24 November 2015

Charles Millsteed
Director – Economic Regulation
Queensland Competition Authority
Level 27, 145 Ann Street
Brisbane Qld 4000

Dear Charles,

DBCT 2015 Draft Access Undertaking (DAU)

Vale Australia Pty Ltd (**Vale**) welcomes the opportunity to provide a submission to the Queensland Competition Authority (**QCA**) in respect of the proposed 2016 Draft Access Undertaking (**2015 DAU**) for DBCT Management (**DBCTM**). The Pricing and Access principles presented in the 2015 DAU are expected to replace the 2010 Access Undertaking (2010 AU), which is due to expire on 30 June 2016.

Vale has been an active participant in the DBCT user group's efforts to develop an agreed industry position regarding this matter. We note the DBCT user group will be providing an industry submission to the QCA and Vale takes this opportunity to generally endorse the DBCT user group's submission to the QCA. Vale also wishes to provide further comments to clarify its position on some of the key principles.

1. Executive Summary

The 2010 AU was established after considerable consultation and negotiation between the DBCT user group and DBCTM. During this negotiation process compromises were made by both parties to reach what was considered a balanced position based on the market environment that existed at the time. The 2015 DAU submission has been made following discussions held between the DBCT user group and DBCTM in an attempt to reach a similar agreed position. Although there has been some level of agreement on proposed policy changes, the most significant difference in views between the DBCT user group and DBCTM is the appropriate pricing parameters that should apply for the regulatory period. The DBCT user group and DBCTM have significantly divergent views on the level of risk and the corresponding return required to compensate DBCTM for this risk.

DBCTM's 2015 DAU Submission asserts that the undertaking reset process is being made at a time of great uncertainty and volatility in global markets and setting DBCTM's rate of return based on the QCA's past decisions would be incongruous with the change in its risk profile. DBCTM states that if the level of equity return provided under the reset process is in line with previous QCA decisions, DBCTM cannot justify putting further capital into the asset. DBCTM outlines 3 key points in their submission to justify their view of a change in risk profile.

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- It is operating in a market environment that has changed dramatically since the 2010 AU was reviewed and finalised. DBCTM believes the most significant of these points is that it is now exposed to real competition from a number of alternative ports.
- As a single commodity terminal with no alternative use, DBCTM's performance is inextricably linked to the Queensland coal export industry.
- The financial market outlook is also very uncertain, with the risk free rate remaining at historical lows

Vale does not support DBCTM's assertion that there has been a material change in the environment since the 2010 AU to warrant a change in the risk position of DBCT. Vale believes that many of the issues raised by DBCTM to justify its various positions tend to conflict with each other. DBCTM claim that it is now subject to real competition from other terminals for existing and future capacity, however, it believes its depreciation remediation allowance should be assessed over a significantly reduced economic life of the terminal due to possible asset stranding risk. This position is held despite the Wood Mackenzie report provided in DBCTM's submission indicating that the seaborne coal market will continue to increase over the next 20 years.

Vale notes that DBCTM's claim for financial compensation results in a minimal reduction in its current level of the Terminal Infrastructure Charge of $3.0653/tonne for FY17 compared to the FY16 rate of $3.0853/tonne, despite the expected significant reductions in the market parameters used to calculate the Weighted Average Cost of Capital (WACC). Vale does not believe this proposal represents a balanced position and is concerned that DBCTM's motivation to seek other pricing parameter changes is to offset the forecast new WACC position rather than a change in their level of risk. The methodologies used to determine each of the WACC parameters has been debated strongly during the QCA's Cost of Capital Review and Aurizon Network's 2014 Draft Access Undertaking process. Vale supports the continuation of the WACC methodologies outlined in these processes as they promote predictability to all stakeholders, and they are relevant to DBCTM as it operates in the same coal chain as Aurizon Network.

Vale believes that DBCTM has included many other amendments within their submission that alters the pricing parameters. These amendments include an accelerated recovery of depreciation and remediation cost, increased corporate costs, and a removal of the NECAP expenditure cap. Vale does not support these amendments as it does not believe that DBCTM has justified that they are now subject to significantly more risk since the 2010 AU was approved, and they do not promote the efficient operation of DBCT or the related coal chain.

Vale does not support the financial claims, or the change in risk profile, presented by DBCTM and believes DBCTM's approach is not balanced and promotes DBCTM's interests significantly more than would be consistent with its commercial or regulatory risks. Vale does not believe this represents a document that will ensure efficient and timely investment in, or use of, the DBCT coal terminal, or facilitates participation in the supply chain as there is a lack of appropriate balance between DBCTM and Stakeholders. Vale believes it would not be appropriate to approve the 2015 DAU in its current form and would suggest that substantial changes are required to achieve this balance.

2. Market environment

The 2015 DAU is being assessed during a period of low global coal prices which has prompted the coal industry to undertake cost cutting and productivity measures to remain globally competitive. Mines in the DBCT coal chain that ship a higher proportion of metallurgical coal have seen a severe deterioration of their margins over the preceding few years. This position is in contrast to the market environment of coal supply shortages that existed during the determination of the 2010 AU. The coal market is historically characterised by these boom and bust cycles and most analysts predict that the current oversupply in the coal market will eventually subside to long

term growth but at a lower rate than during the previous coal market peak. The Wood Mackenzie report, Shipper Mine Life Analysis, provided as part of the 2015 DAU submission, also supports the view of long term growth in the coal market indicating that global demand for seaborne metallurgical coal will continue to grow over the next 20 years to reach more than 405Mtpa by 2035.

This cyclic environment is typical of commodity markets and the risk of this cyclical environment is worn by the Access Holders and Access Seekers who are required to invest significant amounts to develop a mine as well as underpinning their access to rail and port infrastructure via long term take or pay agreements. This environment has not changed as coal producers continue to make changes to their operations to reflect the market cycle, however, the long term take or pay commitments on rail and port infrastructure continue in essentially the same form set in the original undertaking. Vale believes that changing any regulatory methodological approaches due to the current market being at the bottom of the cycle would be inefficient as they were not changed when coal prices were high during the resets of the previous undertakings.

This issue was recently considered in the QCA's Draft Decision on Aurizon Network's 2014 Draft Access Undertaking – Maximum Allowable Revenue. The QCA stated that it must be satisfied that the Maximum Allowable Revenue, as a whole, satisfies section 138(2) criteria of the QCA Act. The QCA expended their views but stating that:

> "In addition to our assessment of Aurizon Network's MAR proposal, we have taken into account some additional considerations within section 138(2)(h) including:
>
> - *predictability* – the regulatory arrangements should be as stable and predictable as possible given other objectives. Stability and predictability are likely to promote confidence in the regulatory arrangements and economic efficiency by reducing uncertainty associated with long term investment decisions
>
> - *the economic climate* – we consider that Aurizon Network's customers are undergoing challenging market conditions in the short term. It is in the public's interest for Queensland's mining industry to be as competitive as possible"

3. DBCTM Key Points

DBCTM has outlined 3 key points in its submission which it believes are important in the assessment of it 2015 DAU submission:

- It is operating in a market environment that has changed dramatically since the 2010 AU was reviewed and finalised. DBCTM believes the most significant of these is that it is now exposed to real competition from a number of alternative ports.
- As a single commodity terminal with no alternative use, DBCTM's performance is inextricably linked to the Queensland coal export industry.
- The financial market outlook is also very uncertain, with the risk free rate remaining at historical lows.

DBCTM believes the effect of these 3 key points has fundamentally changed the environment under which it operates now compared to when the current 2010 AU was reviewed and approved by the QCA.

Market Competition

DBCTM believes that it has an increased level of risk compared to the time of approval of the 2010 AU as it is now exposed to real competition from other coal terminals. It highlights the potential for competition due to the expansions of the Abbot Point Coal Terminal and Hay Point Coal Terminal, the development of the Wiggins Island Coal Terminal, and various other potential new developments and expansions of coal terminals in the future.

It is difficult to reconcile DBCTM's concern with the risk of real competition for new and existing tonnages as Vale does not believe DBCTM's approach in the 2015 DAU would be typical of a entity now subject to real competition. Vale believes that DBCTM only has to look to its customers for an example of what a typical reaction would be to increased market competition. The current global coal market is currently under stress due to the oversupply of coal to the market which has increased competition in the global coal market. In reacting to this, DBCTM's customers have initiated significant productivity and cost improvement initiatives to maintain their competitive position despite lower expectations on returns. Vale believes that DBCTM's 2015 DAU appears to be inconsistent with this typical reaction to competition as it believes its return should be raised and there does not appear to be any consideration of productivity or cost improvements proposed to reduce overhead costs. Of course it can be argued that due to DBCTM's regulated nature it is unable to take advantage of the higher returns achieved by its customers during the previous peak in the global coal market, however, this same revenue cap form of regulation is now shielding it from the lower returns now expected by its customers in this period of lower coal prices and higher competition. Therefore, Vale does not believe that DBCTM's approach in the 2015 DAU is representative of an entity within a competitive market and concludes that a combination of regulatory and practical barriers limit DBCTM's exposure to real competition from other coal terminals.

Vale believes the extent other terminals provide effective competition to DBCT is severely limited by many practical constraints such as:

- The terminal costs at DBCT are at a cost advantage to other terminals due to the economies of scale achieved with a nominal capacity of 85Mtpa.
- There is insufficient uncontracted terminal capacity at other coal terminals to provide long term capacity. Vale understands that all capacity at the other terminals is contracted with the exception of some limited capacity at Wiggins Island Coal Terminal and Barney Point Coal Terminal in Gladstone, however, Barney Point Coal Terminal is due to be closed in the very near future. Therefore, moving tonnages away from DBCT is problematic as an Access Holder would need to co-ordinate the timing of a capacity expansion at an alternative terminal with the termination of the DBCT contract to avoid duplicated take or pay liabilities. Vale believes that given the time required to develop and construct new terminal capacity it is unlikely that any new capacity will be introduced during this regulatory period.
- Other coal terminals are limited in their ability to provide the multi-cargo and coal blending requirements that are available at DBCT. DBCT is the major coal terminal in Queensland for metallurgical coal which allows coal customers to purchase different coals, from different coal producers, which are then loaded into different holds in the same vessel. These multi-cargo arrangements are limited at other coal terminals due to a lack of diversity and quantity of metallurgical coal types. It would be unattractive for an existing metallurgical coal producer to move tonnes away from DBCT as it will limit its ability to compete in the coal market for these multi-cargo vessels. It is possible for a customer to overcome this issue by loading at multiple terminals but this option is less attractive as it involves additional shipping costs.
- Rail cost differentials between alternative coal terminals. Terminal capacity is only one part of the supply chain for the transportation of coal from the mine to the customer. The other significant part of the supply chain is the rail transportation between the mine and terminal. For most mines within the Goonyella system the nearest coal terminal is DBCT,

and as rail haulage costs are effected by distance travelled, the cost of hauling coal to alternative coal terminals will be significantly more expensive than the cost of rail haulage to DBCT. This is a major consideration when global coal prices are low.

- Additional to the rail cost differential there is a lack of spare uncontracted below rail capacity on the rail network. The rail network has been expanded to meet the requirements of Aurizon Network's contractual capacity and the latest Aurizon Network Development Plan indicates that each rail system is at capacity in some part of the system and any new long term capacity to alternative coal terminals would require an expansion of the rail network. Vale believes it is unlikely that any significant new rail capacity will be added to the network during this regulatory period due to the time required to develop and construct the infrastructure.
- Above rail infrastructure is also likely to be a practical barrier to any Access Holder seeking to transfer capacity to an alternative coal terminal. The Goonyella rail system that services the DBCT coal terminal is fully electrified which has resulted in the above rail providers investing in significant electrified rolling stock to service their customers. The Newlands rail system, servicing Abbot Point, is not electrified and therefore above rail haulage operators would be required to purchase new diesel rolling stock to accommodate any switch of capacity between alternative coal terminals.
- Mine rail infrastructure within the Goonyella area was typically established to transport coal through DBCT and changes to this infrastructure to allow a mine to rail to alternative coal terminals is likely to require significant capital investment. Rail balloon loops and associated infrastructure in the Goonyella system were generally designed and constructed to operate the transportation of coal in the direction of the Port of Hay Point. Vale believes that under the current coal market conditions an Access Holder is very unlikely to spend the significant capital investment on rail infrastructure to facilitate the flexibility to rail to alternative ports.
- The long term take or pay commitments that have been made on rail haulage and infrastructure is also likely to restrict an Access Holder's ability to switch to alternative coal terminals. Due to the take or pay arrangements under these long term contracts, the option to switch railing to an alternative terminal will only arise at the time these contracts are renewed as the penalties imposed for early termination under these contracts is likely to severely restrict an Access Holders ability to switch terminals mid-term of the agreement.

Based on these practical barriers outlined above, Vale believes that the only coal terminals listed in table 1 and 2 of the DBCT submission that could utilise the existing infrastructure are Hay Point Coal Terminal and a potential development of Dudgeon Point. Vale does not believe either of these coal terminals provide real competition or a change in the market environment since 2010.

- Hay Point Coal Terminal is a coal terminal owned and operated for the dedicated use of BHP Billiton Mitsubishi Alliance (BMA) and is not an open access multi-user facility. A BHP Billiton media statement on the 16 February 2015 stated the terminal is viewed as a key part of BMA's supply chain to improve its productivity. There is no evidence or indication that BMA has any intentions to provide third party access. Vale does not believe there is any basis for a claim that this terminal has increased the level of competition for DBCT since 2010.
- Proposals to develop coal terminals at Dudgeon Point have been put on hold due to the current economic conditions surrounding the coal market. Originally two proponents were selected to potentially develop new terminals with one of the proponents, Dudgeon Point Project Management Pty Ltd (DPPM), being part of the broader Brookfield Group that also owns DBCTM. Vale believes it is an extreme contradiction by DBCTM, as part of the Brookfield Group, to suggest that it faces greater risk from competition, and therefore

increased asset stranding risk, when the potential competition is from within its own parent group.

Based on this evidence, Vale is not convinced that DBCTM's exposure to real competition has significantly changed the market environment since the 2010 AU was reviewed and finalised. Vale also finds DBCTM's argument of increased competition from future port developments inconsistent with other positions that it has taken within the 2015 DAU. Port developments will only proceed if there is sufficient coal to under write the port expansion, therefore, Vale believes the argument for real competition from future port developments is inconsistent with the request for further asset stranding risk relief based only on the existing mine lives.

Single Commodity Terminal

DBCTM asserts in its 2015 DAU submission that it is a single commodity terminal with no alternative use and is inextricably linked to the Queensland coal export industry and the ongoing viability of its customers. It has raised this concern as the coal industry is now facing a more difficult market environment.

Vale believes that the coal market has always been, and is likely to continue to be, cyclical in nature as with most commodity markets. Commodity markets are historically subjected to highs and lows as they trade between periods of supply and demand constraints. While the recent market peak has tended to last longer and remain higher than most historical cycles, the ultimate return to a demand constrained environment is consistent with the long run coal commodity cycle. Markets reacted to the supply shortage and developed new sources of supply during this period to meet the demand just as some high cost production will now be removed from the market during this low level of demand.

Despite this fall in global demand for coal over the last few years, DBCT has continued to see the throughput increase through the terminal over the past few years. DBCT achieved a throughput record in 2014 and the current year to date throughput figures suggests this will be surpassed in 2015. The Wood Mackenzie report, Shipper Mine Life Analysis, provided as part of the DBCTM submission, also suggests the global seaborne coal market will continue to see long term growth, and that Australia will continue to take a leading position in the supply of coal to this market. So despite the current downturn, the fundamentals for the coal export market appears to be strong in the long term. This suggests coal terminals on the coast of Queensland will be required well into the future and there does not appear to be any risk or evidence to support that a single commodity coal terminal is subject to any significant risk and certainly no increased risk since the assessment of the 2010 AU.

Vale would also argue that the 2014 Queensland Port Strategy paper developed by the Department of State Development, Infrastructure and Planning potentially lowers the risk of DBCT's asset stranding risk. This paper proposes to restrict port development to 5 priority port areas which includes the Port of Hay Point. Vale believes DBCT must benefit from this strategy as there is a restriction on new port development areas which therefore must strengthen the long term utilisation of existing infrastructure rather than the construction of new infrastructure.

Vale concludes that the current downturn in world coal prices is part of the normal long term commodity cycle that is inherent in all commodity markets and this cyclic nature will produce periods of both boom and bust periods, however, most market commentary continues to support the long term growth of the seaborne coal market. Vale believes this long term market view is supported by the Wood Mackenzie report provided in DBCTM's submission and has been the view of the global seaborne coal market not only since the approval of the 2010 AU but since the construction of DBCT. While Vale agrees with DBCTM's view that the coal industry is now facing more difficult conditions, it does not agree that the outlook is uncertain as the general long term view of the global seaborne market is that it is expected to grow but at a slower rate than the last

growth cycle. Vale believes that continuing to set the Access pricing based on a long term view is appropriate as it matches the long term view of the seaborne coal market.

Financial Market Outlook

DBCTM's last key point in their 2015 DAU submission is that the financial market outlook is very uncertain, with the risk free rate remaining at historical lows but evidence suggests investors expect returns to remain relatively high. DBCTM believes that this requires adjustments to the methodologies used to determine the parameter values within the calculation of the Weighted Average Cost of Capital (WACC).

DBCTM has proposed a post-tax nominal WACC of 7.46% as it claims this would provide a return that, *"at least compensates investors for the risks commensurate with investment in a stand-alone coal export terminal".* Vale notes that DBCTM's justification of its WACC is based on investor returns which is not necessarily consistent with section 168(a) of the QCA Act that states that the return on investment be commensurate with the regulatory and commercial risk involved. The issue of investor returns has also been raised during the assessment of Aurizon Network's undertaking reset process. The QCA's Draft Decision on Aurizon Network's Maximum Allowable Revenue stated that while it agreed that an assessment of the WACC proposal should involve consideration of the investor's perspective it was not the only relevant consideration. The QCA concluded that while under-investment in infrastructure has negative implications for the asset owner and its investors, over-investment also has negative implications as it may lead to under-investment at other functional levels of the coal supply chain including mine development.

Although DBCTM's proposed WACC is lower than the current value that has applied during the 2010 AU period, this difference is primarily due to the reduction in the market parameters applied to the calculation. The approach and methodologies used to determine these parameters have generally been consistently applied to the calculation of DBCTM's WACC since it was regulated. However, now that the market parameters are in the lower range, and effectively providing a benefit to DBCTM's customers, DBCTM has proposed that the approach in setting these market parameters should be changed. Vale does not propose to comment individually on each of these issues as it has recently provided comments on this through the QCA's Cost of Capital reviews and the Aurizon Network's 2014 Draft Access Undertaking consultation process. Vale believes a significant amount of time and consultation has been undertaken to review these methodologies over the past few years and they are relevant to the consideration of DBCTM's WACC. Vale does not believe the market has changed from the time of these reviews and believes that the approach and methodologies outlined by the QCA during these activities are still current and remain relevant for this decision. Vale also believes that continuing the previously adopted approaches and methodologies benefits all stakeholders as it provides predictability and consistency within the regulatory environment.

Of the remaining company specific WACC parameters, the one that generates the most significant assessment for a regulated entity is the asset/equity beta. The historical approach to determining the asset/equity beta by economic regulators is to find comparator firms within the same industry, or that have similar risk characteristics to DBCTM to provide guidance on the appropriate asset/equity beta to be applied. As identified by DBCTM in their 2015 DAU submission, there are very few comparator firms that operate a port facility such as DBCT. This situation is similar to most of the entities regulated by the QCA, so to combat this it has historically identified comparator firms with a similar risk profile even though it is may not be from the same industry. For example, in the QCA's Draft Decision on Aurizon Network's Maximum Allowable Revenue, its consultant's report provided by Incenta reviewed a range of comparator firms that included DBCT as the low range and various toll road operators as the higher range. These comparator firms were selected as being appropriate comparators to Aurizon Network as they had similar risk profiles.

The Incenta Economic Consulting (**Incenta**) paper, Review of Regulatory Capital Structure and Asset / Equity Bet for Aurizon Network and response to stakeholder comments dated April 2014,

assessed a sample of 107 regulated and non-regulated industries when trying to determine the appropriate asset beta to apply to Aurizon Network. Incenta identified DBCT as the bottom of the range with an asset beta of 0.35 which had been independently determined by Grant Samuel and it is a regulated asset in the same coal chain, and in Incenta's view had a similar systematic risk characteristic as Aurizon Network. In determining this lower bound for Aurizon Network, Incenta noted that the DBCT estimate represented an indirect form of market evidence, as it was an expert opinion that informed an actual transaction involving a regulated infrastructure asset in the same coal chain as Aurizon Network. Vale believes an asset beta at DBCT of 0.35 with a resulting equity beta in the range of 0.7 to 0.8 is consistent with the independent advice of Grant Samuel's assessment of DBCT, and the robust debate during the assessment or the appropriate asset/equity beta methodology to be applied in the Aurizon Network assessment.

Vale believes that any determination of the equity beta, and ultimately the WACC, should consider the final positions that are reached on the following pricing parameter changes proposed by DBCTM.

- Reducing the maximum assumed remaining useful life for depreciation purposes,
- Introducing a significant remediation premium and the assessment of a shorter period of time for the recovery of the premium,
- Reducing its Gamma assumptions,
- Increasing its working capital allowance,
- Including the depreciation of spares,
- Removal of prudency caps for NECAP expenditure,
- Applying an updated and increased corporate overhead benchmark cost, and
- Increasing the Term of the future access agreements from 10 to 15 years with a 5 year evergreen extension option.

Vale believes these changes would provide DBCTM with a higher return that is not justified by a change in the level of its commercial or regulatory risk.

4. Other Pricing Parameters

Remaining Useful Life

DBCTM's existing depreciation profile is currently aligned to its lease term which includes using a straight line approach and an economic life of 50 years from 2004. DBCTM believe that its risk profile has now changed as a consequence of the changing industry and competitive environment, and a review should be completed on its economic life assumption and consequent depreciation profile of the RAB. DBCTM proposes to use a Weighted Average Mine Life methodology which matches the depreciation profile of the RAB to the weighted average life of the mines that DBCT services. DBCTM proposes that the depreciation profile would be reviewed at each regulatory reset and change based on market conditions. DBCTM proposes to reset the current depreciation profile of the RAB to reflect a 25 year economic life.

Vale does not agree with this proposed change in methodology to determine the maximum economic life of the terminal as it is not convinced by DBCTM's arguments that there has been a justifiable change in their asset stranding risk since the last regulatory reset. Vale believes the following factors do not support an argument that it is subject to a change in asset stranding risk.

- DBCT's throughput continues to increase year on year, with throughput for 2015 likely to achieve a new record at the terminal. This is all occurring at a time of low coal prices and indicates that prices do not affect the utilisation of DBCT.

- Vale does not agree with DBCTM premise that it is now subject to real competition. As outlined earlier in this submission, Vale believes there are many practical barriers to Access Holders transferring capacity to alternative terminals.
- The assessment of an increased stranding risk appears to be inconsistent with the recent activity by DBCTM to complete a study into the development of further capacity at DBCT.
- Vale believes the Wood Mackenzie report, Shipper Mine Life Analysis, provided as part of DBCTM's 2015 DAU submission is not clear in it view on the long term coal market. The report indicates that the seaborne coal market will continue to grow over the next 20 years with Australia continuing to be a major participant in this market, however, it then concludes that the weighted average mine life should only be 25 years.
- Vale believes the 2014 Queensland Port Strategy paper developed by the Department of State Development, Infrastructure and Planning potentially lowers the risk of DBCT's stranding risk. This paper proposes to restrict development to 5 priority port areas which includes the Port of Hay Point. Vale believes DBCT must benefit from this strategy as there is a restriction on new port development areas which favours the incumbent port infrastructure.
- It is not clear to Vale if the weighted average mine life by marketable reserves has changed since the approval of the 2010 AU. Mines will generally continue to explore and evaluate new areas over time to evenly spread the costs of this exploration so it is likely that the reserve position has not changed since 2010.
- DBCTM states that it proposes that an economic life of 25 years results in a reasonable depreciation profile that reflects the risk of the industry it services and provides it with some mitigation against asset stranding risk in an inherently volatile and increasingly competitive market. Vale believes this assessment by DBCTM is not appropriate as it ignores the existing mechanisms within the current undertaking that are already designed to reduce its asset stranding risk. Vale believes that it would be inefficient to provide a new mechanism as it is likely to result in an over-recovery of revenue compared to DBCTM's commercial and regulatory risk.

Remediation Cost Allowance

DBCTM has proposed to include a substantial increase to its annual cost allowance provided for the future remediation of the terminal. DBCTM outlines that it believes it has a clear obligation to rehabilitate the site, but is not sure as to the timing of this or the task that would be required.

However, despite this considerable level of uncertainty, DBCTM believe their remediation cost allowance should be reflective of the high range of the estimated remediation value and that this should be returned to DBCTM over a period of 32 years. Vale believes this approach is not particularly balanced and should consider:

- There is significant uncertainty regarding the standard of the remediation obligation, and therefore, Vale does not believe allocating the high point of the estimate is appropriate.
- Potential changes in technologies over the life of the lease could provide alternative remediation options at lower costs.
- The 2014 Queensland Port Strategy paper developed by the Department of State Development, Infrastructure and Planning has identified the Port of Hay Point as one of the 5 priority port development areas within the State. This suggests long term use of these existing terminal precinct for coal or potential alternative use.
- Vale does not support the approach taken by DBCTM to allocate a 50% probability to a proposed economic life of 25 years. Vale does not believe this is a valid assessment of the economic life of the terminal. Vale believes that as the remediation cost is a

requirement of the terminal lease, the assessment of the timing of this can only be referenced to this. Therefore, Vale believes that only the end of the 50 year lease and the 49 year extension option are valid periods of time to consider for any remediation costs.

- The Wood Mackenzie report, Shipper Mine Life Analysis, predicts continued growth in the seaborne coal market over the next 20 years. Vale would argue that given the level of mine infrastructure operating at this time to accommodate these volumes, there is a high probability that DBCTM will take advantage of its 49 year lease option.

Overhead Costs

DBCTM commissioned a report from Stephen Meyrick, Dalrymple Bay Coal Terminal: Corporate Costs, to complete a detailed review of the corporate cost allowance for the 2015 DAU period. In this report, Meyrick provides three different cost estimates due to the difficulty in finding appropriate comparator firms that operate in a similar manner or within a similar environment to DBCTN. Meyrick's report concludes that his analysis supports a corporate cost allowance of $8.2 million which reflects a medium view of costs for a stand-alone listed Brisbane entity.

Throughout the analysis Meyrick highlights the concerns with comparator firms and access to information on costs and structures of other entities. Vale does question the conclusions of the Meyrick analysis for the following reasons

- Revenues are used to determine corporate costs. Revenues are generally not a good indicator of costs and Vale believes it is more appropriate to return to principle drivers of costs rather than use revenues. Under the revenue cap approach, the revenue includes the recovery of these costs as well as the potential for double counting the value of the assets as the revenue includes both the return of, and return on assets.
- It is not clear that Meyrick has considered the different structure of DBCTM where it is only the owner of the asset and does not operate the asset. This will result in a significant reduction of activities compared to some of the comparator firms.
- Vale does not believe sufficient consideration has been given to the market conditions and the underlying efficiency process that is being driven through entities providing services to the coal industry. Due to the lower coal market the competition for work in the industry has seen significant reductions in the costs of services being provided by contractors. If there is real competition in the coal terminal market, Vale believes that DBCTM would not be looking to increase is operating costs but rather how to drive greater efficiencies within it operations to win the services for providing terminal access at DBCT.
- Meyrick justifies some of the increases in costs based on the increased complexity resulting from the expansion of terminals nominal capacity. Vale believes this issue is not likely to have a significant effect on DBCTM as the increased terminal capacity has not increased the customer base, nor has it changed the single operations and maintenance contract for the operation of the terminal. An increase in terminal nominal capacity is likely to require the terminal operator (Dalrymple Bay Coal Terminal Pty Ltd) to increase personnel and associated support areas, however, Vale fails to see how an increase affects DBCTM's corporate costs as the terminal owner.
- Although comparator firms are an important part of any assessment, Vale believes that historical costs would also be an important data point in any analysis of efficient costs. Vale believes that DBCTM's historical costs would also provide comparator information in assessing the issue of whether their corporate costs did increase with the expansion of DBCT's nominal capacity.
- DBCTM states that its corporate costs are consistent with the incentive-based regulatory framework. Vale is concerned that this incentive is asymmetric and encouraging DBCTM

to over-estimate its corporate costs as there is little evidence to support DBCTM conducting efficiency measures to reduce or at least restrict corporate cost increases.

NECAP

Vale does not support the proposed changes to the undertaking which removes the cap on Non-Expansion Capital expenditure (**NECAP**) as it is concerned that DBCTM's decisions on NECAP expenditure will be governed by their rate of return rather than efficient decisions for the terminal, and ultimately the supply chain. DBCTM has recently provided a notice to Vale advising that it is expecting a material reduction in the WACC determination through the undertaking reset process, which has forced Brookfield to review their commitment to NECAP expenditure. DBCTM advised that any project not required because of contractual or compliance obligations will not proceed until there is a material increase in DBCTM's allowed rate of return.

During the consultation process for NECAP Series L, Vale expressed numerous concerns with the proposed projects to be completed and the timing for these projects. At the time, DBCTM argued strongly for these projects to proceed and provided further justification to Vale to support why the projects were needed and why they were needed to be completed now. Vale believes a cap on NECAP expenditure needs to remain as it provides a limited measure to encourage DBCTM to undertake this expenditure evenly over the years and regulatory periods. Vale is concerned that without a cap DBCTM will uses its monopoly position to undertake NECAP expenditure to benefit its own position and not necessarily to provide efficiency improvements to the terminal.

The other issue that a reduction in NECAP expenditure presents to Access Holders is the inefficiency this may create for the operating and maintenance costs of the terminal. Historically, the undertaking has been developed based on the concept that the operator's costs would be efficient as it is owned by some of DBCT's customers. The operation and maintenance costs operate on a cost plus basis that are passed through to DBCTM's customers as it is deemed that coal producer ownership of the terminal operator will ensure cost efficiency. Vale believes the DBCTM decision on NECAP expenditure at DBCT is expected to restrict productivity and efficiency but there is currently no mechanism within the undertaking to counter the operator incurring inefficient costs as a result of DBCTM's decisions.

A large proportion of the NECAP Series L expenditure projects were justified based on terminal efficiency measures. For example, Vale received the following advice from DBCTM on the 28 August 2015 to justify project NL02, Head Chute Upgrade to Conveyor L3:

> *"L3 head chute is currently at the end of its life and requires replacement. During FY 2012/2013 DBCT P/L completed repairs to the chute and its associated support structure for a cost of $265,000. These repairs have enabled the life extension of the chute until this year. The current chute was not originally designed for the shiploading rates that the terminal currently does leading to coal wearing the chute in areas that were not designed to take the impact from the coal. This results in sections of the chute failing and unplanned downtime to complete repairs. Two failures for a cost of approximately $80k and 4 days downtime have occurred in the past two years even after the repairs made in 2012/2013. There are two options to replace the chute being:*
>
> - *Like for like replacement with a cost of approximately $750k. A like for like replacement will not address the issues associated with coal impact, access and dust prevention. A like for like replacement will be treated as an operating cost and will form part of the Terminal handling charge to be paid in the current year.*
> - *A modified chute specifically designed for the current shiploading rates, will have an extended life as compared to the like for like replacement. The modified design will*

also improve access to the chute and dust emissions. The modified chute will cost approximately $835k. The modified chute will be treated as Non Expansion Capital and be added to the RAB the year after the work is complete.

It should also be noted that the Operator has spent the money to complete the design for the modified chute however they do not have the drawings required to fabricate a like for like replacement. Therefore they would have to spend additional money to get construction drawings for a like for like replacement."

This is one example of the discussions held between DBCTM and Vale during the consultation on the Series L NECAP projects and indicates how DBCTM's actions to reduce NECAP expenditure is now expected to increase the efficient operation of the terminal despite the terminal operator being owned by some of the current Access Holders. Vale also questions whether this situation complies with the current undertaking requirement for good operating practice under clause 12.10(a). Vale believes this approach places the operational risk of the terminal with producers however, they do not have any control on the amount or timing of efficiency and productivity improvements projects at the terminal.

For further information regarding on this submission, please contact myself on (07) 3136 0936.

Yours sincerely,

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