

Mr George Passmore
Director Business Performance
Queensland Competition Authority
Level 27
145 Ann Street
Brisbane QLD 4000

Dear Mr Passmore

REVIEW EVENT APPLICATION – REQUEST FOR RESPONSE TO INDUSTRY COMMENTS

Queensland Rail welcomes the opportunity to respond to industry feedback on Queensland Rail's review event application dated 23 September 2019 (**Review Event Application**).

The Review Event Application has been provided for the final year of the term of the 2016 Queensland Rail Access Undertaking 1 (**AU1**) being 1 July 2019 to 30 June 2020. The proposal is intended to capture several changes in circumstances as they apply to the calculation of the approved West Moreton Reference Tariff, including:

1. [REDACTED] ad-hoc services (as advised by Queensland Rail's West Moreton coal customers) from [REDACTED]; and
2. Subsequent reduction in contracted train paths from 1 January 2020 to [REDACTED] (as per the 2019 New Acland Access Agreement) plus a proposed change in the Reference Train Service.

Queensland Rail has provided this Review Event Application consistent with the determinations of:

1. The QCA June 2016 Decision on AU1 which:
 - a. Approved five-year profiles for the building blocks that determine the West Moreton Reference Tariff, including efficient common network costs relating to both fixed and variable components of operating and maintenance expenses; and
 - b. Provided for altered or additional reference tariff conditions that would apply where an innovation was introduced – by either Queensland Rail or its customers that improved productivity or efficiency (such as a change to the Reference Train Service)¹.
2. Endorsed Variation Event 1 (Yancoal 2016)² and Endorsed Variation Event 2 (Yancoal 2018)³ which both considered proposed changes to the West Moreton Reference Tariff per the approved tariff model to be inclusive of changes to proposed incremental costs resulting from changes to train paths based on the cost profiles for the 2016 Final Decision.
3. Review Event 1 – New Hope July 2018⁴ which considered the renegotiation of a lower level of contracted paths with an Access Holder to be a material change in circumstances being that the actual number of contracted train paths on West Moreton in a regulatory year was forecast to be lower than the number of paths used to set the West Moreton Reference Tariff;

¹ QCA Decision Queensland Rail's Draft Access Undertaking June 2016 Page 175

² QCA Approval of Yancoal Endorsed Variation Event of 22 December 2016 – 9 November 2017

³ QCA Approval of Yancoal February 2018 Endorsed Variation Event - 21 June 2018

⁴ QCA Draft Decision on New Hope review event 21 June 2018 and subsequent Final Decision 19 July 2018
Queensland Rail Limited (ABN 71 132 181 090)

As Queensland Rail has previously noted in its submissions on its 2020 Draft Access Undertaking 2 (DAU2)⁵, AU1 has seen an environment of high thermal coal spot prices which has provided favorable circumstances to produce and market coal. At the commencement of AU1 (June 2016 quarter), thermal coal spot prices averaged \$68 AUD/t, rising to a peak of approximately \$131 AUD/t in September 2018⁶. The September 2019 assessment for 2019-20 is an average equivalent thermal coal spot price of \$100 AUD/t⁷.

The high coal prices have been reflected in throughput levels over the period, access applications for additional capacity, as well as the pursuit of system productivity improvements such as is in this case, the proposed change in the Reference Train Service to haul additional coal volumes per train path.

It has been well documented that the forecast reduction in train paths in the Review Event Application has been caused by delays in approvals for New Hope's New Acland Stage 3 mine and the consequent run down of coal reserves from the existing New Acland Stage 2 mine. While the duration of the mine development delay is unknown, Queensland Rail remains confident that final approvals will eventually be given and the West Moreton system will operate at up to the 9.7mtpa system capacity that is currently available.

Both Yancoal and New Hope's submissions have suggested asset optimisation, or in its place revenue deferral (i.e. Loss Capitalisation), as an appropriate response to the revised West Moreton Reference Tariff. In Queensland Rail's 16 November 2018 Response to Industry Comments on DAU2, Queensland Rail's independent expert Frontier Economics reviewed the appropriateness of optimisation on the West Moreton system and outlined why asset optimisation is an inappropriate measure for the system including⁸:

1. Optimisation is inconsistent with the principles of Financial Capital Maintenance (FCM);
2. Current prices proposed for the West Moreton system "are manifestly not a result of inflated asset values (past inefficiency) being carried into current periods"; and
3. Queensland Rail was on course to record negative cash flows (revenues earned less operating expenses and capital expenditure) of almost \$50 million for the period 2013-2018, which indicates that Queensland Rail is not simply collecting the benefits of an inflated asset base.

The Frontier Economics' report goes further to suggest that:

"...it would seem a perverse outcome if RAB optimisation allowed miners to recover all of their costs while Queensland Rail bears all of the downside from declining volumes – particular in light of submissions that suggest Queensland Rail is protected from volume risk"⁹.

It should be noted that preliminary estimates for the Below Rail Financial Statements for 2018-19 forecast that Queensland Rail will incur losses of over \$8 million on the West Moreton system for FY2018 - 19¹⁰. Deferral of legitimate revenues will only exacerbate these circumstances moving forward and further restrict Queensland Rail from recovering its efficient costs of providing access services in the West Moreton rail system.

Queensland Rail submits that the proposed Review Event Application West Moreton Reference Tariff is affordable to the mines. Of relevance to uplifts in reference tariffs in AU1, in Queensland Rail's 16 November 2018 Response to Industry Comments on DAU2 Frontier Economics' assessment of West Moreton system mine affordability is:

⁵ Queensland Rail's Draft Access Undertaking 2 (DAU2) Explanatory Document, 14 August 2018 Page 41

⁶ The Office of the Chief Economist September 2019 Historical Data tables

⁷ The Office of the Chief Economist September 2019 Forecast Data tables

⁸ Queensland Rail's Response to Industry Comments on Queensland Rail's Draft Access Undertaking 2 (DAU2), Attachment 1: Frontier Economics' Expert Report – Asset Optimisation, 14 November 2018

⁹ Queensland Rail's Response to Industry Comments on Queensland Rail's Draft Access Undertaking 2 (DAU2), Attachment 1: Frontier Economics' Expert Report – Asset Optimisation, 14 November 2018, Page 10

¹⁰ Subject to independent audit

“...our opinion is that a miner's ability to pay would clearly be much higher than when previous tariffs were approved by the QCA (through the course of 2015-16).”¹¹

Further, Queensland Rail has undertaken detailed assessment of Yancoal's ability to pay which also demonstrates that the proposed Review Event Application West Moreton Reference Tariff is at an 'affordable' level.¹² While Yancoal's affordability has been discussed by Queensland Rail in previous QCA submissions as referenced in this letter, AME Advisory mine cost data also indicates the New Acland mine free on rail costs are only marginally more expensive than the Cameby Downs mine. However, with the rail distance from New Acland mine (Jondaryan loadout) to the Port of Brisbane being over 150 kms less than from Cameby Downs mine (Columboola loadout) to the port, above and below rail costs for New Acland mine are significantly less than those for the Cameby Downs mine. Revenue deferral should only be considered where a reference tariff is not affordable. Any consideration of revenue referral or asset optimisation is inappropriate in this context because Queensland Rail's proposed Review Event Application West Moreton Reference Tariff remains affordable to both mines.

Queensland Rail notes the acceptance of New Hope and Yancoal in their submission that Queensland Rail has fixed costs. The producers also suggested that maintenance costs should be lowered. However, the AU1 maintenance allowance was determined by the QCA in its approval of AU1 to represent at least the efficient level for the system. In any event, Queensland Rail needs to be given a reasonable time to adjust its fixed maintenance costs to a change in demand for train services. Up until mid-September 2019, before redundancy notices were issued to 150 New Acland mine workers¹³, New Hope still appeared to be hopeful that the Government would issue the required water and mining licenses to enable it to commit to the New Acland Stage 3 mine development.

In considering whether to approve a variation to a Reference Tariff as a result of a Review Event, the QCA must take into account factors including that the variation is appropriate having regard to the *Queensland Competition Authority Act 1997 (Qld) (QCA Act)*, including those factors listed in section 138(2) of the QCA Act.

In applying the section 138(2) criteria, in particular the object of Part 5 and the Pricing Principles, the industry has focused solely on affordability and the suggested likelihood of cessation of mining activities or delay of future investment in coal projects (without evidence of the likelihood of that eventuality). It is not sufficient for the QCA to limit its application of the relevant QCA factors to the issues raised in the industry submissions. The criteria reflect a balancing of interests between Queensland Rail and users. The object of Part 5 of the QCA Act requires the QCA to consider the promotion of the economically efficient operation of, use of and investment in Queensland Rail's network.

The variation proposed by Queensland Rail is consistent with the QCA Act criteria in that:

1. the tariff increase promotes the economically efficient operation of, use of and investment in the network, by permitting Queensland Rail to recover an amount closer to the efficient costs of running the network, ensuring that Queensland Rail is in a position to maintain the network to a level that is safe and appropriate to accommodate contracted and ad hoc services; and
2. the tariff proposed is affordable, reflecting the interests of access holders, including the interests in ensuring the network is maintained to a standard sufficient to facilitate their anticipated use, including for ad hoc services.

Queensland Rail is committed to providing a safe and reliable network for its users and will provide further comments as required, subsequent to the QCA's draft decision. Queensland Rail has also submitted its West Moreton Reference Tariff model as approved for all previous changes to the AU1 West Moreton Reference Tariff, and updated for the Review Event Application parameters.

¹¹ Queensland Rail's Response to Industry Comments on Queensland Rail's Draft Access Undertaking 2 (DAU2), Attachment 1: Frontier Economics' Expert Report – Asset Optimisation, 14 November 2018, Page 10

¹² Refer to Queensland Rail's Response to the QCA's Draft Decision on Queensland Rail's Draft Access Undertaking 2 (DAU2), 11 July 2019, Pages 10-11 for Yancoal affordability

¹³ New Hope Group Media Statement, 2 September 2019

If you or your officers have any questions on this Review Event Application, please do not hesitate to contact Matthew Byrnes on 07 3072 0578.

Yours sincerely

A handwritten signature in black ink, appearing to read "Neil Buckley". The signature is written in a cursive style with a large, stylized initial "N".

Neil Buckley
General Manager Rail Access Solutions

8 November 2019