
Peabody Energy Australia Response to QCA Staff Paper

Declaration Review

30 May 2018

Contents

Page

1	Executive summary	2
	1.1 DBCT	2
	1.2 Aurizon - CQCEN	3
2	Background	4
	2.1 Peabody's Queensland mining operations	4
	2.2 Peabody's Queensland infrastructure arrangements	5
3	Declaration of DBCT	6
	3.1 Market definition	6
	3.2 Criterion (a) – promotion of competition	7
	3.3 Criterion (b) – natural monopoly	12
	3.4 Criterion (c) – economically significant	12
	3.5 Criterion (d) – public benefit	12
4	Declaration of Central Queensland Coal Network (CQCEN)	13
	4.1 Criterion (b)	13
	4.2 Criterion (a)	13
	4.3 Other criteria	14
5	Conclusion	14

1 Executive summary

- 1 Peabody Energy Australia (Peabody) welcomes this opportunity to respond to the QCA Staff Issues Paper (**Staff Paper**) in relation to its review of the declarations of the Dalrymple Bay Coal Terminal (**DBCT**) and the rail infrastructure of Aurizon Network and Queensland Rail.
- 2 Peabody has a longstanding commitment to the Queensland coal market and currently holds interests in five active coal mines in the Bowen Basin which together produced 15.5mtpa in 2017 (Table 1). Peabody also holds a range of other mining leases and mineral development licences in Queensland (Figure 1).
- 3 Peabody is a member of both the Queensland Resources Council (**QRC**) and the DBCT User Group and endorses and supports the detailed submissions made by both groups, in relation to the Central Queensland Coal Network (**CQCN**) and DBCT respectively. This brief submission is intended to supplement those submissions.

1.1 DBCT

Market and service definition

- 4 Peabody considers that the relevant market in relation to DBCT for which the declared service is provided is the market for the supply of Hay Point common user coal handling services.
- 5 As a wholly-owned and vertically-integrated terminal, the terminal operated by BHP in Hay Point is not a practical or commercially realistic substitute for DBCT. BHP does not have commercial incentive to make capacity available to third parties at its Hay Point facility, even if prices at DBCT were to increase, given the commercial value in the downstream seaborne coal market it derives from full control of the terminal.
- 6 There are a range of practical and commercial factors which also mean that other coal terminals (such as Abbot Point Coal Terminal (**APCT**) and the terminals in Gladstone) are not close substitutes for Peabody's mines.

Criterion (a)

- 7 Peabody considers that the correct formulation of the test to be applied under criterion (a) is that offered by the Tribunal in *Virgin Blue*, being:

In our view, we need to be satisfied that if the Airside Service is declared there would be a significant, finite probability that an enhanced environment for competition and greater opportunities for competitive behaviour – in a non-trivial sense – would arise in the dependent market.¹

- 8 Getting the test right is particularly important in this case because, unlike other declaration processes, this is not a case where the QCA is considering the likely impact of access regulation in relation to an unregulated facility. Rather, the QCA must test whether continuing the existing and longstanding regulatory framework that has operated for almost 20 years (and where multi-user access was provided by the State prior to that) would promote the competitive environment, compared with the competitive environment if regulation was removed.
- 9 Having regard to this context and test, Peabody submits that the relevant counterfactual exercise for the QCA to undertake in assessing criterion (a) is to:

¹ Virgin Blue Airlines Pty Limited [2005] ACompT 5, at [155]-[162]

- identify each related market;
 - make a judgement about the competitive environment in those markets, having particular regard to the extent to which the existing regulatory environment has contributed to that environment or those competitive conditions to date; and
 - make a comparison of competitive environment with the likely environment or conditions supporting competition in those markets if declaration was removed.
- 10 In applying this test, Peabody notes a range of important structural and behavioural features of the DBCT Undertaking which have promoted competition in these markets to date. These include:
- (a) tariff regulation applying an orthodox building block model;
 - (b) ring fencing and structural constraints on vertical integration by Brookfield/DBCT Management (**DBCTM**);
 - (c) controls that prevent operational discrimination through features such as an independent operator (and certain minimum terms governing operations), and QCA approved Terminal Regulations; and
 - (d) long term, transparent and stable (regulated) terms of access, with rights of renewal for users.

Peabody does not consider that these structural constraints on the market power of DBCTM would continue, absent declaration – including under any new commercial arrangements.

- 11 The regulatory certainty and market structure provided by declaration has improved the environment and competitive conditions in a number of related markets, including the rail haulage market, the market for tenements within the Hay Point catchment area, and the market for secondary capacity at DBCT. Peabody agrees with the DBCT User Group that the nature of the secondary market for capacity has a number of features that differ from the market for the service itself, and which mean that secondary capacity is not a close substitute and does not form part of the same market.

Criterion (b)

- 12 Peabody submits that the Harper Review amendments reflected in the amendments made to the QCA Act criteria have simplified the application of criterion (b). It is, and is intended to be, a relatively straightforward and mechanical application of the natural monopoly test – i.e. whether the existing facility (including as expanded) can meet all reasonably foreseeable demand over the period of declaration, at the lowest cost of production.
- 13 Peabody notes the extensive work done by PricewaterhouseCoopers (**PWC**) for the DBCT User Group, which demonstrates that DBCT is clearly a natural monopoly in the supply of the relevant service.

Other criteria – economic significance and public benefit

- 14 The history of DBCT as a regulated, multi-user coal terminal provides ample evidence of its economic importance to Queensland and the strong public interest associated with maintaining declaration.

1.2 Aurizon Network - CQCN

- 15 Peabody supports the detailed submission made by the QRC in support of the re-declaration of the CQCN.

Criterion (a)

- 16 Aurizon Network (**Aurizon**) has demonstrated that it is capable of exploiting its monopoly position in order to maximise its commercial interests, irrespective of the adverse consequences for customers and competitors. The recent approach of Aurizon seeking to impose inflexible maintenance practices in an effort to pressure industry and the QCA in an effort to achieve a better rate of return outcome in UT5 is a clear case in point.
- 17 Despite these tendencies, over the last decade, there has been evidence of dynamism and market entry in the Queensland rail coal haulage market, including by Pacific National (**PN**) and the self-supply of haulage by BHP (through BMA Rail). Looking forward, there is the prospect of growth by other rail haulage providers such as Genesee Wyoming Australia which has already secured a sizeable share of the Hunter Valley coal haulage market.
- 18 Despite Aurizon's attitude and approach, the market entry and expansion by PN and others can only reasonably be viewed as due to the effectiveness of declaration and oversight of the access regime by the QCA.
- 19 Given its vertical integration, absent declaration, Aurizon has both the strong incentive and ability to reverse these gains by restricting access and/or discriminating in favour of its own above rail operations. In light of the recent approach by Aurizon exploiting its monopoly position, even with declaration, its likely approach towards competitors absent regulation is a troubling prospect.

Other criteria

- 20 Peabody supports the QRC submission in seeking a minimum declaration period of 15 years, consistent with other rail declarations and certifications. Consistent with all multi-user railways, foreseeable demand over this period will be satisfied at lowest cost by expanding the CQCN. The economics of railway infrastructure let alone the appetite for creating new railway corridors (noting the objections to the proposed rail line to the Galilee Basin) makes this economic fact almost axiomatic.
- 21 While there may be a need for modest expansion of the CQCN over the next 15-20 years there is no viable likelihood of duplication (or provision of a commercially sensible alternative to the service at lower cost of production).
- 22 Peabody also supports the submissions and evidence provided by the QRC that demonstrate the economic significance of the CQCN and the strong public benefit in redeclaration, including because of the continued regulatory and investment certainty it provides for miners that have substantial fixed investments in the Queensland coal sector, such as Peabody.

2 Background

2.1 Peabody's Queensland mining operations

Peabody is the leading global pure-play coal company and a member of the Fortune 500, serving power and steel customers in more than 25 countries on six continents. The company offers significant scale, high-quality assets, and diversity in geography and products. Peabody is guided by seven core values: safety, customer focus, leadership, people, excellence, integrity and sustainability.

In Australia, Peabody is the fifth largest coal miner with operating assets in Queensland and New South Wales.

Peabody has a longstanding commitment to the Queensland coal market and currently holds interests in five active coal mines in the Bowen Basin which together produced 15.5mtpa in 2017 (Table 1).

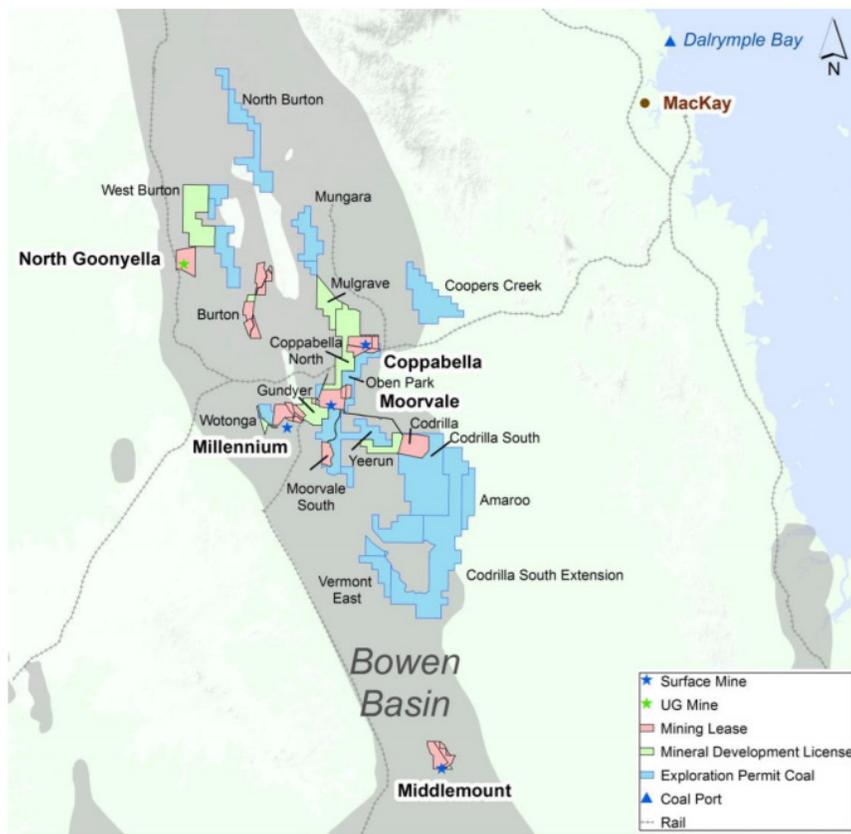
Peabody also holds a range of other mining leases and mineral development licenses in Queensland (Figure 1).

Table 1 – Peabody’s Queensland mines

Mine	Coal type	2017 output (mtpa) ²	Peabody interest
North Goonyella	Coking	3.4	100%
Millennium	Coking, PCI	3.3	100%
Coppabella	PCI	2.8	73%
Moorvale	PCI	1.8	73%
Middlemount	PCI	4.2	50%

Source: Peabody 2017 Annual report, www.peabodyenergy.com

Figure 1 – Peabody Queensland mining interests



Source: Peabody Investor Presentation, May 2018

2.2 Peabody’s Queensland infrastructure arrangements

Coal from Peabody’s Queensland mines has been almost exclusively focussed on the export market. As a result, reliable access to key export infrastructure at a predictable and reasonable cost has been

² This is the total output of the mine. PN holds a 50% stake in Middlemount.

a critical component of Peabody's decision to invest in our mines and development opportunities (including tenements).

Peabody's mines are all geographically proximate to the Dalrymple Bay coal terminal (**DBCT**) with Coppabella, Moorvale, North Goonyella and Millennium being designed to export their production out of DBCT and continue to do so.

Middlemount mine is the only one of Peabody's mines that primarily uses a port other than DBCT (with DBCT utilised for incremental capacity). At the time that Middlemount was commissioned, DBCT had capacity constraints. As a result, Middlemount entered into an arrangement to ship coal from Middlemount to the Abbot Point Coal Terminal (**APCT**), which is significantly further away than DBCT and substantially more expensive to access. The rail and port arrangements from Middlemount to APCT are materially more expensive to use than those port and rail arrangements for its other mines to DBCT.

Peabody's below-rail and port arrangements are underpinned by long-term, regulated take-or-pay agreements with Aurizon Network and DBCT Management Pty Ltd (**DBCTM**), respectively, with expiry dates in the early to mid-2020s.

Peabody has a long-term rail haulage agreement with each of Pacific National and Aurizon Operations, which are primarily based on using electric locomotives from its existing mines to DBCT over the Goonyella System.

3 Declaration of DBCT

Peabody agrees with and supports the arguments raised by the DBCT User Group in support of re-declaration of DBCT and considers that each of the four access criteria in section 76 of the *Queensland Competition Authority Act 1997* (Qld) are satisfied in respect of the declared service (the handling of coal at DBCT by the terminal operator).

Our reasons in support of this conclusion, including an explanation of how the relevant issues apply to Peabody, are summarised below. We refer the QCA to the DBCT User Group submission for more detail in relation to these arguments and supporting economic evidence in reports from PricewaterhouseCoopers and Castalia.

3.1 Market definition

Peabody considers that the relevant market in which the declared service is provided is the market for the supply of Hay Point common user coal handling services, in which the only existing supplier is DBCTM. This market definition is consistent with the findings of the ACCC in relation to its consideration of the proposed acquisition of Asciano by Brookfield, where it stated that one of the relevant markets in that assessment was the market for "*the supply of coal handling services at DBCT*".³

The market definition of the service is relevant to measuring the size of the foreseeable market in assessing criterion (b) and the nature of dependent markets in assessing criterion (a).

Peabody considers that it is appropriate to define a market for coal handling services in which DBCTM is the only supplier, because there would be significant commercial and operational difficulties which prevent alternative ports from being economic substitutes for Peabody's requirements, including:

³ ACCC, Statement of Issues - Brookfield consortium, proposed acquisition of Asciano Limited, 15 October 2015

- **Lack of available port and rail capacity.** As outlined in more detail in the DBCT User Group submission, there is a likely to be a lack of uncontracted capacity at each of the potential alternative ports. In addition, Peabody understands that the Goonyella to Abbott Point Expansion (GAPE) rail link, which is needed to access APCT, does not have any uncontracted capacity. Even if GAPE rail link capacity was available (from an existing GAPE Customer), Peabody is aware the terms of the unregulated GAPE below rail arrangements set out in the GAPE Deed are financially unsatisfactory. Indeed, the experience with funding of GAPE is a case study that highlights the long term negative impact of unregulated funding of rail network expansion by Aurizon Network.
- **Significantly higher port and rail costs.** Peabody estimates that the additional rail and port costs associated with shipping to ports other than DBCT from Peabody's current mines would be substantial. In its report in support of the DBCT User Group submission, PWC estimates that the costs for existing DBCT users to ship to the existing ports of RG Tanna, Abbot Point and Wiggins Island are in the order of \$15/t, \$18/t and \$30/t respectively, as compared to costs associated with DBCT of \$4.86/t. These estimates are in line with Peabody's experiences from operating in Queensland.
- **Below rail investment.** Peabody's current mines, predominantly export from DBCT, and the rail network linking these mines is set up to facilitate loaded trains exiting the mine site onto the rail network for delivery to DBCT. In order to facilitate delivery to an alternative port, Peabody would have to undertake additional investment at its mine sites to reconfigure the relevant parts of the rail network. Peabody has not undertaken a detailed study of such investment but estimates that it would be a material cost at each site.
- **Below rail network differences.** Peabody's existing contracts for haulage with Pacific National and Aurizon Operations are based on electric locomotives. However, in order to access APCT, Peabody would need to use track which is not electrified. Peabody expects that there would be substantial switching costs associated with moving to diesel locomotives and these would be passed on to it, by its haulage operator, in the form of higher haulage costs.
- **Co-shipping opportunities.** A natural advantage for coal producers using the Goonyella System to get their coal to a port is that due to the volume and diversity of coal that is shipped through DBCT, buyers of coal are able to pick up multiple different types and grades of coal for delivery on the same ship. This currently provides Peabody with an advantage in marketing its coal products to end user customers that would be lost in using alternative ports.
- **Take or pay contracts.** As noted above, Peabody acquires infrastructure under long-term take or pay arrangements, which have current expiry dates in the early to mid 2020s, which limits Peabody's ability to switch to using other ports without incurring significant break costs.

For these reasons, and the additional reasons outlined in the DBCT User Group submission, Peabody considers that services provided from alternative ports are not sufficiently close substitutes to those provided by DBCT to be considered as supplied in the same market.

3.2 Criterion (a) – promotion of competition

Peabody agrees with the QCA Staff paper that it is not necessary to demonstrate that competition will be enhanced by declaration, but only that there is a competitive environment and that the conditions for competition are enhanced, consistent with the approach of the Competition Tribunal in *Sydney International Airports*.⁴

In *Virgin Blue*, the Tribunal articulated the test as follows:

⁴ Sydney International Airport [2000] ACompT 1. Referred to in the QCA staff paper at page 18.

In our view, we need to be satisfied that if the Airside Service is declared there would be a significant, finite probability that an enhanced environment for competition and greater opportunities for competitive behaviour – in a non trivial sense – would arise in the dependent market.⁵

Peabody considers that this remains the correct formulation of the test to be applied under criterion (a), when the QCA is considering whether declaration has promoted (and will continue to promote) competition in related markets.

Ensuring clarity around this test is of particular importance in the present case because of the relatively unique question that is posed as part of the declaration review. Unlike most declaration processes, this is not a case where the QCA must consider under criterion (a) the likely impact of applying access regulation to an unregulated facility. Rather, the QCA must examine whether continuing the existing and longstanding regulatory framework that has operated for almost 20 years (and where multi-user access was provided by the State prior to that) would promote the competitive environment, compared with the competitive environment if regulation was removed.

With this perspective, Peabody submits that attention needs to be paid to the extent to which the regulatory framework has improved the conditions and environment for competition and investment in related markets, and tests whether that is likely to continue.

Peabody considers that the relevant counterfactual exercise that the QCA needs to undertake in assessing criterion (a) is to:

- 1 identify each related market;
- 2 make a judgement about the competitive environment in those markets, having particular regard to the extent to which the existing regulatory environment has contributed to that environment or those competitive conditions; and
- 3 make a comparison of the competitive environment with the likely environment or conditions supporting competition in those markets if declaration was removed.

If the comparison shows that removing declaration would be likely to materially and adversely impact upon the conditions for competition in those related markets, then declaration should be viewed as promoting competition under criterion (a) – which must therefore be viewed as satisfied.

In assessing the likely state of competition that would exist *with declaration*, Peabody agrees that the QCA can be readily informed by the existing state of competition in the related markets.

In assessing the counterfactual state of competition *without declaration*, the QCA agrees that the amendments introduced following the Harper Review focus attention on the likely nature and extent of access that would be likely to be provided by the owners of DBCT if it was unregulated. Clearly, in doing this, it is highly relevant for the QCA to consider the nature and extent of DBCT's market power in the relevant market.

Given the factors outlined in relation to market definition, above, DBCT should be regarded as a monopoly supplier in the relevant market. It will have a significant degree of market power and can be expected to, rationally, use that market power. The ways in which the owners of DBCT would have the ability and incentive to exercise market power are outlined in more detail by Castalia in a report provided in support of the DBCT User Group Submission, but in short it can be expected that removal of declaration would result in a substantial increase in port access prices. As explained by Castalia,

⁵ Virgin Blue Airlines Pty Limited [2005] ACompT 5, at [155]-[162]

this would have a distortionary effect in the market for the acquisition of tenement rights, as these costs would be borne to a greater extent by new access seekers.

There are a number of elements to the DBCT Undertaking that provide critical behavioural and structural constraints on the exercise of market power by DBCTM. The relevance and importance of these protections was specifically highlighted by the ACCC process in relation to Brookfield/Asciano.

These include:

(a) Tariffs are regulated based on an orthodox building block model (Schedule C).

Significant increases in access prices can be expected if declaration was removed.

It is self-evident that DBCTM would have both the incentive and ability to substantially increase prices, absent declaration. This has occurred before. The ACCC in 2016 identified the adverse impact that rolling back declaration had on pricing for major infrastructure. In its East Coast Gas Market Inquiry, the ACCC noted that there was evidence of gas pipelines exploiting market power to engage in monopoly pricing – and that this pricing has impacted the efficiency and operation of downstream markets. The ACCC found that this has occurred, in large part, because of the substantial removal of access regulation from pipelines over the last 20 years.⁶

The constraints placed upon monopoly pricing by DBCTM over the last two decades in Queensland has been a major contributor to the conditions and environment within which Peabody, and other producers, have invested in tenements, mine development and associated activities and markets such as rail haulage.

Direct regulation of tariffs is supported under the DBCT Undertaking by accounting separation, the requirement to maintain regulatory accounts and specific pricing objectives and principles (see clauses 10 and 11).

(b) DBCTM is prevented from vertically integrating into related markets, such as rail haulage or coal supply (e.g. ring fencing under clause 9 and the associated definition of ‘Supply Chain Business’)

If declaration is removed, there is a substantially greater likelihood of vertical integration by DBCTM.

In the absence of these structural constraints, DBCTM would have the ability and incentive to vertically integrate. The scope and attractiveness of this is obvious – as highlighted by the attempted acquisition of Asciano by Brookfield in 2015 as well as its integration into secondary capacity trading. The potential for such vertical integration, which would not be subject to any form of regulation by the QCA, creates a material risk of chilling competition in a number of related markets, including markets for the provision of rail services and the existing market for secondary capacity trading.

Peabody expects that it would be specifically affected by the likely additional integration into and controls over the secondary trading market that DBCTM could rationally expect to undertake. Peabody has been a frequent user of this market, having traded both short term and long term excess capacity of over 15 million tonnes of port loading capacity since 2015. Peabody would

⁶ ACCC, East Coast Gas Market Inquiry, Final Report at page 121. The ACCC found: “The gas access regime was implemented by state and territory governments almost 20 years ago. At the time the regime was implemented, with the exception of one or two smaller pipelines, all the transmission pipelines on the east coast were deemed to be covered and subject to economic regulation. Less than 20 per cent of transmission pipelines are now subject to any form of regulation.”

be very concerned at restrictions or additional costs being placed on its ability to trade in this market.

(c) *The DBCT Undertaking constrains operational discrimination through features such as an independent operator (and certain minimum terms governing operations), approved Terminal Regulations*

The DBCT Undertaking contains a number of vital structural protections that would be unlikely to continue if declaration was removed. This includes:

- a requirement that DBCTM maintain an independent, user-controlled operator for the Terminal under certain minimum terms (clause 3.2, Schedule I);
- operational arrangements will be governed by Terminal Regulations for which there is a specified process for consultation with users and approval by the QCA for variations (clause 6);
- management of requests for access are subject to non-discriminatory queuing principles and process (clauses 5 and 12);
- a specific process and rights for DBCT users to transfer capacity is regulated, and any involvement by DBCTM in secondary trades is limited (together with tight confidentiality constraints) (Schedule D);
- DBCT customers are provided with a transparent, predictable capacity master planning process and process requiring DBCTM to undertake and fund feasibility assessment for expansion (clause 15).

(d) *Terms of access are stable and transparent – with rights of renewal*

All DBCT users can have confidence in the non-discriminatory terms offered in respect of the terminal, including, in particular, rights of renewal, under the standard access agreement approved as part of the DBCT Undertaking.

This 'package' of features has provided a market structure that has contributed materially to the environment and conditions within which the coal industry in Queensland has grown and flourished over the last 20 years – including markets for coal tenements, rail haulage and the market for secondary terminal capacity.

Peabody considers that if declaration was removed, most (if not all) of the structural features would likely be lost. There is a real probability that this would materially and adversely impact the competitive environment in these related markets, which Peabody submits provides the basis for the QCA to find that criterion (a) is satisfied.

Peabody supports the submission of the DBCT User Group, that declaration of DBCT has promoted and will continue to promote competition in a number of related markets including rail haulage, the market for tenements in the Hay Point catchment area and the market for secondary DBCT capacity (which has a number of features that make it separate to, and not closely substitutable with, the service itself).

In relation to these markets, Peabody notes that:

- In relation to the coal haulage market: Peabody has directly benefited from the entry and operation of Pacific National (**PN**) in the Queensland market, and uses PN as a haulage provider to transport its coal to DBCT. Peabody notes that Brookfield (owner of DBCT) holds an interest in rail assets in Western Australia and has previously shown an interest in investing in Asciano. The structural protections against vertical integration provided by the Undertaking proved important in the context of the Brookfield bid for Asciano.

- In relation to the market for coal tenements in the Hay Point catchment area:
 - The market for tenements is distinct from the market for coal production and sale. The market is characterised by a large number of smaller players, producers and speculative investors that identify, develop and sell tenements to producers.
 - Peabody has been a prominent seller in the tenements market, and the majority of the tenements it has sold has been to smaller or new producers that may not have been able to purchase these tenements without the structural support provided by the Undertaking. The Undertaking provided a framework that ensured DBCTM (and Aurizon) would not be able to use their market power to expropriate the value of a small tenement if it was commercialised. Absent such regulation, the costs and risks around commercialisation of undeveloped tenements would be greatly increased and the number of interested buyers would likely be reduced along with the market value of those tenements (if the tenements were seen as being of commercial value at all).
 - A case in point is the sale of the Olive Downs South and Willunga projects by Peabody (and another) to Pembroke Resources in 2016. Pembroke Resources represented a new entrant to the market and one that may not have entered had there been an unstable and non-transparent access environment for critical infrastructure.
 - A key feature in developing tenements is not just the development of a new coal mining area but also as a means to extend mine life for existing mines. New tenements offer a producer a value-added proposition as well as greater scale through being able to run multiple operations within a single supply chain. Peabody is an example of a producer in the Goonyella system that has benefited from multiple operations across multiple tenements and that this has provided it with significant value in terms of scale, product choice for customers and substitution within a single area.

Finally, Peabody makes the following observations in relation to the relevance of existing contractual arrangements for the counterfactual (i.e. the world absent declaration):

- Peabody does not agree that the QCA should assume that the current terms of access will continue by virtue of the rolling rights of renewal that presently exist under the standard DBCT access agreements. While this may be the case, Peabody is conscious that this may not be the approach taken by DBCTM if unregulated. At most, the QCA should have regard to the current terms of access only for the remainder of their current terms.
- Second, and critically, most of the key structural protections above are provided by the DBCT Undertaking and not by access agreements. Those protections would be lost even if current access agreements continued for a period of time.
- Third, the terms of current access agreements evidently only benefit current customers and their existing production volumes. They would not benefit new access seekers or new volume requirements for current customers. However, for the purpose of applying criterion (a), the QCA should be focused primarily on the role that declaration has played in supporting investment and competition in related markets – which means in the development of new volumes. That is to say, the competitive benefit of reasonable terms of access is most relevant to how they provide confidence to participants looking at new contracts for new volumes, rather than maintaining existing terms for existing volumes.

Peabody also notes that the QCA should be mindful not to consider or accept contrived commercial arrangements sought to be put in place by DBCTM in order to construct a counterfactual if “reasonable” alternative terms that are transparently intended only to justify deregulation. Peabody notes that the ACCC has explicitly recognised this risk and that it will not consider such

counterfactuals when undertaking merger assessments⁷ and Peabody submits that the QCA should adopt a similarly critical approach in this case.

3.3 Criterion (b) – natural monopoly

Peabody considers that the approach to criterion (b) is relatively straightforward. The relevant facility is the DBCT, both as it is today and as it is reasonably possible to expand. Having identified the facility, including potential reasonable expansion options, the QCA must give regard to the available evidence about the likely costs of that facility meeting reasonable expectations of forecast demand, as opposed to having that demand met by other facilities.

Peabody considers that the expert economic report prepared by PWC, provided with the DBCT User Group submission, provides clear evidence which supports a conclusion that foreseeable demand is met at least cost by DBCT (incrementally expanded as required) rather than any combination of other greenfield or expanded brownfield coal terminals. The inputs into this analysis are consistent with Peabody's understanding of the relevant infrastructure costs and demand forecasts, and Peabody considers that the conclusions are robust, and capable of being relied on by the QCA.

As a result, Peabody considers that there are compelling reasons for the QCA to find that criterion (b) is satisfied.

3.4 Criterion (c) – economically significant

Peabody considers that there can be little debate that DBCT is economically significant having regard to its size and its importance to the Queensland economy.

DBCT is the largest coal terminal in Queensland, exporting 30% of coal produced by an industry that contributes over 10% of Queensland economic value add. The facility itself has a capacity of 85mtpa of coal per annum and employs, directly or indirectly, approximately 350 people as well as supporting thousands more jobs in the related coal industry.

Peabody strongly endorses the submissions of the DBCT User Group in relation to the satisfaction of this criterion.

3.5 Criterion (d) – public benefit

Peabody considers that there are clear and compelling public benefits in maintaining the existing declaration over DBCT. The Queensland coal industry, including Peabody, has made historical investment decisions on the expectation that DBCT would remain a regulated asset. Removal of declaration would result in a windfall gain to the owners of the asset, and have a chilling effect on future investment in the Queensland coal industry.

Removal of declaration would also remove a range of significant protections which have facilitated and supported historic investment in the Queensland coal supply chain. These protections include:

- a transparent vessel queue management system, providing all access holders (no matter what size) a fair and reasonable opportunity to obtain access to load their coal onto vessels at DBCT;
- standard reasonable terms and conditions (again which apply equally to all access holders);
- efficient pricing (rather than the monopoly and discriminatory pricing that DBCTM would otherwise be incentivised to apply);

⁷ See the ACCC 2008 Merger Guidelines at paragraph 3.19.

- a certain pricing methodology – such that there is long term certainty about how the pricing will be calculated;
- an evergreen renewal option which provides certainty that capacity will be available for the life of a mine;
- obligations to expand DBCT capacity where there is sufficient demand;
- ringfencing protections – designed to ensure that there is no favouritism of related parties or discrimination against non-related parties, thereby preserving competition in related markets;
- terminal regulations ensuring there is not operational discrimination

The effect of removing these protections would be to make future investment decisions less certain, less profitable and ultimately less likely. The expected outcome from this is a reduction in investment, which would have a flow-on effect throughout the Queensland economy, without any commensurate flow-on benefits to Queensland arising from increased profits earned by the owners of DBCT. Peabody considers that the current regulatory arrangements have been well suited to supporting investment in DBCT's capacity as has been required over time, and Peabody has no expectation that the owners would have an incentive to operate in a way that would be of any additional benefit to the industry if regulation was removed.

4 Declaration of Central Queensland Coal Network (CQCEN)

Peabody is a member of the Queensland Resources Council (**QRC**) and endorses the submission lodged by the QRC in relation to the re-declaration of the CQCEN.

Specifically, Peabody notes that:

4.1 Criterion (b)

The QRC has sought a minimum re-declaration period of 15 years, which is consistent with the periods of railway declarations and certifications under Part IIIA.⁸

Consistent with all multi-user railways, foreseeable demand over this period will be satisfied at lowest cost by expanding the CQCEN. The economics of railway infrastructure makes this economic fact almost self-evident. While there may be a need for modest expansion of the CQCEN over the next 15-20 years there is no viable likelihood of duplication (or provision of a commercially sensible alternative to the service at lower cost).

4.2 Criterion (a)

The same principled approach to criterion (a) discussed above in relation to DBCT also applies to assessing the criterion in respect of CQCEN.

In the case of the CQCEN, the critical importance of access regulation is particularly acute given the vertical integration of Aurizon. Absent declaration, Aurizon would have a strong incentive (and ability) to foreclose entry and/or discriminate in favour of its above rail operations over competitors. There are numerous examples of Aurizon using its monopoly position in a manner that damages related markets, including:

⁸ In the Pilbara, the Goldsworthy railway was declared for 20 years. The Tasmanian railway was declared for 10 years.

- The experience of Peabody (through its interest in Middlemount) and other users of the GAPE system in relation to the unregulated funding arrangements for the Northern Missing Link. The resulting commercial arrangements (under a series of 'GAPE Deeds') continue to be a source of high cost and disputes between Aurizon and industry.
- Similarly contentious negotiations over the funding of the WICET expansion, which ultimately led to litigation between Aurizon and the QCA.
- The very recent spectacle of Aurizon seeking to use inflexible maintenance practices to place pressure on the QCA and industry in an attempt to achieve higher rates of return.

Quite simply, Aurizon has demonstrated itself to be a monopolist that exploits its power at every opportunity in order to maximise its commercial position, often irrespective of the adverse consequences for customers or competitors.

Despite these tendencies, remarkably, the last decade has nonetheless provided evidence of market entry and growth in above rail competition in Queensland. Given Aurizon's attitude and approach, this can only reasonably be viewed as due to the effectiveness of declaration and the oversight of the access regime by the QCA. Over this period, PN has entered and grown in the Queensland coal haulage market. BHP has commenced the self-supply of rail haulage using BMA Rail. Looking forward, there is the prospect of entry by other providers such as Genesee Wyoming Australia. Peabody understands that Genesee and Wyoming Australia has already taken a sizeable share of the above rail market in the Hunter Valley over the last 2-3 years.

This continued dynamism and market involvement by alternative haulage providers is entirely dependent on the ring-fencing and non-discriminatory framework imposed on Aurizon through declaration and associated access undertakings and its active enforcement by the QCA.

For the same reasons as set out above in relation to DBCT, Peabody also submits that declaration of the CQCN is critically important in promoting the competitive environment for tenements in the Hay Point catchment area.

4.3 Other criteria

Peabody supports the submissions and evidence provided by the QRC that demonstrate the economic significance of the CQCN and the strong public benefit in re-declaration, including because of the continued regulatory and investment certainty it provides.

5 Conclusion

Peabody welcomes the opportunity to respond to the Staff Paper on the future declaration of services provided from these two important infrastructure assets:

- Peabody supports the submissions made by the DBCT User Group in relation to DBCT and the QRC Submission in relation to the CQCN;
- Peabody firmly believes that the criteria for declaration are satisfied in respect of DBCT and that declaration should continue for a further period. The prospect of DBCT being deregulated is a material risk to industry and would represent a substantial transfer of costs and economic value from a competitive coal industry to a monopoly service provider, a material decrease in competition for future tenement development and other related markets and a reduction in growth and employment for the state of Queensland.
- Peabody also believes that the criteria for declaration are satisfied with respect of the CQCN and that declaration should continue for a further period. The effect of removing regulatory oversight from a vertically-integrated service provider that owns a critical monopoly asset will have crippling and long-term effect on competition in the rail haulage market.

If you have any queries or issues relating to this submission, please contact Mark Smith (Director Infrastructure) on +61 7 3333 5628.