Dalrymple Bay Coal Terminal User Group
Submission on QCA Draft Decision
DBCT 2019 Draft Access Undertaking

4 December 2020

Contents

1 Introduction

This submission in respect of DBCT Management Pty Ltd's (***DBCTM***) 2019 draft access undertaking (the ***2019 DAU***) is made on behalf of the Dalrymple Bay Coal Terminal User Group (the ***DBCT User Group***).

The DBCT User Group comprises both access holder and access seekers, including both users of the existing terminal and proposed customers of the 8X DBCT expansion. Most of the existing user members have also had an initial discussion with DBCTM in relation to the price review under their existing User Agreement, where DBCTM is proceeding on the assumption that the 2019 DAU will be approved without a reference tariff. As a result the DBCT User Group considers it is well placed to speak to the likely outcomes for future access negotiations and future access charges of the regulatory model that is being proposed – for both existing and future users.

The DBCT User Group has made extensive submissions to the Queensland Competition Authority (the ***QCA***) on the 2019 DAU to date including in submissions on each of:

(a) 23 September 2019 (***1st User Group Submission***) and 22 November 2019 (***2nd User Group Submission***);

(b) 24 April 2020 (***3rd User Group Submission***) 5 June 2020 (***4th User Group Submission***) concerning the Interim Draft Decision of February 2020 (the ***Interim Draft Decision***); and

(c) 23 October 2020 (***5th User Group Submission***) concerning the Draft Decision of August 2020 (the ***Draft Decision***).

The DBCT User Group has also presented its views at the 18 November 2020 stakeholder forum, with the summary slides presented at the forum included in **Schedule 1** of this submission.

That extensive participation has occurred due to an unanimous view among the DBCT User Group that the 2019 DAU remains inappropriate. That inappropriateness stems from the negotiate/arbitrate pricing approach being wholly unsuited to constraining DBCTM's market power, such that it is not adequately resolved by the amendments proposed in the Draft Decision.

The DBCT User Group's concerns about DBCTM's approach continue to be exacerbated by the approach DBCTM has taken to 'negotiations' with existing users in the price review process, and the lack of transparency provided by DBCTM about its future pricing expectations.

Consequently, this submission is a final plea from the DBCT User Group for the QCA to:

(a) determine appropriate amendments to the 2019 DAU in accordance with the statutory functions of the QCA Act reflecting the QCA's own analysis that a reference tariff model would have advantages in the context of the DBCT service;

(b) not approve a form of regulation that substantially departs from a form of regulation known to be appropriate on the basis of merely speculated benefits DBCTM has not demonstrated will arise; and

(c) provide a form of regulation that will actually constrain DBCTM from engaging in monopoly pricing.

2 Executive Summary

2.1 2019 DAU is inappropriate and should not be approved

The DBCT User Group continues to support the QCA's conclusion in the Draft Decision that the 2019 DAU should not be approved, for reasons including:

(a) not promoting the object of Part 5 of the QCA Act;

(b) not balancing the interests of DBCTM, access holders and access seekers;

(c) imposing additional cost and uncertainty which could adversely affect investment incentives and be contrary to the public interest; and

(d) not providing a sufficient constraint on DBCTM's ability to exercise its market power.[1]

2.2 Negotiate-arbitrate (without a reference tariff) is inappropriate for the DBCT service

The DBCT User Group remains of the view that a negotiate-arbitrate model can never be appropriate in the circumstances of the DBCT service, where DBCTM is a monopolist with market power, unconstrained by competition or any countervailing power of users, which has been found to have the ability and incentive to engage in monopoly pricing.

The reasons for that are set out in **Part A** of this submission, including:

(a) that the reasoning in the Draft Decision for accepting a negotiate-arbitrate model is underpinned by serious errors of law regarding how the QCA should assess what constitute appropriate amendments;

(b) that relying on the 'primacy of negotiations' is not appropriate in the circumstances of the DBCT service where there is very limited scope for negotiation and DBCTM's conduct is not constrained by competition or countervailing power;

(c) the lack of any evident benefits that will arise from a negotiate-arbitrate form of regulation, particularly where the existing reference tariff model already facilities negotiated outcomes;

(d) the additional costs, and disproportion impacts of those costs on access holders and access seekers, that the negotiate-arbitrate model will produce;

(e) weaknesses of the proposes arbitration regime which prevent it being an effective 'backstop' including costs, uncertainty of outcomes and the inappropriate nature of outcomes that are likely to result.

2.3 Improvements to the negotiate-arbitrate model

However, the DBCT User Group is cognisant that the QCA reached a Draft Decision expressing a preliminary view that a negotiate-arbitrate model could be appropriate in the face of universal opposition from all stakeholders other than DBCTM having received submissions on many of those grounds.

Accordingly, **Part B** provides further submissions on how, if the QCA remained minded to approve an access undertaking containing a negotiate-arbitrate framework, it should be amended in order to reduce as much as possible the serious damage that position will cause in the next 5 year regulatory term (before the QCA will have an opportunity to return the regulatory settings to an appropriate position).

In particular it addresses, further amendments that should be made to:

(a) reduce the costs of a negotiate-arbitrate model;

(b) further reduce information asymmetry (beyond the measures the QCA is currently proposing);

(c) reduce the uncertainty of outcomes of arbitration; and

(d) create greater incentives for appropriate pricing to be offered (including through alternative forms of arbitration such as final offer arbitration or arbitration with appropriate floor and ceiling limits).

[1] Draft Decision, 4.

2.4 Other issues

Part C of this submission, provides submissions on other detailed issues not otherwise covered in Parts A or B which arise from the absence of a reference tariff, including issues such as the depreciation methodology, remediation allowance and rights of termination for access seekers which have been required to contract capacity without pricing.

3 Assessing appropriateness requires transparency and evidence

Sunlight is said to be the best disinfectant – in the sense that transparency is important for truly revealing what is occurring but hidden in dark corners away from scrutiny.

That is particularly apt, given DBCTM's approach in respect of the 2019 DAU.

The DBCT User Group submits that transparency and actual evidence about the likely outcomes of the substantial changes that are proposed, is not just helpful, but absolutely necessary, for the QCA to be able to form a reasonable and informed view about appropriateness of an undertaking or required amendments to an undertaking.

Which makes it highly concerning that DBCTM has refused to provide any indication to the QCA, users or access seekers in relation to pricing it will propose under a negotiate-arbitrate form of regulation.

The only indication provided to date is the submissions from DBCTM[2] that an application of the section 120 QCA arbitration criteria should result in a price that is:

(a) higher than the efficient costs of supply (including a reasonable rate of return commensurate with the regulatory and commercial risks involved in provision of the service);

(b) up to the 'value of the service' to the users or access seeker – which appears to be framed by reference to the maximum economic rent that a monopoly supplier can extract,

where the 'economic rent' between those points is divided between DBCTM and the user.

Given that the efficient cost of supply is the price that would be anticipated to prevail in a competitive market, DBCTM has expressly flagged its intention to extract monopoly rents above that level.

The recently published Dalrymple Bay Infrastructure prospectus clearly leaves the impression that DBCTM expects to financially benefit from a move to a negotiate-arbitrate model. While it does not disclose the anticipated price increase, it discloses that DBCTM's CEO will receive a material financial bonus payment exceeding 50% of his fixed remuneration if the QCA approves such a model,[3] suggesting DBCTM envisage a very material financial benefit from the change in regulation.

At the stakeholder forum one of the QCA's members posed questions regarding the extent of price rises that would be involved.

Based on the QCA's analysis in the declaration review, the range between the efficient cost of supply and the 'value' could be in the order of $12.42/tonne – being the average additional cost for a Goonyella user to access capacity at the only alternative coal terminal anticipated to have long term surplus capacity (WICET).[4] The magnitude of that range is evidently very significant relative to the existing TIC of $2.45/tonne.

[2] DBCTM Submission, 23 April 2020, Section 4.
[3] Dalrymple Bay Infrastructure Prospectus, 166
[4] Declaration Review, Final Decision – Part C: DBCT at 259.

The DBCT User Group acknowledge that the above was an average and the difference in costs will vary between users (and potentially not even really be calculable for those mines for which it is not physically feasible to switch to WICET).

However, the question about the extent of prices rise anticipated should be addressed to DBCTM – which is the entity that wishes to remove regulatory price setting without providing any further indication of the prices it intends to charge where regulatory constraints are lessened.

Where DBCTM's intention silence on its intended pricing leaves the QCA with no way of knowing what the likely price rises are, and the QCA unwilling to provide any guidance on the point at which arbitration will constrain DBCTM's pricing, the DBCT User Group submits that it cannot be appropriate to approve the proposed negotiate-arbitrate form of regulation.

Accordingly, the DBCT User Group submits again that the QCA cannot conduct the required analysis without requiring DBCTM to produce the additional information described in the 5th User Group Submission. A failure to consider that information which is the best available evidence of the likely outcomes of the changes proposed, necessarily leaves the QCA in the position of having to speculate about likely outcomes without any real evidential basis for doing so.

If nothing else, the lack of transparency in a regulatory setting, together with DBCTM's submissions resisting provision of information to existing users, should give the QCA serious pause about how DBCTM is likely to conduct itself in future private negotiations.

4 Misleading description of DBCTM's engagement with Users

For completeness, the DBCT User Group wishes to record its disappointment about DBCTM's (and DLA Piper's) inaccurate and misleading characterisation of the engagement between DBCTM and Users in respect of the 2019 DAU in the DBCTM submission of 23 October 2020 and comments in the stakeholder forum. DBCTM's disappointing record on collaboration in this process is clear and speaks volumes about the likelihood of DBCTM being willing to entertain negotiated outcomes that are not simply a monopoly price:

(a) it proposed a negotiate-arbitrate model without consultation and has insisted upon pursuing it despite unanimous opposition from all existing and future users;

(b) it has not been willing to discuss that core element of the 2019 DAU, which is so intertwined with the other changes DBCTM is proposing, such that the scope on which it is seeking collaboration is confined to the point of being largely meaningless;

(c) it has refused to date to provide any indication of its anticipated pricing outcomes under that model in the regulatory process and in the price review process it has commenced;

(d) it's 'collaboration' prior to the last round of submissions consisted of proposing positions on which it demanded a response within 7 business days (a wholly unreasonable position given the multiple and varied participants which make up by the DBCT User Group) and then sought to claim that not being able to do so indicated the DBCT User Group was unwilling to collaborate;

(e) it proposed a position on depreciation that is highly prejudicial to an appropriate outcome on remediation given the artificially truncated useful life assumed – and then failed to disclose to the QCA that it was expressly rejected by the DBCT User Group for that key reason;

(f) it has not disclosed further information that it relies on in relation to its last submission and comments made at the stakeholder forum in respect of remediation estimates; and

(g) it has not sought to engage in any collaboration since the last submissions.

Part A – Determining the Appropriate Form of Regulation

5 The QCA's statutory function

5.1 Threshold for approval being given

Section 138(2) QCA Act provides that:

> *The authority may approve a draft access undertaking only if it considers it appropriate to do so having regard to each of the following –*
>
> *(a) the object of this part*
>
> *(b) the legitimate business interests of the owner or operator of the service*
>
> *(c) if the owner and operator of the service are different entities – the legitimate business interests of the operator of the service are protected*
>
> *(d) the public interest, including the public interest in having competition in markets (whether or not in Australia)*
>
> *(e) the interests of persons who may seek access to the service, including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected;*
>
> *(f) the effect of excluding existing assets for pricing purposes;*
>
> *(g) the pricing principles mentioned in section 168A; and*
>
> *(h) any other issues the authority considers relevant.*

The object of Part 5 of the QCA Act is then specified in section 69E QCA Act as:

> *The object of this part 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.*

The pricing principles in section 168A QCA Act are:

> *The pricing principles in relation to the price of access to a service are that the price should –*
>
> *(a) 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; and*
>
> *(b) allow for multi-part pricing and price-discrimination when it aids efficiency; and*
>
> *(c) not allow a related access provider to set terms and conditions that discriminate in favour of the downstream operations of the access provider or a related body corporate of the access provider, except to the extent the cost of providing access to other operators is higher; and*
>
> *(d) provide incentives to reduce costs or otherwise improve productivity.*

Read together, those provisions set out the threshold for approval being given to an access undertaking and the mandatory considerations the QCA must have regard to in making that decision.

A number of matters are evident from those requirements that the DBCT User Group submits requires a different approach from that which is evident in the Draft Decision.

1. The threshold for approval of an undertaking is entirely different to the threshold for declaration

The threshold of 'appropriateness' that applies under section 138(2) QCA Act turns on a wider range of factors, than satisfaction of the access criterion in section 76(2) QCA Act which provide the threshold for declaration.

The DBCT service has been declared by the Treasurer. As a result, the QCA's role is now simply to consider the appropriateness of the undertaking submitted for the declared service.

It is an error of law to treat the QCA's recommended conclusion on criterion (a) as determinative or the key influence on the outcome of the much broader different test of appropriateness.

However, the DBCT User Group holds serious concerns based on the reasoning of the Draft Decision and comments in the stakeholder forum that, in substance, the two different tests are being conflated and considered together. This is particularly evident in the way the QCA appears to have considered the relevance of impacts on competition.

2. Extent to which competition is relevant

Competition is made a mandatory consideration for the QCA in assessing appropriateness under section 138(2) QCA Act in two ways, namely through the requirement to have regard to both:

(a) the object of Part 5 QCA Act, which refers to the desired effect of 'promoting effective competition' (s 138(2)(a), s 69E QCA Act); and

(b) the public interest, which is expressly stated to include 'the public interest in having competition in markets' (s 138(2)(d) QCA Act).

However, in applying those considerations the QCA must be very conscious of the fact that:

(a) unlike criterion (a) in the access criteria, these are considerations – not a threshold that must be satisfied – such that even if the QCA considered there was no material adverse impact on competition – that does not make an undertaking appropriate;

(b) the language of the section has clear differences to criterion (a) – with, for example, the factors relevant to appropriateness of an undertaking not imposing a materiality threshold;

(c) the 'promotion' of competition involves an improvement in the environment and opportunities for competition[5] – such that in assessing appropriateness by reference to the object of Part 5 QCA Act, appropriateness cannot rest on whether competition is actually improved – and the potential for inefficient pricing is relevant to the opportunities and environment irrespective of whether the QCA is convinced that the inefficient pricing will be of such an extent that competition in a dependent market will be materially impacted.

It automatically follows from those differences, that applying reasoning of the type adopted by the QCA in relation to criterion (a), including seeking to reach conclusions about appropriateness based on the conclusion that a 'transfer of value' from the users to DBCTM is not sufficient, is a failure to properly consider and apply the section 138(2) factors.

For the same reasons, starting from the proposition that the declaration review identified the competition problem to resolve in the undertaking (as DBCTM continues to asset the QCA should do) – fails to recognise that:

(d) appropriateness is about more than competition; and

[5] *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] 155 FCR 124

(e) there can be impacts on competition arising from an undertaking that were not the focus of the declaration review.

Again, the DBCT User Group holds serious concerns based on the reasoning of the Draft Decision and comments in the stakeholder forum that the QCA's recommendation position in the declaration review is having a heavy influence on the QCA's assessment of the form of regulation appropriate for the 2019 DAU, such that competition is not being considered in the different manner provided for in section 138(2) QCA Act.

3. The revenue adequacy principle does not suggest revenue exceeding efficient costs is appropriate

The DBCT User Group acknowledges that one of the pricing principles in section 168A QCA Act that the QCA is required to have regard to is that the price of access should *'generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved'*.

However, the DBCT User Group strongly rejects the suggestion made by DBCTM, and seemingly accepted by a member of the QCA in the forum, that such a principle should be interpreted to mean it is appropriate that revenue should *exceed* that required to meet efficient costs of providing the service.

Rather, the ordinary language of that principle suggests that it would be consistent with that principle if expected revenue *met* those costs (which both reference tariff and negotiate-arbitrate regulation should do).

The Revised Explanatory Memorandum which explained the introduction of the equivalent pricing principles into the national access regime is particularly instructive, noting:

> *The motive for regulating access prices is that, in the absence of regulation, the exercise by infrastructure providers of monopoly power could result in prices that are inefficiently high. … This principle aims to balance the setting of access prices to include a return reflecting the commercial and regulatory risks associated with investment (and thus not deter investment), while addressing monopoly pricing concerns.*[6]

In other words, it is clear this principle is intended to prevent inefficiently high pricing – and that should weigh against the negotiate-arbitrate regime that is openly sought to be justified by DBCTM for the very reason that it will generate returns above the efficient cost of supply.

In addition, as the ACCC has previously recognised:

> *The intent of the BBM [building block reference tariff model] is to ensure a firm can recover its efficient costs and receive a return on its investment that will compensate it for the risks involved but is not in excess of what it would earn in a fully competitive market (i.e. the circumstance where monopoly pricing is not possible). This is consistent with the pricing principles in Part IIIA that access providers are entitled to recover their efficient costs.*[7]

There is no basis for preferring the negotiate-arbitrate model based on the 'revenue adequacy' pricing principle in section 168A(a) QCA Act – as the reference tariff model is absolutely consistent with the pricing principles as already recognised by the ACCC.

[6] Revised Explanatory Memorandum to the Trade Practices Amendment (National Access Regime) Bill 2006, at [22.6]
[7] ACCC, Part IIIA access undertaking guidelines, August 2016, at 23.

4. The interests of access holders and access seekers are relevant

The interests of access seekers are expressly provided to be a mandatory consideration for the QCA in assessing appropriateness (s 138(2)(e) QCA Act).

In addition, the interests of access holders are clearly also relevant because:

(a) the interests, renewal and investment decisions of existing users are clearly relevant to:

(i) the object of Part 5 of the QCA Act through their impact on the efficient use of and investment in the terminal; and

(ii) the public interest, due to the royalties that they pay (which would be materially reduced by price increases given the status of terminal charges as a deduction), and employment and economic activity they provide being significant; and

(b) the QCA has recognised their relevance as a matter to be considered under section 138(2)(h) in the Draft Decision.[8]

Existing users and current access seekers have been unanimous in their opposition to DBCTM's proposal.

They have confirmed that they see none of the benefits (that the QCA speculates might exist) actually arising. Users and access seekers have expressed clear concerns about the only likely outcome being inefficiently higher pricing – which is consistent with the QCA's and Treasurer's findings in the declaration review that DBCTM has market power and an incentive and ability to increase prices, subject only to the constraints imposed by regulation, where what is being proposed is a lessening of regulation.

The DBCT User Group submits the interests of access holders and access seekers should weigh heavily against adopting a negotiate-arbitrate form of regulation.

5.2 Appropriateness

Ultimately the threshold for approval of a draft access undertaking is whether the QCA considers it is 'appropriate'.

The QCA has indicated in the Draft Decision that 'appropriate' should be given its ordinary meaning, and quoted case law suggesting:

The phrase "considers appropriate" indicates the striking of a balance between relevant considerations so as to provide the outcome which is fit and proper[9]

The DBCT User Group support that interpretation of what it requires to be appropriate.

However, where it has been clearly demonstrated that every factor in section 138(2) QCA Act weighs strongly against a negotiate-arbitrate model – with the potential exception of the interests of the operator (although the reference to 'legitimate' should be given meaning such that the DBCT User Group doubts it actually provides any support) – the DBCT User Group submits that the QCA should not be satisfied that the outcome proposed is 'fit and proper'.

It is not sufficient, and does not demonstrate an appropriate weighing of the section 138(2) QCA Act factors to speculate that 'negotiated outcomes may have a number of benefits'[10] as the Draft Decision does, without:

(a) being able to identify what negotiated terms are likely to provide benefits and how likely they are to arise (both with and without the proposed form of regulation);

[8] Draft Decision, 22-24.
[9] *Mitchell v R* (1996) 134 ALR 449 at 458
[10] Draft Decision, 7

(b) actively weighing the likelihood and magnitude of any such benefits against the adverse consequences of the negotiate-arbitrate model that are likely to arise; and

(c) where benefits only accrue to DBCTM, balancing those benefits against all of the other considerations set out in section 138(2) QCA Act.

In any case, it is acknowledged that the QCA has determined that the 2019 DAU is inappropriate and should be amended – such that the more important issue is what the QCA Act requires at the next stage of determining the amendments the QCA 'considers appropriate'.

5.3 Determining appropriate amendments

Under section 134(2) QCA Act, where the QCA determines (as it rightly has in the Draft Decision[11]) that the 2019 DAU is not appropriate to approve, the QCA must require the 2019 DAU be amended in *'the way the authority considers appropriate'*.

The DBCT User Group once again registers its strong disagreement with the QCA's position in the Draft Decision that its role under section 134 QCA Act is somehow impacted by the draft access undertaking *'as submitted'*.

That reasoning demonstrates a clear error of law in how the QCA's statutory function is to be performed. It is the initial analysis under section 138(2) QCA Act of the initial draft access undertaking submitted that necessary starts with what was submitted. However the amendment consideration process under section 134 QCA Act is not one confined, as the Draft Decision seeks to, by reference to a starting point of what was submitted.[12]

Rather, an assessment of what constitutes appropriate amendments (or fit and proper amendments to use the QCA's analysis from the Draft Decision) necessarily requires a consideration of the different amendments that could be required. How else can one logically determine whether the proposed amendments are appropriate?

Appropriateness, is not something that can be assessed in a vacuum. Appropriateness is necessarily a relative concept, which takes its meaning from its benefits and disadvantages relative to the potential alternatives.

That is particularly evident in this case where the changes required to the 2019 DAU to revert to a reference tariff form of regulation are no more extensive than those the QCA is considering – such that even 'starting with' the 2019 DAU as submitted should not confine the QCA in the way the Draft Decision appears to assume.

By contrast, the real difficulty of the interpretation adopted in the Draft Decision of narrowly confining the QCA to only incremental changes to the form of regulation submitted is readily apparent. In particular, that position suggests that the QCA's decision on amendments that are appropriate should be influenced by the terms of a draft access undertaking that the QCA has already found inappropriate (as it is only where the QCA has considered the initial draft access undertaking inappropriate that the amendment power under section 134 QCA Act applies). In other words, a monopoly infrastructure provider can constrain the QCA's power to determine appropriateness through the inappropriate starting point it submitted.

Accordingly, the DBCT User Group submits that to properly consider the appropriate amendments, the QCA necessarily needs to weigh the relative merits of the reference tariff and negotiate-arbitrate form of regulation in a way that is not evidenced in the Draft Decision.

[11] Draft Decision, iv.
[12] Draft Decision, 17.

6 The relevance of 'primacy of negotiation'

6.1 QCA's approach

The preliminary recommendations reached in the Draft Decision are principally based on two propositions, namely:

(a) the claim that primacy should be given to negotiated outcomes because there may be benefits of negotiated outcomes;[13] and

(b) the assumption that the existing form of regulation does not provide such primacy, and disincentivises negotiated outcomes, such that it is necessary to obtain the potential benefits to implement a negotiate-arbitrate regime.[14]

Given that it is clear from the Draft Decision that without this reasoning, the QCA would not consider a negotiate-arbitrate regime appropriate these claims and assumptions need to be critically considered.

6.2 Assessing whether primacy of negotiation is appropriate in the circumstances of DBCT

The DBCT User Group acknowledges that, in appropriate circumstances, providing primacy to negotiated outcomes can lead to more efficient outcomes.

That is of course how competitive markets produce efficient outcomes.

However, the DBCT service is not provided in a competitive market, and the principle of 'primacy of negotiation' cannot be expected to produce benefits or efficient outcomes irrespective of the circumstances of the relevant service and market.

Different forms of regulation have been developed for a reason. Economic regulators and legislators have long recognised that each form of regulation has costs and benefits and accepted that what constitutes appropriate regulatory settings will therefore vary with the circumstances of the regulated service.

As much was clearly recognised by the Productivity Commission in its review of the national access regime:[15]

That is not to suggest that negotiation and arbitration will be appropriate in every context. The particular experiences of service providers, access seekers and regulators in some sectors … have given rise to alternative approaches to access dispute resolution. Measures such as upfront regulatory arrangement can be more effective than the generic access regime at resolving access disputes in the specific circumstances of individual industries.

The Productivity Commission's analysis is particularly revealing in that it clearly indicates that the question the Commission was considering (the approach which should be taken in a general regime which would apply to any significant infrastructure service) was fundamentally different to that which is before the QCA.

In this 2019 DAU process the QCA has the benefit of being able to (and, in fact, is required to) determine the appropriate form of regulation for a particular service.

The DBCT User Group submits that it is evident from the approach taken to the form of regulation by Australian economic regulators and policy makers, where they have the opportunity the QCA has here, that the following are the most critical aspects of the circumstances of the service that need to be considered:

[13] Draft Decision, 7.
[14] Draft Decision, 53.
[15] Productivity Commission, National Access Regime Productivity Commission Inquiry Report No. 66, 25 October 2013, at 128.

	Circumstances that favour negotiated outcomes	Circumstances that favour reference tariffs
Supplier's market power and constraints	No market power or material constraints such that regulatory intervention is only needed as a last resort	Market power without sufficient constraints in the absence of regulation
Scope for negotiation	Multiple tailored or customised services provided to different customers	Common service provided to customers
Costs	Limited number of users so the costs of negotiation/arbitrations are limited	Large number of users such that the cost of negotiations/arbitration are excessive

A review of those factors, weighs strongly in favour of only a negotiate-arbitrate regime being appropriate. This is discussed in further detail in section 7 to 10 below).

However, even if the QCA was to reach the contrary conclusion, that of itself is not sufficient. As discussed in more detail in section 11 below, the reference tariff model is also a negotiate-arbitrate regime under which negotiated outcomes are given priority – such that for it to be appropriate to remove the reference tariff the QCA must also be convinced that the benefits the QCA anticipates would not arise with a reference tariff.

7 Market power and lack of constraints

7.1 Regulatory precedent for services with similar characteristics

The DBCT User Group also submit, consistent with its earlier submissions, that in assessing appropriateness the QCA should have greater regard to regulatory precedent regarding the appropriate form of regulation in circumstances most similar to those of the DBCT service.

In particular, it needs to be kept in mind that across the declaration review and 2019 DAU process, the QCA has consistently found:

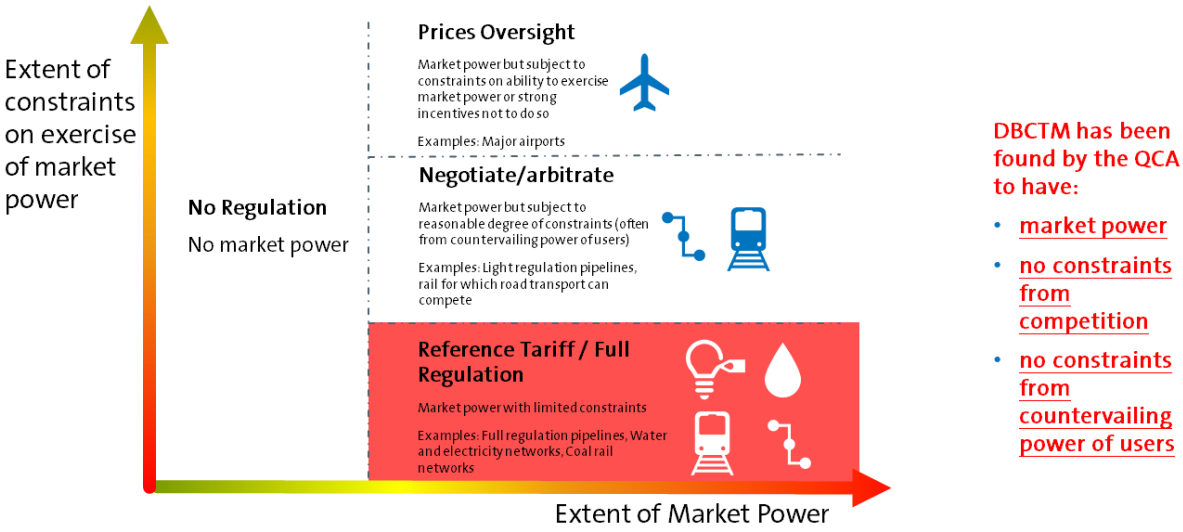
(a) DBCTM has market power;

(b) DBCTM faces no constraints from competing coal terminals;

(c) DBCTM faces no constraints from countervailing power of users;

(d) DBCTM has the ability and incentive to engage in monopoly pricing – subject only to the constraints imposed by access regulation.

In equivalent circumstances, it is clear from other regulatory decisions that regulators have imposed reference tariffs or full regulation as shown in the diagram below.



DBCT is squarely in the bottom right hand corner of this graph – where only full regulation is appropriate

The DBCT User Group does not dispute the QCA's view that there may be alternative means to constrain market power other than the approval of a reference tariff.[16] However what is demonstrated above is that what provides a sufficient constraint varies with the extent of market power that is held. DBCTM has an extreme degree of market power that is much greater than other infrastructure services for which it has been accepted that a negotiate-arbitrate regime will adequately constraint them.

Where a monopoly service has these characteristics, it cannot be resolved merely through trying to resolve information asymmetries – as, even with perfect information, negotiation based models will not constrain market power which is not constrained by competitors or countervailing power.

7.2 How DBCT is different to services for which negotiate-arbitration regulation is adopted

As the diagram above (presented in the stakeholder forum) aptly shows, the appropriate regulatory approach is a spectrum based on the extent of the infrastructure service provider's market power and the effectiveness of competition.

The circumstances of the DBCT service are distinctly different to infrastructure services where negotiate-arbitrate has been considered appropriate.

In particular:

(a) light regulation gas pipelines are subjected to light handed regulation in recognition that while the pipeline might be a monopoly for transport of gas from a particular basin or field it is often constrained by:

  (i) basin on basin / field on field competition – as customers can obtain gas from an alternative field or basin; or

  (ii) a very small number of customers – such that the co-dependency create a reasonable degree of countervailing power held by the customers; or

(b) rail networks that are subjected to light handed regulation are typically characterised by features such a combination of competition from road haulage, dependence on a major

[16] Draft Decision, 8.

customer that provides countervailing power, or a wide variety of freight types and services such that reference tariff pricing would be extremely costly and difficult;

Light handed regulation is seen by regulators as appropriate in those settings because it is anticipated that the circumstances make it likely that appropriate outcomes will arise from negotiation without regulatory intervention – such that primacy can appropriately be given to negotiation with a lower cost form of regulation provided through an unlikely to be called upon backstop being appropriate.

However, those type of features evidently do not exist in respect of DBCT.

Rather, as the QCA has previously recognised in the context of analysis of an appropriate weighted average cost of capital, DBCTM is much more akin to electricity and water utilities – which are clear monopolies with strong market power, providing a common service, to multiple users, with no competition or countervailing customer power.

Accordingly, the circumstances of the DBCT service, overwhelmingly suggest that full regulation or reference tariffs are appropriate.

The analysis of this issue in the Draft Decision is limited – in that while it accepts the characteristics of DBCT are relevant, and that DBCTM's ability and incentive to exercise its market power must be constrained for an undertaking to be appropriate[17] - it goes on to conclude that such a constraint can be provided without a reference tariff.[18]

However, given the stark contrast between the position adopted in the Draft Decision and the approach taken by other economic regulators, the DBCT User Group struggles to see how this conclusion reflects the realities of the DBCT service.

7.3 Even assuming arbitration could be made a sufficient constraint it is not a cost-effective method of regulation

The only conclusion really open on reading the Draft Decision is that the QCA has concluded that the arbitration regime will provide the required constraint. However, even if it was accepted that was true (which the User Group rejects as discussed in section 12 below), that is not where a proper assessment of appropriateness would stop. Not all ways of providing a constraint are equal. Relying on numerous bilateral and costly arbitrations to provide the constraint is clearly not an effective or appropriate outcome.

The DBCT User Group notes the Interim Draft Decision's acknowledgement that:[19]

there are likely to be benefits to requiring DBCTM to amend its 2019 DAU to incorporate a reference tariff

and

we consider that a reference tariff has certain specific advantages associated with it … and we consider these are advantages are likely to outweigh the drawbacks of including a reference tariff or tariffs in the 2019 DAU. This means that a reference tariff or tariffs may therefore be an appropriate, convenient, cost-effective and transparent method for addressing the concerns with the DAU's pricing model that have been identified in this interim draft decision.

It follows that even if the QCA was somehow satisfied that it will possible to constrain DBCTM's market power under either form of regulation – the QCA has already concluded that it is more beneficial to do so using a reference tariff model. The DBCT User Group submits that conclusion

[17] Draft Decision, 49
[18] Draft Decision, 51.
[19] Interim Draft Decision, 61

is inconsistent with the Draft Decision conclusion that a negotiate-arbitrate model without a reference tariff is appropriate.

8 Limited scope for negotiation

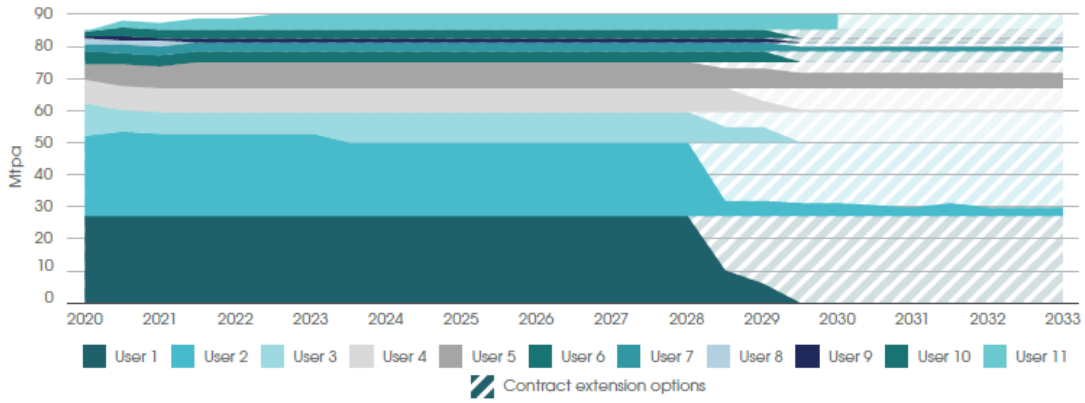
8.1 No allocative efficiency benefits – as contracting of capacity and negotiation of pricing are separated

Primacy of negotiation is traditionally justified by reference to allocative efficiency. That is, that negotiated outcomes create efficiency by providing an approach which results in capacity being allocated to those customers which place the greatest value on the service (and therefore have the greatest willingness to pay).

However, allocative efficiency will not be produced from negotiated outcomes in respect of the DBCT service.

As shown in the diagram below from the Dalrymple Bay Infrastructure prospectus[20], all existing users and access seekers which have entered 8X conditional access agreements have effectively contracted long term capacity – without pricing having been determined.

Figure 4.12: Contracted capacity and current extension options[134]



Even for future access seekers, DBCTM's proposal is to continue the position that contracting capacity occurs through order of priority in the queue (subject to modifications for notifying access seeker process) – without reference to willingness to pay.

Accordingly the benefits the Draft Decision suggests could arise cannot be based on allocative efficiency.

8.2 There is no customised service

In addition, the benefits the Draft Decision suggests could arise cannot be based on any customisation or tailoring of the actual coal handling service provided.

As the QCA has previously found:

(a) there is a single core coal handling service provided by DBCTM;

(b) any variations in an access holder's use of that service will vary over time, and fall within what would normally be expected to form part of the core service; and

(c) to the extent that there was additional value in varied services that would have been expected to have been negotiated under the existing form of regulation.[21]

[20] Dalrymple Bay Infrastructure Prospectus, 78.
[21] Interim Draft Decision, 10 and 59-61

Those findings reflect that DBCT is designed and operated as a multi-user port where that single core coal handling service is provided by common infrastructure to all users by the same operator in accordance with the same universally applicable terminal regulations.

As a result, unlike for a multi-purpose port or rail line, where different types of vessels/freight will involve different usage of the port or rail infrastructure, there is no real prospect of negotiated outcomes adding value or aiding efficiency through the provision of a customised service.

DBCTM's CEO admitted as much in the recent QCA stakeholder forum, confirming that DBCTM did not envisage varying the service that was contracted.

In those circumstances, where there is a standardised service, one of the key benefits that regulator's typically perceive negotiate-arbitration regulation to provide does not exist.

The AER's submissions to the AEMC in relation to the regulation of gas pipelines is instructive:[22]

The negotiate-arbitrate framework is an appropriate model for a sector that provides customised services …

However, in many ways the negotiate-arbitrate framework sits more comfortably with transmission pipelines than it does with distribution pipelines. There are fewer services offered by distribution pipelines and they are more standardised than those offered on transmission pipelines, meaning tariffs charged for distribution pipelines are more likely to reflect the reference services.

Given this, when investigating the best framework for regulating distribution pipelines, it will be important for the AEMC to decide whether tailoring terms and conditions has value for distribution pipelines and their customers. If it does not, we question the value of having the negotiate-arbitrate framework for distribution, and whether more specific price determinations, such as those in electricity may be more appropriate.

The DBCT User Group submits that analysis reflects the question the QCA should be considering in its analysis of the amendments that it considers are appropriate under section 134 QCA Act.

8.3 Existing contracts leave an extremely narrow scope of negotiations

As noted above, the Draft Decision suggests that there may be benefits from negotiated outcomes.

The fact that the Draft Decision relies heavily on this suggestion, appears to indicate the QCA considered there was a reasonable likelihood of a negotiate-arbitrate regulation resulting in more customised or tailored terms for access holders or access seekers.

However, as discussed in the 5th User Group Submission and at the stakeholder forum, there is in fact a very narrow range of matters in relation to which negotiations can actually occur.

In particular:

(a) for existing users, all terms other than price have already been agreed as part of the access agreement they have signed, such that the scope of negotiation during a price review is effectively limited to price and otherwise only necessary consequential changes[23] (and the DBCT User Group strongly rejects that the 'opportunity' to negotiate a higher price can be considered a benefit). Not renewing at this price review is not an option with all existing users having renewed their contracts until at least 2028;

(b) for access seekers that are parties to '8X' conditional access agreements, such entities are in the same position, because the conditional access agreement brings into existence

[22] AER Submission, Review into the scope of economic regulation applied to gas pipelines, August 2017 at 6-7.
[23] Clause 7.2 current Standard Access Agreement

an access agreement on the terms of the standard access agreement which applies when underwriting condition satisfied – such that, again, only price remains to be negotiated;

(c) even for other access seekers, as the only category of potential user/access seeker which could potentially agree non-standard terms:

(i) as DBCTM openly admitted at the stakeholder forum, the scope of the service cannot realistically be tailored given it is a multi-user service provided by common infrastructure such that there is (consistent with the QCA's findings) a single coal handling service;

(ii) timing pressure to obtain the capacity in parallel to contracting rail capacity and developing and financing the related new coal mining project for which the capacity is sought – will impose pressure on access seekers to agree standard terms; and

(iii) access seekers are not well placed to determine what customised amendments they may benefit from at the early stage of project development when access is required to be contracted.

In addition, negotiation of customised terms for new access seekers is even less viable in respect of short term capacity and the notifying access seeker process – which based on DBCTM's claims about the likelihood of future access, will be a reasonable proportion of new access seeker contracting in the next regulatory period, such that this should not be written off as a minor issue.

This is admitted in the Dalrymple Bay Infrastructure's recent prospectus which notes that:[24]

Negotiations are therefore expected to primary focus on the TIC

Where the only real scope for negotiation is price – without any change in the service provided – the DBCT User Group question how it can be concluded that there may be benefits from such negotiations.

To the DBCT User Group's understanding the key reason that DBCTM has submitted that a higher price (above the efficient cost of supply) will be beneficial is that it will incentivise investment in the terminal. However, the DBCT User Group submits that the QCA cannot be satisfied that a reference tariff model does not already provide these incentives given:

(d) significant expansions have occurred to the terminal while it has been regulated – with Brookfield's own submission to the NCC in respect of certification expressly noting:[25]

BIP considers that the DBCT Access Regime has, in general, worked well and to the benefit of all stakeholders. Most importantly, this has been reflected in an increase in the capacity of the terminal of around 52 per cent since the 2006 Access Undertaking was approved. The owners have investment more than AU $1.4 billion in the staged expansion of the terminal in response to growth in demand for coal from the region;

(e) DBCTM already has enforceable obligations to expand to meet reasonably anticipated future demand which would remain in the access undertaking[26] and the Port Services Agreement with the State;[27]

(f) A reference tariff model provides the ability to adopt a higher WACC where the QCA considers that is appropriate to incentivise expansion or compensate DBCTM for any

[24] Dalrymple Bay Infrastructure Prospectus, 58.
[25] Submission from Brookfield Infrastructure Partners L.P. – Application for Certification of the DBCT Access Regime, 14 February 2011, [11].
[26] Clause 12, 2019 Draft Access Undertaking
[27] Clause 11, Port Services Agreement

additional expansion risk being assumed – and that has in fact occurred in connection with a previous DBCT access undertaking.

8.4 Limited prospects and value of variations DBCTM has indicated it may offer

DBCTM's only response to the identified limited scope of negotiations to date, was to suggest at the stakeholder forum that it would be willing to discuss changes such as a rolling term, linkage of the terminal infrastructure charge (***TIC***) to coal price or longer term price certainty.

The DBCT User Group strongly submits, those assertions about a future willingness, which DBCTM can never be held accountable for when they do not ultimately deliver, do not justify a conclusion that beneficial negotiated are likely.

Firstly, as discussed in section 11 below, any of those terms could have been agreed under the existing reference tariff form of regulation – such that if DBCTM was truly willing and interested in offering those terms – it would already have happened. Accordingly, none of them justify or make appropriate the adoption of a negotiate-arbitrate regime.

Second, users that were involved in the initial discussions to which DBCTM referred in the stakeholder forum have confirmed that:

(a) those were ideas floated by DBCTM with an indication that a higher price would be payable for such terms, without DBCTM being willing to disclose the pricing proposed; and

(b) DBCTM made absolutely no commitments that it would ultimately provide such terms and users' universal perception was that DBCTM was merely paying lip service to the concept of tailored non-price terms for the purposes of its arguments before the QCA.

Consequently, the DBCT User Group submits that those mere loose suggestions from DBCTM about future possibilities provide no real evidence that DBCTM will or is likely to provide customised or tailored terms of value to users or access seekers.

Third, even if it is assumed that DBCTM would be willing to agree to such terms and that changes of the nature raised by DBCTM would have some potential value to a user or access seeker, there is no evidence provided to indicate that DBCTM would offer these at a price which would result in this customisation being considered an overall benefit by a user or access seeker.

Fourth, the DBCT User Group has significant doubts that:

(a) pricing with a coal price linkage is ever likely to be agreed – noting that:

  (i) a number of users have discussed coal linkages with rail haulage and access providers in the past without any such agreements being reached due to the complexities involved in setting a coal price linkage that both parties consider fair and appropriate;

  (ii) taking coal price risk is not something that an infrastructure service provider of DBCTM's nature has ever been comfortable with assuming – such that the value they are likely to require to be traded for it will be highly inefficient for coal producers which are knowledgeable in and can better manage the coal price risk themselves through production, marketing and hedging strategies;

  (iii) Dalrymple Bay Infrastructure's prospectus specifically highlights that DBCTM is not exposed to coal price risk;[28]

  (iv) given the different qualities (and therefore prices) of coal produced by various shippers through the terminal, and the fact that the quality of coal produced by a

[28] Dalrymple Bay Infrastructure Prospectus, 73.

user can also change over time, the difficulties of negotiating such arrangements are exacerbated;

(b) pricing fixed for a longer term is ever likely to be agreed, given that:

(i) users are becoming more risk averse in relation to long term contracting than was previously the case given the volatility of coal prices (where impacts of COVID and Chinese trade barriers have added to the usual cyclical market volatility);

(ii) where the QCA imposes a negotiate-arbitrate regime, users and access seekers consider the adverse consequences of doing so will have become starkly evident in the first 5 years and will not want to foreclose the potential for the QCA to seek to prevent such outcomes continuing into the future by having locked in inefficiently high prices for a longer period.

Fifth, the rolling term is a clear example of the problems of DBCTM's proposed negotiate-arbitrate model. A rolling term will only be attractive to an individual user where it provides it with an ability to terminate earlier than every 5 years (when the renewal option becomes exercisable under the standard terms[29]). Yet when that is coupled with the socialisation arrangements that exist in existing user agreements and DBCTM's proposed 2019 DAU standard access terms, it clearly changes the volume risk profile for other users. That is the case because the earlier end of such a rolling term agreement, will increase tariffs of other users through the socialisation arrangements.

Consequently, even if it may arguably be a benefit to the individual users which receives a shorter rolling term – it is a disadvantage to all other existing users – and an inefficient externality that other users cannot mitigate or control. The DBCT User Group consider that cannot be considered an overall benefit and, in fact, is a clear example of why this form of regulation is inappropriate and open to manipulation and gaming.

9 Increased Costs

9.1 Negotiate-arbitrate will involve substantially higher costs

The total costs of a negotiate-arbitrate model will be ***substantially*** higher than a single process for assessment of a reference tariff.

In particular:

(a) due to the need for numerous bilateral negotiations, there will be a material increase in transaction costs relative to the current streamlined single process for setting common terms;

(b) access holders and access seekers will cease to be able to engage a common legal and economic adviser, and will be required to appoint individual advisers at great individual expense simply in order to be able to asset the merits of DBCTM's pricing (noting that DBCTM has already sent confidentiality agreements to existing users in the context of the current contractual price review that would restrict them from sharing advisers);

(c) the potential for arbitration will involve very significant additional costs, including further legal and economic adviser costs; and

(d) there is unlikely to be any reduction in QCA costs, as if even a single arbitration occurs the QCA will need to conduct a similar process to determine the tariff – if anything the costs are likely to be greater due to the QCA having to engage with the application of the arbitration criteria for the first time.

[29] clause 20 Standard Access Agreement

Those negative cost consequences should weight strongly against adopting the negotiate-arbitrate model.

However, it is not just the total cost that makes negotiate-arbitrate regulation inappropriate, but the asymmetric nature of how that increase cost is borne by different stakeholders and the resulting impact on parties incentives in relation to negotiations and arbitration.

9.2 Asymmetric cost burden

DBCTM's lack of concern about the cost issues are perhaps unsurprising, given that it is users and access seekers, not DBCTM, that will face the vast bulk of these increases.

While DBCTM may arguably face some minor incremental costs:

(a) it will be able to engage a common set of legal and economic advisers;

(b) given the excessive amount it chooses to spend on regulatory processes it may well reduce its overall costs; and

(c) given the commonality of issues that will be subject to access negotiations and arbitration, will face relatively limited additional costs for each arbitration it is involved in (relative to each user or access seeker having to duplicate the costs incurred by other users or access seekers).

9.3 Consequences of asymmetric cost burden

The cost burden falling on users and access seekers is particularly inappropriate due to the impacts that will have on the parties' incentives in access negotiations, negotiating outcomes and the constraints imposed by the availability of arbitration. .

In particular, the costs of arbitration will be regarded as very significant for individual users, and to an even greater degree, individual access seekers.

As raised at the recent stakeholder forum (both by the User Group and a representative of New Hope as an access seeker), the hundreds of thousands of dollars that would typically be involved in an arbitration of this nature can be very significant in terms of cash flow at the early stages of a project (which will not be producing at this stage).

Because the costs are so onerous, it will provide a strong disincentive for access seekers, which may not have an existing revenue producing project, to make use of the proposed backstop. That disincentive will be well known to DBCTM, who does not face the same issue as the incremental costs of a further arbitration will involve very limited extra costs for DBCTM.

This creates the very real risk that access seekers will settle for inefficiently high price outcomes due to the prohibitive costs or arbitration, and DBCTM will not be constrained to offer reasonable prices due to the theoretical presence of arbitration in those circumstances.

This disadvantage to efficient access seekers is inappropriate, provides a barrier to entry, and should weigh heavily against a non-reference tariff model.

10 Incentives to negotiate

Logically, the likelihood of beneficial negotiated outcomes occurring should be considered having regard to the incentives DBCTM will have in pricing negotiations.

The QCA has consistently found across the 2017 and 2019 access undertaking processes and the declaration review that, in the absence of regulatory constraint, DBCTM has market power, and the ability and incentive (as a profit maximising strategy) to engage in monopoly pricing.

That consistent finding arises from the simple fact that DBCTM is a natural monopolist that faces no competition, such that users have no countervailing powers as cannot threaten to switch to other competing suppliers. Given captive sunk investments users and access seekers in the Hay Point catchment are therefore completely 'captive' to DBCTM.

Accordingly, for the QCA to find that DBCTM would be incentivised to reach an efficient negotiated outcome the form of regulation would need to incentivise it to do so.

The DBCT User Group submits that, in the form the Draft Decision indicated the QCA was willing to require it to be amended, it does quite the opposite.

From DBCTM's perspective:

(a) It knows that it stands no risk of losing volume through monopoly pricing. The only 'threat' that a user or access seeker has if they do not agree with the price is to arbitrate – existing users have long term contracts the earliest of which expires in 2028, and even access seekers have projects that are dependent on access to DBCT as a monopoly port such that not contracting is not a realistic option available;

(b) DBCTM (and users/access seekers) know that DBCTM will have significant cost and tactical advantages in an arbitration as discussed above – and will, frankly, be optimistic about receiving inefficiently high pricing from an arbitration given the commentary in the Draft Decision about the arbitration criteria;

(c) DBCTM also knows that some users will find the costs of arbitration prohibitive; and

(d) DBCTM knows that the QCA will take into account previously agreed or determined outcomes such that it is highly incentivised to pursue higher price against each individual users so as to trigger an upwards spiral of higher prices on other users, which will have a revenue accretive domino effect across the users of the terminal – this is the very strategy referred to by the Essential Services Commission in the Port of Melbourne Market Rent Review Report as a 'recycling of monopoly outcomes'.[30].

As a result, DBCTM is only incentivised to agree a negotiated outcome where it has already achieved an inefficiently high price against a user/access seeker which is willing to settle at that level either because arbitration does not provide a credible backstop for them or because they suffer from information asymmetry to the extent that they are unaware that the price is inefficient.

11 Right to reach negotiated outcomes already exists

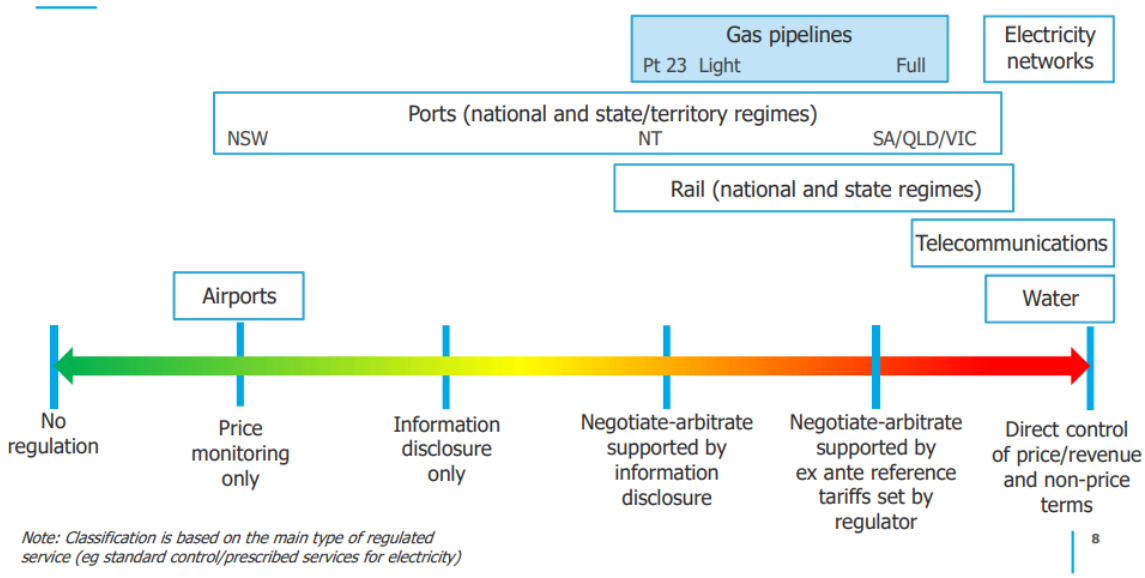
11.1 Existing reference tariff model provides primacy to negotiated outcomes

The DBCT User Group submits that the assumption that the existing DBCT reference tariff form of regulation does not provide primacy of negotiated outcomes is clearly incorrect and needs to be reconsidered.

That is because it is, in fact, a negotiate-arbitrate regime supported by ex-ante reference tariffs set by a regulator, not regulation by direct pricing controls without provision for negotiation as is applied to electricity networks.

These are in fact materially different points on the spectrum of potential regulatory approaches as shown in the diagram below:[31]

[30] Essential Services Commission, Port of Melbourne – Market Rent Inquiry 2020, 41
[31] Owens, Richard, *Gas Pipelines: Have we got the regulatory balance right?* (presented at ACCC/AER Regulatory Conference), 1 August 2019



The Draft Decision correctly recognises this position:[32]

a regulatory framework that incorporates a reference tariff can provide scope for parties to reach an agreement on the terms and conditions of access

However, that significantly understates the potential the existing reference tariff form of regulation provides for negotiated outcomes. In fact the existing form of regulation is actually a form of negotiate-arbitrate regime itself, simply with a set of reference price and non-price terms which apply as the backstop except where DBCTM and the relevant user/access seeker agree there is benefit in reaching different terms.

Under the existing access undertaking, there is clear provision for non-reference tonnage, where the terms are not in all material respects the same as the standard access agreement and access charges are subject to agreement (see sections 5.4(e)(2) and (5), 5.4(j)(4), 5.5(d)(3), 5.12(b)(3), 11.3(a)(4) and 12.5(a)(2)(B), of the existing access undertaking and the definitions of Non-Reference Tonnage, Reference Terms and Reference Tonnage).

It is clear from those provisions that where both DBCTM and a user/access seeker considered there were benefits from a different negotiated outcome they would pursue them.

Given both of the alternative forms of regulation which the QCA is being asked to consider, give the parties an opportunity to negotiate, if negotiated outcomes do lead to benefits as the Draft Decision speculates, that benefit can be obtained under either form of regulation.

Once that is understood, it becomes clear that there are no real benefits which can arise from a negotiate-arbitrate model that cannot be achieved under a reference tariff form of regulation – such that a proper weighing of the section 138 QCA Act factors which takes into account the disadvantages of the negotiate-arbitrate model, should find the negotiate-arbitrate model inappropriate.

11.2 Lack of any negotiated outcomes

Despite the QCA's recognition that the existing reference tariff mode of regulation gives primary to negotiated outcomes, by DBCTM's own admissions, no material changes have been negotiated.

[32] Draft Decision, 7.

Accordingly, the QCA should be asking why and scrutinising any suggestion that negotiated outcomes are likely or that DBCTM has incentives to make appropriate offers in access negotiations.

The Draft Decision suggests that *'parties may be less inclined to engage in commercial negotiation of non-price terms when there is a reference tariff*'.[33] The suggestion appears to be that a reference tariff provides a disincentive for a negotiated outcome. However, that does not stand up to scrutiny.

A reference tariff *does not* disincentivise negotiations about terms that vary from the standard access agreement or reference terms – it only disincentivises accepting a higher inefficient price for the standard terms. Where DBCTM was willing to over variations that were considered sufficiently valuable to a user that could occur.

The DBCT User Group submits that it is not the form of regulation that is giving rise to the lack of negotiated outcomes, but DBCTM's unwillingness to offer variations on reasonable terms.

The legal adviser to the DBCT User Group has advised access seekers on negotiations with DBCTM, including where the potential for non-standard terms has been discussed, and can confirm that it is not true that users or access seekers have never raised such terms. What the current form of regulation does, is ensure that where DBCTM or an access seeker raises a non-standard term for negotiation, the discussion about the price trade-off to achieve that non-standard term is an informed one where both parties understand how much either party is asking for the price to vary from the reference tariff – i.e. being able to quantify the value placed on such a non-standard term.

However, the QCA has in front of it is clear evidence that over a lengthy period DBCTM has been unable or unwilling to provide alternative terms to a user or access seeker that the parties have been able to agree provided benefits they valued sufficiently to agree to a non-standard price. Yet that is the very efficient benefits that a negotiated outcome is intended to provide.

Against, this backdrop, the DBCT User Group submits that the QCA must seriously reconsider whether:

(a) there is any likely benefits from negotiated outcomes; and

(b) if it considers there are likely benefits from negotiated outcomes, whether those benefits are actually any more likely to be achieved without a reference tariff.

12 Arbitration does not provide an appropriate backstop

12.1 What would be required to provide an appropriate backstop?

The Draft Decision, and the QCA's preliminary view that it would approve a negotiate-arbitrate form of regulation, is dependent on its conclusion that arbitration provides an appropriate backstop that constrains DBCTM's ability and incentive to engage in monopoly pricing.[34]

In order to be an appropriate, it should be uncontroversial that the form of backstop adopted therefore needs to be a credible threat that dissuades either party to access negotiations from taking unreasonable positions that materially depart from an efficient price.

To achieve that objective, an appropriate backstop needs to:

(a) provide relatively certain and predictable and predicable outcomes;

[33] Draft Decision, 53.
[34] Draft Decision, 49.

(b) be accessible (in terms of cost and timing) and not strategically favour a particular party; and

(c) produce efficient pricing where it applies.

For the reasons set out below, the DBCT User Group considers that arbitration does not meet any of those requirements.

12.2 Certain and predictable outcomes

In order for DBCTM and access holders/seekers to be incentivised to reach negotiated outcomes without resort to arbitration, the parties need to have a clear understanding of the likely range of outcomes from an arbitration.

The ACCC, as a regulator that has had significant experience with access arbitrations, has previously provided importance guidance on the need for predictability in arbitration outcomes.

In particular, in respect of the consideration given to regulation of natural gas pipelines, the ACCC submitted:

The ACCC considers predictability and transparency are essential features of all regulatory frameworks and can also help reduce the frequency of commercial arbitration in the current context. A degree of predictability around likely arbitral outcomes will be a key contributor to the success of the Framework and parties reaching commercial agreement.

…

The ACCC supports an arbitration option that provides incentives for pipeline operators to settle, and this is likely to be done through an expectation of more cost oriented prices along with the risk of public notification of a dispute and the risk of backdating arbitral determinations. i[35]

However, the DBCT User Group consider that there is nearly no certainty provided by the proposed arbitration arrangements in respect of DBCT where:

(a) the Draft Decision indicates that the QCA will not provide any substantive guidance in its arbitration guidelines;

(b) the QCA has not (to the DBCT User Group's knowledge) arbitrated pricing to a declared service previously applying the proposed arbitration criteria;

(c) there is contention and dispute in the submissions about the interpretation of the section 120 QCA Act arbitration criteria – and a concern that the 'value criterion' which the QCA envisage applying could lead to a serious upwards bias to future pricing;

(d) the QCA is not prescribing any methodology (building blocks or otherwise) that DBCTM must use to set pricing – just that it must disclose 'its methodology';

(e) even where DBCTM applies a building blocks methodology, it is only proposed that the remediation estimate (not the actual resulting remediation allowance) and the depreciation methodology are prescribed by the QCA – such that any constraints on those matters can easily be overcome by DBCTM inflating other parameters – particularly noting that some of the most fundamental parameters such as the weighted average cost of capital (***WACC***) are proposed to be left unprescribed;

(f) a QCA member appeared to suggest in the stakeholder forum that pricing above competitive levels was appropriate and acceptable where it was 'merely' an inefficiently high price that represented a transfer of value from users to DBCTM and the monopoly pricing was not so significant that it was impacting on competition in dependent markets.

[35] ACCC, ACCC Submission on Gas Pipeline Information Disclosure and Arbitration Framework Implementation Options Paper, 13 April 2017, 15

The combination of those factors produces very significant uncertainties regarding the outcome for the negotiating parties.

Where parties have clear expectations of the likely range of possible outcomes from an arbitration that will incentivise reaching a negotiated outcome in that reasonable range – rather than incurring the costs and risks of arbitration for limited possible advantage.

However, where the range is wholly uncertain (as it will be in respect of the DBCT service based on the current proposal), but DBCTM knows that there will be significant upside from its current reference tariff pricing and the uncertainty really only relates to how high the QCA will permit it to raise its pricing, DBCTM will be highly incentivised to pursue higher pricing in arbitrations. This completely undermines the very purposes of the QCA proposing arbitration.

12.3 Accessibility

As discussed above in section 9 of this submission:

(a) there are material costs imposed by arbitrations;

(b) the cost burden will fall disproportionately on users and access seekers which will each individually face the full costs of an arbitration;

(c) the costs are likely to be prohibitive for at least some access seekers, such that they are likely to effectively forced to settle at inefficiently high prices; and

(d) DBCTM will have a significant cost and strategic advantage due to participating in multiple arbitrations such that the incremental cost of another arbitration is a far lesser burden and disincentive for engaging in arbitration.

In addition, there are real timing challenges where access is being sought in the context of short term capacity or in the notifying access seeker process. A negotiate-arbitrate model implicitly assume that there is time for the parties to engage in an informed negotiation and utilise arbitration as a credible backstop where there is no agreed resolution. However, that assumption does not hold true in at least those contexts.

12.4 Production of efficient pricing

The DBCT User Group also does not consider that the proposed arbitration arrangements would produce efficient and appropriate pricing.

The DBCT User Group continues to hold those concerns because:

(a) DBCTM's strategic advantage of being involved in every arbitration is likely to put them in a better position to make arguments to the QCA, and to provide greater resources towards pursuing its position in an arbitration;

(b) the information asymmetry issues that confront users will be particularly exacerbated in an arbitration where DBCTM will have perfect information on its future intentions and costs, whereas DBCT users and access seekers will only have disclosures of past outcomes;

(c) the arbitration criteria in section 120 QCA Act are high level in nature, and with the QCA never having conducted a pricing arbitration of this nature before, and in the absence of clear substantive guidelines from the QCA, create a high degree of uncertainty as to how they will be interpreted;

(d) based on the Draft Decision the reference to 'value' in the arbitration criteria appears to be being suggested to be the point at which the use of the terminal would cease to be the

lowest cost, which based on the findings in the declaration review regarding costs to access other terminals, will involve (on average) pricing up to $12.42/tonne higher;[36]

(e) where socialisation is retained – which the QCA appears to be proposing to accept as part of the standard terms – inappropriate changes can be made to pricing based on changes DBCTM agrees with other users (which will only arise after the arbitration – such that it cannot be resolved or considered in the arbitration itself); and

(f) the DBCT User Group is concerned about the prospects of 'recycling of monopoly pricing' as described in the recent Essential Services Commission review of Port of Melbourne market rents – where each inefficient outcome DBCTM achieves will place upwards pressure on all future negotiated and arbitrated outcomes.

13 Conclusions

For the reasons set out above and in previous submissions, the DBCT User Group pleads with the QCA to:

(a) perform its statutory function in determining the amendments that are inappropriate without being shackled to the inappropriate draft submitted;

(b) carefully consider the circumstances of the DBCT service and the evidence that has been presented as to how a negotiate-arbitrate will actually operate in those circumstances;

(c) where the QCA remains convinced that the primary of negotiation is important, accept the evidence that such negotiated outcomes can already occur under a reference tariff model,

and ultimately require that the 2019 DAU be amended to revert to a reference tariff form of regulation.

[36] Declaration Review, Final Decision – Part C: DBCT at 259.

Part B – Amending the Negotiate-Arbitrate Framework

14 If the QCA was to insist on arbitration how can it be improved?

The DBCT User Group submits there is no way to make a negotiate-arbitrate form of regulation appropriate for the circumstances of the DBCT service.

However, the DBCT User Group is conscious of the QCA's preliminary position in the Draft Decision that, despite having universal user and access seeker submissions about many of the adverse outcomes discussed in Part A of this submission, the QCA was willing to approve a negotiate-arbitrate model without a reference tariff.

Accordingly, the DBCT User Group have provided alternative submissions in this Part B below as to how to mitigate the very worst of the outcomes that will otherwise arise from that regime by requiring measures that would:

(a) reduce the costs involved;

(b) reduce the uncertainty of outcomes involved ;

(c) further reduce information asymmetry; and

(d) create greater incentives for DBCTM to proposed reasonable and appropriate pricing (including through alternative arbitration models such as final offer arbitration and floor and ceiling limits).

Each of these measures, particularly in combination would be a significant improvement to the position in the Draft Decision – even though a reference tariff model would continue to be more appropriate.

15 Reducing costs

15.1 Compelling collective negotiation

As discussed at length in Part A of this submission and previous DBCT User Group submissions, a key concern regarding a negotiate-arbitrate regime is:

(a) the significant increase in costs it will cause; and

(b) the disproportionate cost burden that will be borne by users and access seekers.

Part of the reason for the increased costs is the requirement for multiple bilateral negotiations, and ultimately multiple bilateral arbitrations instead of a single ex-ante regulatory process.

Consequently, to mitigate the costs involved in a negotiate-arbitrate form of regulation it is critical, that the process is streamlined and simplified as much as possible through collective negotiations, and rights to a collective arbitration.

From the DBCT User Group's perspective, there are two barriers to that occurring.

First, DBCTM has refused to engage in collective negotiation. It has strong incentives to continue to do so – because a collective negotiation would improve the availability of information and resources for the negotiating users/access seekers and make arbitration less cost-prohibitive, such that users/access seekers would be less likely to be practically forced into agreeing inefficiently high pricing due to not having access to a credible backstop.

Given DBCTM’s monopoly position, individual users and access seekers are currently powerless to resolve DBCTM’s refusal to engage collectively. Accordingly, the QCA would need to resolve this issue by the undertaking:

(c) compelling DBCTM to engage in collective negotiations with access holders and access seekers which choose to collectively negotiate price or access terms; and

(d) providing a right for collective arbitrations (as discussed below).

Second, the parties would need to ensure that any risks of contravention under the *Competition and Consumer Act 2010* (Cth) arising from such a collective negotiation were removed.

The DBCT User Group acknowledges that this is likely to require an authorisation from the ACCC (rather than something than can be resolved through the QCA undertaking). While there are costs to doing so, given the position in the Draft Decision and that the costs of obtaining such an authorisation are anticipated to materially reduce the costs the negotiate-arbitrate model will impose in the event of bilateral negotiations becoming necessary, members of the DBCT User Group intend to lodge an application with the ACCC shortly after this submission.

Of course the very fact that members of the DBCT User Group are required to take such a step to try to mitigate some of the detriment caused by the undertaking proposed, demonstrates the inappropriate nature of the amendments proposed. An undertaking the QCA has determined is appropriate should not require ACCC intervention to make it appropriate.

However, if the QCA is minded to approve a negotiate-arbitrate model, the DBCT User Group submits improving the bargaining position of users and reducing the costs of such a regulatory model through requiring DBCTM to engage in collective negotiation where that has been authorised by the ACCC (and permitting collective arbitration where such collective negotiations fail) is critical to improving the appropriateness of the model.

15.2 Provision of right to collective arbitration

The adverse cost impacts of the negotiate-arbitrate form of regulation are not just caused by the negotiation phase, but the cost prohibitive nature of the proposed arbitration backstop.

The DBCT User Group estimates that the costs of an arbitration for a user, taking into account the costs of legal counsel, an expert economist and potentially other experts and consultants is in the order of a minimum of hundreds of thousands of dollars (for each user or access seeker).

However, as discussed below this materially understates the potential cost exposure for a user or access seeker, as it only accounts for its own individual costs (and does not include a potential costs award in respect of the QCA's or DBCTM's costs of the arbitration).

In addition, recent experience in other negotiate-arbitrate regimes, such as the experience with Port of Newcastle following its declaration is that that cost can easily blow out to over a million dollars (for an individual user) through legal challenges. For example, the Port of Newcastle declaration led to legal challenges to Glencore's right to arbitration[37], and then further legal challenges to the arbitration result itself.[38] DBCTM will be incentivised to act in a similar way to enhance the prospects that users and access seekers will agree to an inefficiently high price rather than pay the high and uncertain cots of arbitration.

That magnitude of costs involved will be prohibitive for access seekers for a potential project, which will often not have existing revenue from the project from which to fund these costs. That point was raised at the stakeholder forum by New Hope, as an access seeker, and should not be ignored.

There is specific provision in the QCA Act for the QCA to accept parties with a sufficient interest as parties to an arbitration (see section 116(1)(d) QCA Act), such that a collective arbitration is

[37] *Port of Newcastle Operations Pty Ltd v ACCC* [2017] FCA 1330
[38] *Application by Port of Newcastle Operations Pty Ltd* [2019] A CompT 1

clearly permitted by the QCA Act. Clearly there will often be parties with such a clear common interest such as:

(a) all existing users having a common interest in the arbitration outcomes under the existing user agreement's price review provisions (clause 7); and

(b) all access seekers in respect of a particular expansion having a common interest in arbitration outcomes in respect of pricing regarding that expansion capacity.

The QCA would need to resolve this issue by the undertaking:

(c) providing a right to collective arbitration; and

(d) providing for the arbitration outcome to be final and binding on the parties in the absence of a party having misled the QCA during the arbitration.

15.3 Protection from costs awards

In the event of an arbitration to resolve terms of access to the DBCT service, under section 208 QCA Act the QCA has the power to make costs awards, requiring a party to pay:

(a) the costs of the other party to the arbitration; and/or

(b) the costs of the QCA itself in conducting the arbitration.

These costs are likely to be very significant – and again make arbitration cost prohibitive for access seekers and some existing users such that it ceases to provide a credible backstop.

For example in the recent regulatory processes, DBCTM has outspent other stakeholders very significantly having engaged the services of at least 3 barristers (including a senior counsel), numerous solicitors from DLA Piper, numerous economists from Houston Kemp and numerous other consultants from GHD. All but GHD are understood to be on higher Sydney or Melbourne rates.

Where the QCA acknowledges in the Draft Decision that it is relying on arbitration to constrain DBCTM's market power, this costs exposure for users/access seekers in using that credible backstop need to be eliminated or largely removed by the undertaking or guidelines that confirm that costs will not be awarded against an arbitrating user or access seeker unless an arbitration is vexatious.

16 Reducing uncertainty

16.1 Need to reduce uncertainty

As discussed in section 12.2 above, in order to incentivise efficient negotiated outcomes, and provide a credible backstop and constraint on DBCTM's market power, it is critical that arbitration will produce a predictable range of likely regulatory pricing outcomes – which will effectively provide the 'bookends' for a negotiation.

That does not mean that users/access seekers must be able to determine with absolute precision price outcomes what the arbitrated price will be (which the Draft Decision appears to consider will disincentive negotiated outcomes) – but that there is a much narrower range of possible arbitration outcomes than that which exists under the arrangements DBCTM and the QCA are proposing.

This will provide greater comfort to users/access seekers that they will not embarrassed by agreeing to a price that is significantly higher than those others are likely to have agreed to – which DBCTM has asserted in its latest submission is important.[39]

[39] DBCTM, 23 October submission, 16

Where arbitration outcomes are instead left as uncertain as would be the case under the current DBCTM/Draft Decision proposal:

(c) the right to arbitrate will not incentivise parties to make offers that are within a reasonable range of the appropriate outcome that would result from QCA arbitration – because parties cannot determine what the likely range of outcomes of arbitration are; and

(d) given the difficulties presented by the current arbitration mechanism DBCTM and the QCA envisage, DBCTM is likely to know that arbitration is not a credible threat for many users/access seekers and will be incentivised to pursue a profit maximising strategy of seeking to extract inefficiently high pricing from such users.

In other words, too much uncertainty regarding the outcomes which would be delivered by arbitration will result in a high proportion of access negotiations going to arbitration, with the small number of negotiated outcomes that are reached being anticipated to be for inefficiently high prices.

The DBCT User Group have set out below approaches that should be adopted by the QCA to resolve this uncertainty.

16.2 Determining the building blocks price (or at least the WACC)

It is clear from the Draft Decision that the QCA has concluded that an arbitrated outcome will not be bound to reflect the efficient cost of supply (including a rate of return reflecting the commercial and regulatory risks involved in providing the service).

However, each of the following cost related matters *are* a mandatory consideration under the QCA Act in making an access determination:

(a) the direct costs of providing access to the service (s 120(1)(f) QCA Act); and

(b) the pricing principles, which include that pricing 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 (s 120(1)(l); 168A(a) QCA Act).

Accordingly, having the QCA determine a pure building blocks price for all users would provide significant assistance in resolving information asymmetry and providing at least a yardstick of some kind with which to be able to predict potential arbitration outcomes. Without this, there is such uncertainty that it is simply not reasonable to believe that the prospect of arbitration will provide a reasonably like range of outcomes to inform commercial negotiations.

In publishing such a price, the QCA could make it clear that in doing so, it was not determining the position that would apply in an arbitration – noting that it was determining the cost relevant to section 120(1)(f) and section 120(1)(l) rather than applying all of the section 120 QCA Act criteria.

If the QCA was not willing to itself determine a building blocks price, less optimal alternatives (that would still reduce uncertainty) would be for:

(e) the QCA to determine the weighted average cost of capital for DBCTM (which provides the most uncertain component of the building blocks price on which there has been substantial differences in view between the DBCT User Group and DBCTM in each preceding regulatory periods and which the QCA has not yet indicated it will determine for the purposes of the 2019 DAU); or

(f) the QCA to procure that an independent economist determines the building blocks price – which the QCA would then take into account if called on to arbitrate, and which would be anticipated to inform negotiations between the users/access seekers and DBCTM.

Without such a building blocks price, there is a very significant range of uncertainty – where the QCA has only determined the depreciation methodology and remediation estimate (as proposed in the Draft Decision).

This also has the potential to materially reduce costs, as economists engaged by negotiating parties could comment on the QCA's analysis rather than developing a building blocks price from scratch.

16.3 Arbitration guidelines

As discussed in previous DBCT User Group submissions, the proposed arbitration guidelines provide no assistance in resolving the difficulties arising from the insistence upon arbitration as the backstop.

The difficulty has never been the process which would be followed in an arbitration.

The DBCT User Group appreciates the QCA will seek to undertake the arbitration process as efficiently as is practicable. They also anticipate the QCA complying with the requirements in the QCA Act to act with as little formality as possible and act as speedily as a proper consideration of the dispute allows.[40] There are concerns about how this will operate given the QCA has never conducted a pricing arbitration of this nature before. However, the arbitration guidelines proposed are so generic in nature, and of no substantive assistance, that they add no value to those existing statutory requirements.

The draft guidelines provided by the QCA are also a far cry from the more useful guidelines envisaged in the Interim Draft Decision which were foreshadowed as being intended to:[41]

provide greater assurance that arbitrated prices would likely be reflective of the efficient costs of supply, including a return on investment commensurate with the regulatory and commercial risks involved, and as a result, provide a credible threat to constrain DBCTM from exercising its market power in a negotiation

As the Interim Draft Decision recognised, the section 120 QCA Act arbitration criteria do not resolve the uncertainty as to the methodology to be applied in an arbitration.[42]

The Draft Decision appears to reject the utility of more substantive guidelines on the basis that:

(a) concerns about market power and information asymmetry are resolved in other ways such that prescribing the methodology to apply in an arbitration is not necessary; and

(b) guidelines that are overly prescriptive may reduce the prospect of successful negotiated outcomes.[43]

For the reasons discussed earlier in this submission, the DBCT User Group continues to consider that the first concern is clearly erroneous, and resolving the uncertainty of arbitration outcomes is a necessary pre-requisite for any arbitration model having a chance of constraining DBCTM's market power in negotiations.

The second concern appears to conceive of the guidelines as providing a level of prescription and certainty well beyond what the DBCT User Group anticipated or the Interim Draft Decision suggested – effectively providing a strict methodology from which negotiating parties' could determine a point estimate and then be disincentivised from reaching agreement at any price other than that point estimate.

[40] Section 196 QCA Act.
[41] Interim Draft Decision, 42.
[42] Interim Draft Decision, 42.
[43] Draft Decision, 76.

However, that is not what the Interim Draft Decision appeared to envisage or what the DBCT User Group is proposing. To be appropriate the guidelines need to create something approaching the level of certainty that exists for users and access seekers about how a future reference tariff will be determined. That is not absolutely certainty, a fixed dollar figure or pinpoint estimate of the time that will disincentivise negotiation. Rather, it is knowing that it will be based on the efficient cost of supply, typically calculated based on the QCA's existing methodology but with a range of possible outcomes arising from:

(c) the QCA potentially adjusting the way it assesses a particular parameter; or

(d) the QCA adjusting the building blocks 'bottom-up' tariff build-up based on a 'top-down' assessment of appropriateness.

Where such a guideline provides a reasonably calculable range of outcomes reflecting that level of certainty it will:

(e) inform and facilitate negotiations occurring; and

(f) *increase* the prospects of negotiating parties reaching agreement within that reasonably arguable range because they will know that an expensive arbitration is also likely to land them somewhere in that range.

If the QCA intends to rely solely on arbitration to constrain DBCTM's market power, guidelines that achieve significantly greater substantive certainty of outcomes are critical to improving both the prospects and appropriateness of negotiated outcomes.

16.4 Arbitration criteria

As discussed in previous DBCT User Group submissions, the DBCT User Group has concerns about the proposed arbitration criteria leading to inappropriate pricing outcomes.

While, DBCTM sought to mislead the QCA during the stakeholder forum in relation to the DBCT User Group's position on this issue, the DBCT User Group's position on arbitration is clear on the face of its submissions, namely:

(a) that the arbitration criteria initially proposed by DBCTM in the 2019 DAU are inappropriate – particularly due to the 'willingness to pay' criteria and artificial geographic market sought to be referenced;

(b) that the section 120 QCA Act criteria are an improvement on those proposed in the 2019 DAU;

(c) however, the section 120 QCA Act remain inappropriate – at least where the reference to value is interpreted as the Draft Decision appears to suggest it should be.

Under the approach DBCTM asserts, and what appears to potentially be the QCA's preliminary interpretation,[44] the 'value' represents the maximum amount that could be charged for the DBCT service before it become uneconomic for users to continue to use the service – i.e. the maximum amount of monopoly pricing that DBCTM could profitably engage in in the absence of regulation.

It is hard to see how that can be an appropriate reference point in setting pricing for a regulated service in an arbitration.

It is also not how the DBCT User Group considers this arbitration criterion was intended to be interpreted. This criterion is to be applied in determining appropriate pricing for a monopoly service that meets the access criteria in section 76(2) QCA Act. The DBCT User Group submits that value in this context is intended to capture the true economic value of the service – i.e. that which would apply in a hypothetical competitive market for the service.

[44] Based particularly on Draft Decision, 72, footnote 255.

To construe it as a reference to the maximum monopoly rent available in the absence of regulation appears to creates truly absurd results such as:

(d) the most efficient users being charged more due to the service having higher value to them (actually blunting incentives for producers to improve efficiency); and

(e) the greatest extent of monopoly pricing DBCTM could engage in in the absence of regulation being relevant to the QCA in setting an appropriate price in a regulatory arbitration – despite that being wholly inconsistent with the object of Part 5 of the QCA Act as described in section 69E QCA Act and the very purpose for which DBCT is declared.

Either this criteria should be removed from the arbitration criteria which the QCA will apply or the QCA should confirm a more appropriate interpretation (say by way of substantive arbitration guidelines as discussed above).

For completeness, the DBCT User Group notes there is nothing in the QCA Act which prevents an undertaking providing for a different set of arbitration criteria applying under the undertaking than the default provisions in section 120 QCA Act that apply to arbitrations concerning any declared services for which there is no undertaking.

16.5 Reference tariff backstop

For completeness, the DBCT User Group continues to note the alternative method (to arbitration) raised in its last submission which would provide a more certain back-stop, in a reference tariff that could be applied for in the event negotiations did not resolve an outcome.

This would continue to provide any benefits perceived to arise from negotiated outcomes, but with numerous advantages of a negotiate-arbitrate regime including greater certainty of outcome, lower costs and a far more credible threat of constraint which should incentivise more appropriate offers during the initial commercial negotiation.

17 Further reducing information asymmetry

17.1 Mandating building blocks pricing

The DBCT User Group acknowledges that the QCA's Interim Draft Decision and Draft Decision have focused on improving information disclosure by DBCTM with a view to resolving information asymmetry.

However, it is important to recognise that the information the QCA proposes to require to be disclosed is only really useful where it is assumed that:

(a) DBCTM will propose a price that can be understood based on building blocks parameters (when there is currently no obligation on them to do so proposed); and

(b) The QCA will apply a building blocks based approach in determining the appropriate price in an arbitration (even if it is then potentially varied based on a top-down review for overall appropriateness).

Yet there is no obligation on DBCTM to utilise a building blocks methodology currently in the 2019 DAU. In addition, the Draft Decision can be read as rejecting appropriate indications given in the Interim Draft Decision that in an arbitration it would be likely to implement pricing which reflected the efficient cost of supply.

The DBCT User Group submits that in order for the QCA's proposed information disclosure requirements to meaningfully reduce information asymmetry it is necessary that:

(c) the undertaking compel DBCTM to disclose how the price it is offering is calculated on a building blocks base, including where there is a component of the price that is not part of the existing QCA building blocks, explaining how that component has been calculated; and

(d) the QCA's arbitration guidelines confirm that the QCA's starting point will be determining the efficient cost of supply, calculated on the basis of the building blocks methodology.

To be absolutely clear, the DBCT User Group is not seeking a strict obligation that the price should be simply set at the point estimate developed by a purist building blocks methodology. The DBCT User Group has acknowledged in previous submissions that is not required to be the case in a reference tariff model.

However, it will materially improve users/access seekers ability to assess the appropriateness of DBCTM's pricing where a user/access seeker can compare 'like with like' in relation to treatment of building blocks parameters, and understand the nature and extent of any uplift above the building blocks price that is proposed by DBCTM.

Without these amendments to the QCA's proposals, the measures the QCA is proposing to resolve information asymmetry are well intentioned by flawed, and will fall well short of the resolving the information asymmetry concerns users and access seekers have expressed.

17.2 Modelling

As the QCA has recognised in the Draft Decision, resolving information asymmetry is a critical to any prospect of making a negotiate-arbitrate model more appropriate.

Yet, DBCTM does not, and has never been willing to, provide modelling of the pricing that it is proposing.

This has not presented a major issue while there has been a reference tariff form of regulation as DBCTM has:

(a) needed to make submissions to the QCA seeking to explain its view point (in order to seek to convince the QCA of the appropriateness of its proposals); and

(b) couched its proposed pricing in terms of the building blocks model (such that while it has always sought a higher price than the QCA has considered appropriate – that has been through changes to WACC parameters or other building blocks which effectively have to be made transparent and therefore subject to scrutiny by users and the QCA).

That has provided sufficient transparency to users, which have then been able to (with the assistance of an expert economist) both model DBCTM's proposals and estimate how changes in methodology which would be more likely to be adopted by the QCA would alter the pricing outcome.

However, that level of transparency and understanding will be removed under a negotiate-arbitrate model.

In order for users/access seekers to be able to properly assess DBCTM's pricing proposals and engage in informed negotiations, it is critical that they can understand the impacts of DBCTM's proposals and how outcomes would vary through particular departures.

The appropriate way to ensure this occurs accurately is for the undertaking to require DBCTM to provide a transparent model to users/access seekers (with the functionality to allow users/access seekers to change individual inputs).

17.3 Need for publication of arbitration results

DBCTM has continued to assert that:

(a) arbitrations are private such that publication of arbitration outcomes should be limited to 'principles and methodologies' rather than the TIC itself; and

(b) access undertakings should only concern access seekers, such that information on arbitration outcomes should not be given to existing access holders.

This is obviously consistent with the disappointing lack of transparency that DBCTM has provided throughout this process as discussed earlier in these submissions, but clearly conflicts with the QCA's intentions to try to mitigate information asymmetry, and should be rejected.

First, arbitration in these contexts can be whatever it needs to be in order to make the access undertaking appropriate – which, as the QCA recognised in the Draft Decision is being sufficient to constrain DBCTM's ability and incentive to exercise its market power. It is not bound by how arbitration at common law or under other statutes or regulatory regimes operates. If DBCTM and DLA Piper genuinely believe that arbitrations are required to be strictly kept private then they are incapable of serving the purpose the QCA desires, and the negotiate-arbitrate regime as a whole simple cannot be appropriate.

Second, section 101(2)(h) QCA Act expressly provides that the access provider of a declared service (such as DBCTM) is required to give access seekers information about determinations made in access arbitrations occurring under the QCA Act. In other words, the position intended by the parliament is that in a negotiate-arbitrate regime, this information will be available. While an approved undertaking can provide otherwise – there is no legitimate basis for doing so in these circumstances.

Third, DBCTM will of course be a party to all arbitrations – such that DBCTM's position is entirely inappropriate because of how it is evidently designed to entrench ongoing information asymmetry and place access holders and access seekers at a strategic disadvantage.

Fourth, as discussed earlier in these submissions, it is clear from the section 138(2) QCA Act factors, the QCA's practice, all past DBCT access undertakings, and the references to the undertaking in existing user agreements, that the intention has always been that the access undertaking can and will deal with matters that impact on existing access holders and how existing access agreements operate.

Fifth, the DBCT User Group strongly disagrees with the DBCTM submission that publication of arbitration outcomes will result in the arbitrated price becoming a de-facto reference tariff prejudicing the likelihood of meaningful negotiations. Future negotiating parties will be aware that an arbitrated result will be a function of a range of matters that will not universally apply – and the QCA's proposed arbitration criteria in section 120(1) include matters specific to the relevant access seeker, such as the value of the service to them.

Accordingly, the DBCT User Group submits that no legitimate rationale has been presented by DBCTM for concealing arbitration outcomes and (if the QCA is minded to approve a negotiate-arbitrate based undertaking) the outcomes of a TIC should be disclosed to all access holders and future access seekers.

In the unlikely event that there are varied terms, the nature of the variation should be disclosed to allow parties to take that into account. However, as discussed earlier in these submissions, there is very limited scope for negotiation and therefore very limited prospect of material variations in non-pricing terms, such that DBCTM's assertions about potential disclosures of commercially sensitive pricing terms, is far more theoretical than real.

18 Creating incentives for offers of appropriate pricing

18.1 Final offer arbitration

The DBCT User Group is conscious that the QCA raised as an issue for the stakeholder forum whether 'incentives on parties be strengthened by directly assessing the TICs being proposed by stakeholders during negotiations'.[45]

The ACCC's recently proposed Australian news media bargaining code provides an alternative model of arbitration of that nature, utilising 'final offer arbitration' (sometimes referred to as 'baseball arbitration').[46]

As the DBCT User Group understand it, 'final offer arbitration' ultimately results in the arbitrator's task being to determine which of the negotiating parties' position should be accepted. The intention of choosing between the two final offers is to discourage ambit claims and incentivise both parties to submit a reasonable offer (as otherwise the other parties' proposal is more likely to be accepted) and allow for quicker arbitral outcomes.[47]

In the case of the proposed news media code, the ACCC proposes modifying it from a strict final offer arbitrator to provide the arbitrator with the ability to depart from the final offers where it considers that each final offer is not in the public interest because it is highly likely to result in serious detriment to:

(a) the provision of covered news content in Australia; or

(b) Australian consumers,

in which case the arbitrator must adjust one of those offers in a way that results in that offer being in the public interest.[48]

18.2 Final offer arbitration in respect of DBCT

A final offer arbitration approach has attraction to the DBCT User Group (relative to other negotiate-arbitrate regulatory settings) – as it would assist with one of the major concerns raised by the DBCT User Group about DBCTM's incentives to continue to make ambit claims and seek monopoly pricing in both negotiations and arbitrations.

However, the potential success of a final offer arbitration model in respect of DBCT is dependent on both negotiating parties being in a position to make an informed assessment about what constitutes an appropriate price, and the approach the QCA will apply in determining such appropriateness in an arbitration.

For the reasons discussed in detail earlier in this submission, that will require more to be done about information asymmetry and uncertainty of arbitration outcomes than the Draft Decision recommends.

The DBCT User Group submits that the QCA would need to provide substantive guidelines on how it would assess the appropriateness of prices in an arbitration so the parties can make informed decisions about what constituted reasonable offers.

In particular, to make a final offer arbitration regime effective and appropriate, the DBCT User Group submits that:

[45] QCA, DBCT 2019 DAU General Forum – Topics for Discussion, Topic 2(b)
[46] Section 52ZO of the *Competition and Consumer Act 2010* (Cth) as proposed in the Exposure Draft *Treasury Laws Amendment (News Media and Digital Platforms Mandatory Bargaining Code) Bill 2020 (Cth)*
[47] ACCC, Q&As: Draft news media and digital platforms mandatory bargaining code, 9-10.
[48] Section 52ZO(5)-(6) of the *Competition and Consumer Act 2010* (Cth) as proposed in the Exposure Draft *Treasury Laws Amendment (News Media and Digital Platforms Mandatory Bargaining Code) Bill 2020 (Cth)*

(a) the parties would need to be put on an equal footing in terms of information – which would require prescription of using a building blocks model and publication by DBCTM of a transparent model showing actual costs;

(b) uncertainty about the QCA's likely view in an arbitration would need to be reduced to enable users/access seekers to make an informed judgement, through measures like substantive guidelines on the methodology/ies that the QCA would apply in considering the parties' offers in an arbitration and the QCA assisting both parties with an assessment of the building blocks price (or at least WACC) prior to the final offers being made.

In those circumstances, the DBCT User Group would consider final offer arbitration more appropriate than a conventional arbitration.

The DBCT User Group would be supportive if final offer arbitration was to be adopted for the QCA to retain a discretion to not select either parties' price (and determine what it considered the appropriate price) where it considered the adoption of a stakeholder's price to be inappropriate having regard to the object of Part 5 QCA Act.

18.3 Providing floor and ceiling limits for arbitration

Another way in which negotiating parties could be in incentivised to make appropriate offers during negotiations would be through reasonable floor and ceiling limits being specified by the QCA which would apply the 'bookends' for any arbitration where the user/access seeker accepted standardised access terms.

The floor and ceiling limits would obviously have to be very different to the way those limits are set in some QCA administered pricing regimes (for example in the Queensland Rail undertaking) by reference to the incremental costs and stand-alone costs of providing the service respectively.

Instead, if this model was to be adopted in respect of DBCT:

(a) the floor would presumably be set at the level of a pure mechanistic application of the building blocks approach to price determination applying the QCA's then current approach (which the QCA would therefore need to determine up front as part of approving the access undertaking) – ensuring that DBCTM would earn revenue sufficient to meet the efficient cost of supply; and

(b) the ceiling would be set at a small specified % or fixed monetary value above that floor price.

So for example, hypothetically if a pure building blocks analysis based on the QCA's current methodology would result in a tariff of $2.30 that would become the floor with say a ceiling of $2.53 (a 10% increase).

It would need to be made clear in publishing the floor and ceiling limits that the QCA had not determined that either limit (or the mid-point between them) was appropriate – but rather that the QCA had determined that was an overall appropriate range for pricing to be set in.

The intention of such a model would be to expressly set the ceiling price at a level that any increase permitted above the efficient cost of supply would be relatively minor so as not to have adverse impacts on competition and investment in dependent markets.

Such an approach would only apply where the user or access seeker was agreeing to new access on the terms of the standard access agreement or as part of an existing user agreement – such that it would leave open the theoretical possibility of a price outside the floor and ceiling limits where materially different access terms had been agreed between the negotiating parties. .

If the QCA was minded to consider adopting such a model, the DBCT User Group would want to be further consulted on this proposal, as its support of it as a methodology is highly dependent on the extent of the proposed 'negotiating range' between the floor and ceiling limits.

19 Conclusions on improving a negotiate-arbitrate model

Where the QCA is minded to make a final decision requiring the 2019 DAU to be amended in a manner that retains a negotiate-arbitrate / non-reference tariff model, the DBCT User Group strongly submits that the QCA should adopt the measures set out in Part B of this submission to:

(a) reduce the costs involved;

(b) reduce the uncertainty of arbitration outcomes involved ;

(c) further reduce information asymmetry; and

(d) create greater incentives for DBCTM to proposed reasonable and appropriate pricing (including through adopting final offer arbitration or floor and ceiling limits).

Part C – Other Matters

20 Ancillary pricing related matters

20.1 Depreciation

The DBCT User Group strongly supports the QCA's position in the Draft Decision that it should prescribe the depreciation methodology required to be utilised in calculating the TIC.

The DBCT User Group's experience in past regulatory reference tariff processes is that the approach to depreciation can have a significant impact on the ultimate pricing outcome – such that this is a key building block on which reducing uncertainty is critical to providing greater predictability of the potential range of outcomes, so as to facilitate negotiated outcomes.

As discussed in detail in the User Group 5th Submission, the DBCT User Group does not consider the depreciation methodology most recently proposed by DBCTM as appropriate because:

(a) it artificially assumes a 2051 useful life – when that is inconsistent with the QCA's previous findings and economic data regarding the strength of likely metallurgical coal demand (and related commentary in Dalrymple Bay Infrastructure's recent prospectus); and

(b) it makes the calculation of depreciation more opaque to users and access seekers than is currently the case.

Given the great lengths DBCTM goes to in their submissions to advocate for the similarity of outcomes of this model, it also appears to have been contrived and back-calculated so as to produce similar outcomes to that which currently applies in the early years – rather than being something that has independently been determined to be appropriate.

Ultimately, the DBCT User Group continues to consider that the appropriate outcome is for:

(c) the QCA's existing methodology to continue to apply – as it is well understood and no evidence has been raised by DBCTM as to why it is not appropriate; and

(d) the QCA to continue to determine the calculation of depreciation and the regulatory asset base.

As indicated at the stakeholder forum, the DBCT User Group would be willing to consider DBCTM's proposed methodology where:

(e) the same calculation approach was applied;

(f) but with long-life assets being depreciated to 2054 (consistent with the QCA's previous findings about the useful life of the terminal); and

(g) with greater transparency provided such that users/access seekers could determine whether individual pieces of plant and equipment were being depreciated properly.

20.2 Roll forward and socialisation

The QCA has sought submissions on the approach to the review of the TIC during the pricing period in the absence of a reference tariff.

As the QCA has noted, DBCTM's proposed approach of providing for a common approach to these issues practically limits the scope for negotiation, and is therefore at odds with DBCTM's asserted rationale for the negotiate-arbitrate model. It appears to be doing that because, in substance, DBCTM is seeking the ability to increase prices about efficient levels while at the same time maintaining its no-risk socialisation settings. This is not a balanced or appropriate

result. However is near complete immunity to changes in coal prices and volume is something that is promoted throughout the recent Dalrymple Bay Infrastructure Prospectus.

As discussed in detail in the 5th User Group Submission:

(a) socialisation was appropriate where all access agreements effectively had materially the same terms, and those that materially differed would have been non-reference tonnage and not part of the socialisation arrangements;

(b) however it ceases to be appropriate under the negotiate-arbitrate regime that DBCTM is seeking to impose.

The DBCT User Group continues to have serious concerns in relation to how open DBCTM's proposed roll forward and socialisation arrangements is to gaming.

In that regard, the DBCT User Group encourages the QCA to scrutinise the issues raised in the 5th User Group submission regarding the difficulties and adverse outcomes of applying a universal approach to roll-forward and socialisation, where DBCTM will be incentivised to chase higher risk for a greater return while users will be exposed to the volume risks if they ultimately eventuate.

In the 5th User Group Submission, the DBCT User Group has raised multiple specific examples of how such a regime can be gamed by a profit maximising monopolist with an incentive to do so.

DBCTM's own suggestion in the stakeholder forum that they would consider offering a shorter rolling term also demonstrates the problems arising from their position. It is possible that creating a lesser term commitment may benefit one user and result in them being willing to pay a higher price to DBCTM, but that will have a detrimental impact on all other users where socialisation raises all other users charges in the event they do cease the rolling term early.

That detrimental impact is one that cannot be managed or mitigated by existing users which have socialisation built into their contracts.

Accordingly, the DBCT User Group submits that it is critical that the negotiate-arbitrate model is not implemented unless the QCA is confident that such gaming can be prevented or alternatively all socialisation is removed (including for existing users).

20.3 How roll forward impacts on existing User Agreements

Existing User Agreements will not automatically incorporate any changes to the roll-forward mechanism that is ultimately incorporated into the access undertaking the QCA approves.

As a result the contractual price review process will effectively continue to apply with socialisation built it, unless determined otherwise in an arbitration.

However, the whole purposes of having a common roll-forward position would seem to be undermined by the position being potentially different as a result of ad-hoc decisions in bilateral negotiations while other users reached agreement in a different form.

20.4 Interaction with existing User Agreement price review process

The QCA has also sought submissions on the interaction of the negotiate-arbitrate regime with the existing contractual price review processes under the existing user agreements.

The DBCT User Group strongly rejects DBCTM's assertions that the undertaking should not seek to deal with or supplement the contractual price review regime (in clause 7 of the existing user agreements and proposed standard access agreement). In fact, the relevant clauses expressly refer to having regard to the terms of the access undertaking[49] – demonstrating a clear intention

[49] Cl 7.2(b)(i) current Standard Access Agreement

that the regulatory arrangements were supposed to interact and support the operation of the contractual provisions.

It is also obvious on a reading of the relevant provisions that they are flawed where operating in isolation from such additional regulatory support.

In particular, they do not contractually oblige DBCTM to provide information to existing users as part of the pricing review process – such that it is clear that in order to have any hope of resolving the information asymmetry issues the QCA has identified, it will be necessary for the QCA to compel the provision of the same information to both existing users and access seekers.

There is no rational policy reasons for subjecting existing users to greater information asymmetry than access seekers, and doing so would simply be anticipated to result in users pushing for arbitration where the statutory information gathering powers of the QCA would become available to resolve the information asymmetry. However, being dependent on arbitration for provision of information seems completely contrary to the QCA's objective of trying to encourage negotiated outcomes. Accordingly, DBCTM position on this issue should be rejected.

Finally, the DBCT User Group also notes that the contractual price reviews commence 18 months before the 'Agreement Revision Date' (typically the scheduled commencement of the new undertaking). This currently places the existing users in the invidious position of a contractual price review without an undertaking in place that regulates pricing during the relevant period to which the price review relates. In addition, because the contractual right to arbitration can be triggered 6 months out from the pricing period commencing, an arbitration could be started under the existing user agreements from 1 January 2021 – when there still wouldn't be an undertaking in place.

This timing issue will also be repeated each time this contractual price review process is triggered. While the amendments DBCTM proposed in their last submission providing the ability to have regard to an approved access undertaking that is approved and in effective in the upcoming pricing period assist *if* such an access undertaking is approved – traditionally no such access undertaking would have been approved at that point.

21 Remediation Issues

21.1 Remediation estimate

The DBCT User Group strongly supports the QCA's position that it should prescribe the remediation estimate required to be utilised in calculating the TIC.

The DBCT User Group's experience in the past two regulatory reference tariff processes is that the largest cause of increases in the tariff has been the major changes to the remediation estimate which has now been escalating at an exponential rate. Accordingly, this is a key building block on which reducing uncertainty is critical to providing greater predictability of the potential range of outcomes, so as to facilitate negotiated outcomes. It is also a matter in relation to which:

(a) there is very significant information asymmetry – which has become evident in this process where GHD and DBCTM have access to significant information about the terminal site which is not being provider to users or access seekers; and

(b) significant technical analysis is required – such that expert consultants have been required to be engaged (and would involve very significant costs where individual users had to do that).

In relation to the estimated remediation cost itself, the stakeholder technical remediation forum aptly demonstrated the excessive nature of the remediation estimate that DBCTM proposes.

As discussed in the 5th User Group submission, the estimates of Advisian and SLR (appointed to by the QCA and the DBCT User Group respectively) provided much lower estimates than proposed by DBCTM and GHD. The DBCTM/GHD estimates were characterised by unrealistic and unsupported worst case assumptions and numerous contingencies – including an overall contingency being applied to contingencies for specific issues.

It is also evident that, while entirely independently derived, there is a high degree of alignment in the approach of Advisian and SLR, providing strong evidence of the appropriateness of their approach.

A memorandum prepared by SLR reflecting further technical commentary on each of the topics discussed at the stakeholder technical remediation forum is included as **Schedule 2** to this submission.

In assessing that commentary (and any further commentary received from other stakeholders), the DBCT User Group also emphasises that the purposes of the remediation allowance are to:

(c) fund the estimated cost of remediation and

(d) do so in a way that is equitable to users across the remaining useful life of the terminal.

In that context, it is not appropriate to operate on the basis of an excessive DBCTM remediation estimate that will effectively frontload funding of the ultimate lower remediation costs to the detriment of current users.

Rather the task is to come up with the most accurate estimate possible based on the currently available information. That does not place DBCTM in a position of not being able to fund remediation, because there will be an opportunity in future regulatory periods (with each new undertaking) to reset this estimate upwards or downwards.

The DBCT User Group notes that if the QCA is minded to increase the remediation estimate based on information that DBCTM or GHD provides in a further submission that DBCTM has not raised previously, that will constitute a failure to provide nature justice to other stakeholders on this issue.

21.2 Need to resolve other elements of the remediation allowance

As discussed in detail in the 5th User Group submission, to resolve information asymmetry on this issue (as the Draft Decision appears to intend), the QCA needs to determine the calculation of the remediation allowance (not just an appropriate remediation estimate).

That is necessary because:

(a) the remediation estimate alone is not what impacts on the price charged by DBCTM – rather it is the remediation allowance which ultimately forms part of the TIC

(b) it is clear from submissions to the QCA to date, that there are material differences between the stakeholders on other elements that underlie the calculation of that remediation allowance (such as the useful life of the terminal and the WACC).

Consistent with the 5th User Group Submission, the DBCT User Group submit that:

(a) there is no basis for departing from the QCA's previous findings regarding the terminal having a useful life until at least 2054, particularly given the strong underlying demand for metallurgical coal projected past that point and Hay Point catchment mines being in the 1st quartile (and a review of Dalrymple Bay Infrastructure's recent prospectus will demonstrate that DBCTM is happy to acknowledge the long term life of the terminal in contexts where it suits it);

(b) it is misleading to suggest (as DBCTM) do that they will be contractually obliged to remediate in 2051 – as the remediation obligation will become 2100 with renewal of the lease, and they have clear economic incentives to exercise that renewal option (which is costless); and

(c) it is appropriate for the QCA to determine the weighted average cost of capital (as discussed earlier in these submissions as being needed in any case to reduce the uncertainty of arbitrated outcomes).

22 Non-pricing provisions

22.1 Right of expansion access seekers to terminate post-contracting

The QCA has raised for consideration whether DBCTM's proposal to amend the 2019 DAU so that access seekers contracting expansion capacity would have termination rights at a certain point, resolves the difficulties arising from access seekers being forced to contract capacity without knowledge of the pricing they will face.

Given that the contractual arrangements provided by DBCTM may potentially vary, depending on the expansion involved and the position that ultimately applies, the comments below address what the proposed undertaking provisions require DBCTM to include.

The DBCT User Group continues to consider that DBCTM's proposal in this regard is inadequate and fails to resolve the issues caused as:

(a) It only applies to contracting of expansion capacity and does not apply to other likely contracting scenarios – such as where short term access is being contracted or the notifying access seeker process applies;

(b) The right of termination arises when the 'Expansion Pricing Approach' which will apply has been set – which may provide little in the way of certainty. The DBCT User Group particularly notes that 'Expansion Pricing Approach' is proposed by DBCTM to be defined as meaning:

the dollar amount, formula, mechanism or process for setting an Initial TIC, which will be applied to determine the Initial TIC for a Terminal Component, following a Terminal Capacity Expansion

The obvious inadequacy in what DBCTM proposes is that this permits such a level of high level abstraction that DBCTM can effectively trigger the right of termination at a point when the expansion user will still not have any real indication of the likely pricing it will face. The termination right needs to arise at the time there is actual certainty of the price and pricing methodology for the next pricing period;

(c) There is nothing in DBCTM's proposed drafting that prevents DBCTM from subsequently changing its Expansion Pricing Approach from that which it notifies;

(d) The right of termination to be included in the conditional access agreements under DBCTM's drafting is 'as specified by DBCT Management' – which strongly suggests that DBCTM intends for the content of the termination right to remain at DBCTM's discretion and is not actually guaranteed;[50] and

(e) Because an expansion user will also be having to contract rail access and rail haulage in parallel, contract long lead time procurement items and obtain financing or equity funding for development at the same time, it is likely that the termination right will be fairly illusory for many access seekers.

[50] 5.4(l) 2019 DAU (as proposed to be amended by DBCTM in its latest submissions)

The DBCT User Group considers that the only way to truly resolve this problem is for access seekers to have a right to terminate after they have received the arbitration outcome.

22.2 Other issues

The DBCT User Group's position on other non-pricing issues remains as set out in the 5th User Group Submission.

However, specific mention is made of the following given that the User Group's position on these was made clear in previous submissions – but DBCTM seeks to claim otherwise in its most recent submission.

(a) **Short term capacity:** It is consistent with the efficient operation of the Terminal (and the interests of all users where socialisation continues) that all capacity that can be contracted on a long term basis is contracted on that basis rather than on a short term basis. However, there is no requirement to do that in the 2019 DAU. It is not correct to assert as DBCTM does that it has no incentives to contract on a short term basis – its negotiate arbitrate regime actually provides lots of incentives as some users are likely to be willing to pay for some 'spot' short term capacity at a higher rate. Given DBCTM's claims in its latest submission that it will be incentivised to contract capacity long term where it can – it is appropriate to simply oblige it to do so.

(b) **DBCTM requiring different terms:** This language in section 5.4(e)(5)(A) and 5.4(h) should be amended to definitively remove DBCTM's power to require non-standard terms. Access Seekers in these situations should be entitled to execute an Access Agreement on the terms of the Standard Access Agreement or such other terms as are agreed (not 'proposed by DBCTM' as DBCTM suggests in its latest submission). The current drafting allows DBCTM to demand non-standard terms in a manner that is inconsistent with section 13 of the 2019 DAU and undermines the very purpose of having a standard access agreement.

(c) **Reporting tonnages to Aurizon Network:** DBCTM's proposal is inappropriate. The DBCT User Group appreciate there is a need for greater supply chain alignment – but that is not achieved by simply providing information about user's contracted tonnages to Aurizon where neither of Aurizon or DBCTM are willing to accept obligations to actually align the coal supply chain. If DBCTM is serious about trying to achieve greater coal supply chain alignment the DBCT User Group would encourage them to first concentrate on discussions with Aurizon about how that could practically occur. The appropriate time to implement measures of this nature is as part of a wider package on which alignment has actually been achieved across the entirety of the coal supply chain.

(d) **Negotiation cessation notice:** the User Group's concerns are clear that DBCTM's drafting of section 5.8(a)(4) permits DBCTM to require security to be provided immediately or they can cease negotiations – even though the access rights contracted may not commence for a significant period. That is a significant imposition given that security for large amounts of take or pay obligations involves material costs. The DBCT User Group proposed drafting which sought to resolve that problem by deferring provision of security until it was actually required under the access agreement.

23 Conclusions

For the reasons set out below, the DBCT User Group submits that:

(a) the 2019 DAU submitted by DBCTM is highly inappropriate, for reasons including those recognised by the QCA in the Interim Draft Decision and Draft Decision – such that the QCA should maintain its position from the Draft Decision and not approve it;

(b) the amendments the QCA proposes to the 2019 DAU are not appropriate – taking into account:

  (i) the substantial increase in costs caused;

  (ii) the lack of evidence to justify the QCA's proposed findings about negotiated outcomes providing benefits;

  (iii) the ineffectiveness of arbitration as a backstop and a constraint on DBCTM's market power because of the costs and significant uncertainty in relation to arbitration outcomes that arises; and

  (iv) the fact that any benefits that could arise from negotiated outcomes are just as likely to arise under the current reference tariff based regulatory settings which also deliver primacy to negotiated outcomes.

The DBCT User Group cannot emphasise enough how disappointed it is that the QCA appears likely to reject all of that given what appears from the Draft Decision to be a pre-determined view which conflates the statutory considerations for the declaration review and the 2019 DAU process and relies on the 'primacy of negotiations' where regulatory practice suggests such primacy is not appropriate.

However, if the QCA intends to insist that a negotiate-arbitrate regime is appropriate despite the weight of evidence to the contrary, the DBCT User Group submits that the QCA must do a lot more to:

(c) reduce the cost of the proposal – such as through compelling collective negotiation and arbitration and providing reasonable protections to users/access seekers in relation to arbitral cost awards;

(d) reduce the uncertainty of the proposal – such as through determining an appropriate building blocks price, to provide greater confidence about the likely arbitral outcomes and thereby incentivise negotiated outcomes;

(e) further reduce information asymmetry; and

(f) enhance DBCTM's incentives to negotiate an efficient price (including through modifications to the type of arbitration provided, like final offer arbitration or arbitration subject to floor and ceiling limits).

Schedule 1

Presentation materials for QCA Stakeholder Forum

DBCT 2019 DAU
DBCT User Group

QCA Stakeholder Forum

18 November 2020

The QCA's role – determining appropriate amendments

1. Where the QCA determines the 2019 DAU is inappropriate, the DAU must then be amended in 'the way the authority considers appropriate': s 134

2. Assessing the appropriate amendments requires consideration of amendments to return the DAU to a reference tariff model

3. Insistence upon refusing to consider a reference tariff model due to constraining the amendment power to 'starting with the DAU submitted' is an error of law

‘Primacy of negotiations’ inappropriate for DBCT

1. ‘Primacy of negotiation’ does not provide appropriate outcomes in all circumstances
2. It is clearly ***not appropriate*** in the circumstances of the DBCT service:

Circumstances of DBCT

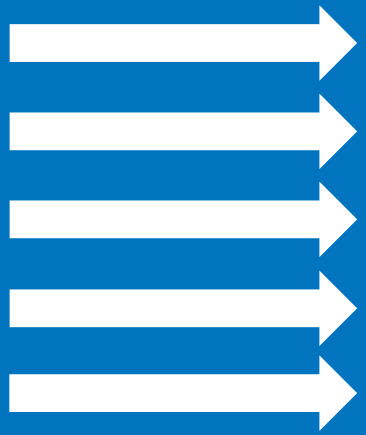
Market power and lack of competition

Incentives to engage in monopoly pricing

Limited scope for negotiation

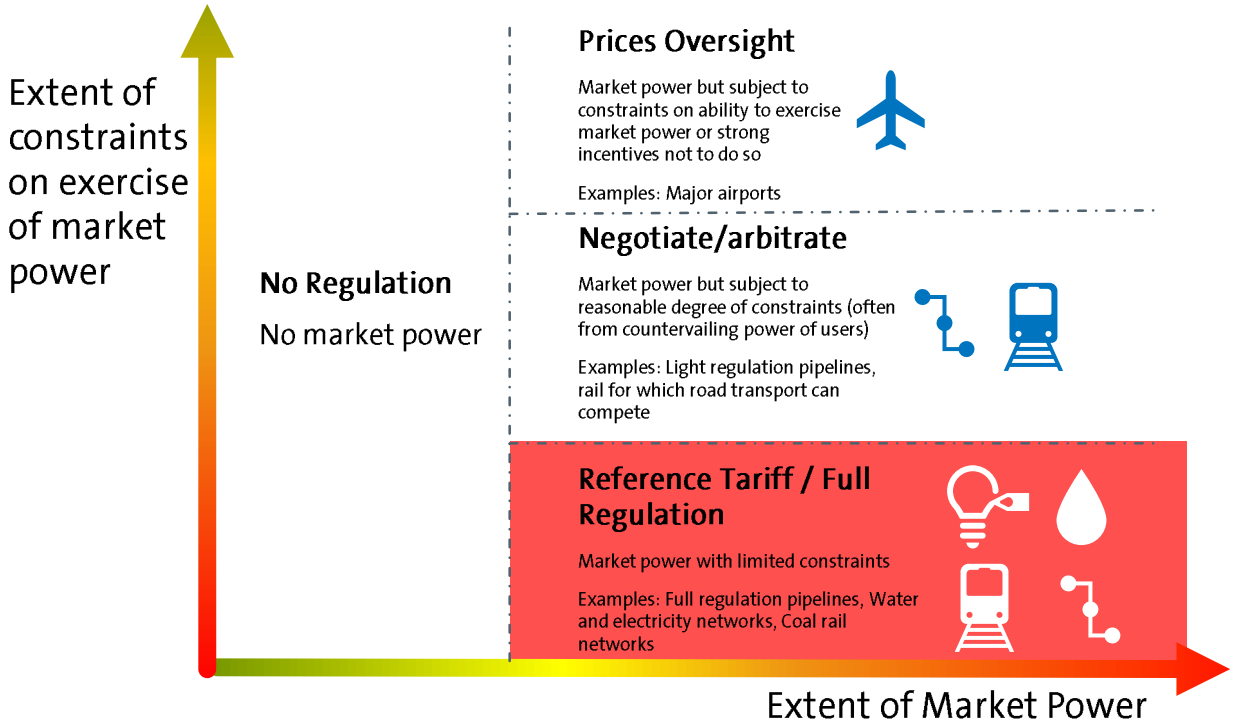
No differentiation in service

Information assymetry



Negotiations unlikely to produce efficient outcomes

Determining the appropriate form of regulation



DBCTM has been found by the QCA to have:

- **market power**
- **no constraints from competition**
- **no constraints from countervailing power of users**

DBCT is squarely in the bottom right hand corner of this graph – where only full regulation is appropriate

Analysis of appropriateness

The comparison weighs heavily in favour of reference tariffs, such that amendments seeking to mitigate the defects of the negotiate/arbitrate model cannot be appropriate

Issue	Reference Tariff	vs	Negotiate/Arbitrate
Efficiency of price	Likely to be based on building blocks based estimate of an efficient price (with ability for QCA to vary where appropriate)	←	Likely to lead to monopoly pricing / pricing at higher than efficient levels, with price discrimination attributable to bargaining position, willingness to arbitrate and resources
Regulatory certainty	Well understood and certain regime	←	Significant shift to regime with uncertain outcomes
Risk of 'error'	Theoretical risk of regulatory error (but no evident bias). Anticipated to even out over the long term	←	Known risks of inefficient outcome arising from information asymmetry, DBCTM's market power and potential for gaming
Impact on investment	Efficient pricing and certainty will result in efficient investment (with demonstrated history of terminal and coal investment)	←	Likely investment distortions due to price being greater than the efficient price and uncertain
Impact on competition	Efficient price promotes efficient investment and greater competition in dependent markets	←	Uncertainty of pricing outcomes/ likelihood of monopoly pricing dampens investment incentives and reduces competition in dependent markets
Costs	Lower costs with single ex-ante price determination process and stakeholders being able to share costs	←	Higher costs with multiple bilateral negotiations and arbitrations
Ability to negotiate	Ability to agree alternative pricing for non-reference tonnage	=	Required to agree (or arbitrate) terms

Schedule 2

SLR Memorandum on Remediation Estimate

Memorandum

To:	John Hedge	**At:**	Allens
From:	Abrelle Neubauer	**At:**	SLR Consulting Australia Pty Ltd
Date:	30 November 2020	**Ref:**	620.30205 DBCT Rehabilitation Estimate Technical Forum DBCTM Response Review M02-v1.0 20201130.docx
Subject:	Stakeholder Technical Forum and Review of DBCT Management Response to QCA		

1 Introduction and Background

Dalrymple Bay Coal Terminal (DBCT) is a coal-handling facility at the Port of Hay Point in Queensland, located approximately 38 km from Mackay.

This memo was prepared to respond to the *DBCT 2021 Access Undertaking DBCT Management Response to QCA Draft Decision October 2020* (hereafter the DBCTM Response) specifically *Appendix 2 GHD Advisory – Response to QCA's draft decision on 2019 DAU 21 October 2020* (hereafter GHD Response) and issues raised in the technical stakeholder forum on remediation. The technical responses are provided in **Section 3** and **Section 4** of this memorandum.

1.1 Ownership and Regulation (Queensland Competition Authority and Access Undertakings)

The terminal is owned by the Queensland Government and leased to DBCT via a series of long-term lease agreements (together, the long-term lease). DBCT Holdings (DBCTH) is the agency that represents the Queensland Government. The Terminal is leased to DBCT Management (DBCTM, owned by Brookfield Asset Management). Terminal operations are subcontracted to DBCT Pty Ltd (DBCT P/L) which is owned by a majority of mining companies within the DBCT User Group.

The long-term lease is subject to the Port Services Agreement (PSA) between DBCTM and DBCTH which establishes DBCTM's obligations for the long-term lease at its expiry including rehabilitation requirements.

Access to the coal-handling services provided at DBCT is regulated by the Queensland Competition Authority (QCA) under the Queensland Competition Act 1997 (Qld). The QCA regulates access and pricing affairs at DBCT through various activities including the review of Draft Access Undertakings (DAUs) and approval of Access Undertakings (AUs).

1.2 DBCT Proposed Rehabilitation Cost Estimates – 2019 DAU

As part of the 2019 DAU to QCA, DBCTM proposed a Rehabilitation Plan and associated estimated rehabilitation cost of $1.22 billion (in October 2018 AU dollars) for rehabilitation of the DBCT site. The 2019 DAU is intended to replace the current approved 2017 AU, due to expire on 1 July 2021. Under the 2017 AU, the approved rehabilitation cost estimate was $432.69 million (M) (2015 Australian dollars (AUD)).

The QCA refused to approve the DBCTM proposed estimated rehabilitation cost of $1.22 billion as it was considered to be overestimated in GHD Advisory *DBCT Rehabilitation Plan and Rehabilitation Cost Estimate DBCT Management* (2019) (the GHD report).

QCA engaged Advisian to review the prudency and efficiency of the rehabilitation plan and costs developed by GHD Advisory (GHD), and to develop an independent estimate of the rehabilitation costs to a level of detail comparable to that undertaken by GHD. This was presented in Advisian Worley Group *Dalrymple Bay Coal Terminal Rehabilitation Cost Review Queensland Competition Authority* 311001-00034 (2020) (the Advisian report).

Advisian generally concurred with the methodology and scope of works proposed by GHD, but developed its own independent estimate based on the delineation of works outlined in the GHD report. The independent estimate of rehabilitation costs by Advisian was approximately $814 M (in March 2020 AU dollars).

The significant difference in the GHD and Advisian overall rehabilitation cost estimates was due to:

- Cost rates used for bulk earthworks, handling and imported clean fill;
- Quantities estimated for cut and fill earthworks to return the site topography to its natural state;
- Assumptions about the location for disposal of contaminated waste;
- Depths for removal of contaminated soil and road substrate; and
- Approaches to the removal of offshore and onshore piles.

QCA's draft decision on the 2019 DAU included refusing to approve DBCTM's proposed rehabilitation cost estimate stating that *"…we are not convinced at this time that the rehabilitation costs estimated by GHD and Advisian reflect an efficient forecast of the likely cost"*. QCA determined the way forward was to seek further views from stakeholders on the appropriateness of the estimates provided by GHD and Advisian.

SLR Consulting Australia Pty Ltd (SLR) was engaged on behalf of the DBCT User Group to provide a review of the rehabilitation estimates developed by GHD and the independent estimate proposed by Advisian and provide informed comments to the QCA on a rehabilitation cost estimate for the 2019 DAU. A high-level rehabilitation cost estimate was developed with modifications from the Advisian estimate made by exception. The reviewed estimated rehabilitation cost by SLR was $735.99 M with the report (hereafter SLR Review Report) flagging a need for further investigation of a number of factors which could have material impacts on the rehabilitation cost estimate prior to updating or developing a new estimate including:

- DBCT closure obligations;
- Consultation with DBCTH on methodologies considered reasonable for rehabilitation of the site; and
- Consultation with DBCTM on the Rehabilitation Plan and general strategies to incorporate the existing knowledge base and intended closure planning process.

The significant difference between the Advisian and SLR rehabilitation cost estimates were:

- Exclusion of decommissioning, demolition and disposal costs for third party assets i.e. Aurizon balloon loop and Queensland Rail (QR) substation and Ergon 33/11 kV substation (-$68.38 M); and
- Reduction in Tug Harbour contractor margins from 20% to 10% and percentage paid by DBCTM from 100% to 80% (-$8.18 M).

1.3 DBCT Management Response Report

The DBCTM Response specifically the GHD Response was reviewed in developing this memorandum and relevant aspects are addressed in **Section 3** and **Section 4** of this memorandum.

Background information to SLR's rehabilitation cost estimate opinions and responses to the DBCTM Response Report and GHD Response is presented in **Section 2**.

2 Background Information Applicable to SLR Rehabilitation Cost Estimate Opinions

The PSA requires site rehabilitation such that the remediation and rehabilitation costs for the Terminal site must be borne by DBCTM at its cost. DBCTM collects a remediation allowance annuity to accumulate the expected future rehabilitation costs which represents an accounting provision.

AASB 137 Provisions, Contingent Liabilities and Contingent Asset (Australian Accounting Standards Board, 2020) paragraph 14 notes that a provision shall be recognised when all of the below is true:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

"*If these conditions are not met, no provision shall be recognised*."

Where a provision is required to be recognised, SLR considers the method of making a reliable liability estimate is to:

- Determine a range or best estimate based on evidence, knowledge and judgement (considering experience and expertise);
- Document key assumptions and other sources of estimation uncertainty at the reporting date with a significant risk of causing a material adjustment to the carrying amounts of liabilities within the next accounting period; and
- Account for risk where the liability is likely to be material.

2018-19 Financial Reporting Requirements for Queensland Government Agencies FRR 4D Liabilities (Queensland Treasury, 2019) states that:

"Agencies with substantial liabilities that have been measured on the basis of complex and/or subjective assumptions and estimates should apply a risk analysis to them…

Where it is impractical to disclose the extent of the possible effects of changes to the underlying assumptions and estimates made, the agency should disclose that fact and also state that outflows within the next reporting period may be different due to variations to the assumptions made and that this could require a material adjustment to the carrying amount of the liability in future reporting periods."

As part of developing a reliable estimate for liabilities, SLR contends that the rehabilitation estimate should be revised based on evidence, knowledge and judgement and that a corresponding adjustment should be made in the carrying amount of the liability in future reporting periods (e.g. every 5 years as per AU) where relevant.

Note: The DBCTM Response Report paragraphs 163 and 165 relate to evidence to potentially be investigated that can be used in revising the rehabilitation cost estimate in future reporting periods.

3 Technical Forum

The DBCT 2019 DAU stakeholder forums - technical forum on remediation was held on 18th November 2020. The aim of the technical forum was to determine if specific material differences between the remediation cost estimates developed by Advisian, GHD and SLR can be resolved among stakeholders and relevant experts, in a manner that is consistent with the criteria for prudency and efficiency outlined in our draft decision

Five topics for discussion were set out in the agenda to discuss; SLR's responses are summarised in **Table 1**.

Table 1 Summary of Position on Technical Forum Remediation Topics

Topic for Discussion	Context and SLR Opinion	Questions	SLR Responses
1. Waste disposal	GHD estimated the cost of waste disposal based on the assumption of disposal of non-contaminated waste at Hogan's Pocket Waste Facility (65 km from site) and contaminated waste at a commercial facility at Roma (750 km from site). It clarified that the site in Roma was selected because it can currently accommodate the expected volumes of heavy contaminated waste. Advisian assumed general waste disposal at Paget Transfer Station (30km from site) and contaminated waste at Hogan's Pocket (65km from site). These assumptions are based on the view that none of the sites can currently accommodate the volumes of waste but will be able to expand to accommodate the projected disposal volumes. GHD stated that Advisian's approach could be appropriate but mentioned that the cost of expanding the facility would need to be accounted for in the unit rates. SLR largely agreed with Advisian's assumptions for waste disposal locations but suggested that other arrangements could be considered through the closure planning process.	(c) Are there other existing options for waste disposal in closer landforms that could be considered for disposal?	**Yes.** Potential locations would include nearby quarries, Coal mines, etc. e.g. Collinsville is <350 km away. An options analysis would have to be taken to determine the closest options and capacity for disposal followed by confirming interest and associated requirements including any costs.
		(b) Would the cost of expanding a waste facility be solely borne by DBCTM in an environment where other remediation and waste disposal activities are occurring? If so, what are the estimated costs of expansions?	According to AASB 137, Contingent liabilities are possible obligations whose existence will be confirmed by uncertain future events that are not wholly within the control of the entity e.g. expanding a waste facility. A contingent liability is not recognised in the statement of financial position. However, unless the possibility of an outflow of economic resources is remote, a contingent liability is disclosed. **No**. If expansion of a waste facility is required, a business case could be made to Council to support the waste facility expansion with other activities, users, etc. considered for financial inputs and use. Part of the engagement strategy with Council etc. should be to address these aspects.
		(a) Is the commercial facility at Roma already able to accommodate the expected volumes of contaminated waste and thus, would not need to be expanded in the future?	**Uncertain** based on SLR's current information, but this is not likely to be used due to distance and given this would not be considered efficient under the QCA's assessment criteria i.e. it does not represent *"the best means of achieving and outcome determined prudent, having regard to the options available"*.

Topic for Discussion	Context and SLR Opinion	Questions	SLR Responses
2. Contaminated soil and substrate removal	GHD initially assumed higher depths of removal for contaminated bedding coal and soil (400 millimetres), road substrate (500 millimetres), and substrate under substations (1,000 millimetres). It clarified these conservative assumptions were based on its experience and an informed expectation of contamination at DBCT. GHD stated detailed studies of the level of contamination would be required when DBCTM's rehabilitation obligations fall due, and the plan and cost will be updated if any new information becomes available. It noted any recovered bedding coal would not be able to be sold to benefit the rehabilitation project. DBCTM suggested that the depths for removal should be the mid-points with Advisian's assumptions (i.e. 325 millimetres, 375 millimetres and 625 millimetres for the areas outlined above). Advisian assumed uniform depths of 250 millimetres across these three areas based on its recent industry experience. It assumed low grade bedding coal would be sold to recover operational costs for DBCTM. It factored in potential variations from this assumption in its estimate for a risk allowance. SLR generally agreed with Advisian's assumptions, including the sale of bedding coal to recover operational costs.	(a) Based on all available information and noting future contamination studies will be conducted to determine the actual depths of contaminated material for removal, what are the appropriate assumptions for depths of removal of contaminated material at each of the three areas discussed above?	For hydrocarbons, the 250 mm depth across road substrate and substations substrates considered Advisian experience related to actual hydrocarbon clients where it would be a higher risk. Advisian advised in the forum, the 250 mm depth does include conservatism as well. Bedding coal contamination for sale may not reflect contamination for other uses or disposal; this should be confirmed. With prior planning before closure, DBCTM could consider options to extract bedding coal prior to closure for sale in order to reduce material movement volumes and rehabilitation costs required at closure (no benefit to the project in term of values is proposed as per AASB 137). An increased volume should be based on evidence, knowledge and judgement. The information that layers of bedding coal and compacted fill are present up to 1 m deep at various locations across the terminal, depths extrapolated from road drawings not specific to the site and preliminary pavement design, and contamination assumptions due to age (may not be average/typical depths) is inadequate to inform sitewide volume calculations. The Transport and Main Roads website https://www.tmr.qld.gov.au/Community-and-environment/Research-and-education/Heritage-centre/History-of-queensland-roads.aspx#year1970 notes that *"from the 1970s to 1990s, methods of road design and construction evolved to more sophisticated methods. To cope with more traffic, roads became bigger and the machinery to build them increased in size also."* Correspondingly the accuracy of the depths and associated volumes for road substrate are also questionable based on date of construction.

Topic for Discussion	Context and SLR Opinion	Questions	SLR Responses
			Further, the assumption that heavy soil contamination will result from operations due to environmental management systems being inadequate to mitigate this to acceptable levels directly contradicts the objective of the Environmental Protection Act 1994 (Qld) *"to protect Queensland's environment while allowing for development that improves the total quality of life, both now and in the future, in a way that maintains the ecological processes on which life depends"*. The GHD Response stated that *"Given the age of the substations, it is highly likely that the soils within the substation boundaries are contaminated with polychlorinated biphenyls"*. Construction of DBCT commenced in 1981 and in 1983 operating commenced. The Department of Environment and Science (DES) *Guideline for Identifying and managing equipment containing polychlorinated biphenyls (PCBs) ESR/2016/1939* Version 2.01 Effective 01 July 2019 notes that if equipment *"was produced after 1979 or imported after 1986 then the equipment should be PCB-free… because imports of PCBs to Australia have been banned since 1986."* Midpoint Advisian and GHD depths are not a good approach to estimating contamination as both estimates reflect considerations for rehabilitation strategies across costs e.g. fill volumes where contamination disposed, and given conservativeness built into the Advisian estimates, there is no significant and/or representative evidence which warrants an increase in volumes e.g. bedding coal may be 1 m thick in some areas and less than 300 mm in others but this does not mean that 625 mm is an average depth across the surface and this may grossly overestimate disposal and other cost requirements.

Topic for Discussion	Context and SLR Opinion	Questions	SLR Responses
			When future updates of the rehabilitation cost estimate are made based on studies and relevant evidence, recalculations should be undertaken as relevant e.g. increase/decrease of already conservative, weighted estimates based on evidence, knowledge and judgement. Meanwhile assumptions should be clearly stated (see **Section 2**).
3. Offshore pile removal	GHD estimated the costs for complete removal of offshore piles, having also considered partial removal, with the justification that it would be the best long-term solution and consistent with returning the site to its natural state. It clarified its expectation that environmental protection measures would increase in the future and also that leaving piles in the seabed could cause environmental issues over time. Advisian considered complete removal of piles would have a detrimental impact on marine life. Its position was to estimate costs for partial removal just below the seafloor level to allow the seabed to fill naturally over time. SLR agreed with Advisian's assumption of partial extraction of offshore piles due to the risks and environmental and economic consequences.	(a) Recognising the uncertainty and lack of clear standards that define the 'natural state' standard, which method for offshore pile removal (full or partial) best reflects DBCTM's obligations for remediation?	In the GHD 2019 report, a proposed method for extraction was put forward. As per the SLR Review Report, the preference for partial removal of piles is the difficulty due to size and geotechnical conditions and that the method does not guarantee full extraction (GHD, 2019 Sect. 14.4.2 p. 79) which could result in environmental issues for rehabilitation. While GHD has confirmed at the technical forum that the proposed approach was completed successfully at one other site to date; it is yet to be confirmed whether it can be done successfully for the disturbance at DBCT. SLR recommends consultation with DBCTH as per **Section 1.2** as well as consultation with relevant agencies on what would be acceptable considering the environmental risks vs. benefits.
4. Indirect labour and project management costs	GHD's cost estimate for indirect labour cost included an assumption that DBCTM would undertake a major project management role. It clarified that DBCTM has undertaken significant project management roles for NECAP and expansion projects, which have been approved by the Operator and the QCA. These costs have, at times, exceeded the 10 per cent assumption allocated to project management in the rehabilitation plan. It added that DBCTM is far more familiar with the DBCT assets than an external contractor for project management.	a) Is it prudent and efficient to assume that DBCTM would have a significant project management role in the rehabilitation of DBCT to warrant the estimate project management costs in GHD's cost estimate?	Rehabilitation, closure and remediation skills and experience are generally significantly different from operational skills. With little experience in rehabilitation to date, DBCTM personnel retention is more practical for other roles excluding overall project management of the rehabilitation and closure e.g. site knowledge. Expansions experience is not the same and closure for the site will demand more than skilled project management professionals and highly regarded EPCM partners. Technical expertise and the experience and ability to identify closure risks and impacts across the project during delivery is important. This has

Topic for Discussion	Context and SLR Opinion	Questions	SLR Responses
	Advisian's position is that project management would be outsourced to a Tier 1 contractor and taking a highly conservative position for DBCTM having a significant project management role increases costs by approximately $20 million. SLR agreed with Advisian's assumption for procurement that would reduce DBCTM's project management costs from 10 per cent to 8 per cent.		significant risks and implications for project management and expenditure. **No**. It is reasonable to assume that a Tier 1 Contractor would control the site under the direction of a Project Management Office (PMO) established by DBCTM (Owner) which would provide site knowledge and context to the overall process. SLR agrees that the engagement of an experienced Tier 1 contractor presents a more risk-balanced delivery model and would enable the works to be planned in a more effective and executed timely manner. SLR believes assuming DBCTM would not have a significant project management role in site rehabilitation would allow project management costs to be efficient from a risk standpoint as *"the scope of works represents the best means of achieving an outcome determined prudent, having regard to the options available"*.
5. Risk and contingency allowance	GHD applied an additional 25 per cent to direct costs as the risk and contingency allowance for the decommissioning and demolition costs and 20 per cent for the disposal, remediation and rehabilitation costs. It clarified the former was based on its own commercial experience for asset-closure projects and reflects a similar contingency used during the 7X expansion project. The latter was based on the development of a Class 4 cost estimate. It stated both assumptions are lower than the typical contingency ranges recommended in the guidance from Department of Transport and Main Roads (QLD), and as such, could be understated.	a) What is the prudent and efficient approach for estimation of risk and contingency allowances for the remediation cost estimate?	It appears that GHD have allocated a 'global' risk allowance over the Direct Costs which is approximately 25%. The Advisian risk allowance for the project totals 11% of direct costs while the SLR risk allowance totals 17% of direct costs. GHD notes that Advisian has recommended contingencies significantly higher than 25% for projects managed by the Queensland Department of Transport and Main Roads. GHD also noted that SLR had recommended higher contingencies on the Inland Rail project. Discussion on the 10% contingency for rehabilitation securities in NSW and lack of adequacy was also undertaken. As noted in **Section 4** that follows, one of the issues around the contingency amount was the inclusion of contingency on top of contingencies i.e. GHD disposal rates from local service providers added 20% to allow for potential capacity shortfall, and a wet weather contingency was built into Axiom rates for offshore.

Topic for Discussion	Context and SLR Opinion	Questions	SLR Responses
	Advisian built-up risk profiles for each type of work based on prevailing documentation and verified risk profiles during its site visit; it also accounted for client risks and other contingencies based on project management outsourced to a Tier 1 contractor. The resulting allowance was approximately $100 million lower. GHD stated it could not assess Advisian's determination of contingences against industry benchmarks and DBCTM's experience at DBCT, and Advisian had not clarified the class of its estimate. SLR generally agreed with Advisian's probabilistic method to determining the risk and contingency allowances.		SLR believes the most efficient approach to estimate risk and contingency allowances is via risk profiles and determination or appropriate typical rates where relevant. This is supported by the Queensland Treasury approach outlined in **Section 2**. This allows the risk to reflect the existing knowledge base with consideration for the financial or other consequence associated with those activities. Advisian has assigned risk where it is most likely to be managed in both the Contractor's price and the Owner's costs as client schedule and contract risks. As discussed in **Section 4.2** that follows and applicable to estimates in general, if unrepresentative costs go into the estimate, the overall cost with whatever added contingency would also be unrepresentative. Particularly for DBCT site, SLR has identified some potential material variances of tens of millions of dollars linked to short-term lease requirements, seawall rehabilitation, definition of reasonable methodologies by DBCTH (for documentation on record), appropriate water management design for the backfilled quarry dam, etc. Depending on the costs for these items, the rehabilitation estimates may change as well as relevant indirect costs and risk profiles associated with these activities. Based on the existing project knowledge base and risk profile, SLR proposes probabilistic methods are used to determine risk and contingency allowances instead of deterministic methods; this also aligns with the Queensland Treasury strategy in **Section 2**. Using AACE predetermined guidelines for this process for the type of estimate is simple, understandable, and consistent; however, it cannot effectively address the unique DBCT site-specific impact of risks. This deterministic method can be considered most effective on small and/or non-complex projects.

4 Response Review

4.1 SLR's Opinion on the DBCTM Response

The DBCT Management Response Report proposes a way forward for consideration by the QCA. Key proposals raised and discussed in the Technical Forum Remediation were as listed below; these are addressed in **Section 3**:

- For waste disposal, use GHD assumption of disposal 750 km to Roma or use Hogan's Pocket as disposal site including the entire cost of expansion of that facility to accommodate the DBCT waste volumes;
- For contaminated soil and road substrate removal use mid-point of Advisian and GHD depth (325 mm) and for contaminated substrate removal under substation use mid-point of Advisian and GHD depth (625 mm);
- For offshore pile removal accept complete removal of piles into estimate and Rehabilitation Plan;
- For indirect labour and project management costs reinstate DBCTM proposal for project management; and
- For risk and contingency allowance reinstate GHD contingencies based on industry standards and benchmarked by DBCTM experience.

The DBCTM Response Report also proposed the following. SLR's responses are noted for each:

- *For the remediation date accept 2051 as the relevant date with regard to the rehabilitation of DBCT* – **disagree**; as presented in the SLR Review Report, the economic life of the Bowen Basin will likely extend beyond 2051 with mine expansions and new projects coming online e.g. Olive Downs approved with an 80 year mine life which coincides with the timing of lease renewal i.e. 2100;
- *For the classification of estimate nominate as consistent with AACEI Class 4 or FEL 1 level (or equivalent other standard)* – **irrelevant to the material variances**; the classification of the rehabilitation estimate was assumed to be the cause of material variances particularly for contingency and methodologies for developing the estimate. The GHD Estimate was a Class 4 estimate on the industry standard AACEI matrix, which is in the range of accuracy of a FEL 1 feasibility study as contemplated by the access undertaking.

  SLR contends that the classification of estimate is not the cause of the material variances for contingencies and methodologies for developing the estimate and instead the material variances identified in both the Advisian Report and SLR Review Report including the following:

  - SLR considers that responsibility for rehabilitation for third party assets themselves would be held by the third party and responsibility for rehabilitation of underlying disturbance would be likely required by DBCTM;
  - 20% contractor's margin applied to the Tug Harbour is considered high and was replaced by 10%;
  - SLR considers that surface water control and management considerations for the Quarry Dam would result in the reduction of the Advisian predicted material volume to form a stable final landform;
  - SLR considers that waste disposal arrangements could be planned in advance of closure given timing and highly unlikely that waste would be hauled 750 km (see **Section 3 Topic 1**);
  - SLR agrees with 250 mm under the running pavement as road substrate removal depths, 250 mm of contamination to be removed from relevant areas, and 250 mm of contaminated soil under substations to be removed assumed by Advisian (see **Section 3 Topic 2**);

- Potential for future environmental impacts / harm to result in full extraction of offshore piles (see **Section 3 Topic 3**);
- Tier 1 contractor management vs. Owners management for the decommissioning, demolition and rehabilitation process resulting in reduction in the Owner's project management costs from 10% of directs to 8% (see **Section 3 Topic 4**);
- Inclusion of contingencies within the direct rehabilitation estimate then covered by the additional contingencies (see **Section 3 Topic 5**).:
  - Rough weather contingency within Demolition of shiploaders for Offshore Domain (amount unclear); and
  - Addition of a 20% premium on disposal of materials to landfill to fund a project specific landfill site to be established within 30 km of the DBCT site with capacity to meet project needs (the costs for disposal of these wastes totals ~$214.9 M of which the 20% premium is $35.8 M with a contingency of 25% applied on that ~$9 M); and
- Reduction of contingency to reflect risk at the owner's level given additional risk items included in the Advisian estimate including a risk contingency based on certainty factors (see **Section 3 Topic 5**).

High contractor's margins, included contingencies within estimates prior to applying the overall contingency, proposed Tier 1 contractor management for works, etc. have affected SLR's proposed changes to the contingency and not the estimate classification.

Assigning the relevant contingency to the rehabilitation estimate without address and/or determination of the above factors will not make the rehabilitation costs prudent (required to comply with DBCTM's rehabilitation obligations under the PSA e.g. third party cost exclusion, short-term lease areas differing obligations and opportunities to reduce costs) or efficient (i.e. make cost of works consistent with conditions prevailing in the relevant markets e.g. reflective of contractors margin, owner's project management costs under a Tier 1 contractor led project, etc.). Additionally assigning the relevant contingency to the rehabilitation cost estimate will not improve the overall reliability or correctness of the estimate.

Additionally, potential material variances identified in the SLR Review Report should also be addressed to ensure the rehabilitation costs are prudent and efficient i.e.:

- Areas under short term leases may have less stringent requirements (to be confirmed) and less conservative rehabilitation strategies may be used on these areas to compliment PSA areas; and
- Potential for future environmental impacts / harm to result in modified rehabilitation outcomes to pre-construction landform for the seawall.

SLR would propose to DBCTM that in the next update of the estimate, firstly the above aspects be addressed to increase the reliability and correctness of the estimate, secondly additional contingencies be excluded from the relevant cost line items, and then the appropriate contingency for the classification of estimate be applied of the rehabilitation estimate at that point to reflect representative costs against the industry standard.

- *For Qleave levy adjust to reflect recent increase to 0.575%* – **agree**; as this represents the current total levies; and
- *For escalation accept 2.6% escalation and escalate both estimates from nominated base dates to end June 2021 for comparative purposes* – **disagree**; as per the SLR Review Report, the non-labour cost increase of 2.5% can be considered high given likelihood of technological improvements, etc. Given the COVID-19 events of 2020, forward labour cost increases of 3.1% will likely also be considered high

for at least the next 10 years. The net rate of 2.6% per annum considering these aspects would be reduced to no greater than 2%.

4.2 SLR's Opinion on the GHD Response

SLR notes that the GHD Response commences with the position that:

"Good practice for rehabilitation estimation is to adopt a conservative approach for work scoping and cost planning, as significant uncertainty regarding the extent of work required for remediation requires assumptions to allow for sufficient funds to be generated to cover the works."

However, whilst the level of conservativeness in rehabilitation approach can be subjective, SLR believes it should be based on evidence, knowledge and judgement to the extent possible and reasonable or rational as per AASB 137 i.e. if no evidence or knowledge of any issues then taking a highly conservative stance may result in the most costly estimate and not the most likely estimate or 'best estimate'. AASB 137 notes that the obligation should be estimated by weighting all possible outcomes by probabilities to determine the expected value which is closer to a risk and threat approach than a blanket contingency.

The GHD Response provides responses to Advisian's position set forward in the Advisian report. Key GHD responses related to:

- Waste disposal assumptions of moderate to heavy soil contamination intersecting with volumes and types of materials existing facilities can accommodate or incorporate waste disposal expansion costs (see SLR's response in **Section 3 Topic 1**);
- Bulk earthworks rates from GHD considered an upper bound of rates of $13.46 per cubic metre based on a recent project (NECAP) compared to an Advisian rate of $7.96 per cubic metre and assumes this amount is understated – **disagree**. Based on review SLR determined that Advisian's rate comprised grader, D8 bulldozer, water cart, backhoe, tipper truck and labour C and considered a productivity of 115 m^3 per hour resulting in a per cubic metre rate of $7.96.
  Recent benchmarking works undertaken by SLR according to first principles using Queensland wet rates and similar fleet for bulk earthworks with haulage to >5 km was found to be near to the Advisian rate at approximately $7.77 including contractor mark up of 10.47%. These rates are comparable to the Qld Mining Estimated Rehabilitation Cost Calculator rate of $6.49 per cubic metre using small fleet benchmarked in 2018. While the format for efficient updating of rates can be relevant for cost estimation, there should be consideration for practicable, realistic rates. There is a significant discrepancy between the estimated rate, and actuals and rates based on first principles. Due to the material impact on the rehabilitation cost estimate, SLR considers the most likely cost should be used and the risk allowance applied for any cost increases. On this basis SLR considers the GHD rate of $13.46 per cubic metre to be overstated for these works;
- Imported clean fill rates for small and large volumes differ in the GHD report and is representative of economies of scale offset by transport distances – **disagree**. In large rehabilitation projects such as this, given environmental and safety requirements including testing of engineered fill, haulage arrangements, etc. it is foreseeable that the overall volume would come from few quality sources with adequate volumes where practicable. Given this consideration and that the same activity is being costed, one rate for fill should be utilised;
- Contaminated soil, road substrate and substation substrate removal (see **Section 3 Topic 2**);
- Offshore pile removal (see **Section 3 Topic 3**);
- Indirect labour and project management costs (see **Section 3 Topic 4**); and
- Risk and contingency allowances (see **Section 3 Topic 5**).

5 Conclusion

Based on the outcomes of the Technical Forum and considering the DBCTM Response and GHD Response, SLR disagrees with proposed modifications to the Advisian Report (and correspondingly the SLR Review Report) in the areas outlined within this memorandum with the exception of agreement on the increase of the Qleave levy percentage to be included in the rehabilitation cost estimate.

SLR considers that a thorough, risk based approach including probabilistic determination of risk and contingency allowances would be most representative to reflect the unique DBCT site rehabilitation project and associated cost estimate. While the estimate class is relevant to the process, SLR considers the development of the estimate itself and relevant assumptions to be of prime importance and more relevant to address than the 8% reduction in contingency in the SLR estimate compared to the GHD estimate (~$40 M difference) as some of the identified potential material variances in **Section 4.1** could impact the estimate more materially than this.

Checked/ Authorised by: NA