

24th December 2015

Mr John Hindmarsh
Chief Executive Officer
Queensland Competition Authority
Level 27,
145 Ann Street BRISBANE QLD 4000

Dear Mr Hindmarsh

Yancoal submission on Queensland Rail 2015 Draft Access Undertaking

Thank you for the opportunity to provide a submission with regard to Queensland Rail's (**QR's**) 2015 Draft Access Undertaking (**DAU**) and the Queensland Competition Authority's (**QCA's**) related Draft Decision (the **Draft Decision**). This matter is of vital concern to the economic viability of, and future investment in, Yancoal's Cameby Downs Mine.

Cameby Downs is one of two remaining coal users on Queensland Rail's West Moreton network. The costs of access to QR's network are significant compared to both the price of coal and the price of other Australian coal rail networks, and a major barrier to coal mines utilising the network being able to be more efficient.

This letter provides Yancoal's submission concerning QR's DAU (including responding to a number of issues raised in the Draft Decision).

Yancoal supports the QCA's decision to refuse to approve the DAU and largely supports the decisions that make up the Draft Decision. Set out briefly below is Yancoal remaining concerns with a number of the positions proposed in the Draft Decision.

1 West Moreton network pricing issues

The issue of greatest concern to Yancoal with the Draft Decision is the proposed Reference Tariffs and the pricing methodology which underlies them. Yancoal makes the following submissions in respect of those issues:

- (a) **Adjustment amount:** Yancoal is strongly supportive of the need for an adjustment amount and is willing to accept it being paid as a discount to future charges. To be clear, if an adjustment amount is not ultimately provided for that will be such a substantial and unwarranted change to the regulatory framework (and Yancoal's expectation of how it would operate based on both the provisions of the current undertaking and QR's previous representations) that the resulting regulatory uncertainty will necessarily be taken into account when Yancoal and its shareholders are considering future investment in Cameby Downs (in comparison to other mines within the Yancoal portfolio for which this issue does not exist). It is highly inequitable in the circumstances for QR to retain the overpayments, which have largely occurred through its own delay in submitting an appropriate replacement undertaking.
- (b) **Adjustment amount east of Rosewood:** The adjustment amount appears not to have been calculated to include any amount in respect of services east of Rosewood (based on footnote 630 and Appendix A, Draft Decision). There is no evident reason for this or justification – as it will simply result in QR retaining the over-recovery from services (or the parts of services which originate in the West Moreton network) using the Metropolitan network. This should clearly be corrected in the final decision.

- (c) **Asset valuation:** For the reasons set out in its initial submissions on the QR DAU, Yancoal strongly supports the QCA's draft decisions regarding the approach to valuation of life-expired assets in the West Moreton network. QR has already obtained a full return of and on capital for these assets, and the QCA's approach produces a valuation that far better reflects the nature of the network in terms of its age and not being fit for the purpose for which it is utilised (and the resulting related high maintenance costs and adverse impact on above rail haulage costs).
- (d) **Allocation of common costs to coal services:** The QCA's approach of requiring Yancoal and New Hope to pay tariffs based on the maximum possible paths available for coal, rather than what they contract for are forecast to use, punishes them for Wilkie Creek's closure and investment decisions QR has made in the past. The paths are not allocated to coal, they are a government policy cap on coal paths. The approach being adopted has the potential to produce a 'death spiral' where each mine that shuts increases the tariffs by such a significant extent that it makes it likely another mine will have to shut. If the QCA insists on its current approach then the asset base must be optimised to reflect the deterioration in demand that has occurred with Wilkie Creek's closure (or at least a return on capital regarding Wilkie Creek deferred pending it becoming clearer whether Wilkie Creek will reopen). If an allocation was to occur using something like the QCA's current approach:
- (i) it is not clear why the total number of paths available for all traffics is not being assumed to be the larger number of paths discussed in the B&H report (which would effectively decrease the proportion the so called 'coal paths' formed of the total paths available); and
 - (ii) it is critical that the 'Endorsed Variation Event' the QCA proposes is included to allow the reference tariffs to be revised – and for that trigger to operate based on any of Cameby Downs or Acland expanding or Wilkie Creek reopening (i.e. on an individual origin basis – which the Draft Decision suggests – but the proposed QCA drafting does not seem to reflect).
- (e) **Prudency/efficiency of maintenance and opex costs and future capital programs:** As noted in Yancoal's prior submissions, Yancoal has serious reservations about whether the current high level of maintenance and operating costs is efficient and whether the future capital program is prudent given increases in the face of declining demand. Those reservations seem to be borne out by the B&H Strategic Services report which indicated QR's maintenance, operation and capital plans were 'not reasonable on a number of levels'. Yancoal is reliant on the QCA to scrutinise and assess these issues, but there appears to be clear grounds to question the efficiency of what has been proposed by QR.
- (f) **Take or pay:** prescribing that access charges are 100% take or pay in nature, results in windfall gains to QR where trains do not operate (as they receive the full access charges, even though variable costs are not incurred) and reduces their incentive to perform the contracted tonnage. It is not clear to Yancoal why the current approach of take or pay being calculated as 80% of access charges does not continue to be an appropriate approximation of the proportion of charges which are fixed in nature. The drafting of the Standard Access Agreement schedule needs to be refined to reflect the QCA's proposal regarding capping (particularly in terms of relinquishment fees being taken into account).

- (g) **WACC parameters:** Yancoal supports the methodology applied by the QCA to determine the weighted average cost of capital (**WACC**) for QR. Yancoal assumes that the WACC parameters will be reassessed closer to the approval date in accordance with usual practice, and the indicative tariff will consequently be varied as a product of the change in WACC parameters.
- (h) **Forecast coal volumes:** Yancoal considers that the coal volume forecasts provided by QR (that the Draft Decision proposes to accept) remain overly pessimistic, at least if an appropriate tariff is ultimately approved. The Draft Decision indicates that the QCA has not sought an independent assessment of QR's volume forecasts (page 197), yet QR's estimates have been accepted in the face of evidence that both Yancoal and New Hope are using substantial ad-hoc services above currently contracted levels, and with other indications of likely higher future demand (whether from potential future expansions of Cameby Downs and New Acland or Sekitan's proposed reopening of Wilkie Creek). Yancoal acknowledges that the proposed volume trigger was designed to mitigate this issue, but it is not a true replacement for a more accurate forecast as:
- (i) calculating a reference tariff on the basis of under-estimated volumes results in a higher initial reference tariff, which will itself place downwards pressure on volumes; and
 - (ii) the proposed Endorsed Variation Event is only based on contracted volumes increasing, such that it will not respond to sustained ad-hoc demand above forecast levels (which has the adverse result of incentivising QR to frustrate and delay access negotiations with a view to those access rights being utilised on an ad-hoc basis at the existing reference tariff, creating windfall gains for QR, rather than being contracted on a long term basis and lowering the reference tariff).

Yancoal requests that the QCA seek an independent assessment of QR's volume forecasts, amend the Endorsed Variation Event volume trigger to also cover sustained ad-hoc demand above forecast levels, and amend the drafting of the proposed paragraph (c) of the Endorsed Variation Event definition to also cover volume increases for individual origins (as proposed in the Draft Decision, 198).

- (i) **Importance of affordability and competitiveness:** Even if each of the matters above are addressed, Yancoal remains concerned about the competitiveness of the access pricing being proposed by the QCA. It remains difficult to understand how the proposed access charges is consistent with the object of Part 5 (efficient use and operation of the network), the public interest, including promoting effective competition in upstream and downstream markets, and the interests of access seekers and access holders – all of which are required to be taken into account in determining whether the QR DAU is appropriate under section 138(2) of the *Queensland Competition Authority Act 1997* (Qld). The Draft Decision indicates that the QCA did not take affordability into account and material weight was not given to the issue of relative prices of other train services. Yet for the viability of the remaining coal services on the West Moreton network it is a critical issue that the cost of rail access is well above that of their competitors in the Bowen Basin and Hunter Valley. The current and proposed access charges and adverse impact on above rail services do not promote effective competition in coal markets as Cameby Down's competitive position shifts significantly from low cost at mine to high cost on arrival at the port due to excessive and inefficient rail costs. Yancoal considers that it is clearly in the public interest, the interest of access holders and access seekers and consistent with the object of Part 5 of the QCA Act to reduce the proposed tariff to reflect the affordability

and competitiveness issues arising from the current and proposed tariffs, and requests that the QCA take this into account in setting the appropriate reference tariff.

2 Other issues

- (a) **End User contracting:** Yancoal supports the tripartite structure and the QCA's proposed amendments in the Draft Decision which have made it more practicable for end users to directly hold access rights. However, for that potential to be fully realised, the access undertaking requirements regarding information to be provided by an access seekers will also need to be revisited (as there remain issues in clause 5.1 and 5.2 of Schedule B of the DAU that non-operator access seekers will not be able to address);
- (b) **More balanced Access Agreement terms:** Yancoal supports the rebalancing of the terms of the Standard Access Agreement, as provided for in the Draft Decision. However, Yancoal questions whether it remains appropriate to keep the 10% threshold in favour of QR before claims can be made for non-provision of access in an environment where Wilkie Creek's closure and the deterioration in non-coal traffic has produced spare capacity, such that QR's risk of non-provision of access, other than through its own underperformance, should have substantially decreased.
- (c) **KPIs:** Yancoal also supports the inclusion of a KPI regime in the Standard Access Agreement, but considers that in order to provide for a KPI regime with appropriate financial outcomes it would be preferable for the standard access agreement to refer to the regime applicable under the undertaking and then have the undertaking provide obligations on QR to propose such a performance regime (with the QCA empowered to determine a regime if QR does not submit something appropriate). QR will not have no incentives to negotiate an appropriate performance regime if that is left as a matter for the parties to negotiate.
- (d) **Renewals:** Yancoal supports renewing access holders having priority over access seekers in the queue (who do not have the same sunk costs as existing access holders). However, there needs to be greater flexibility in what is treated as a renewal. Rather than solely being for strictly equivalent access rights, it should include existing access holders applying for substantially the same access rights (to provide some flexibility, particularly in relation to volume and haulage provider controlled changes to the train service description).
- (e) **Review of undertaking for inequitable outcomes:** Yancoal has no opposition to QR's proposed longer term provided that the QCA has the power to require amendments in the event of inequitable and unanticipated outcomes occurring. A clause similar to that appearing in the Dalrymple Bay Coal Terminal access undertaking regarding this issue would be appropriate.
- (f) **Planning and scheduling changes:** Yancoal remains concerned about the substantial amount of discretion QR has to change the master train plan and daily train plan without consent of access holders. Given Yancoal (and/or its coal customers) have to arrange shipping significantly in advance, major closures should not be able to be moved without significant advance notice or consent of the impacted access holders.
- (g) **Investment framework:** In order for the investment framework to be of more utility it will be necessary for the QCA to remove the discretion QR is given throughout the document (other than their right to elect whether to invest) and make the tests for when an Extension should proceed or user funding can be provided, objective in nature.

3 Summary

Yancoal urges the QCA to carefully reconsider the matters highlighted in this submission, particularly in relation to the West Moreton network tariff and the impact that it will have on competitiveness of coal users on the network.

Affordability and competitiveness are no longer a 'nice to have'. Should QR's DAU as proposed be adopted, the viability of the Cameby Downs Mine would be in serious jeopardy. The operation requires assistance and cooperation from its external service providers to ensure all participants in the value chain can operate efficiently, sustainably and profitably, both now and in the future, and that the mine can continue to generate public benefits through employment, State royalties and economic flow-on impacts.

The current QR proposal does not achieve this outcome and further revisions in addition to that provided for in the Draft Decision will be necessary to achieve that outcome.

Yours sincerely

A handwritten signature in black ink, appearing to read 'M. Dodd', with a stylized flourish at the end.

Mike Dodd
General Manager, Infrastructure
Yancoal Australia Ltd