diminishing volumes) would be clearly detrimental to such certainty. Such a price spike has adverse impacts beyond Cameby Downs – as it would also have a chilling impact on future investment given the message it would send to potential investors about their exposure to volume risk on the system; and • an affordability based tariff will see the continuation of coal access rights providing funding for the operation of the West Moreton system, rather than adding another regional system that is required to be nearly entirely subsidised by the State.
Interests of access seekers	Access seekers clearly have an interest in the tariff being at levels that make access to the West Moreton network affordable such that they can justify efficient investment in new West Moreton coal projects. Yancoal acknowledges that this factor weighs in favour of QR having the ability to set future access charges over the term of the 2020 DAU below the reference tariff level as a way of incentivising volume recovery.
Effect of excluding existing assets	It is clear that excluding existing assets through optimisation would make a building blocks tariff more affordable than that proposed by QR in the 2020 DAU process to date. To the extent that the QCA considers that a building blocks tariff is required, it will be critical for optimisation to occur now in order for the tariff to be reduced to an affordable level that doesn't damage existing investments, hinder future investments and undermine the prospects of future volumes recovering. Where an affordability based tariff is adopted (as both QR and Yancoal propose), a decision on optimisation could be deferred for the term of the 2020 DAU to provide an opportunity for volumes to recover.
Section 168A QCA Act Pricing Principles	Yancoal acknowledges that the pricing principles include that charges should: *'generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved'*.

	While that would typically weigh in favour of a building blocks price, in the current circumstances, Yancoal considers that instead weighs in favour of some form of loss capitalisation as a method of preserving the potential for QR to earn a return on its investment in the future if volumes recover to the extent that that is economically viable. Yancoal notes that: • an affordability based tariff would be consistent with the pricing principle that charges should 'provide incentivises to reduce costs or otherwise improve productivity' (as QR would have strong incentives to mitigate its 'under-recoveries'); and • the issue raised in the QCA Paper of the reference tariff acting as a ceiling price, would align with the pricing principle that charges should allow for 'price discrimination when it aids efficiency'.
Other relevant issues	The QCA has previously recognised that the interests of existing access holders are generally a relevant factor. In this case, there is a real risk that an unaffordable tariff brings an earlier end to production at New Hope's New Acland mine (where Yancoal assumes that profitability will already be diminishing as volumes reduce), and/or results in earlier than anticipated cessation of operations at or closure of Yancoal's Cameby Downs mine. Yancoal also notes that where all stakeholders are supportive of an affordability based tariff that is a good indication that an affordability based tariff is appropriate.

Schedule 2

Why negotiation cannot be relied up to reach the appropriate tariff

1 Evidence in relation to QR's willingness to negotiate

Yancoal appreciates that, in the abstract, it might be anticipated that a rational hypothetical infrastructure provider with one or two customers would recognise their mutual dependence and both parties would have strong incentives to reach a commercial resolution.

However, QR's conduct in respect of the West Moreton network does not reflect that assumption holding true.

First, QR has specifically requested in the QR Low Volume Tariff Submission, the QCA determine an affordability reference tariff.

Second, QR does not have a track record of changing pricing on the West Moreton network to affordable levels to retain or attract further volumes to the network, even where clear threats to future volumes have become evident.

For example:

(a) Yancoal has sought to negotiate an affordable low volume tariff with QR throughout much of the 2020 DAU process without any success;

(b) QR did not seek to change its approach to coal pricing when Wilkie Creek became economically challenged;

(c) despite grain volumes being lost to road transport (and having complete discretion on pricing as it was not a reference tariff service), QR has not provided pricing which assisted in retaining or restoring grain volumes; and

(d) in the face of weakening coal prices and declining volumes, rather than seeking to adjust tariffs to affordable levels, QR has submitted a review event submission, and now the QR Low Volume Tariff Submission, seeking tariffs known to be well above what is affordable for the remaining producers.

In addition, QR has always expressed the view, both in individual discussions and in submissions to the QCA, that:

(e) it does not believe that its tariff makes a difference to the affordability, continued operation of, or investment in, West Moreton coal projects; and

(f) coal revenues are far more positive than the coal producer's actual forecasts or consensus industry projections suggest.

Rather than the conduct and statements of a party incentivised to alter its conduct to retain or promote volumes, these are examples of the conduct and statements of a party which assumes that negotiating a lower price is simply a zero sum game which represents a loss of revenue that would otherwise be earned by QR. The inescapable conclusion is that QR either do not accept that there is a threat to their future coal volumes or they are not concerned with that threat eventuating.

2 QR's incentives

The concept floated in the QCA Paper of QR negotiating an affordable tariff below a building blocks based reference tariff, implicitly relies on the dual assumptions that QR will be incentivised to commercially negotiate an affordable tariff (so as to increase volumes on the line) and has the ability to accurately estimate what such an affordable tariff would be.

Yancoal considers both of those assumptions are unfounded.

It has been evident for a long period now that there was a threat of lower coal volumes, and yet QR has not sought to reduce its costs or proposed affordable tariffs in negotiations with Yancoal or in the QCA regulatory process.

It appears to Yancoal that QR's behaviour is materially different to the Mount Isa line, where it appears to have a greater willingness or ability to reach such commercial resolutions.

Yancoal considers that contrast in behaviour reflects QR having very different incentives on the West Moreton network that reflect:

(a) confidence that the State will continue to fund the operation of the West Moreton network irrespective of whether coal volumes continue (as the State does for numerous other parts of QR's regional network) – such that QR is not exposed to consequences of the loss of volume in the manner a privately owned monopolist would be;

(b) conflicting priorities given the clear emphasis placed on QR to meet, as its greatest priority, outcomes in relation to passenger services (which coal use of the Metropolitan system can potentially impact on);

(c) uncertainty in QR's own long-term future strategic direction in relation to future coal access with increasing passenger volumes on the Metropolitan system and the existence of alternative proposals for coal transportation via the Inland Rail project;

(d) politically, not wanting to be perceived to be overly supportive of or subsidising coal (in contrast to the State's strong support for the North West Queensland minerals province); and

(e) given QR's publicly owned nature, it being easier for QR to comply with a QCA imposed decision to set tariffs at a certain level than to voluntary make a decision that involves justifying making short term 'losses' at a cost to the State.

None of those factors are likely to change in the foreseeable future, such that Yancoal believes QR will continue to be unwilling to commercially negotiate affordability based access prices during the term of the 2020 DAU.

3 QR's ability to estimate affordability

Even if it was assumed that QR was interested in seeking to negotiate an affordable reference tariff, to actually reach agreement with an access holder or seeker, QR would need to be able to accurately estimate that affordability level.

Yancoal acknowledges that is not an easy thing, particularly for QR who is not actually in the business of coal production. To seek to overcome that, Yancoal has genuinely sought to assist QR in developing an understanding of affordability levels through disclosing (on a confidential basis) the cost profile for Cameby Downs and coal price projections for the term of the 2020 access undertaking.

However, both QR's assessments in negotiations and their assessment of affordability in submissions to the QCA, indicate a failure to understand the economics facing West Moreton coal producers.

In particular, their most recent submission in the review event process simply continues to assert the tariffs they are seeking are affordable when they are in possession of data that indicates they are not.

Accordingly, Yancoal considers it is not appropriate to assume that QR is able to estimate and therefore commercially negotiate an affordable tariff.

Schedule 3

Responses to Other QCA Questions

1 De-coupling of access charges and reference tariffs

QCA Question: Does a 'de-coupling' of access charges from the reference tariff provide an appropriate way forward given the forecasts of low volumes and substantial unused capacity?

The appropriateness of de-coupling access charges and reference tariffs is very much dependent on whether:

(a) the reference tariff is set on the basis of affordability for Cameby Downs (as both Yancoal and QR consider appropriate) or a calculation of maximum allowable revenue based on a building blocks methodology); and

(b) the 'de-coupling' is by way of prescribing the reference tariff as the ceiling price for access charges or just a default price which the access charges can be higher or lower than.

Yancoal has made efforts to negotiate a commercial tariff for the low volume scenario with QR for a substantial part of the 2020 DAU process. Disappointingly, despite those efforts no resolution has been able to be reached. From Yancoal's perspective, the inability to reach agreement is largely attributable to QR's lack of incentives to accept and/or inability to estimate tariffs that are actually affordable for Cameby Downs.

In addition (as discussed further in section 3 of this Schedule below), Yancoal understands that under the provisions of its existing access agreement, Cameby Downs will automatically continue to pay the reference tariff.

Accordingly, Yancoal considers that if the reference tariff was calculated simply as a building blocks based ceiling limit on the assumption that the parties would be able to negotiate a lower appropriate tariff – that would be a flawed approach – which does not reflect the lived experience of the likely outcome. In practice, such an approach would simply result in Yancoal being charged the reference tariff and access seekers having to seek arbitration.

Consistent with the body of these submissions, Yancoal considers that the reference tariff should be set at the level of the currently prevailing tariffs as an affordable level for Cameby Downs based on its existing 2.1 mtpa production as it:

(a) keeps Cameby Downs in business (and therefore the West Moreton rail network, Aurizon's rolling stock and QBH's coal terminal utilised);

(b) enhances the prospects of an access seeker being able to negotiate new access (and thereby help volumes recover in the future); and

(c) provides an affordable price at which access can be obtained in circumstances where an access dispute is not an appropriate of setting prices (for ad-hoc and temporary services for example).

If the QCA considered appropriate, Yancoal would be willing to support QR being given the flexibility to negotiate tariffs below that reference tariff, subject to the following needing to occur to ensure that such an approach was appropriate:

(a) the loss capitalisation methodology would need to treat any net profit as offsetting capitalised 'losses' (so that where QR negotiates new access at discount rates it doesn't produce the perverse outcome of creating further losses based on the difference between the charges actually received and the reference tariff); and

(b) given the automatic application of reference tariffs under existing access agreements, there would need to be measures to balance the interest in incentivising new volumes with the interest in preserving equity between various user's access charges, which could include:

(i) having such concessional charges limited to particular circumstances that are clearly tried to encouraging new volume (e.g. for up to 12 months during a ramp-up period for a new project or for ad hoc or other short term non-permanent volumes);

(ii) where Yancoal continues to pay the reference tariff under its existing access agreement, a rebate of some kind so the benefits of the additional volumes are shared between QR and continuing users which are paying the reference tariff; or

(iii) charges below the reference tariff outside of those circumstances needing to be approved by the QCA.

2 De-coupling take or pay and relinquishment fees

QCA Question: Is it appropriate to also 'de-couple' take or pay and relinquishment fees from the terms set out in the access undertaking?

Yancoal considers that with an affordable reference tariff, parties will have greater flexibility to agree on the operation of additional ad-hoc services without this change.

Yancoal also has some residual concerns about:

(a) the long-term impact on QR's revenue certainty and therefore tariffs of any long term access agreements that is entered during the 2020 access undertaking on a non-take or pay / no relinquishment fee basis; and

(b) equity between access holders in relation to treatment of these issues.

In relation to the equity concerns, Yancoal is unsure as to what outcome this would have under the existing access agreement, which (as discussed in section 3 below) provide for amendments to the access agreement to Reference Tariff Provisions which 'directly or indirectly relate to the application or interpretation of that reference tariff'.

3 Existing Access Agreements

QCA Question: Would 'de-coupling' access charges from the reference tariff work with existing access agreements?

3.1 Automatic pass through of reference tariffs

The 2018 Cameby Downs Access Agreement (the ***Existing Cameby Access Agreement***) relevantly provides for:

(a) a review of the access charges schedule in Schedule 3 to align with the approved reference tariff and provisions of the undertaking 'directly or indirectly related to the application or interpretation of that reference tariff' (clause 19.1);

(b) escalation of the charges in accordance with the approved reference tariff escalation (clause 2, Schedule 3); and

(c) increase of the QCA levy to align with the levy as set by the QCA (clause 3, Schedule 3).

Those provisions are consistent with the equivalent provisions in QR's standard access agreement, and Yancoal assumes that any remaining access contracted by New Hope would therefore have been contracted on the same basis.

Yancoal considers that, as a result of those provisions, any-decoupling of reference tariffs and access charges would effectively only take effect as it related to future access agreements.

[redacted]

Given the automatic outcome of applying the unaffordable reference tariff that would apply under existing access agreements, and the issues in relation to QR's abilities and incentive to negotiate an affordable price, it cannot not be appropriate to impose a building blocks based reference tariff and hope commercial negotiations would reduce that to an affordable level.

3.2 Consequences of there being no reference tariff

For completeness Yancoal notes that if the QCA determined not to approve any reference tariff, the outcome under clause 2, Schedule 3 of the Existing Cameby Access Agreement is for a CPI based escalation of the access charge inputs.

In other words this would effectively continue the existing tariff in real terms.

That would clearly be more appropriate than a reference tariff at a completely unaffordable building blocks based tariff, and given that Yancoal considers that such charges are effectively the affordability level – it would be willing to support the QCA determining that was the appropriate outcome.

However, for the avoidance of doubt, Yancoal would prefer the reference tariff continuing to be set at prevailing levels (and therefore affordable), such that there is certainty as to the pricing for ad-hoc and additional volumes – and considers that is the appropriate result as it is more likely to incentivise such additional volumes.

4 Endorsed variation event for increased contracted volumes

QCA Question: Is it appropriate to include an endorsed variation event for resetting the reference tariff when contract volumes increase, if access charges are 'de-coupled' from the reference tariff?

Yancoal's previous submissions supported an endorsed variation event where contracted volumes increase, on the assumption that the tariff was likely to be building blocks based.

However, for the avoidance of doubt, Yancoal strongly believes that in the circumstances of the likely Cameby Downs only volume outlook, to be appropriate the reference tariff must be based on affordability – rather than a build blocks approach.

Consequently, while Yancoal remains supportive of an 'endorsed variation event' where contracted volumes increase, it sees the 'endorsed variation event' as changing the notional building blocks price which is used in the loss capitalisation methodology, rather than directly altering the affordability based reference tariff itself.

That is, the endorsed variation event would result in adjustment of the reference tariff if there is a significant increase in contract volumes on the West Moreton network such that volume has risen to such an extent that the building blocks based reference tariff falls below the affordability based reference tariff (subject to allowances for QR to recover capitalised losses at that point).

5 Materiality threshold for endorsed variation event

QCA Question: If an endorsed variation event for increases in contracted volumes is included, should it be subject to a materiality threshold?

Generally, Yancoal would expect that as volumes rise it is legitimate for any notional building blocks based tariff to decrease (noting that Yancoal strongly believes the reference tariff itself should be set by reference to Cameby Down's affordability, so that the notional building blocks tariff is utilised for loss capitalisation calculation rather than as the tariff).

However, Yancoal acknowledges that it is not reasonable for tariff changes to trigger with every minor change in volume – as it is concerned that would disincentive QR from facilitating ad-hoc usage and temporary surges in volume.

Where the reference tariff itself is based on affordability (with a notional building blocks based tariff being used to calculate loss capitalisation) there is automatically a materiality threshold that will practically apply. That follows because there would only be an adjustment to the reference tariff under those arrangements, if volume has risen to such an extent that the building blocks based reference tariff falls below the affordability based reference tariff (and then only after some or all of that difference is utilised to recover previously capitalised losses) . Yancoal is supportive of an endorsed variation event that applies in that manner.

Whereas if (contrary to all of Yancoal's submissions above) the tariff is based on a building blocks approach, tariff relief will need to be prioritised immediately given the significant adverse impacts anticipated from such a tariff – such that no materiality threshold should apply.