

QR 2018/19 West Moreton Capital Expenditure Claim

5 February 2020



1 Introduction

This submission is made on behalf of Yancoal Australia Limited (**Yancoal**), as operator of the Cameby Downs mine, in response to Queensland Rail's (**QR**), 2018/19 West Moreton Capital Expenditure Claim (the **Claim**).

Clause 2 of Schedule E of QR's access undertaking provides for the Queensland Competition Authority (**QCA**) to accept capital expenditure into the Regulatory Asset Base if:

- (a) it has been accepted by the QCA as:
 - (i) prudent in scope;
 - (ii) prudent in the standard of works; and
 - (iii) prudent in cost;
- (b) it has actually been incurred; and
- (c) either the capital expenditure project has been commissioned or formally discontinued.

The QCA has indicated it intends to engage independent advice through an engineering assessment of the projects in the Claim.

Yancoal thanks the QCA for this opportunity to provide initial comments on the Claim.

2 Prudency

2.1 Review event and affordability concerns

Yancoal remains extremely disappointed by QR's review event submission based on declining contracted volumes and the QCA's decision to approve QR's proposed increase in West Moreton tariffs.

The outcome of the approval given in that process has been to raise West Moreton tariff levels to a level above what Yancoal considers affordable.

Tariffs at that level, particularly if retained into the future as part of a subsequent 2020 draft access undertaking tariff decision, create material risks of future closure (for Yancoal) or non-investment (for New Hope) decisions.

In an environment where tariffs are being raised to unaffordable levels on the basis of declining volumes, the prudency of capital expenditure which the Claim indicates were based on higher projected volumes needs to be scrutinised. Particular scrutiny is required to the extent that QR had opportunities to defer, scale back or not proceed with such investment as the future volume uncertainties were becoming clearer.

2.2 Extent of decline in volumes and relevance to prudency

As the QCA knows from other regulatory processes, including QR raising the low volume scenario in relation to its very first submission on QR's 2020 draft access undertaking and QR's review event submission:

- (a) volumes on the West Moreton system are declining;
- (b) there is (and was at the time of QR making investment decisions) uncertainty as to whether volumes will recover (as there is no certainty as to when New Acland Stage 3 may receive required government approvals); and
- (c) as a result it is likely that for a material period, coal volumes will be a maximum of 2.1 mtpa (from Cameby Downs).

Yancoal believes that context must impact on the QCA's assessment of the prudence of scope and standard of West Moreton system capital expenditure projects.

That reflects some of the factors that the QCA is expressly required by QR's access undertaking to have regard to in its assessment including:

- (d) in respect of prudence of the scope of works:
 - (i) the need to accommodate what is reasonably required to comply with access agreements; and
 - (ii) the extent of reasonable demand, and the need for new capital expenditure projects to accommodate that demand; and
- (e) in respect of prudence of the standard of works:
 - (i) the requirements of rolling stock operators and what is reasonably required to comply with access agreements; and
 - (ii) current and likely future usage levels.

While Yancoal appreciates that notionally some of the capital expenditure forming part of the Claim, is sought to be justified as reducing maintenance costs, the prudent trade-off between capital and maintenance costs must change given the deteriorating and uncertain demand outlook.

2.3 Initial comments on the Claim and scope of engineering assessment

There is insufficient detail in QR's proposal for Yancoal to be able to provide detailed feedback on whether it was prudent for QR to continue with individual projects in light of the evident risk of declining volumes discussed above. In particular, QR appears to have provided no real analysis of how and when it considered the potential to either:

- (a) defer projects until the volume uncertainty was removed;
- (b) scale back projects to reflect smaller volumes; or
- (c) cease such projects.

However, the opportunities QR had to mitigate expenditure in light of the evident uncertainty should be part of the assessment. That is particular the case for long-life, high capital projects, such as bridge replacements, which only make sense in the event of continued high volume use.

While Yancoal appreciates that the Claim relates to 2018/19 capital expenditure, it should not simply be concluded that because the initial investment planning may have pre-dated the review event submission that it must be accepted as prudent. That follows, because the future volume uncertainty is not a new issue triggered by a sudden unanticipated event, but rather caused by a continuing delay which was evident in 2018/19 and should have been influencing the prudence of investment decisions long before the actual drop in contracted volumes eventuated.

Accordingly, Yancoal agrees that independent engineering assessment should be conducted in relation to each of the projects constituting the Claim, and requests that the assessment take into account the issues noted above.

3 Conclusion

Based on the above analysis, Yancoal submits that the QCA should carefully scrutinise the prudence of scope and standard of work for each of the projects involved in the Claim, particularly taking into account:

- (a) an uncertain demand outlook – that existed throughout the period relating to the Claim;

- (b) the opportunities QR had to defer, reduce in scope or cease projects (and the merits of doing so); and
- (c) pricing based on QR earning a return on existing capital expenditure already being at unaffordable levels based on the declining volume.

Yancoal anticipates that it will provide further comments once it has had an opportunity to review the independent engineering assessments.