QueenslandRail

Queensland Rail
GPO Box 1429
Brisbane QLD 4001

T 07 3072 0781
E ceoqueenslandrail@qr.com.au
www.queenslandrail.com.au

Our Ref: MCR-19-905

Professor Flavio Menezes
Chair
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Professor Menezes

Queensland Rail's Draft Access Undertaking 2 (DAU2)

I am pleased to attach Queensland Rail's submission in response to the QCA's Discussion Paper on West Moreton coal pricing issues dated 24 October 2019.

We look forward to continuing to work with the QCA and stakeholders to achieve appropriate outcomes having regard to ongoing volume uncertainty.

If you have any questions please do not hesitate to contact Douglas Jasch, Manager Policy and Regulation, on 3072 0544.

Yours sincerely

[redacted]

Nick Easy
Chief Executive Officer

17 December 2019

Queensland Rail's Response —
QCA Discussion Paper on the Approach to Pricing for West Moreton Coal

19 December 2019

Table of Contents

1. West Moreton System Tonnage Uncertainty

Queensland Rail's Draft Access Undertaking 2 (**DAU2)** has been developed within the context of considerable coal volume uncertainty for the West Moreton System. To address this uncertainty, in August 2018 when DAU2 was lodged Queensland Rail also submitted to the Queensland Competition Authority (**QCA**):

- a high 9.1 million tonnes per annum (**mtpa**) scenario which assumed that the New Acland Stage 3 mine (**NAS3**) will be operational at the time of DAU2's commencement; and
- a low 2.1mtpa scenario[1] which assumed that Yancoal will be the only operating mine on the West Moreton System when DAU2 is approved (1 July 2010).[2]

Stakeholders had anticipated that as the DAU2 process progressed towards the expected approval date of 1 July 2020 the uncertainty around NAS3 tonnages would be resolved. However, New Hope Corporation Limited (**New Hope**) is yet to receive the necessary approvals to develop its NAS3 mine and there is no date set for a decision. It now appears unlikely that NAS3 will be railing when DAU2 comes into effect.

On this basis, Queensland Rail has looked to Yancoal Australia Limited (**Yancoal**) railings for its initial DAU2 forecast. Queensland Rail notes that Yancoal has received the required approvals to expand its Cameby Downs mine from 2.8mtpa run-of-mine (**ROM**)[3] to 3.5mtpa ROM, which once completed will result in Yancoal being able to increase railings from 2.1mtpa to 2.6mtpa.

[redacted]

On 25 October 2019 in recognition that a low tonnage scenario is likely, the QCA released a discussion paper (**Discussion Paper**) on an appropriate approach to pricing for coal services on the West Moreton System under a low tonnage environment. The Discussion Paper noted that Queensland Rail would formally submit a 2.1mtpa reference tariff submission to the QCA in November 2019 for approval.

On 22 November 2019, Queensland Rail submitted a 2.1mtpa reference tariff:

- making amendments to its August 2018 2.1mtpa capital, maintenance and operational expenditure; and
- providing a loss capitalisation methodology.

This submission responds to the QCA Discussion Paper in the context of the November 2019 2.1mtpa reference tariff submission.

[1] The 9.1mtpa scenario was formally submitted to the QCA with the reference tariff for approval. The 2.1mtpa scenario was submitted to the QCA for information purposes and did not seek the approval of a reference tariff for this tonnage level.

[2] The 2.1mtpa scenario assumed that the NAS3 mine will be approved during the DAU2 term, and therefore included sufficient maintenance, capital and operational expenditure to allow a quick ramp up of tonnages when NAS3 mine railings begin.

[3] Run-of-mine (**ROM**) coal: The raw mined material as it is delivered by the mine prior to treatment of any sort. It consists of coal, rocks, middlings, minerals and contamination etc. The non-coal elements are removed prior to railing to the port.

[4] In 2018/19 Yancoal railed 2.16mtpa of coal. Further Yancoal estimates that it produces approximately 2.2mtpa http://www.yancoal.com.au/page/assets/mine-sites/cameby-downs/cameby-downs-continuation-project/.

2. QCA Discussion Paper

Discussion Paper questions

The Discussion Paper outlines the QCA's preliminary consideration of an approach to a low volume environment, as well as providing discussion topics aimed at assisting stakeholders in preparing their comments in response to this.

The Discussion Paper was issued prior to Queensland Rail's November 2019 2.1mtpa low tonnage submission and does not have the benefit of that submission.

While the Discussion Paper contained seven questions with associated explanations, the paper also sought that stakeholders consider whether there are any other key West Moreton System coal service pricing matters on which they should make submissions:

> "*While….questions highlight some relevant matters, they do not seek to comprehensively cover all the topics raised to date, or the matters discussed….. Hence, interested parties should rely on their own analysis to determine* ***whether there are additional matters related to the West Moreton pricing approach on which they wish to comment.***"[5]

Discussion Paper Questions:

(1) Does a 'de-coupling' of access charges from the reference tariff provide an appropriate way forward given the forecasts of low volumes and substantial unused capacity?

(2) Is it appropriate to also 'de-couple' take or pay and relinquishment fees from the terms set out in the access undertaking?

(3) Would 'de-coupling' access charges from the reference tariff work with existing access agreements?

(4) Is it appropriate to include an endorsed variation event for resetting the reference tariff when contract volumes increase, if access charges are 'de-coupled' from the reference tariff?

(5) If an endorsed variation event for increases in contracted volumes is included, should it be subject to a materiality threshold?

(6) What features of a loss capitalisation approach are required so that it suits the nature of the West Moreton asset and the market for access?

(7) If access charges are 'de-coupled' from the reference tariff, does our draft decision approach to estimating WACC appropriately compensate Queensland Rail?

2.1 Proposed QCA approach

The proposed Discussion Paper approach is a type of negotiate/arbitrate model that moves away from the manner in which West Moreton reference tariffs have been and are currently set.

The QCA has expressed the view that an approved reference tariff 'locks in' an access charge, rather than being a guide or ceiling for negotiations. The QCA considers that, having regard to s. 138(2) of the *Queensland Competition Authority Act 1997* (Qld) (**QCA Act**), it may find a West Moreton reference tariff is not appropriate for the next undertaking period.

[5] West Moreton coal pricing approach—discussion paper, 24 October 2019, p. 6.

The Discussion Paper proposes that in a low tonnage environment the QCA set the reference tariff at the ceiling. However, this reference tariff would be unaffordable for Yancoal. Rather than the QCA approving an 'affordable' reference tariff as proposed by Queensland Rail, the Discussion Paper proposes that Queensland Rail and the access seeker negotiate an access charge at a rate below the QCA approved ceiling reference tariff (i.e. a 'de-coupling' of access charges from the reference tariff) and if agreement is not reached a dispute is lodged with the QCA for adjudication.

To deal with the tonnage uncertainty and the likelihood that the system will operate with a low tonnage scenario, the QCA considers it may be appropriate to 'de-couple' access charges from the West Moreton approved reference tariff by:

- approving a reference tariff based on the building blocks method at low volumes (referred to as the ceiling price);
- providing for negotiation of access charges that are lower than the ceiling price;
- providing for the QCA to be able to determine disputes about access charges without being bound to the ceiling price (ie. by determining an access price lower than the ceiling price); and
- 'de-coupling' take or pay and relinquishment fees from the terms set out in the access undertaking and standard access agreements (to allow the QCA to make a determination that an access charge should not include take or pay charges and/or that relinquishment fees should not be permitted).

The QCA also considers that it may be appropriate to require an endorsed variation event when contract volumes are greater than the volume forecasts used to assess the reference tariff (discussed in Part 3 of this submission).

2.2 Queensland Rail response

Creating uncertainty

Queensland Rail has acknowledged that, in a low tonnage scenario, an approved reference tariff calculated in accordance with the building blocks method would be beyond the willingness of access holders to pay.

Queensland Rail welcomes the QCA's willingness to consider a shift to a negotiate/arbitrate model. However, Queensland Rail considers that at this stage of the consideration of DAU2, with a final decision proposed in February 2020, the proposed 'de-coupling' of access charges from the reference tariff is not an appropriate way forward.

In accordance with its undertakings to access holders, and in the interests of maintaining the regulatory certainty that both the QCA and access holders have promoted, Queensland Rail has proceeded with DAU2 on the basis of making minimum changes from its current access undertaking (**AU1)**, with changes only being proposed on an exception basis. Queensland Rail has previously made commitments to industry to seek that the QCA approve both the ceiling tariff and the (affordable) reference tariff.

In its submission dated 22 November 2019, Queensland Rail has proposed a solution which maintains that certainty (so far as possible in the current environment), while not imposing a tariff which is above the willingness of a single access holder to pay in a low tonnage scenario. Queensland Rail's proposal gives access holders the certainty of an approved reference tariff (the 'affordable' reference tariff) for a low tonnage scenario, with a mechanism for recovery of losses, and a nominated reference point for when Queensland Rail may begin to recover those losses.

The QCA's proposal, on the other hand, delays a decision on an 'affordable' reference tariff, pending further negotiations between Queensland Rail and access holders (likely to be Yancoal as the only access holder). Given the parties have to this stage not reached agreement on an access charge which Yancoal is willing to pay, this approach may simply force the parties into a dispute and defer that assessment until that dispute can be determined. Putting the parties to the time and expense of a dispute is not in the interests of Queensland Rail or access holders.

Further, the QCA has not explained how treating the reference tariff as a ceiling tariff will operate if volumes rise sufficiently that a reference tariff is likely to be within the range of customers' willingness to pay.

In addition to creating considerable and unnecessary uncertainty, the QCA's proposal involves moving to a negotiate/arbitrate framework for *one* aspect of the conditions of access, while otherwise maintaining a prescriptive approach to non-price conditions. While an approved standard access agreement continues to be a 'safe harbour' in any access dispute, there is no genuine negotiate/arbitrate model. A true negotiate/arbitrate model would facilitate negotiations on *all* conditions of access, which allows for compromises facilitating greater flexibility on price. Price should not be negotiated separately from non-price terms.

The QCA proposes consequential changes to the take or pay and relinquishment fee provisions to, it says, give effect to flexibility for the parties to negotiate access charges – again, failing to take into account the impact of non-price conditions.

Promoting efficient use of the West Moreton System

The QCA's proposal involves 'de-coupling' take or pay and relinquishment fees from the terms set out in the access undertaking.

While the QCA does not expand on the purpose or benefits of this proposal, presumably it is to permit the QCA to make a determination in an access dispute that access charges should not include take or pay, and that no relinquishment fees should apply.

This proposal does not promote efficient use of the West Moreton system. While an affordable access charge may encourage customers to use the network, the removal of take or pay charges and relinquishment fees encourages the inefficient practices of capacity hoarding and over-contracting, which are clearly inconsistent with the interests of access seekers and access holders, and does not promote the efficient use of rail infrastructure and competition in dependent markets (ss. 138(2)(a), (d), (e) and (h)).

In making its decision, the QCA must take into account a potential change in circumstances where New Hope receives its approvals, or where a third mine commences operation on the West Moreton System. There must be incentives for access seekers to contract only the capacity they are genuinely likely to acquire.

Removing take or pay and relinquishment fees provides no incentive for access seekers to make a genuine assessment of their forecast capacity requirements, which in turn prevents Queensland Rail from making reliable investment and maintenance decisions.

Existing Access Agreements

The QCA Discussion Paper asked "*Would 'de-coupling' access charges from the reference tariff work with existing access agreements*?" Queensland Rail submits that this Discussion Paper proposal is not practicable where Queensland Rail and (an) access holder/s have entered into existing access agreements on the expectation that the QCA will continue to approve a reference tariff based on a building blocks mechanism.

Existing access agreements (in the form of the standard access agreement approved by the QCA), provide for access charges to be set at the approved reference tariff, which under the QCA's proposal would be the ceiling price.

The QCA has no power to arbitrate disputes under an existing access agreement.

Under Queensland Rail's proposal, on the other hand, the 'affordable' reference tariff is the approved reference tariff, so that there is no need to negotiate any amendments to existing access agreements.

The QCA Discussion Paper proposed approach largely moves away from the current West Moreton System reference tariff building block methodology.

Queensland Rail does not support the Discussion Paper approach to the reference tariff and considers that Queensland Rail's 22 November 2019 submission addresses the issues that the QCA is seeking to resolve, while also maintaining the principles underlying the current building block methodology.

3. Endorsed Variation Events

Discussion Paper Questions:

Is it appropriate to include an endorsed variation event for resetting the reference tariff when contract volumes increase, if access charges are 'de-coupled' from the reference tariff?

Queensland Rail submits that an Endorsed Variation Event (as defined in AU1) is not an appropriate mechanism for resetting the reference tariff for DAU2.

3.1 Endorsed Variation Events vs Review Events

The concept of an event that triggers a review of approved reference tariffs was established by the QCA in a rail context under Queensland Rail's 2001 Access Undertaking (**2001 AU**).

AU1 and DAU2 both have defined Endorsed Variation Events and Review Events. An Endorsed Variation Event is one that allows for a pass through change to a reference tariff without a full investigation by the QCA. A Review Event requires the QCA to fully investigate whether the pass through is appropriate having regard to all of the factors in section 138(2) of the QCA Act.

Both an Endorsed Variation Event and a Review Event must relate to events that in all circumstances require a variation to a reference tariff. This is because where those events arise, Queensland Rail is obliged, in all circumstances, to submit a variation to the reference tariff (based on the occurrence of either an Endorsed Variation Event or a Review Event. In deciding to approve definitions for those Endorsed Variation Events and Review Events, the QCA has satisfied itself that whenever those events occur the reference tariff must be varied.

An Endorsed Variation Event is intended to be used in circumstances where the QCA is satisfied from the outset that a category of costs should be passed through in reference tariffs. In AU1 and DAU2 this occurs, for example, where the QCA Levy is reviewed or where there is a relevant type of Change of Law, Change to Credit or Impost Change (as defined) that in aggregate meet a specified percentage threshold.

Review Events are broader in nature and will involve wider regulatory enquiries by the QCA before the QCA could be satisfied that a variation should be made to the reference tariff.

Consistent with its commitment to industry to seek only incremental changes to AU1, Queensland Rail did not propose changes to the definitions of Endorsed Variation Event or Review Event.

3.2 Operation of Endorsed Variation Events

The event described in paragraph (c) of the definition of Endorsed Variation Event is:

> *Contracted coal-carrying Train Services, for a single origin or in aggregate, on the West Moreton Network and the Metropolitan Network are, at the Approval Date or thereafter, greater than the forecasts of coal carrying Train Services used to develop Reference Tariffs for the West Moreton Network and the Metropolitan Network.*

This definition refers solely to an increase in the number of contracted train services. However, both forecast gtk and the number of contracted train services using different parts of the network are relevant to the development of the reference tariff.

It is not appropriate for this type of event to apply only where the number of contracted train services (or even gtk for contract train services) is greater than forecast. The event favours access holders in that where the event arises it appears focused at reducing the unit cost of the reference tariff but does nothing to protect Queensland Rail should volumes be less (not "greater") than forecast.

This means that in circumstances where there is an increase in contracted train services from a particular origin but a corresponding decrease in contracted train services from a different origin, to address the decrease in contracted train services Queensland Rail must also go through a Review Event. In those circumstances, an increase in contracted train services triggers an Endorsed Variation Event (where the QCA does not need to satisfy itself in relation to section 138(2) factors) and a decrease in contracted train services from another origin triggers a Review Event (where the QCA does need to satisfy itself in relation to section 138(2) factors). There is a clear asymmetry in the QCA's consideration, in a manner that can operate against the interests of Queensland Rail.

In addition, where the increase in one set of contracted train services came about because of the decrease in another set of contracted train services, the two events are essentially one event, but requiring two separate and asymmetric processes. It is not appropriate for Queensland Rail to be subject to two processes for something that should be addressed through a single process.

3.3 Proposed volume related Endorsed Variation Event

The Discussion Paper proposal is that DAU2 should include a volume based trigger for an Endorsed Variation Event. Such a trigger would require a variation to the reference tariff where volumes increase as compared to those in the forecast used to prepare reference tariffs.

The QCA's consideration is not specifically linked to the proposed loss capitalisation mechanism. The QCA indicates that under the 2.1mtpa volume scenario "*any impact of the price reset mechanism is likely to be small (and will in any event be indirect) to the extent that the access charge being paid is less than the reference tariff".*

For the reasons discussed above, Queensland Rail does not consider that an Endorsed Variation Event is an appropriate mechanism to deal with volume related events. Queensland Rail considers that there should be an appropriately drafted volume based event that triggers a review and variation of the reference tariff. That event should:

- be clearly drafted based on factors relevant to the reference tariff;
- address both increases and decreases from the forecasts used in developing the reference tariff;
- only relate to contracted train services (unless the trigger is intended to act as a de facto reference cap); and
- use appropriate materiality thresholds (to minimise the risk of multiple successive variations for minor changes).

3.4 Loss Capitalisation approach

Queensland Rail has considered the QCA's reset proposal but does not consider that there is merit in frequent recalculation of reference tariffs while volumes are within the low volume range, while Queensland Rail sustains losses on its capital program and the reference tariff is well below the ceiling tariff.

Queensland Rail's 21 November 2019 2.1mtpa submission to the QCA removed the need for Endorsed Variation Events by proposing that the low volume reference tariff should be applied for all coal-services on the West Moreton System until contracted tonnes on the system exceed 4.1mtpa, at which point Queensland Rail will submit a Draft Amending Access Undertaking to the QCA on the higher tonnage reference tariff. The drafting in DAU2 will provide the QCA with the same powers as an initial undertaking notice for its assessment of the draft amending access undertaking.

Queensland Rail considers a 4.1mtpa volume trigger and the approval by the QCA of Queensland Rail's maintenance model, provides an appropriate balance between minimising additional administration associated with the frequent submission of draft amending access undertakings or reviews under an Endorsed Variation Events, and will provide access holders with a safety net to ensure that they are not paying a higher reference tariff than required as volumes increase. Using contracted paths as the trigger provides an incentive for access seekers to contract the paths. The estimated annual loss will be adjusted annually to reflect the estimated efficient maintenance costs of providing coal services at the actual volumes moved in the relevant year, estimated operating expenditure and QCA approved RAB roll-forward for the relevant year.

On this basis, it seems that where volumes increase between the floor of 2.1mtpa and 4.1mtpa the affordable reference tariff mechanism and loss capitalisation account mechanisms should be allowed to operate without the need for any submissions in respect of an Endorsed Variation Event. Requiring Queensland Rail to make submissions in support of an Endorsed Variation Event would simply amplify administrative costs for Queensland Rail and industry. In such an environment, it would seem more appropriate to minimise the costs imposed on Queensland Rail while waiting for a time when volumes reach a sufficient level to warrant a review of the Reference Tariff.

4. WACC

Discussion Paper Questions:

If access charges are 'de-coupled' from the reference tariff, does our draft decision approach to estimating WACC appropriately compensate Queensland Rail?"

Queensland Rail has consistently sought to minimise the uncertainty associated with the allowed rate of return to apply for DAU2. Queensland Rail's original proposal accepted the Weighted Average Cost of Capital (**WACC**) methodology adopted in the QCA's draft decision on Aurizon Network's 2017 draft undertaking (**UT5**), save for an updated asset beta that better reflected Queensland Rail's regulatory and commercial risks.

Queensland Rail engaged Frontier Economics (**Frontier)** to estimate an asset beta for its network. Frontier concluded that, in relation to the choice of comparators:

- other railroads and ports are likely to be the closest comparators to Queensland Rail;
- airports are next closest;
- the companies operating in the pipeline and toll road sector are somewhat less comparable; and
- the regulated electricity and water sector are least comparable, sharing no key risk based features with Queensland Rail.

The analysis and conclusions set out in the Frontier Report continue to be valid for DAU2 and Queensland Rail continues to hold the view that the QCA should reconsider this report in its final decision. That said, the submission by New Hope[6] highlights the issues with the DAU2 Draft Decision analysis in that New Hope focuses exclusively on the returns provided by a range of regulated businesses. New Hope's analysis of the appropriate rate of return for Queensland Rail focuses on regulator decisions for:

- water and wastewater services (IPART Water);
- fixed line telecommunications services (ACCC — telco);
- gas distribution services (ERA — ATCO);
- passenger rail network services (ERA — PTA);
- electricity distribution and transmission services (AER — Ausgrid) and
- gas transmission services (AER — VTS).

In addition, New Hope's analysis includes three decisions that provide commercial rail network services (ie, IPART — rail, ACCC — HVAU and ACCC — Interstate).

New Hope's analysis of these regulatory decisions was synthesised in Figure 1, with the conclusion that:[7]

> *"This indicates that the Draft Decision is broadly in line with these recent decisions, and if anything slightly favourable to QR. The only two decisions providing for a higher allowance relate to businesses that are more risk exposed – i.e. the ARTC interstate operations and businesses subject to the NSW rail access regime. Most recent decisions for comparable energy, water and rail businesses provide for a rate of return below the Draft Decision allowance."*

To summarise, New Hope's analysis is that the single characteristic for determining the WACC for Queensland Rail is whether or not it is regulated. Further, the reasonableness of the QCA's Draft Decision is capable of being

[6] New Hope Group, *Submission in response to Queensland Competition Authority Draft Decision: QR 2020 Draft Access Undertaking*, September 2019.
[7] New Hope Group, *Submission in response to Queensland Competition Authority Draft Decision: QR 2020 Draft Access Undertaking*, September 2019, p 12.

assessed by reference to the rates of return provide generally to other regulated businesses. However, the premise that all businesses under economic regulation have the same "risk" is without economic or financial foundation.

In reviewing New Hope's normalised analysis Queensland Rail has identified the following issues:

- the presented IPART rail parameters are inconsistent with IPART's final rate of return decisions for Railcorp's Hunter Valley Coal Network, which adopts a gearing of 45% and an equity beta of 1.00;[8]
- the analysis miscalculates the de-levered and re-levered equity betas for the two ACCC rail decisions, with New Hope reporting an equity beta of:[9]
  - 0.64 rather than the correct value of 0.78; and
  - 0.87 rather than the correct value of 1.04.

This results in New Hope under-estimating the normalised WACC for these rail companies with:

- IPART — rail comparator should be 8.1 per cent (rather than the reported 6.6 per cent);
- ACCC — HVAU comparator should be 6.1 per cent (rather than the reported 5.5 per cent); and
- ACCC — Interstate comparator should be 7.0 per cent (rather than the reported 6.4 per cent).

Notwithstanding the above, Queensland Rail does not consider that New Hope's analysis provides a sound basis for assessing the reasonableness of the DAU2 Draft Decision through a comparison of WACC decisions by other regulators. Such an analysis would concentrate on businesses that are comparable to Queensland Rail, and would seek to answer the following questions:

Questions	Answer
Does the QCA's "bottom-up" WACC methodology result in a below average rate of return?	This question could be assessed by applying Queensland Rail's company specific WACC parameters to the WACC methodologies of other regulators.[10]
Is the QCA's assessment of the risk of Queensland Rail in line with judgements of other regulators?	This question could be assessed by applying the company specific WACC parameters adopted by other regulators for comparable businesses to the QCA's WACC methodology.
Is the QCA's rate of return for Queensland Rail comparable with the rates provided to comparable businesses by other regulators?	This question could be assessed by recalculating the WACC decisions of other regulators for comparable businesses over the same period as DAU2 Draft Decision.

This is the analysis undertaken by HoustonKemp.[11] The HoustonKemp report observed that Australian regulators have adopted distinct and diverse approaches to the calculation of the rate of return. This diversity of approaches highlights the discretion regulators necessarily apply when determining an allowed rate of return, including the WACC methodology they choose to apply, the estimation of market parameters and their assessment of the 'risk' of specific regulated businesses.

Queensland Rail strongly supported recent developments where the QCA has had regard to the alternative approaches to setting the rate of return adopted by other Australian regulators. That said, Queensland Rail notes that the QCA's treatment of other regulators' methodologies has concentrated on component parameters of the WACC rather than the overall rate of return. Given the importance of the rate of return Queensland Rail encourages the QCA to extend its analysis and to undertake a systematic examination of each regulator's whole methodology and to consider the three questions posited above.

[8] IPART, Rate of return and remaining mine life | Rail Access 2019-2024 | Final report, July 2019, p 7.
[9] Using the Conine formula and the QCA's values of a debt beta of 0.12 and gamma of 0.48.
[10] To ensure a comparable outcomes the application of alternative WACC methodologies should apply to the same time period assumed in DAU2 draft decision.
[11] HoustonKemp, *Approaches to the WACC for rail networks | A report for Queensland Rail*, 16 September 2019.

Queensland Rail considers the QCA's "bottom-up" WACC in the Draft Decision is insufficient to encourage efficient investment in rail infrastructure in the West Moreton system. This conclusion is supported by the HoustonKemp analysis that concluded:[12]

> *"… the choices made by the QCA's including:*
>
> - *the application of a WACC methodology that delivers below average rate of return, with the QCA's methodology delivering a WACC of 6.02 per cent while the average of other methodologies would result in a WACC of 6.40 per cent;*
> - *the adoption of the lowest compensation for systematic risk, compared to that determined by other regulators for similar rail networks, with the QCA delivering 148 basis points less compensation for risk compared to the average of other regulators;[13] and*
> - *the provision of the lowest overall rate of return and is 160 basis points less than the comparable average WACC allowed by other regulators for comparable rail networks.*
>
> *The QCA's position in the distribution of these WACCs indicates that its methodology yields a systematically lower rate of return relative to other regulators."*

A further signal that the QCA's "bottom-up" rate of return may not provide a sufficient rate of return is the apparent need to provide a margin above this "bottom-up" rate. Specifically, the Aurizon final decision provided a 25 basis point uplift on the QCA's "bottom-up" WACC.[14] An additional margin of 20 basis points was subsequently agreed between Aurizon and coal producers to apply from 3 May 2019.[15]

Queensland Rail notes that the uplift agreed by Aurizon with coal producers is larger than the apparent 20 basis points increase due to the substantial fall in the risk free rate. Queensland Rail calculates that the 5-year risk free rate for the 20 day period to 3 May 2019 was 1.39 per cent, a fall from the 1.90 per cent adopted under the QCA's "bottom-up" WACC. This suggests that the agreed uplift over the QCA's "bottom-up" WACC is in the order of 95 basis points.[16]

This agreement between Aurizon and coal producers highlights that commercial markets do not consider that the QCA's "bottom-up" WACC provides a return sufficient to encourage efficient investment in coal rail networks. Queensland Rail encourages the QCA to have regard to the analysis provided by Frontier and HoustonKemp in its assessment of the overall adequacy of the rate of return allowed in DAU2.

Queensland Rail will also provide the QCA with the data behind the HoustonKemp paper "Evaluation of inflation forecasting methods which was submitted with 'Queensland Rail's Response to industry comments on the QCA's Draft Decision on Queensland Rail's Draft Access Undertaking 2 (Collaborative Submissions) 27 September 2019' for evaluation by the QCA and its consultants.

Additionally, the loss capitalisation account represents a material risk for Queensland Rail and that risk is unlikely to be reflected in its rate of return. That is, if NAS3 does not receive approval Queensland Rail will not be able recover the outstanding balance in the loss capitalisation account and will be left with some stranded assets. The WACC applicable to the low tonnage scenario should be increased to recognise this.

[12] HoustonKemp, *Approaches to the WACC for rail networks | A report for Queensland Rail*, 16 September 2019, p 30.
[13] The average WACC using the QCA's methodology but the credit rating, gearing and beta determined by other regulators for similar rail networks is 7.50% compared to the QCA's Draft Decision for a WACC of 6.02%.
[14] QCA, *Decision | Aurizon Network's 2017 draft access undertaking*, December 2018, pp 73-74.
[15] QCA, *Decision | Aurizon Network's 2019 draft amending access undertaking*, November 2019, p 16.
[16] The initial 25 basis points plus the agreed 20 basis point further increase plus the fall in the risk free rate of 51 basis points.

5. 87 Train Path Constraint

5.1 TMR advice on 87 Train Path Constraint

In correspondence dated 24 April 2019 the Department of Transport and Main Roads (**TMR**) confirmed to the QCA that there is no 87 coal train path constraint (**87 Train Path Constraint**) through the Metropolitan System:

> *"During this period, TMR engaged with users and Queensland Rail to determine opportunities to add greater certainty to their investment planning necessary to underpin emerging increases in rail transport on the south-west and metropolitan Brisbane rail system. TMR was also cognisant throughout the period of the coal industry's opportunities to access additional ad hoc paths necessary to meet annual export targets.*
>
> *I am not aware of a specific date or visible marker of a change in TMR's position subsequent to 2015. However, I note in correspondence dated 23 December 2015, TMR formally recognised Queensland Rail's sole responsibility to determine the allocation of available train paths on the corridor while ensuring the continuing existence of 16 non-coal preserved freight train paths.*
>
> *TMR advice provided to Mr Sam Fisher, General Manager Marketing and Logistics (New Acland Coal Pty Ltd/New Hope Group) in a 12 November 2018 letter reaffirmed this position…"*[17]

5.2 Background of the 87 Train Path Constraint

The 87 Train Path Constraint is a largely misunderstood concept. There is a misconception that the 87 Train Path Constraint applied for a considerable period of time, and that it had a material impact on investment. This is not the case.

Queensland Rail seeks to extend existing coal contracts

On 22 February 2011, Queensland Rail wrote to TMR advising that as at November 2010 there were 87 return coal train services contracted through the Metropolitan System as set out in Table 1 below. The contracts for these services were due to expire between June 2012 and December 2014. TMR had previously confirmed that 62 of the return coal paths could be recontracted to 2024. Queensland Rail was seeking TMR endorsement to also extend the remaining 25 return coal train paths to 2024, with approval being provided by TMR in correspondence dated 8 July 2011.

The 87 return coal train paths through the Metropolitan System did not represent a 'constraint' at this time, but rather the 87 return coal train paths were equal to the then existing demand. Had there been greater demand Queensland Rail would have also sought endorsement to contract paths in addition to the 87 and would have expected that this endorsement would have been granted as there was available capacity in the Metropolitan and West Moreton System.

[17] Queensland Rail's Response to the QCA's Draft Decision on Queensland Rail's Draft Access Undertaking 2 (DAU2) 11 July 2019, p.2 and Attachment 1.

5.3 A 'Temporary Pause'

Subsequently, TMR put in place a 'temporary pause' (for a limited period) to contracting greater than 87 return coal train services through the Metropolitan System to provide TMR with an opportunity to engage "*with users and Queensland Rail to determine opportunities to add greater certainty to their investment planning necessary to underpin emerging increases in rail transport on the south-west and metropolitan Brisbane rail system*".[18] However, as identified by TMR this 'temporary pause' was lifted in 2015.

5.4 Industry investment decisions not affected

New Hope has asserted[19] that the 87 Train Path Constraint led to the coal companies restricting investment. The available evidence does not support this position.

While there was a temporary pause to contracting greater than 87 return coal train paths through the Metropolitan System, this did not affect the total number of coal trains that actually traversed the System as ad hoc train services ran in addition to contracted train services resulting in greater than 87 return coal train services travelling from the West Moreton System to the port.

Further, the behaviour of access holders does not support the notion that access holders were disadvantaged by the 87 Train Path Constraint. As stated earlier in this submission, the initial contracted 87 return coal train paths through the Metropolitan System outlined in Queensland Rail's correspondence to TMR dated 22 February 2011 did not represent a 'constraint' at that time, but rather was equal to the demand for contracted paths at the time. Additionally, Table 2 below demonstrates that contracted coal train paths were well below 87 return coal train paths between 2014 and 2018.

Queuing

Queensland Rail's treatment of access applications and queuing demonstrates that Queensland Rail and industry were operating in an environment where there was no 87 Train Path Constraint, with Queensland Rail being ready, willing and able to contract up to 97 return coal paths per week through the Metropolitan System (refer Attachment 1). Further, Queensland Rail reaffirmed to industry at its West Moreton System master planning forum on 12 December 2018 that there are 97 return coal paths available for contracting (refer attachment 2). In any event,

[18] TMR's correspondence to the QCA dated 24 April 2019.
[19] New Hope: Queensland Rail's 2020 Draft Access Undertaking: Initial Submission – Volume 1 Overview and Reference Tariffs, 17 October 2018 p.11.

Queensland Rail has not rejected any access applications based upon the 87 Train path Constraint.

New Hope

The 87 Train Path Constraint did not negatively impact New Hope's investment decisions. This is evidenced by New Hope's continued efforts to expand its coal railings through the development of NAS3, with New Hope stating through its Chairman's address to shareholders on 19 November 2019 that:

> *"The current plan is to ramp back up to circa 5 million tonnes of coal per annum quickly and then assess the timing for further increase up to the approved 7.5 million tonnes per annum."*[20]

This will result in there being in excess of 87 return coal train services through the Metropolitan System and demonstrates that New Hope's planning recognises an environment where there is no 87 Train Path Constraint and has done so since 2006 when it commenced the approval process for NAS3.

It has been the difficulty in obtaining the required environmental approvals for NAS3 that has affected and slowed investment by New Hope rather than any constraint on coal paths through the Metropolitan System. As highlighted above, New Hope first began the expansion approval process in 2006 and is yet to be granted the required approval.

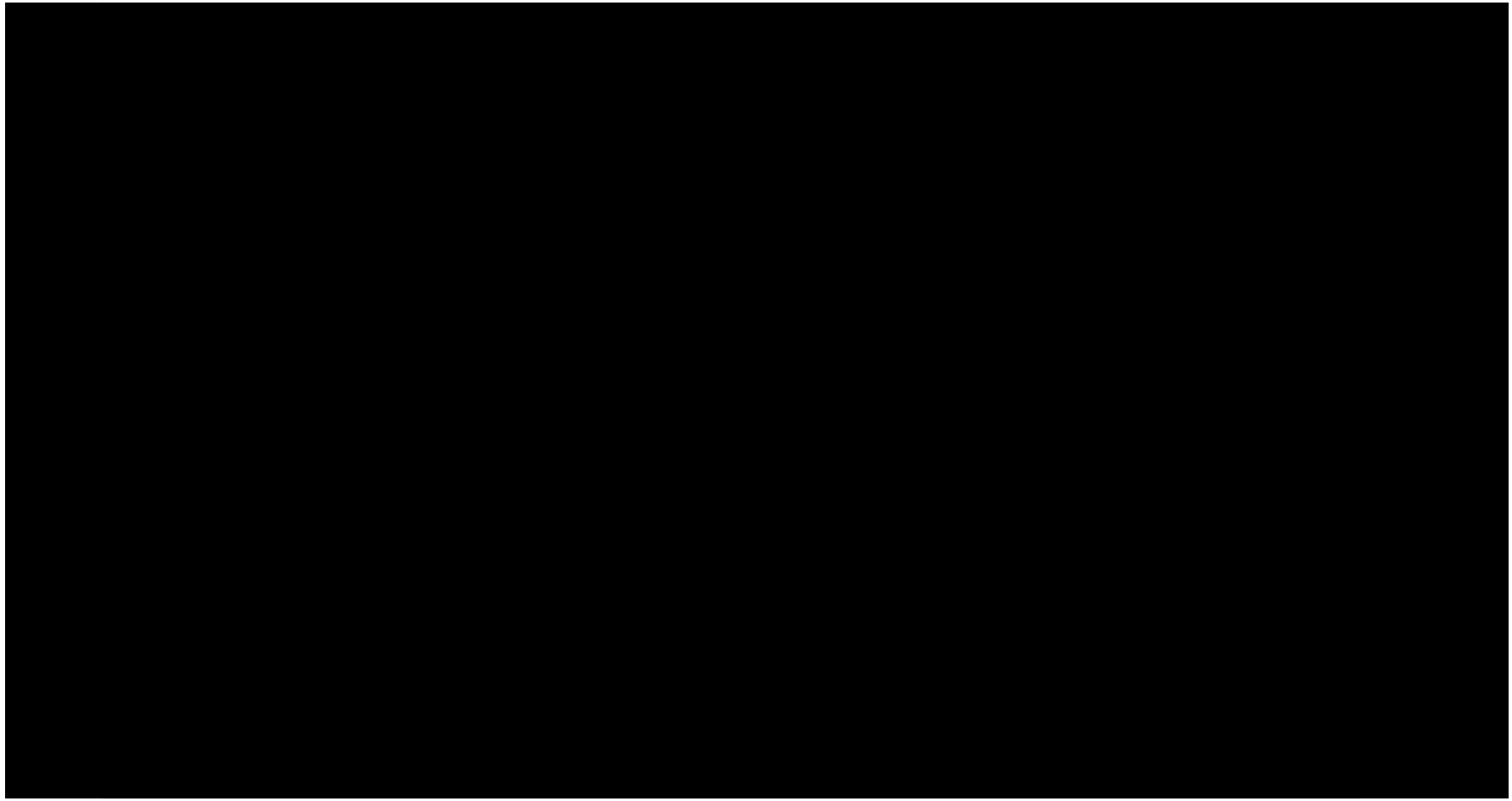
Yancoal

The 87 Train Path Constraint did not negatively impact Yancoal's investment decisions. Notably, Yancoal recently gained approval to expand its mine capacity from 2.8 mtpa ROM to 3.5 mtpa ROM, which once completed will result in Yancoal being able to increase railings from 2.1mtpa to 2.6 mtpa.

A key matter that must be taken into account in relation to expansion would be port capacity. The only coal terminal available for miners in the West Moreton region is the Queensland Bulk Handling (**QBH**) multi-user coal terminal at the Port of Brisbane. There are no alternative terminals available to the mines in the West Moreton region. QBH is wholly owned by New Hope.[21] Accordingly, QBH is a vertically integrated natural monopoly. The existing terminal is not subject to any form of access regulation. New Hope can therefore deny its competitors access to the terminal and/or materially increase prices for the use of the service. Such an ability and incentive to deny or restrict critical terminal access to its competitors creates a material risk and barrier to new projects in the West Moreton region coal tenements market. This combined with New Hope's own expansion plans and a current port capacity of 10mtpa would be a material factor in any decision by Yancoal to expand, rather than train paths through the Metropolitan System.

[20] https://www.asx.com.au/asx/statistics/announcements.do?by=asxCode&asxCode=nhc&timeframe=D&period=M
[21] Queensland Bulk Handling, *QBH Voluntary Access Undertaking* (accessed 15 April 2019) <http://www.qbh.com.au/files/files/QBH%20Voluntary%20Access%20Undertaking.pdf>.

Attachment 1: Aggregate Contracted and Access Application Capacity Requests by Year



Attachment 2: Slide from West Moreton System Master Planning Forum

Coal expansion options – infrastructure options 15.75TAL

Consist	Capacity Options
Current reference train 15.75 TAL	
2 x Locos + 41 x 63t Wagons (680m) Paths (Weekly Return) – 97 Annual Capacity – 9.5 mtpa No additional infrastructure	Additional 2 crossing loops on the range Benefit – 20 additional return paths per week Paths (Weekly Return) – 117 Annual Capacity – 11.5mtpa (2.0 mtpa additional)
Longer train 15.75 TAL	
3 x Locos + 63 63t Wagons (1030m) Paths (Weekly Return) – 97 Annual Capacity – 14.6 mtpa	Additional 2 crossing loops on the range Benefit – 20 additional return paths per week Paths (Weekly Return) – 117 Annual Capacity – 17.6mtpa (3.0 mtpa additional)