DBIM pricing method for 8X expansion

Submission from Selected Users in response to QCA Draft Decision

September 2021

FINAL

Executive Summary

This submission is made in response to the QCA's Draft Determination on Dalrymple Bay Infrastructure Management (DBIM)'s 8X Expansion Application for Ruling on Pricing Method on behalf of the Submitting Users comprising:

1. Anglo American Metallurgical Coal Pty Ltd;
2. BMA;
3. Foxleigh Management Pty Ltd;
4. Glencore Coal Assets Australia Pty Ltd, representing Clermont Access Pty Ltd, Oaky Creek Holdings Pty Ltd and Hail Creek Coal Holdings Pty Ltd;
5. Peabody Energy Australia Pty Ltd;
6. Pembroke Olive Downs Pty Ltd; and
7. Stanmore Resources Ltd.

The Submitting Users are a collection of users of existing terminal capacity at the Dalrymple Bay Coal Terminal (DBCT). Together, the Submitting Users hold contracts for approximately 85% of the current capacity at DBCT of 84.2mtpa.

Submitting Users consider that, in reaching its Draft Determination, the QCA has not had sufficient regard to a range of factors that it must consider under the QCA Act. As a result the Draft Determination is not consistent with the QCA Act's objective of promoting economic efficiency, for the following reasons:

(a) the QCA intends to make a Binding Ruling Determination based on preliminary and poorly substantiated information, meaning that there can only be a low level of confidence in the conclusions drawn from that information. This is in direct contrast to the QCA's longstanding precedent of applying robust analysis and requiring substantiation of assumptions in order to support its decisions, particularly when they result in a significant transfer of value and risk between service providers and customers, or between groups of customers;

(b) the QCA has not had sufficient regard to the risks around its assumed demand outlook, with the result being that the impact of the project on existing users under a realistic range of scenarios has not been fully considered;

(c) the QCA has not considered the need for measures to provide incentives for DBIM to effectively manage risks associated with the project, with the result that a range of project risks may inappropriately be borne by existing users; and

(d) the QCA's assessment, while addressing the matters required under the QCA Act, is not sufficiently targeted towards the promotion of economic efficiency, which in this case primarily relates to ensuring the investment is economically efficient. This is evident both in relation to the test that it has applied in assessing the materiality of impacts on existing users, as well as in its omission to consider the implications of 8X in relation to its discrete component phases, as well as in relation to the 8X program in aggregate.

Given these concerns, the acceptance of a socialised pricing approach creates a risk that a decision to expand may be made where the incremental benefits do not justify the incremental costs, and it is only proceeding on the basis that some of these incremental costs are borne by existing users. This may create costs that lead to a loss of economic efficiency across the terminal and broader coal system and ultimately a potentially less competitive Queensland coal industry.

The importance of the decision regarding differential or socialised pricing in providing efficient incentives for investment has been a cornerstone of the QCA's previous assessments of similar issues, however the strategic importance of having appropriate incentives in place does not appear to have been given sufficient regard in this particular assessment. Each of the issues discussed above reflect significant departures by the QCA from its own established regulatory precedent, with the QCA providing little explanation for the departure.

The Submitting Users continue to consider that, on the basis of the information currently presented by DBIM, these risks warrant the use of differential pricing for the 8X project (or at least in part). As set out in their June submission, Submitting Users would support a differential pricing method that ensured that expanding users only bore the incremental cost associated with providing the additional capacity (both in terms of the incremental investment net of Major NECAP savings, and the incremental operating and maintenance costs). Submitting Users consider that such an approach would have the following benefits:

- it would create strong incentives for DBIM and expanding users to only commit to the 8X program in circumstances where the investment was economically efficient;
- it would create strong incentives for DBIM and expanding users to manage the risks associated with the 8X program; and
- by ensuring that expanding users would retain the benefits associated with NECAP and operating cost reductions, it would avoid the situation where differential pricing created a much higher Unit TAC for new users, with the potential outcome of discouraging utilisation of the expansion capacity.

However, in the event that the QCA's final determination is to maintain its view that socialisation is appropriate, Submitting Users consider that it is imperative that the QCA consider how it can incorporate measures into the pricing framework that mitigate the identified risks that socialisation is expected to impose on existing users. This includes the potential for incorporating mechanisms to ensure that DBIM is incentivised to effectively manage expansion risks directly with the expansion parties where practical.

Mitigating the risks that socialisation imposes on existing users could potentially be addressed by the QCA expanding the matters that it specifies as Expansion Ruling Assumptions, to also include issues designed to manage short term volume and cross default risk, long term volume risk and a broader range of cost and operational risks. In effect, the QCA can use these Expansion Ruling assumptions to create incentives for DBIM to take action, where possible, to effectively manage risks either through its own actions or through its negotiations with expanding users, rather than allowing socialisation to simply pass the risks back to existing users. This submission identifies several options for how the QCA might more appropriately mitigate the risks that socialisation is expected to impose on existing users.

By adopting such measures, the QCA would be building into the 8X pricing methodology critical features designed to ensure that socialisation does not diminish the incentives on DBIM to ensure that the 8X expansion is efficient and to effectively manage risks.

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1 Introduction

In March 2021, DBIM submitted to the QCA an Application for Ruling on Pricing Method in relation to its 8X expansion project, which is designed to increase the capacity at Dalrymple Bay Coal Terminal (DBCT) from 84.2mtpa to 99.1mtpa at a total cost of $1.276bn, seeking the QCA's endorsement for a socialised pricing method to be applied to the expansion.

In August 2021, the QCA released its preliminary view that socialisation is the appropriate pricing method for the proposed 8X expansion, notwithstanding that it is expected to increase the terminal infrastructure charge (TIC) for users of the existing terminal.[1]

This responsive submission is made on behalf of the Submitting Users comprising:

1. Anglo American Metallurgical Coal Pty Ltd;
2. BMA;
3. Foxleigh Management Pty Ltd;
4. Glencore Coal Assets Australia Pty Ltd, representing Clermont Access Pty Ltd, Oaky Creek Holdings Pty Ltd and Hail Creek Coal Holdings Pty Ltd;
5. Peabody Energy Australia Pty Ltd;
6. Pembroke Olive Downs Pty Ltd; and
7. Stanmore Resources Ltd.

The Submitting Users are a collection of users of existing terminal capacity at the Dalrymple Bay Coal Terminal (DBCT). Together, the Submitting Users hold contracts for approximately 85% of the current capacity at DBCT of 84.2mtpa.

This submission is set out as follows:

- Section 2 explains in more detail the Submitting Users' concerns with the Draft Determination; and
- Section 3 identifies the conditions that should be applied to a socialised pricing method in the event that the QCA maintains its view in the Final Determination.

[1] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.1

2 Selected Users' concerns with Draft Determination

DBIM's Access Undertaking sets out the principles that should be applied in assessing the pricing method to be applied for a proposed Terminal Capacity Expansion.[2] However, in making a ruling, the QCA must also have regard to the criteria in s.120(1) and 138(2) of the *Queensland Competition Authority Act 1997* (QCA Act).

While the Draft Determination clearly explains how the QCA has considered DBIM's Application in relation to the principles set out in the 2021 AU, Submitting Users consider that the QCA's Draft Determination does not adequately demonstrate how the QCA has had regard to all of the statutory factors it is required to consider in s. 120(1) and s.138(2) of the Act when making rulings. This is not consistent with QCA regulatory precedent in relation to similar issues considered in previous regulatory reviews of socialised pricing methodologies, both in-principle and in relation to specific network expansions, where the QCA's previous decisions have demonstrated clear consideration of these statutory factors.

This section identifies the Submitting Users' concerns with the Draft Determination, highlighting those instances where the Draft Determination does not adequately reflect the requirements set out in the QCA Act. This has resulted in the QCA's acceptance of a high level analysis from DBIM which, in many instances, lacks clear supporting evidence, at the likely expense of economic efficiency, with negative consequences for non-expanding users.

2.1 QCA Act criteria

Under the terms of the 2021 AU, the QCA will make a price ruling pursuant to s.150F in which it must have regard to the criteria in s.120(1) and 138(2) of the QCA Act. The matters that the QCA is to have regard to in s.120(1) are set out in the box below.

Box 1 Section 120(1) of the QCA Act

120 Matters to be considered by authority in making access determination

1. In making an access determination, the authority must have regard to the following matters—
    - a) the object of this part;
    - b) the access provider's legitimate business interests and investment in the facility;
    - c) the legitimate business interests of persons who have, or may acquire, rights to use the service;

[2] DBIM's Application was submitted in accordance with its 2017 AU, however during the process of the QCA's assessment, the QCA approved a replacement access undertaking on 1 July 2021, the 2021 AU. The 2021 AU provides for the QCA to make a ruling on the pricing method to apply using essentially the same considerations as in the 2017AU.

d) the public interest, including the benefit to the public in having competitive markets;

e) the value of the service to—

(i) the access seeker; or

(ii) a class of access seekers or users;

f) the direct costs to the access provider of providing access to the service, including any costs of extending the facility, but not costs associated with losses arising from increased competition;

g) the economic value to the access provider of any extensions to, or other additional investment in, the facility that the access provider or access seeker has undertaken or agreed to undertake;

h) the quality of the service;

i) the operational and technical requirements necessary for the safe and reliable operation of the facility;

j) the economically efficient operation of the facility;

k) the effect of excluding existing assets for pricing purposes;

l) the pricing principles mentioned in section 168A.

Source: https://www.legislation.qld.gov.au/view/html/inforce/current/act-1997-025#sec.120

Section 138(2) lists those matters that the QCA must have regard in assessing draft access undertakings. The provisions for s.138(2) are set out below.

Box 2 Section 138(2) of the QCA Act

138 Factors affecting approval of draft access undertaking

2. 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;

h) any other issues the authority considers relevant.

Source: https://www.legislation.qld.gov.au/view/html/inforce/current/act-1997-025#sec.138

The QCA's regulatory decisions have typically demonstrated a robust investigation and assessment of each of these legislative criteria. However, in this instance, while the QCA states that it has considered the QCA Act criteria in making its assessment,[3] the Draft Determination does not explain in any systematic way how each of the criteria have been considered or taken into account by the QCA in forming its view.

2.2 The QCA's role in examining a pricing proposal

The QCA has previously identified that QCA Act specifies a variety of economic and non-economic goals for the Authority to follow, and that s.26 of the Act specifies that, among things, in conducting an investigation, the Authority is required to have regard to:[4]

(a) the need for efficient resource allocation;

(b) the need to promote competition;

(c) protection of consumers from abuses of monopoly power;

(d) efficient costs;

(e) quality, reliability and safety;

(f) appropriate rate of return on assets;

(g) the effect of inflation;

(h) impacts on the environment;

(i) demand management; and

(j) social and equity considerations.

The QCA considers that each of these objectives has an economic efficiency driver and that the primary consideration in evaluating whether a specific pricing proposal or structure is justified from a public policy perspective is whether it is clearly consistent with increasing overall economic efficiency.

This view aligns well with the overall object of Part 5, which is specified as follows:

> 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.

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3 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.5

4 Section 26 of QCA Act. See also QCA (2013), Statement of Regulatory Pricing Principles, August 2013, p.3 in which the QCA identifies these provisions as 'regulatory objectives under the Act'.

This effectively incorporates two limbs – Part 5 is intended to promote the efficient use of and investment in infrastructure, *thereby* promoting effective competition. In order to be consistent with the object of Part 5, both limbs need to be achieved – promotion of competition is, in itself, a means of enhancing economic efficiency.

The QCA has also previously emphasised the importance of regulatory governance in evaluating pricing options. The QCA's 2013 paper on Capacity Expansion and Access Pricing for Rail and Ports states that:[5]

> …there are a number of regulatory governance and practice principles that are important for ensuring that the objectives of economic efficiency and fairness can be achieved in the design and application of pricing principles. At a high level, economic efficiency and fairness are important regulatory governance principles. In addition there are a number of operational and lower order principles that are relevant:
>
> (a) Transparency and procedural fairness. The methodology for determining prices needs to be as transparent and procedurally fair as practicable, to ensure participants have confidence that outcomes are consistent with relevant public policy and regulatory objectives.
>
> (b) Predictability. The regulatory arrangements and outcomes need to be as predictable as possible given other objectives. Predictability is likely to promote confidence in the regulatory arrangements and also economic efficiency by reducing uncertainty associated with long term decisions. Stability of prices is often advocated as a principle in its own right but there may be circumstances where stability of prices is not consistent with economic efficiency and is really an aspect of considerations about risk. Predictability does not require stability of prices and is more important than stability in facilitating efficient future decisions.
>
> (c) Practicability. The regulatory arrangements need to be practicable and flexible and minimise administrative and compliance costs as much as possible given other objectives.

As a decision maker, the QCA has an important obligation to demonstrate its decisions are based on cogent evidence and to provide clear reasons as to why a particular decision is considered to be consistent with the requirements of the Act.

The QCA's preliminary view does not have sufficient regard for the efficiency outcomes required by the Act, including ensuring that the ruling effectively incentivises DBIM to act in a way that promotes an efficient outcome. Submitting Users maintain that

5 QCA (2013) Discussion Paper – Capacity expansion and access pricing for rail and ports, April 2012, pp.4-5.

socialised pricing, as anticipated in the Draft Determination, is inconsistent with the object clause, as it may weaken the incentives for efficient investment in infrastructure. Promoting economically efficient investment in the 8X project requires that parties that benefit from the expenditure bear the risks and the costs - if expanding users do not place sufficient value on the benefit to support incremental expansion, then the investment cannot be considered allocatively efficient.

For these reasons, over the last decade, the QCA has consistently adopted the 'incremental up/average down' approach in relation to expansions of regulated coal supply chain infrastructure in central Queensland, on the basis that this is the pricing method that will most effectively promote economic efficiency. However, in making its Draft Determination, the QCA has departed from this well-established principle without an explanation of why an alternate approach is consistent with the criteria in the Act or with the broader objective of promoting economic efficiency.

2.3 Reasons why the Draft Determination fails to effectively promote economic efficiency

Submitting Users consider that, based on the information presented in the Draft Determination, the QCA has not had sufficient regard to a range of factors that it must consider under the QCA Act, and as a result its preliminary decision is unlikely to promote economic efficiency, for the following reasons:

(a) the QCA intends to make a Binding Ruling Determination based on preliminary and poorly substantiated information, meaning that there can only be a low level of confidence in the conclusions drawn from that information. This is in direct contrast to the QCA's longstanding precedent of applying robust analysis and requiring substantiation of assumptions in order to support its decisions, particularly when they result in a significant transfer of value and risk between service providers and customers, or between groups of customers;

(b) the QCA has not had sufficient regard to the risks around its assumed demand outlook, with the result being that the impact of the project on existing users under a realistic range of scenarios has not been fully considered;

(c) the QCA has not considered the need for measures to provide incentives for DBIM to effectively manage risks associated with the project, with the result that a range of project risks will inappropriately be borne by existing users; and

(d) the QCA's assessment, while addressing the matters required under the QCA Act, is not sufficiently targeted towards the promotion of economic efficiency, which in this case primarily relates to ensuring the investment is economically efficient. This is evident both in relation to the test that it has applied in assessing the materiality of impacts on existing users, as well as in its omission to consider the implications of 8X in relation to its discrete component phases, as well as in relation to the 8X program in aggregate.

These reasons are explained in more detail below.

2.3.1 Reliance on preliminary and poorly substantiated information

Need for evidence-based analysis

The QCA has a long-established precedent of applying robust analysis and requiring substantiation and independent verification of assumptions to support its decisions, in order to provide confidence that the decision will promote economically efficient outcomes. This is particularly the case when the decision has the potential to result in a significant transfer of value and risk between service providers and customers, or between groups of customers.

However, in this instance, the QCA's Draft Determination reflects a willingness to make a Binding Ruling Determination based on preliminary and poorly substantiated information. While assumptions drawn from the FEL2 study are inherently uncertain given the FEL2 study is only 'preliminary' in nature with costs estimated at a P50 confidence level, [6] the Draft Determination provides for the Ruling to be reviewed in only limited circumstances.

In forming this approach, the QCA has stated that it considers these estimates as being reasonable for the purpose of assessing whether 8X is a cost sensitive expansion (as defined in the 2021 AU):[7]

> We have considered the reasonableness of these cost estimates having regard to the forecasting approaches applied by DBIM (see Box 1.) Although the costs associated with the asset replacement program are likely to change over time, we consider these estimates reasonable for the purpose of determining whether the 8X expansion will be a cost sensitive expansion.

Submitting Users accept that it is reasonably possible to assess whether 8X will be a cost sensitive expansion based on the preliminary information that has been provided to date – this reflects not only that 8X very clearly meets the criteria of being a cost sensitive

6 DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, p.12

7 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.20

expansion when using the point cost estimates provided by DBIM in its application, *but also* that this conclusion is insensitive across a wide range of potential cost outcomes that may ultimately occur – for example, even if the cost of the 8X program reduced by 50% (and all other assumptions remained the same), it would still be assessed as a cost sensitive expansion.

However, the QCA then goes on to use this same preliminary information for the purpose of assessing the extent to which 8X will provide a benefit to existing users, and whether this is sufficient to support a socialised pricing method being applied. Not only is this a very different purpose than assessing whether the 8X is a cost sensitive expansion, but the conclusions that will be drawn from this assessment are far more sensitive to the potential range of cost outcomes that may occur. The QCA has provided no reasons why it considers that it is appropriate to use such high level information that lacks supporting evidence for the purpose of assessing how the benefits of 8X are likely to be distributed between existing and expanding users. Further, the QCA does not specify the estimated benefits of 8X to existing users as an assumption underpinning the Binding Ruling, meaning that it does not intend to seek further information on this issue or review the Binding Ruling in the event that a more robust assessment resulted in significant changes to these estimates.

This is in contrast to the approach that the QCA has previously adopted in considering pricing methodologies to be applied for capacity expansions. For example, in its 2016 assessment of Aurizon Network's 2014 Draft Access Undertaking, the QCA considered the WIRP pricing capacity expansion required a far more evidenced-based approach to the assessment of how benefits were shared between different user groups. It was not convinced of the robustness of the quantitative evidence provided by Aurizon Network (whose submissions contained more information and greater substantiation than that submitted by DBIM in its current 8X pricing proposal). The QCA required more detailed information to be prepared on the operational benefits of WIRP for non-WIRP users before allocating costs to existing customers.[8] In doing so, the QCA stated:[9]

> It is our view that in order for the allocation of expansion costs to non-expanding users to be considered appropriate, we must be affirmatively satisfied, based on all the material placed before it, that there will be clear economic benefits to those existing users. Therefore, objective supporting material evidence demonstrating how the economic benefits arise needs to be submitted by the expanding users, as it will

[8] QCA (2016), Final decision – Aurizon Network 2014 draft access undertaking Volume III – Pricing and tariffs, April 2016, pp.198, pp.204

[9] QCA (2016), Final decision – Aurizon Network's 2014 draft access undertaking Volume III – Pricing and tariffs, April 2016, p.42

> not be sufficient simply to assert a subjective view that there are economic benefits without providing the evidence of this conclusion.

The QCA further stated:[10]

> In regard to proving that an expansion benefits existing users, we maintained that the onus of proof should lie with Aurizon Network and expanding users. We considered that the degree of benefit should be established and independently verified early in the expansion process. As such, we considered that this information should be provided as part of the pricing proposal for our assessment.

The QCA's consistent requirement for an evidence-based analysis to support decisions impacting on price and pricing methodology is also apparent from other investigations. For example, in the QCA's 2020 assessment of DBCTM's pricing model:

- *Services*—the QCA did not accept DBCTM's assertion that it provides 'varied or different services' to its core handling services – the QCA considered there was a 'lack of evidence' to suggest that similar 'varied or different services' have been charged for separately in the past or at any coal terminal in Australia;[11]
- *Efficient corporate costs*—the QCA directed DBCTM to not only specify a methodology to estimate corporate costs, but it also considered it appropriate for DBCTM to provide access seekers with details on benchmarking methods considered, and the resulting estimates, to enable them to verify the independent estimate and form a view on efficient corporate costs;[12]
- *Remediation plans*—the QCA initially observed a 'lack of transparency' and 'insufficient justification' across DBCTM's proposed rehabilitation cost estimates. It further stated it did not have sufficient information to form a view on the appropriate estimate and invited stakeholder submissions which the QCA indicated it would consider in its determination.[13]

The Draft Determination departs from this well-established regulatory practice of determinations made on clear, substantiated evidence.

10 QCA (2016), Final decision – Aurizon Network 2014 draft access undertaking Volume III – Pricing and tariffs, December 2015, p.40

11 QCA (2020), Draft decision – DBCT Management's 2019 draft access undertaking, August 2020, p.43

12 QCA (2020), Draft decision – DBCT Management's 2019 draft access undertaking, August 2020, p.64

13 QCA (2020), Draft decision – DBCT Management's 2019 draft access undertaking, August 2020, pp.101-102

Uncertainty of benefits to existing users

While Submitting Users accept that 8X, in its proposed form, may provide some benefit to existing users, the information presented by DBIM is of such a preliminary nature that it is not possible to reliably identify the extent of such benefit at this time.

Major NECAP Program

A key issue in terms of assessing the potential benefits of the 8X expansion for existing users is its impact on DBIM's NECAP program. Historically, the NECAP program has focussed on minor NECAP expenditure, including one-off small projects and studies, and ongoing phased maintenance capex programs. Minor NECAP expenditure is expected to remain at around historic levels of around $30m annually.[14]

However, DBIM is forecasting a substantial Major NECAP program, involving larger standalone projects such as machine replacements, with a value of $900m over the next 25 years (without 8X). This Major NECAP program is a significant driver of the Unit TIC. DBIM has identified that, of the estimated $3.15/t ten year average Unit TIC, around $0.68/t of this relates to the NECAP program,[15] and the influence of Major NECAP on the Unit TIC will further increase over time.

However, there is a high degree of uncertainty around the timing and expenditures in this program. DBIM's application presented its forecast Major NECAP expenditure based on DBCT PL's (the Operator's) 2021-2025 corporate plan, which included a high level asset life schedule based on the design life of the relevant facilities amended to take account of their condition and any expected maintenance.[16] However, Submitting Users understand that detailed analysis had been undertaken on a very limited number of assets, including the replacement of ST1, expected to be undertaken in 2020. The majority of asset life dates reflected only a preliminary assessment.

Prior to making its final decision on socialisation of 8X, it is important the QCA requests and reviews any further analysis from DBIM which incorporates the latest thinking around the timing and profile of the NECAP schedule under both a "without 8X" and "with 8X" scenario including any updated corporate plan from the operator particularly if materially different.

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14 DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, p.32

15 DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, p.25

16 DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, p.32

Handling Charges

DBIM, and the QCA, have also relied upon 8X to deliver substantial operating cost savings, however, the level of analysis of operating costs and likely savings is, as yet, rudimentary:

- Operating and maintenance costs for the existing terminal are simply forecast by DBIM to increase by 3% pa over the period to 2054;
- The increase in operating and maintenance costs with 8X have been forecast by the Operator as an annual cost per 8X phase in 2020 terms, which DBIM again escalates at 3% pa over the same term.

The inclusion of significant asset renewals as part of 8X is a key means by which these operating cost savings are expected to be delivered. However, given the extensive asset renewal anticipated in the Major NECAP Program, there is a likelihood that at least some of these operating cost savings will be achieved in any case. Without a more considered assessment of the operating and maintenance cost implications of both the Major NECAP Program and the 8X expansion program, little confidence can be placed in the long term operating and maintenance cost estimates adopted by DBIM. Further, given that DBIM is not ultimately responsible for operating and maintenance activities, DBIM is unlikely to be held to account in any way for these estimates.

Implications

The QCA has identified the key benefits to existing users from 8X as being anticipated reductions in the Major NECAP Program and anticipated reductions in Handling Charges.[17] In doing so, the QCA has emphasised the independence of the Operator from DBIM as a critical means of providing confidence in the estimation of these benefits.[18] However, in relying solely on the Operator's independence from DBIM, the QCA has overlooked the fact that both of these cost items (both with and without 8X) have been assessed by the Operator at only a very preliminary level. The extent to which this information may change following a robust analysis is evident from the changes that can occur in the Operator's asset replacement schedule in a single year.

A detailed analysis and verification process of these costs should be undertaken and may result in a significant change to the estimate of the benefits to existing users from 8X. In the absence of such detailed analysis and verification, Submitting Users do not consider that the extent of benefits to existing users from 8X can be estimated with any reliability.

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17 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.9

18 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.45

Uncertainty of sufficiency of system capacity

The QCA's draft determination is based on the expectation that there is sufficient capacity elsewhere in the system such that the increased terminal capacity from the proposed 8X expansion will directly result in increased system capacity. This assumption draws on the capacity assessment analysis completed by the Integrated Logistics Company (ILC), the coordinator of the Dalrymple Bay Coal Chain (DBCC).[19] This capacity analysis was included in DBIM's Application to the QCA, but redacted from the publicly disclosed documents.

DBIM provides some further explanation of the ILC's approach to modelling system capacity, and the expected impacts of 8X on system capacity, in its Master Plan.[20] This confirms DBIM's assumption that the 8X system capacity of 99.1mtpa is achievable without rail network upgrades except for the rail loop modifications at the port as allowed for in the proposed 8X scope. However, Submitting Users are concerned about the robustness of this assumption, for the following reasons:

- Unlike terminal capacity, the availability of sufficient system capacity depends on the volume and location of the source mines – Submitting Users are not aware of the assumptions that the ILC has adopted for its assessment regarding the location of the specific expanding users. In any case, to the extent that there was a change in the identity and/or volume of the expanding users (as the QCA has accepted could occur in response to changing market circumstances), there is a risk that this assumption may not remain valid. More broadly, the spatial variability in production is not just limited to expanding user mines but applies to all mines using DBCT, Hay Point and Abbot Point, particularly given the requirement for a 'campaign railings' operation to DBCT to reflect its turn of arrival cargo assembly operating mode.
- Notwithstanding the uncertainty about the volume and location of the source mines, Submitting Users have significant concerns about the validity and robustness of any conclusion that no investment in rail infrastructure capacity is required to achieve the nominated increases in system capacity. Submitting Users' concerns reflects the following issues:
  - There is uncertainty about whether there is sufficient capacity in the below rail network and broader supply chain to meet current contract demand. In this regard, Aurizon Network's UT5 Access Undertaking provides a role for an Independent Expert to undertake a range of tasks, including the determination

[19] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.7

[20] DBIM (2021), DBIM Master Plan 2021 – Expansion Opportunities at Dalrymple Bay Terminal, May 2021, p.38-39.

of capacity of the below-rail network and broader supply chain, identifying existing capacity deficits.[21] The first independent CQCN capacity assessment to be done will be by the Independent Expert, with Aurizon Network input on spatial Origin/Destination rail demand across the entire Network, to determine realistic 'Deliverable Network Capacity' and is understood to be due imminently.[22]

– Further, in previous network development plans, Aurizon Network has consistently identified a need for capacity enhancements on the Connor's Range to meet additional Goonyella system demand beyond 5mtpa.[23] The cost of such works is unclear and highly dependent on the identified capacity solution, and could range from relatively modest expenditure on signalling and operational changes, to major expenditure to triplicate a section of the route.

In the absence of a better understanding of the system capacity constraints from the rail infrastructure, there is substantial risk around the assumption that the 8X expansion of DBCT will result in the system capacity increases identified in the Application. However, the efficiency of the 8X investment, cannot be considered in isolation of the rail network, with the benefits of terminal expansion highly dependent on the amount of system capacity that will be generated, and, if relevant, the extent of rail infrastructure investment needed to realise the planned capacity increase.

Implications

The QCA has previously set out that the primary consideration in evaluating whether a specific pricing proposal or structure is justified from a public policy perspective is whether it is clearly consistent with increasing overall economic efficiency on a net present value basis.[24] However, in the absence of robust information on the costs (including NECAP and operating and maintenance costs), system capacity and demand for DBCT with and without 8X, it is difficult to see how the QCA can effectively assess this. While the QCA has specified the 8X scope, cost and timing as well as the resulting system capacity increases as assumptions underpinning the Binding Ruling (meaning that the ruling will be reviewed in the event of variations from these assumptions), there

21 QCA (2019) Decision, Aurizon Network's Revised UT5 draft amending access undertaking, December 2019, p.4

22 The Independent Expert (IE), Coal Network Capacity Co Pty Ltd, is developing an Initial Capacity Assessment Report (ICAR) with the assistance of external consultants. Aurizon Network is engaging with the IE to ensure the ICAR is delivered in a timely manner, and this is currently expected to be delivered at the end of September 2021. See Aurizon Network (2021), Annual Financial Report for the year ended 30 June 2021, p.14

23 See, for example, Aurizon Network Development Plan 2016-17, p.22

24 QCA (2013), Discussion Paper – Capacity Expansion and Access Pricing for Rail and Ports, April 2013, p.2.

are significant important issues around the broader terminal costs, with and without 8X, that the QCA has accepted, without requiring further review.

The consequence of the QCA's willingness to accept DBIM's application in the absence of robust information and analysis on these matters has removed any accountability for DBIM to develop a high quality assessment of these issues, a pre-requisite that the QCA has mandated in previous regulatory decisions when similarly assessing the pricing approach for capacity expansions.[25] Further, the Draft Determination provides no requirement for DBIM to make any further assessment of the impact of 8X on existing users as part of FEL3.

Moreover, the making of a regulatory decision in this instance based on unsupported, poor quality information and a lack of robust analysis may have further adverse ramifications where it undermines the veracity of information likely to be submitted by DBIM in future regulatory processes.

Submitting Users consider that a decision to socialise the 8X expansion has the potential to cause a significant transfer of value and risk between different groups of DBCT users. Based on Synergies' modelling of a socialised Unit TIC with or without 8X, even if it is assumed that the 8X capacity remains fully contracted until 2054, around 42% of the additional TIC revenue that DBIM will earn from 8X will be generated from existing users. In simple terms, this means that around 42% of the $1.276 billion 8X project cost, or $535 million, will be at the cost of existing users, and will limit the ability of existing users to potentially reduce terminal costs in future through optimisation and potential deferral of elements of the Major NECAP Program. The extent of contribution from existing users will be even higher if the 8X capacity is not fully contracted for this entire period (discussed further below).

While there is likely to be some benefit to existing users in terms of a reduction in Major NECAP expenditure and reductions in Handling Charges, the preliminary nature of the size and timing of cost estimates means that there is substantial uncertainty around their impact, and the lack of any requirement for DBIM to further assess these issues means that that the extent of these benefits may never be known with any real confidence.

Accordingly, the Submitting Users consider that the QCA should require a robust, evidence-based analysis of the implications of DBIM's proposed pricing method for the

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[25] See, for example, the QCA's decision in relation to Aurizon Network's WIRP project where the QCA determined that if there were genuine benefits to existing users to justify an allocation of costs to these parties, then there needed to be supporting material evidence demonstrating how the economic benefits arise; it was not sufficient for Aurizon to assert a subjective view. See QCA (2016), Final decision – Aurizon Network's 2014 draft access undertaking Volume III – Pricing and tariffs, April 2016, p.42

8X expansion, consistent with the approach that it has required in other investigations, to ensure that its decision will genuinely promote economically efficient outcomes.

This would require the QCA to seek further information from DBIM, as described in the Submitting Users' June Submission.[26] This should include further details on the long term profile of demand, NECAP and operating and maintenance costs, with and without 8X. Further, in order to demonstrate the robustness and credibility of this information, it should be accompanied by supporting analysis from DBIM, at a FEL3 level of accuracy, together with the results of an independent review undertaken by a suitably qualified independent party.

This will allow the QCA to properly address the following criteria in the QCA Act:

- the object clause as specified in Part 5 of the QCA Act, which supports the need to demonstrate that pricing proposals promote economic efficiency;
- Section 138(2)(e) and 120(1)(c), which require the QCA to have regard for the interest of persons who may seek access to the service;
- Section 138(2)(h) which requires the QCA to considers the rights of existing access holders to the extent that they are not already access seekers under section 138(2)(e).

2.3.2 Risks around demand outlook are not sufficiently considered

The Draft Determination is based on the expectation that the expanded terminal capacity will be fully contracted for the remaining economic life of the asset until 2054.[27] The QCA states:

> We have examined a range of information, including recent independent advice from RMI, to form a view on the long-term demand for access to DBCT. We consider that the market outlook supports the ongoing utilisation of the expanded terminal capacity for the life of the asset (until 2054). Additionally, DBCT is currently fully contracted, as is the capacity associated with the proposed 8X expansion (through conditional access agreements). The current access queue also shows that there is likely demand for further terminal capacity, should it become available. We therefore consider it reasonable to assume that the terminal's system capacity will remain fully contracted for the life of the asset—that is, notional contracted tonnage aligns with system capacity.

[26] DBIM pricing method for 8X Expansion, Submission from Selected Users, p.20-21

[27] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.13

The Submitting Users consider that the QCA has taken an overly simplistic approach to its analysis by accepting a single, benign volume outlook, in which it has not had sufficient regard to the potential for variation in demand for the terminal's services and the risks that varying demand profiles place on different groups of users. This includes short term volume risks associated with the assumed expansion demand, as well as long term volume risks associated with continued investment in mining projects to replace volumes from existing mines as they reach end of life. The Submitting Users also note the access seeker queue at DBCT is not necessarily a true forecast of demand, given the nil cost and high optionality afforded by being in the queue.

Long term demand risk

Long term demand risk relates to the risk of the volume outlook declining following the initial take up in the expansion volumes.

In its Application, DBIM provided no information around its expected long term terminal demand – rather, it focussed only on additional demand over the initial ten-year period for which it has conditional contracts in place.[28] However, in its explanation of the application of a differentiated pricing model (which would rely solely on demand from new users to recover the 8X investment) DBIM would require the 8X investment to be depreciated over ten years – the term of the conditional contracts. In contrast, under the socialised pricing method (where DBIM could rely on demand from both new and existing users to recover the 8X investment) DBIM did not apply accelerated depreciation,[29] presumably on the basis that it was not concerned about reductions in demand negatively impacting its ability to recover this asset value over the remaining economic life of the terminal to 2054.

Submitting Users consider that this highlights a clear risk around the term over which DBIM anticipates demand will exist for the full expansion volume.

Submitting Users raised concerns in their June submission around the long-term demand outlook for the coal industry and the potential for DBCT demand to decline beyond the initial contract term for conditional contracts, particularly noting that in the order of 70% of existing user contracted capacity is due for renewal in 2028 when 8X is scheduled to be delivered.[30] In particular, Submitting Users highlighted the risk that

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[28] DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, pp.21-22

[29] DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, p.36

[30] DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, Figure 6 Chart 1

should terminal demand peak and then decline, a socialised pricing method would leave existing users bearing a higher cost once the additional capacity and improvements delivered by 8X are no longer required by either expanding or non-renewing users.[31]

Notwithstanding the concerns raised by Submitting Users, nor the implicit acknowledgement of this risk by DBIM in its assessment of the differentiated pricing method, the QCA does not appear to have considered the potential that demand outcomes could vary from that assumed, or the potential implications to terminal users in the event of a more negative demand scenario.

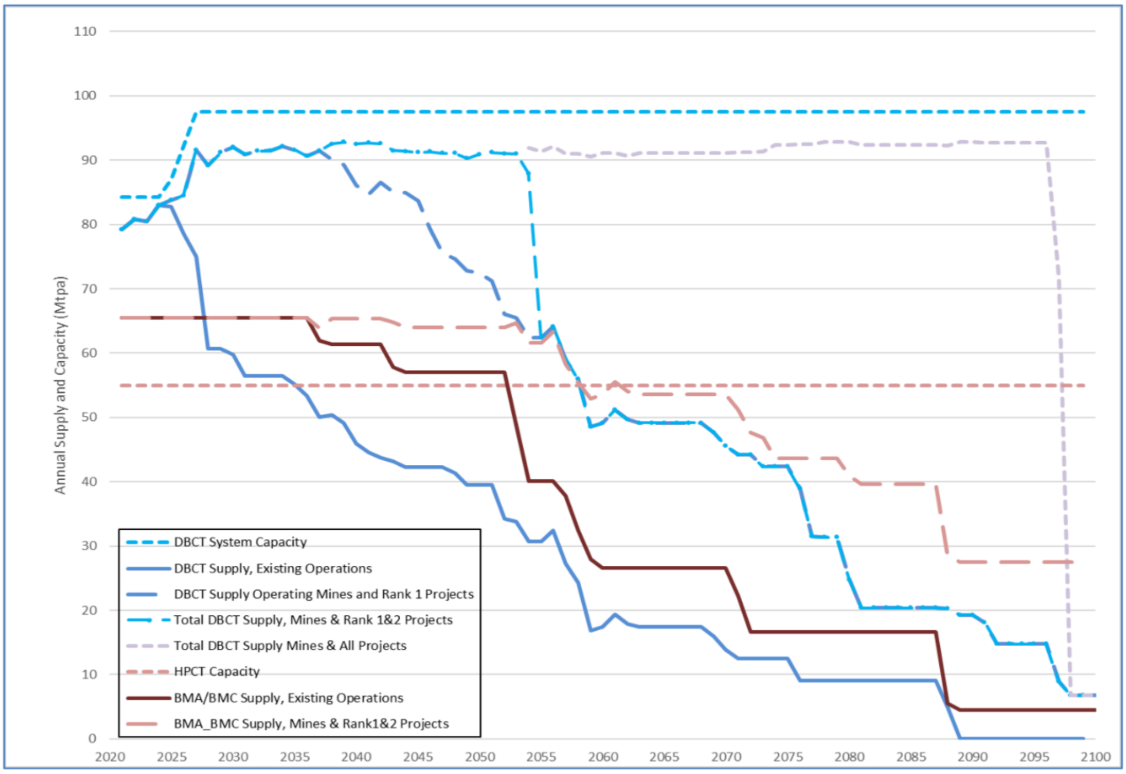
The RMI report referred to by the QCA was prepared for the purpose of reviewing the economic life of DBCT in the context of the QCA's assessment of DBIM's 2019 DAU. As part of its analysis,[32] RMI considered demand both from the perspective of global coal demand and the life of DBCT coal supply, concluding that:

- coal demand into the Asia Pacific region is expected to increase over the next ten years, but flatten from around 2035 before gradually declining from 2060 as existing infrastructure is retired and possibly replaced by more carbon neutral technologies;
- in terms of DBCT coal supply, demand from existing mines will begin to decline from around 2027. Where rank 1 projects are also considered, demand is expected to increase in the short term, and then start to decline from around 2035. Maintenance of DBCT demand to fully utilise the expanded capacity until 2054, and beyond to 2060, will require significant investment in rank 2 and other projects. This is demonstrated in Figure 1.

31 Submission from Selected Users (2021), DBIM pricing method for 8X expansion, June 2021, p.34

32 RMI, DBCT 2019 DAU—Review of the economic life of DBCT assets, prepared for the QCA, February 2021.

Figure 1 Coal Supply to DBCT and HPCT Export Terminals



Source: RMI; DBCT 2019 DAU—Review of the economic life of DBCT assets, prepared for the QCA; February 2021; p.5

This analysis demonstrates the importance of continued investment in mining projects beyond 2035 in order to sustain DBCT coal throughput at the expanded capacity level. RMI, and the QCA, are relying on the assumption that market conditions will support continued investment in, as yet unproven, coal projects for periods well beyond 2035.

However, there is significant divergence in analysts' views over both global coal demand, and the longer-term risks associated with investment in coal projects in Queensland, particularly having regard to uncertainty over changes in the cost and capabilities of different technologies (particularly for renewable energy and steel production), changes to government policies in relation to addressing climate change, and the potential impact of financial institutions' preferences in relation to their exposure to the coal sector (either through debt financing or insurance).

Further the QCA's assumption that the expanded terminal will remain fully contracted until 2054 based on a positive long-term outlook for coal demand in the Asia Pacific region appears inconsistent with its approach to assessing the terminal's economic life for the 2021 AU, where it maintained a conservative view of economic life based on known DBCT coal supply.[33]

33 QCA (2021) Final Decision – DBCT 2019 draft access undertaking, March 2021, pp.174-180

The confluence of these two approaches results in the QCA effectively assuming that DBCT will expand and remain fully contracted for its full expansion capacity until 2054, at which time demand will freefall such that the ongoing operation of the terminal is no longer economically viable. As has been previously highlighted by Submitting Users,[34] this is an entirely unrealistic assumption which imposes additional costs on existing users from two directions:

- the optimistic assumption that the terminal will remain fully contracted until 2054 is a significant factor driving the QCA's analysis of DBIM's 8X pricing method and its conclusion that existing users will derive significant benefits from 8X such that socialisation is warranted, thereby increasing the costs being imposed on existing users. The additional costs to existing users will increase to the extent that the optimistic assumption of the terminal remaining fully contracted until 2054 is not realised;
- however, the pessimistic imposition of a 2054 economic life constraint in circumstances where the RMI analysis indicates that there is likely to be substantial ongoing demand for at least a further 20 years (albeit that this may well be at a lower demand level) results in the acceleration of depreciation of the terminal assets (including the 8X expansion project assets), inflicting additional costs on current users.

The uncertain nature of the long term demand highlights why economic efficiency objectives are most clearly met where the known expanding users pay the full cost of the expansion. There is significant risk around any assumption on future (as yet unknown) demand, and the value that future users will actually place on additional capacity at that time. For these reasons, if the known expanding users are unable or unwilling to accept the costs of the expansion, then there is a real question as to whether the expansion is, in fact, economically efficient.

Short term demand risk

Apart from the long-term risks around the demand outlook, Submitting Users have highlighted in their June 2021 submission a number of concerns around short term coal market risks and the resulting risk that expanding users may default on their conditional contracts and the expansion volumes may not eventuate.

While acknowledging the concerns raised by Submitting Users, the QCA largely dismissed these as material issues for the following reasons:[35]

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34 See section 3.2.1 and 3.2.3 of the Submitting Users' June 2021 submission.

35 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, pp.46-47

- by providing for DBIM to hold security (including bank guarantees and parent company guarantees) from users that it considers less creditworthy, the QCA considers that the regulatory framework enables DBIM to manage any additional risks associated with providing access to new users; and
- the experience at WICET, where there was a strong demand for capacity which dissipated during terminal construction as a result of a market downturn and which remains uncontracted, is not reflective of the extent that existing users are exposed to the risk of an expansion party defaulting.

While acknowledging that the potential cross default risk at DBCT is different than that at WICET, Submitting Users do not consider that the reasons presented by the QCA are sufficient to mean that the short-term volume and cross default risk at DBCT is not a material issue for existing users.

Submitting Users agree that the provisions in the regulatory framework regarding security provide a mechanism for DBIM to manage risks associated with providing access to new users (albeit that this is unlikely to fully address the risks). However, when combined with a socialised pricing method, the regulatory framework does not provide an incentive for DBIM to use these provisions to maximise its management of these risks. This reflects that:

- DBIM has a strong incentive to reach agreement with expanding users for a terminal expansion. This is particularly the case under the 2021 AU where reference tariffs are no longer a feature, and DBIM has the opportunity to seek a higher return from expanding users in order to facilitate the investment;
- in the event of an expanding user default, the pricing framework will result in the costs associated with this default being shared across all the remaining users by way of a resulting increase in Unit TIC – DBIM is not required to bear any of these default costs under the current regulatory framework;
- these factors combine to provide an incentive for DBIM to relax its security requirements in negotiations, in order to encourage expanding users to commit to an expansion agreement containing pricing arrangements attractive to DBIM.

Given the different incentives under the 2021 AU, Submitting Users do not consider that the historical experience of no default on payments to DBIM necessarily provides a reliable precedent for new expansion contracts.

Further, as has been highlighted in their June submission, Submitting Users consider that the experience at WICET is a good illustration of how quickly the investment environment for new coal mines can change in the event of a market downturn, with the resulting potential for default by expanding users, particularly those with greenfields projects that have a higher development risk than brownfields projects, noting DBIM has acknowledged that only 35% of demand for 8X is from existing users.[36] While the size of the consequential impact on TIC at DBCT may not be as high as was experienced at WICET, Submitting Users maintain the view that the risk, and potential impact, is material.

The QCA specifically acknowledged stranded asset risks and default risks of individual expanding users as part of the WIRP expansion. The QCA noted:[37]

> We consider that stranded asset risks (and default risks of individual expanding users) associated with an expansion are better assessed and factored into the expansion approval process—not addressed through the allocation of risks and costs once the expansion is finalised. The stranded asset risk of an expansion should be considered as part of the pre-approval stage in the expansion process (see Chapter 12). We do not consider it appropriate to use socialisation as a way to address the asset stranding risk of an expansion. This may provide expanding users and Aurizon Network with an incentive to invest in an expansion with significant asset stranding risk. We do not consider that this is consistent with the object of Part 5 of the QCA Act.

However, notwithstanding the strength of the QCA's views on this issue in its previous assessment of the WIRP expansion, the outcome of the Draft Determination will in fact result in socialisation being used to address the asset stranding risk associated with 8X.

Implications

Socialisation will result in the risks around demand, including both short term demand (and related cross default risk) and long term demand, ultimately being largely borne by existing users and does not place any accountability on DBIM to ensure that the assumptions underpinning the expansion are robust, or to put in place effective arrangements with new users to manage these risks. Notwithstanding the QCA's views that the size of the risk is less than at other terminals such as WICET, this approach is not consistent with encouraging efficient investment or efficiently allocating risk. The QCA has previously stated that:[38]

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36 DBIM (2021), Dalrymple Bay Terminal 8X Expansion – FEL 2 Study, Application for Ruling on Pricing Method, March 2021, paragraph 182.

37 QCA (2015), Consolidated draft decision, Aurizon Network 2014 draft access undertaking Volume III – Pricing & tariffs, December 2015, p.62

38 QCA (2013), Statement of Regulatory Pricing Principles, August 2013, p.16

> In situations where one party has market power, there is likely to be a need for a regulator to make an assessment in relation to the optimal allocation of risk. In this situation, actual preferences for risk might not be known. But the well known principle that risk should be allocated in proportion to the ability to control risk can be used. In particular, a party that is causally responsible for a risk as a result of a certain action should normally be responsible for assuming the liabilities that arise. In allocating risks in a regulatory context, there is a need to take account of the extent to which the allocation will affect incentives to operate and invest efficiently.

The Draft Determination notes that the regulatory framework enables DBIM to manage any additional risks associated with providing access to new users, by providing for DBIM to hold security.[39] However, there is no requirement or incentive for DBIM to do this.

The QCA's treatment of demand risks and measures to ensure an efficient allocation of this risk are inconsistent with the following criteria in the QCA Act:

- the object clause as specified in Part 5 of the QCA Act, which supports the need to demonstrate that pricing proposals promote economic efficiency;
- Section 138(2)(h) which requires the QCA to considers the rights of existing access holders to the extent that they are not already access seekers under section 138(2)(e).

2.3.3 Insufficient incentives for DBIM to manage risks

As has been highlighted in the preceding sections, there are significant risks around the assumptions that underpin the QCA's assessment of DBIM's pricing proposal. These risks include:

- risks around the scope, cost and timing of the 8X investment, noting that these matters have to date only been investigated to an FEL2 level;
- uncertainty around the extent of benefits to existing terminal users resulting from 8X creating reductions in the cost of the Major NECAP Program and Handling Charges;
- uncertainty around the amount of additional system capacity that may be generated by the expansion in the absence of rail network investment and, if relevant, the extent of rail network expenditure required to achieve the planned increase in system capacity; and

[39] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.47

- risks around terminal demand, including the risk of default by expanding users in the short term as well as the demand risk associated with the long term coal production investment pipeline.

Once a decision is made to use a socialised pricing method, these risks will largely be borne by existing users, as the pricing framework provides for the investment to be included in the terminal Capital Base and recovered across all users, regardless of changes to these assumptions.

The 2021 AU provides a mechanism for an Expansion Ruling based on FEL2 information to be reviewed in the event that the final investment project differs from key assumptions underpinning the QCA's assessment.[40] Where the Expansion Ruling is conditional on assumptions, this will provide a strong incentive on DBIM and expanding users to manage the risks around those assumptions in order to ensure that there is no basis for the QCA changing the terms of the Expansion Ruling.

However, in its Draft Determination, the QCA has limited its specified assumptions to only include matters around the scope, cost, system capacity impact and timing of the 8X investment project. This means that there will be no onus on DBIM and expanding users to effectively manage the risks around the other assumptions.

As a result, the Draft Determination has the potential to lead to perverse outcomes where DBIM is likely to have the incentive to downplay the risks of the program in order to capture the commercial benefits associated with a socialised expansion proceeding, with the knowledge that these risks will subsequently be largely borne by existing users. There will be no consequence to DBIM if the assessment of benefits to existing users is overstated, and nor will there ultimately be a cost to DBIM if volumes fall short of expectations or if expanding users default with insufficient security in place, as this will simply lead to an increase in TIC charged to remaining users.

Submitting Users consider that the QCA's treatment of these issues, including DBIM's incentives to manage project risk, are inconsistent with the following criteria in the QCA Act:

- the object clause as specified in Part 5 of the QCA Act, which supports the need to demonstrate that pricing proposals promote economic efficiency; and
- Section 138(2)(h) which requires the QCA to considers the rights of existing access holders to the extent that they are not already access seekers under section 138(2)(e).

40 See Dalrymple Bay Coal Terminal 2021 Access Undertaking, Clause 12.5 (c)

2.3.4 The importance of cost reflective pricing signals to incentivise efficient investment

The QCA has previously identified that a relevant economic efficiency pricing principle in considering the question of who should pay for use of capacity is cost causative pricing. As the QCA has noted:[41]

> Allocative efficiency requires prices to reflect marginal costs. If an entity's use of a service causes costs to increase at the margin, then for allocative efficiency to be achieved, the entity needs to face a price that reflects the marginal contribution of its use to costs. This principle is sometimes referred to as the 'user pays' or 'impactor pays' principle. The costs that are caused should include the cost of imposing any adverse externalities or reduced to reflect the value of positive externalities.

In considering DBCT Management's Differential Pricing DAU in 2015, the QCA stated that it considered that application of the legislative criteria indicating that it must consider whether the proposed arrangements would provide cost-reflective price signals to access seekers and holders which promote economically efficient investment in and use of the terminal.[42]

QCA has consistently considered that the object of Part 5 would be promoted where: [43]

- existing users are not exposed to a material increase in tariffs due to an expansion triggered by access seekers; and
- expanding users should bear the cost of the expansion, except where there are *clear benefits* to existing users.

Having regard to the object of the QCA Act, and consistent with the QCA's previous findings on this issue, Submitting Users consider that promoting economically efficient investment in the 8X project requires that the parties that benefit from the expenditure bear the cost; if expanding users do not place sufficient value on the benefit to support the incremental expansion expenditure, then the investment cannot be considered allocatively efficient.

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41 QCA (2013), Discussion Paper – Capacity Expansion and Access Pricing for Rail and Ports, April 2013, pp.2-3.

42 QCA (2015), Draft Decision – DBCT Management Differential Pricing Draft Amending Access Undertaking, May 2015, pp.iv

43 See for example the QCA's discussion paper on Capacity Expansion and Access Pricing for Rail and Ports (April 2013) at https://www.qca.org.au/wp-content/uploads/2019/05/1920_CI-CapExpAccPRP-QCA-PricePaper-0413-1.pdf

Test of materiality of impact on existing users

One of the factors that the 2021 AU requires the QCA to consider in an assessment of a pricing method for a cost sensitive expansion is the materiality of the expected increase in Unit TIC under socialisation.

In its Draft Determination, the QCA has primarily assessed the materiality of the increase in the Unit TIC in terms of whether there is the potential for a socialised price to discourage use of the terminal by existing users.[44] The QCA considered that an increase of the TIC of up to $0.56/t (and on average $0.47/t between 2026–27 to 2035–36) is unlikely to have an impact on the use of coal handling services at DBCT by existing users, or negatively affect the economic viability of already operating investments.[45]

This assessment is consistent with the approach that the QCA used in assessing the materiality of impacts on price in the context of its review of the declaration of DBCT services,[46] where the QCA was analysing the potential for differences in DBCT charges to be sufficiently material to deter more efficient (new) entrants from participating in the coal tenements market. However, the Submitting Users consider that is not the appropriate test of materiality in the context of an application for socialised pricing.

The focus of the QCA's assessment should be on the promotion of economic efficiency, with the key concept of how economic efficiency is best promoted needing to be explicitly considered for each investigation. In the case of an investigation into the pricing method to apply for a capacity expansion, a key economic efficiency concept is whether the investment is an economically efficient one.

Given this context, an assessment of the materiality of impacts to existing users should be targeted towards considering whether the impacts are sufficiently material to detract from this objective being met. Any increase in the Unit TIC for existing users increases reduces the extent to which the price for expanding users reflects their marginal cost, increasing the risk that the expansion will proceed where it is not efficient.

In its previous considerations of differential pricing, both for DBCT and for Aurizon, the QCA has consistently taken the view that existing users should not be required to bear a material increase in their access charges (due to an expansion triggered by other users) and that it is economically efficient for expanding users to be required to bear the

44 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.26

45 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.28

46 QCA (2018), Draft Recommendation – Part C: DBCT declaration review, December 2018, p.83

incremental costs associated with their access agreements.[47] [48] Given these contexts, in those investigations, the QCA's assessment of the materiality of impacts on existing users was targeted towards ensuring that socialisation did not undermine the objective for expanding users to bear a price that at least reflected the incremental cost that they impose, as this would ensure that the expansion only proceeds where the value that is placed on the expansion exceeds its incremental cost.

In contrast, the test adopted by the QCA in the Draft Determination, where it considers materiality in the context of the potential impact on the use of the terminal by existing operators, appears to be focussed only on the impact of prices on efficient utilisation of the facility and on competition in related markets, rather than the key concept of ensuring that the investment that is the subject of the Expansion Ruling is efficient. As a result, the QCA risks accepting a price impact for existing users resulting from an inefficient expansion (that is, one where the value placed on the expansion by the beneficiaries – the expanding users – is less than the required cost).

The Submitting Users raised this issue in their June submission, highlighting their view that the focus of the QCA's assessment of the materiality of the impact on the existing users' TIC should be the extent to which it is likely to impact on effective cost reflective pricing for the expansion.

However, the QCA dismissed the Submitting Users' concerns around socialisation undermining cost-reflective pricing, on the basis that DBCT provides a common service to all users, and individual segments of terminal infrastructure cannot be isolated and dedicated to a particular user or group of user.[49] However, Submitting Users consider that this view is only valid once the expansion is complete – where an expansion is being considered, cost reflective pricing requires that the beneficiaries of the expansion meet

47 In its consideration of Aurizon Network's proposed pricing for the WIRP expansion project, the QCA noted that it considered it was unreasonable for the economic viability of a mine that is already operating to be adversely impacted by a material increase in access charges resulting from an expansion triggered by other users. The QCA further noted that existing users should, to the extent practicable, be confident of a relatively stable risk and access charge profile over time. This treatment of incremental costs for a major expansion was reflected in Aurizon Network's 2013 DAAU pricing proposal for GAPE train services, where it was proposed that the incremental costs associated with GAPE infrastructure be allocated to expanding customers. Aurizon Network's proposed revenue deferral approach in 2013 in the context of the Newlands to Abbot Point expansion (NAPE) customer share of GAPE project costs was similarly designed to ensure that existing users did not see a material impact in their access charge. See QCA (2015), Supplementary Draft Decision – Aurizon Network 2014 DAU: Reference Tariffs for Wiggins Island Rail Project Train Services, July 2015, pp.22, 24, 46, 50, 51.

48 In relation to WIRP, the QCA preferred the system premium approach as it included a premium to reflect WIRP users' higher incremental cost. See QCA (2015), Supplementary Draft Decision – Aurizon Network 2014 DAU: Reference Tariffs for Wiggins Island Rail Project Train Services, July 2015, p.vi.

49 QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, pp.33-34

the costs that will be incurred in developing the expansion – a position that has been clearly accepted by the QCA in the past.[50]

Four phases of the 8X expansion not separately considered

While DBIM has packaged its expansion proposals into a single '8X' proposal, in effect there are four separate expansions planned. The divisibility of the project into the individual expansions is clearly demonstrated by DBIM's position that it would not proceed with the later phases in the event that these were not supported by demand.

However, in considering the case for socialisation, the QCA has not had sufficient regard for the different characteristics of the four phases of the 8X expansion. In particular, in coming to the conclusion that the circumstances exist to justify the socialisation for the 8X expansion, the QCA has not demonstrated any consideration of whether the different characteristics of the four phases of the 8X expansion mean that the circumstances that justify socialisation are applicable to each of the discrete expansion phases.

In forming its view on whether circumstances exist to justify socialisation, the QCA should explicitly consider whether those circumstances apply at each of the four discrete expansion phases. Ultimately, the QCA should consider the potential for socialisation to distort the price signals incentivising efficient expansions for each incremental phase of the 8X program. This is particularly an issue of concern for Phases 3 and 4 of the 8X program, which have a significantly higher capital cost per tonne of additional capacity than Phases 1 and 2.

Implications

Submitting Users consider that the QCA's approach to assessing the impacts of socialisation on existing users, together with a lack of consideration as to whether circumstances exist that support socialisation for each of the separable phases of the 8X program, is inconsistent with the following criteria in the QCA Act:

- the object clause as specified in Part 5 of the QCA Act, which supports the need to demonstrate that pricing proposals promote economic efficiency; and
- Section 138(2)(h) which requires the QCA to consider the rights of existing access holders to the extent that they are not already access seekers under section 138(2)(e).

[50] See, for example, QCA (2016), Final decision – Aurizon Network 2014 draft access undertaking Volume III – Pricing and tariffs, April 2016, p.38. See also QCA (2013), Draft Decision, Goonyella to Abbot Point Expansion Reference Tariff – Draft Amending Access Undertaking, July 2013, p.20

2.4 Summary and conclusions

Given the concerns highlighted above, the acceptance of a socialised pricing approach creates a risk that a decision to expand may be made where the incremental benefits do not justify the incremental costs, and it is only proceeding on the basis that some of these incremental costs are borne by existing uses. This may create costs that lead to a loss of economic efficiency across the terminal and broader coal system and ultimately a less competitive Queensland coal industry.

The importance of the decision regarding differential or socialised pricing in providing efficient incentives for investment has been a cornerstone of the QCA's previous assessments of similar issues, however has not been given sufficient regard in this assessment.

Each of the issues discussed above reflect significant departures by the QCA from its own established regulatory precedent, with the QCA providing little explanation for the departure. Such significant changes undermine regulatory certainty and predictability.

The Submitting Users continue to consider that, on the basis of the information currently presented by DBIM, these risks warrant the use of differential pricing for the 8X project (at least in part). As set out in their June submission, Submitting Users would support a differential pricing method that ensured that expanding users only bore the incremental cost associated with providing the additional capacity (both in terms of the incremental investment net of Major NECAP savings, and the incremental operating and maintenance costs). Submitting Users consider that such an approach would have the following benefits:

- it would create strong incentives for DBIM and expanding users to only commit to the 8X program in circumstances where the investment was economically efficient;
- it would create strong incentives for DBIM and expanding users to manage the risks associated with the 8X program; and
- by ensuring that expanding users would retain the benefits associated with NECAP and operating cost reductions, it would avoid the situation where differential pricing created a much higher Unit TAC for new users, with the potential outcome of discouraging utilisation of the expansion capacity.

3 Conditions that should be applied to a socialised pricing method

As presented in Section 2, Submitting Users maintain that the risks associated with the 8X expansion project warrant the use of a differential pricing method (or at least in part). However, in the event that the QCA's final determination is to maintain its preference for socialisation, Submitting Users consider that it is imperative that the QCA consider how it can incorporate measures into the pricing framework that mitigate the identified risks that socialisation imposes on existing users. This includes mechanisms to ensure that DBIM is incentivised to effectively manage expansion risks directly with the expansion parties where practical.

While the QCA has stated in the Draft Determination that the ruling would be conditional upon the underpinning assumptions remaining valid,[51] the QCA has limited its stated assumptions to high level characteristics of the expansion itself (scope, capacity, cost and schedule),[52] and has not specified any assumptions in relation to a range of matters which influence the impact of the expansion on existing users. This diminishes any incentive that DBIM may have to robustly analyse these impacts and manage the risks around these assumptions, creating poor incentive structures that are likely to adversely affect the interests of existing users.

Matters that Submitting Users consider that the QCA should address in the event that a socialised pricing method is applied are set out below.

3.1 Volume risk

3.1.1 Short term volume risk

Nature of risk and potential impact on existing users

The Submitting Users have highlighted in their June submission, and in Section 2.3.2 of this submission, the risks of the 8X expansion to users of the existing terminal in relation to short term demand risk and the resulting cross default risk. In particular, Submitting Users consider that:

- the risk profile of the expansion parties is likely to be materially higher than that of existing users, as there is much higher uncertainty around forecast production volumes from mine developments rather than from existing mines, given project

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[51] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, pp.7-8

[52] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, Appendix A p.52

development risks. Further, the project development risks around greenfield mine projects are significantly higher than brownfields expansions;

- these risks can be partially, but not completely addressed through counterparty screening, contracting arrangements and security provisions; however in the event of a socialised pricing method being applied in accordance with arrangements established in the Draft Determination, the regulatory framework will not place an incentive on DBIM to pursue such measures as the only risk that DBIM faces is that it may earn its revenue from a smaller pool of users;
- in the event of a downturn in the coal market resulting in a default by an expanding user, the environment is unlikely to support this capacity being taken up by another party in the queue until such time that the market recovers sufficient to incentivise further investment in coal production capacity;
- in these circumstances, the foreseeable outcome is that expansion demand will be less than the expansion capacity for a substantial period of time, with potentially limited security coverage to cover the resulting shortfall in revenue, causing an increase in the Unit TIC applicable to existing users.

Submitting Users consider that the QCA should incorporate measures to mitigate this risk to existing users in its Expansion Ruling and to incentivise DBIM to strongly pursue contracting and security arrangements with expanding users.

Recommended mitigation methodology

The framework available to the QCA, whereby it can establish assumptions upon which the Binding Ruling is conditional, provides a ready mechanism for the QCA to establish conditions upon a decision for socialised pricing to apply. In effect, the QCA could use these assumptions (referred to in this section as Expansion Ruling Assumptions) to create incentives for DBIM to take action, where possible, to effectively manage risks either through its own actions or through its negotiations with expanding users, rather than simply using socialisation as a means to pass the risks back to existing users. While socialisation may still result in some of these risks ultimately being borne by existing users, this should occur only as a last resort.

Using this framework, there are opportunities available to the QCA to address the concerns of Submitting Users in relation to the incentives for DBIM to manage default risk and the mitigate the potential consequences on existing users. Submitting Users suggest the QCA give consideration to the following arrangements which could be incorporated into any Expansion Ruling to permit a socialised pricing method for 8X:

(a) Specifying an Expansion Ruling Assumption that assets for each expansion phase will not be permitted to be added to DBIM's Capital Base until such time that the incremental demand commences, with interest during construction accruing until such time that the assets are included in the Capital Base;

- this will address a primary concern of Submitting Users that project risks or market circumstances may result in a delay to the commencement of mine production or, at worst, cancellation of a mine development project prior to completion of construction. Once the mine project has been developed and production has commenced as planned, the volume risks are less acute and more similar to that of existing users;
- to the extent that DBIM and the QCA are correct in their assumption that, if an expanding user were to default on their access agreement, there is sufficient alternate demand from the queue to support an expectation that the expansion will be fully contracted, then there will be no delay to the inclusion of the assets in the Capital Base;
- however, in the event that the Submitting Users' concerns about default risk for high risk new projects are realised, this approach will avoid passing this risk directly back to existing users by delaying the inclusion of the expansion costs in the Capital Base. DBIM's can mitigate the impact of this risk on its commercial performance by ensuring that it incorporates adequate security arrangements in its access agreements with expanding users;
- there is precedent for this approach, with the QCA requiring a similar arrangement in relation to Aurizon Network's WIRP project.

(b) Specifying an Expansion Ruling Assumption that, in the event of a default by an expanding user under an access agreement, the value of the security that DBIM is entitled to seek under the regulatory framework will be deducted from the DBIM's Capital Base used for calculation of access charges:

- this approach has similarities to the way in which defaults were treated under the revenue cap arrangements specified in DBIM's previous access undertakings. Under those arrangements, in the event that reference tariffs were being reviewed due to the early termination of an access agreement, the value of security held by DBIM would be deducted from the revenue cap;
- under the 2021 AU, where reference tariffs no longer apply and the regulatory framework does not establish an ongoing process to manage charges under a revenue cap framework, it is unclear if, and if so how, deducting the value of security from a measure of 'allowable revenue' would translate to the access charges for existing users. In this context, however, a similar outcome could

be achieved by deducting the security value from the Capital Base used in DBIM's ongoing calculation of charges;

– in addition, specifying that the deduction will be equal to the security that DBIM is entitled to require under the regulatory framework will create a strong incentive on DBIM to incorporate security into its access agreements, rather than relying on socialisation as a means of addressing counterparty risk.

Incorporating these matters as formal Expansion Ruling Assumptions would materially address Submitting Users' concerns about the short term volume risk and cross default risk resulting from the QCA's recommended socialised pricing method.

3.1.2 Long term volume risk

Nature of risk and potential impact on existing users

The Submitting Users have highlighted in their June submission, and in Section 2.3.2 of this submission, the costs and risks imposed on users of the existing terminal as a result of the QCA's assumed long term demand profile and the risks around actual demand varying from this assumption. In particular, Submitting Users consider that:

- the QCA has relied on a single demand scenario that the expanded terminal will remain fully contracted until 2054, without having sufficient regard to the potential for variation around this scenario;
- the assumption that the expanded terminal will remain fully contracted until 2054 based on a positive long-term outlook for coal demand into the Asia Pacific region appears inconsistent with the QCA's approach to assessing the terminal's economic life for the 2021 AU, where it maintained a conservative view of economic life based on known DBCT coal supply;
- the confluence of these two approaches results in the QCA assuming that DBCT will expand and remain fully contracted for its full expansion capacity until 2054, at which time demand will freefall such that the ongoing operation of the terminal is no longer economically viable;
- Submitting Users note RMI's view that DBCT demand is likely to increase to a peak around 2035 with demand then flattening and subsequently declining from 2060, however consider that there is material risk that the decline will occur earlier. However, Submitting Users anticipate that there will be continuing demand (albeit at a lower level) substantially beyond the nominal economic terminal life of 2054;
- Submitting Users consider that the QCA's reliance on its demand outlook imposes additional cost and risk on existing users for the following reasons:

- the optimistic assumption that the terminal will remain fully contracted until 2054 is a significant factor driving the QCA's analysis of DBIM's 8X pricing method and its conclusion that existing users will derive significant benefits from 8X such that socialisation is warranted, thereby increasing the costs being imposed on existing users. The additional costs to existing users will increase to the extent that the optimistic assumption of the terminal remaining fully contracted until 2054 is not realised;
- however, the pessimistic imposition of a 2054 economic life constraint in circumstances where the RMI analysis indicates that there is likely to be substantial ongoing demand for at least a further 20 years (albeit that this may well be at a lower demand level) results in the acceleration of depreciation of the terminal assets (including the 8X expansion project assets), inflicting additional costs on current users.

Submitting Users consider that the QCA should incorporate measures to mitigate these impacts on existing users in its Expansion Ruling and to incentivise DBIM to ensure that there is sufficient additional demand to support the cost of the expansion.

Potential mitigation methodology

There are several options available to address these concerns under a socialised pricing model, including:

(a) One option available to the QCA is to explicitly identify the assumed contracting of DBCT's expanded capacity until 2054 as an Expansion Ruling Assumption, and to the extent that this outcome does not occur in practice, apply a premium to the (reduced) expansion volumes to provide that expanding users (as a group) continue to achieve their anticipated recovery of the 8X investment costs.
    - this would create a strong incentive for DBIM to critically evaluate the expected utilisation of the expansion capacity over the remaining nominal economic life of the terminal as part of FEL3, in order to ensure that the final Expansion Ruling Assumption of assumed contracting level is reasonable;
    - to the extent that DBIM's final assumed contracting level for the expanded terminal capacity shows a significant decline prior to 2054, then this would indicate that the economic life of the expansion assets is shorter than the existing terminal. This in turn may mean that that the cost of socialisation (in terms of the potential impact on Unit TIC) may be higher, and that the benefits to existing users from 8X may be significantly less, than currently anticipated by the QCA, and the conditions for full socialisation of the 8X expansion may not apply. This could trigger a move to either a differentiated or 'partial

socialisation' model, whereby the expanding users bear the cost of shortening the economic life of the 8X expansion assets;

– the additional rigour around the assessment of assumed contracting levels and economic life of the expansion assets would reduce the risk that subsequent declines in actual contracting levels compared to that assumed would result in significant additional charges for the remaining expansion volumes.

(b) An alternate approach that may be adopted is to specify an Expansion Ruling Assumption that DBIM will extend the nominal economic life of the terminal beyond 2054:

– if DBIM and the QCA genuinely expect that the terminal is likely to remain fully contracted until 2054, and recognising that demand declines will then occur over a substantial timeframe, it is not clear why current users remain required to bear higher costs in order to fully depreciate the assets by 2054;

– extending the economic life of the terminal would reduce the extent to which existing users are required to bear additional charges to provide increased capacity for expanding users. Synergies' modelling indicates that an extension of the terminal economic life to 2074 could eliminate the need to increase the Unit TIC under socialisation. Importantly, due to the application of straight line depreciation, even if DBCT volumes declined over the period from 2054 to 2074, the need to recover a reducing Capital Base will mean that tariff increases would remain modest, if they occurred at all;

– Importantly, an extension of the terminal asset life would also require DBIM to accept some of the long term demand risk associated with its decision to expand the terminal. If DBIM considers this long term risk to be of concern, it then has the opportunity to seek compensation for this in its contracts with the expanding parties.

While taking an approach consistent with Option (a) would address Submitting Users key concerns around the lack of rigour associated with the estimation of assumed contract volumes and the risk that demand may decline faster than assumed, Submitting Users acknowledge that this may introduce significant complexity in the administration of the arrangements. As a result, Option (b), involving an extension of the economic life of the terminal, may be a more pragmatic approach to address Submitting Users' concerns.

In addition, Submitting Users consider that any decision for a socialised pricing method ultimately results in demand risk, including the risk to the demand outlook from environment, social and governance (ESG) risks such as those related to climate change, being borne by users. As a result, it would be appropriate for the QCA to specify as an Expansion Ruling Assumption that, in its assessment of the rate of return applicable to the calculation of Unit TIC, DBIM will take into account the extent to which socialisation results in demand risk, including ESG risk, being borne by users.

3.2 Cost and operational risk

Nature of risk and potential impact on existing users

The Submitting Users have highlighted in their June submission, and in Section 2.3.1 of this submission, the costs and risks imposed on users of the existing terminal as a result of the preliminary and poorly substantiated nature of the information used to assess the Application. Submitting Users consider that:

- based on the current FEL2 level study, there remains significant uncertainty as to the scope and cost of the 8X project. Any decision to socialise the 8X project based on information at this confidence level would expose existing users to significant cost risk, to the extent that variations to the scope and resulting cost of 8X are then borne by all users of the terminal, regardless of whether such variations created any benefit to existing users. The QCA has acknowledged this risk, and proposes to deal with it by treating the 8X project cost, scope and timing as an Expansion Ruling Assumption, enabling the Expansion Ruling to be reviewed in the event that these circumstances change;[53]

- having regard to known concerns about the sufficiency of the existing Goonyella system rail infrastructure capacity to meet demand, there is substantial risk around the assumption that the 8X expansion of DBCT will result in the system capacity increases identified in the Application without further rail investment, and if required, the extent of that further rail investment. The QCA has also acknowledged this risk, and proposes to deal with it by treating the 8X system capacity increases as an Expansion Ruling Assumption, enabling the Expansion Ruling to be reviewed in the event that these circumstances change;

- based on the preliminary nature of the information presented by DBIM in relation to the impact of the 8X expansion on the Major NECAP Program and on Handling Charges, the assessment of benefits to existing users of the terminal from 8X is subject to a high degree of uncertainty. A more detailed, independently verified, examination of these matters may conclude that the expected benefits to existing users is substantially less than currently assumed by the QCA. The QCA has not acknowledged this risk in its Draft Determination. The QCA's willingness to make a determination on the pricing method based on this preliminary and poorly

[53] QCA (2021), Draft determination: DBIM's application for a price ruling – the 8X expansion, August 2021, p.51

substantiated information removes any accountability for DBIM to develop a high quality assessment of these issues, a pre-requisite that the QCA has mandated in previous regulatory decisions when similarly assessing similar the pricing approach for capacity expansions

Submitting Users consider that the QCA should incorporate additional measures to address these concerns in its Expansion Ruling and in particular to incentivise DBIM to fully investigate the expected implications of 8X for existing users as well as expanding users, in order to ensure that the project only proceeds where it is economically efficient to do so, and that the costs assigned to existing users do not exceed the benefits that they will receive.

Potential mitigation methodology

Submitting Users consider that, there are options available to address these concerns under a socialised pricing model, including:

(a) Specifying the following matters as Expansion Ruling Assumptions:

- the Major NECAP Program with and without the 8X expansion;
- the forecast terminal operating and maintenance cost with and without the 8X expansion;
- the expected impact on other terminal costs as a result of the 8X expansion, including DBIM's operating costs and rehabilitation costs.

The inclusion of these costing assumptions, with and without 8X, as Expansion Ruling Assumptions is considered by Submitting Users to be critical, as these are the issues that drive the assessment of the nature and extent of benefits to existing users. In the absence of these being specified as Expansion Ruling Assumptions, there is no incentive for DBIM to undertake any further analysis, including gaining independent verification, to confirm the extent of the likely benefits to existing users. These matters can and should be considered as part of the FEL3 assessment.

Submitting Users consider that including these additional matters as Expansion Ruling Assumptions will avoid the outcome of a socialisation decision being made in reliance on preliminary and poorly substantiated information, and will allow for a robust assessment of the extent of costs and benefits of the 8X project, including the benefits to existing users, to be undertaken before the price method is confirmed. To the extent that the costs are higher than currently assumed, or that the benefits to existing users are less than currently indicated, this may require an adjustment to the pricing method, potentially involving a partial or even fully differentiated pricing method ultimately being adopted.

3.3 Process for review of Binding Ruling where assumptions change

Section 150(F) of the QCA Act provides that, in making a Binding Ruling, the QCA must specify the circumstances relating to the service that the Authority considers is material to the ruling and, if the ruling is made on the basis of assumptions about future events, must specify those assumptions. Section 150(K) then provides that a ruling will not apply if the circumstances are materially different to that assumed.

The 2021 AU provides a mechanism for the QCA to consider whether the final expansion proposal aligns with the assumptions underpinning the Binding Ruling, and for the Binding Ruling to be confirmed or reviewed. Specifically, Clause 12.5(a) provides that, If DBIM proposes to expand the terminal, it will submit to the QCA a Terminal Capacity Expansion application, which must include the information specified in Clause 12.5(a). Clause 12.5(c) goes on to provide that:

> **(c) (QCA to confirm Expansion Ruling following application for Expansion)** Following receipt of an application under 5.12(a)(2), the QCA will provide to DBIM and each Expansion Party notice of, in respect of a relevant Expansion Component:
>
> (1) where an Expansion Ruling has been made in accordance with Section 5.12(b)(10), the content of the QCA's ruling and details of any material changes apparent in the application which may require a new or varied ruling to be made, including the extent to which the circumstances of the Expansion Component vary from the assumptions made in the original Expansion Ruling;
>
> (2) where an Expansion Ruling has not been made in accordance with 5.12(b)(10), but an Expansion Ruling Application has been made under Section 5.12(a)(2) or 12.5(a)(9), a copy of the Expansion Ruling Application and information on the QCA's process for determining an Expansion Ruling for that Terminal Capacity Expansion.

While acknowledging the intent of Binding Ruling to be reviewed following an application for a Terminal Capacity Expansion, Submitting Users are concerned that the 2021 AU provisions lack clarity in relation to the timing and process for this review. In particular:

- the rationale for the requirement that the QCA confirm the Expansion Ruling following an application under 5.12(a)(2) is unclear, as it would appear more in keeping with the apparent intent of the provision if the QCA were to confirm the Expansion Ruling following an application for an Expansion under clause 12.5(a);

- in the event that the circumstances are different from that assumed, the process by which the QCA will review the Expansion Ruling is not identified.

Submitting Users consider that it would be helpful if the QCA were to include in its Final Determination further detail on the process by which the Expansion Ruling will be reviewed in the event that the FEL3 study shows that circumstances are expected to be different to that assumed based on the FEL2 study. In particular, this should include:

- the thresholds that the QCA intends to apply in assessing whether, based on FEL3, the circumstances are expected to be sufficiently different to that assumed based on the FEL2 study to warrant a new or varied ruling to be made. If the QCA does not specify such thresholds in its Final Determination, then the QCA should establish the process by which it will make such assessment, which should include provision for consultation, not only with DBIM and expanding users, but also with existing users;
- the process by which the QCA will make a new or varied ruling. In particular, the QCA should clarify whether this would require DBIM to make a fresh application under s.150F, which would require the QCA to follow the processes set out in the QCA Act in relation to assessing the application. If not, then the QCA should establish the process by which it will make such review, which should include provision for consultation, not only with DBIM and expanding users, but also with existing users.

3.4 Summary and conclusions

In the event that the QCA's final determination is to maintain its view that socialisation is appropriate, Submitting Users consider that it is imperative that the QCA consider ways to incorporate measures into the socialised pricing framework that mitigate the identified risks that socialisation imposes on existing users. This includes incorporating mechanisms to ensure that DBIM is incentivised to effectively manage expansion risks directly with the expansion parties where practical.

Submitted Users suggest that this can most effectively be addressed by the QCA expanding the matters that it specifies as Expansion Ruling Assumptions, to also include issues designed to manage short term volume and cross default risk, long term volume risk and a broader range of cost and operational risks.

By doing so, the QCA can not only ensure that it bases its assessment on robust and independently verified information regarding the costs and benefits of the project, but that it builds into the 8X pricing methodology critical features designed to ensure that socialisation does not diminish the incentives on DBIM to ensure that the 8X project is efficient and to effectively manage risks.