



Submission to the Queensland Competition Authority

Draft Amending Access Undertaking -
Goonyella to Abbot Point Reference Tariff

Anglo American Metallurgical Coal Pty Ltd

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Anglo American Metallurgical Coal Pty Ltd (**Anglo American**) welcomes the opportunity to make submissions to the Queensland Competition Authority (**QCA**) in respect of the Draft Amending Access Undertaking (**DAAU**) relating to the proposed Reference Tariff for the Goonyella to Abbot Point Expansion (**GAPE**) project submitted by QR Network Pty Ltd (**QRN**).

Terms which are capitalised in this submission that are not defined in this submission have the meaning given in QRN's 2010 Access Undertaking (**UT3**).

1. Executive Summary

In summary, Anglo American is of the view that:

- (a) QRN has adopted an incremental pricing approach which has the effect that the GAPE users pay all incremental costs associated with the enhancements that formed part of the GAPE project. Anglo American is supportive of this approach in respect of the GAPE infrastructure. However, Anglo American believes that the question of whether the capital costs of an extension or expansion should be 'socialised' or recovered via incremental pricing is an issue which should be dealt with on a case-by-case basis.
- (b) QRN should not be entitled to any additional fees or charges due to any potential asset stranding risk as this has been compensated for in the additional fees being paid by foundation customers.
- (c) Using a 'top down' approach to estimate the GAPE maintenance costs may not be accurate, as maintenance costs in respect of new infrastructure are generally significantly less than the maintenance costs involved in maintaining older infrastructure. However, there is insufficient information for Anglo American to determine whether the 'top down' approach and associated the Network Strategic Asset Plan Estimate approach used for estimating costs are appropriate in the circumstances.
- (d) In section 6.3 of the submission which accompanies the DAAU (**Submission**), QRN states that 'operating cost estimates attributable to the GAPE system are based on the GAPE operating cost forecast provided for the August 2009 Regional and System Wide Costs, and an additional Risk Premium allowance'. Anglo American understands that the additional Risk Premium allowance represents an allowance for insurance. However, there is no clarity in the quantum of this allowance nor how the self-insurance arrangements of QRN sit with the approach of QRN to passing-through costs associated with significant events, for example, the cost pass-through that QRN has applied for in respect of the Queensland floods. Anglo American requests the QCA to ensure that the insurance arrangements are appropriate and that there is no 'double-dipping', that is, that coal producers are paying insurance premiums and also having to pay under the cost pass-through for trigger events.
- (e) It is appropriate for the cost of electrification works to be borne by GAPE users. However, rather than recovering those costs via the AT3 tariff for GAPE users, Anglo American considers that the costs should be attributed to the Goonyella system and recovered via AT5. To compensate GAPE users should be

required to make a common cost contribution to the Goonyella system made by the GAPE users.

- (f) To the extent that QRN has not undertaken the Capacity Reviews required by clauses 11.1.4 and 11.3(c) of UT3, it should be required to do so. Any identified difference between Capacity and Committed Capacity should be addressed through QRN undertaking the necessary capital works at the approved weighted average cost of capital (**WACC**). Similarly, QRN should undertake any necessary capital works to return the Goonyella system to its Capacity prior to the connection of GAPE. This should also be done by QRN at the Approved WACC.
- (g) QRN's proposal to capitalise equity raising costs into the Regulatory Asset Base raises a number of complex issues. Anglo American believes that these issues should be left for consideration in the development of the access undertaking for the next regulatory period (**UT4**).
- (h) The Submission does not provide sufficient information for Anglo American to assess whether the proposal in respect of the inclusion of equity raising costs in the Regulated Asset Base (**RAB**) is appropriate. Accordingly, Anglo American supports the Submission of the QRC that the issue should be left for details of consideration during the development of UT4.

2. Transparency

The Submission does not contain sufficient detail to enable a full analysis of the implications of the DAAU for coal producers.

It is a fundamental principle of regulatory governance that the regulatory regime is transparent. As the QCA is aware, the commercial arrangements relating to GAPE are confidential and are intricately linked to the proposed DAAU.

Although the adoption of an incremental approach to pricing means that the costs are borne by the GAPE foundation customers and users of GAPE, it is not correct to say that non-GAPE users in the Goonyella system are not directly impacted by the DAAU. In fact, a non-GAPE user in the Goonyella system is impacted by a least the following:

- (a) the connection of GAPE has resulted in the degradation of capacity on the Goonyella system (see section 7 for further discussion); and
- (b) traffic using GAPE will not make a contribution to the common costs of the Goonyella system.

Therefore, Anglo American believes that it is unacceptable for the terms of confidential commercial arrangements to impact upon the regulatory regime and users of the regulated network without providing users with an ability to make submissions on those terms.

Anglo American believes that any terms and conditions that are sought by QRN in respect of expansions or extensions should be dealt with under UT3 through the process of the approval of Access Conditions. In circumstances where the foundation customers all agree to QRN's terms, then the QCA must approve those Access Conditions unless there is some disadvantage to future users. This process is a fair balance between allowing QRN being able to enter into commercial arrangements to receive a return which is higher than the approved WACC and protecting the interests of future users.

3. Pricing Principles

In respect of the GAPE infrastructure QRN has, essentially, adopted an incremental pricing approach which has the effect that the GAPE users pay all incremental costs associated with the enhancements that formed part of the GAPE project. Anglo American is supportive of this approach in respect of the GAPE infrastructure.

However, this is not consistent with the current approach adopted by the QCA in respect of the regulatory framework in UT3 nor is it consistent with the current proposal in respect of the Standard User Funding Agreement (**SUFA**). If the current approach to SUFA is maintained then there may be different approaches to pricing for different expansions and extensions.

Anglo American is of the view that the question of whether socialisation or incremental pricing approaches should be assessed on a case-by-case basis. For example, some enhancements which occur on the main lines of a central system may benefit all users either directly or indirectly through the reduction of congestion. On the other hand, there may be costs which are incurred which provide no benefit to current users, for example costs associated with a major extension to accommodate one or a small number of producers which does not benefit the current users, where socialisation may not be appropriate. In respect of the GAPE project Anglo American agrees with QRN that the incremental pricing approach should be adopted and notes that the GAPE project does not provide any benefits to existing Goonyella system users and, indeed, has a significantly detrimental effect on the current users as the impact of the connect of the GAPE assets has been to degrade the capacity on the Goonyella system.

QRN has stated that its proposal includes tariffs which are calculated on the Approved WACC of 9.96%, but that QRN is of the view that the GAPE system has a higher potential asset stranding risk such that QRN will need to 'develop appropriate principles to ensure current pricing and risk allocations reflect the consequences of the scenarios'. This seems to suggest that QRN may seek to impose a higher tariff on the GAPE infrastructure at some stage in the future. In Anglo American's view the 'GAPE Fee' which QRN has extracted from the foundation customers was supposed to represent any additional risk that QRN was taking on in constructing the GAPE project.

In circumstances where QRN has been adequately compensated for additional risks through the GAPE Fee, QRN should not be able to recover under UT3 a return in excess of the Approved WACC. This is particularly so in light of the fact that accelerated depreciation as approved in UT3 assists QRN in managing any asset stranding risk.

4. Maintenance

There is insufficient detail in the submission in respect of the estimates for maintenance costs for Anglo American to be able to provide detailed submissions on whether the total maintenance cost of \$14.94 million in financial year 2013 is correct or not.

As a general proposition, Anglo American queries whether the adoption of a "top down" approach is appropriate in circumstances where it is well established that maintenance costs in respect of new infrastructure is significantly less than the maintenance costs involved in maintaining older infrastructure. In addition, Anglo American considers that QRN has not provided sufficient information about the Network Strategic Asset Plan Estimate ('bottom-up approach') used to assess the robustness of the top-down estimate.

In particular, Anglo American notes the following issues:

- (a) it is unclear how QRN has approached the calculation of maintenance costs on a stand-alone basis;
- (b) the benchmarking to current UT3 maintenance costs does not take into account the fact that maintenance costs vary substantially through the lifecycle of railway assets; and
- (c) in respect of fixed costs, it is unclear whether an allocation has been made for assets such as track machines. It is also unclear how maintenance supervision has been treated. Anglo American would be concerned if there was any duplication of costs in circumstances where those assets could have been leveraged off existing assets.

Anglo American considers that QRN should be required to provide further details regarding the calculation of operating cost estimates so that users can make informed submissions on the reasonableness of QRN's calculations.

5. Operating Costs

In section 6.3 of the Submission, QRN states 'operating cost estimates attributable to the GAPE system are based on the GAPE operating cost forecast provided for the August 2009 Regional and System Wide Costs, and an additional Risk Premium allowance'. QRN further proposes that the Risk Premium allowance be calculated using the 'UT3 approved risk premium for Newlands' as a 'proxy'. Anglo American understands that the Risk Premium represents a self insurance premium charged by QRN. However, the details of the Risk Premium remain unclear and Anglo American is concerned that the imposition of the Risk Premium may not be justified. In particular, Anglo American notes the following issues:

- (a) UT3 does not contain an approved 'Risk Premium' or self insurance premium for the Newlands system, and therefore it is difficult to assess whether it is appropriate to use the Risk Premium for the Newlands system as a proxy;
- (b) it is unclear what events or amounts this Risk Premium / self insurance premium is intended to cover;
- (c) the Risk Premium may constitute "double dipping" where QRN is able to manage its risks by other means (for example, QRN recently applied to pass through to users the costs relating to the re-instatement of the rail network following the flooding in central Queensland in December 2010 and January 2011).

Accordingly, Anglo American considers that QRN should be required to clarify the purpose and scope of the proposed Risk Premium so that users can make informed submissions on its appropriateness.

6. Electrification Assets

In section 6.4.4 of the Submission, QRN has allocated the capital costs associated with enhancements within the Goonyella system to the GAPE Reference Tariff and has included electrification works for the additional passing loops in the Goonyella system to be recovered through the AT3 Tariff.

Anglo American is concerned that the recovery of capital expenditure relating to the electrification works via the AT3 Tariff may introduce unnecessary complexity into the operation of the Central Queensland Coal Region. Anglo American believes that, as a

general rule, the capital costs incurred for an Individual Coal System should be allocated to that Individual Coal System, and not redistributed to another Individual Coal System.

Anglo American supports QRN's proposal that the capital costs associated with electrification works in the Goonyella system be allocated to GAPE users. This approach is consistent with the principle that expanding customers pay the incremental costs. However, Anglo American does not believe that such costs should be recovered via the AT3 Tariff. Instead, Anglo American supports the QRC's proposal (outlined in its submission to the QCA on the GAPE DAAU) that:

- (a) the capital costs of electrification works be allocated to the Goonyella system; and
- (b) the GAPE users be required to make a common cost contribution to the Goonyella system (equal to the costs triggered by the electrification works).

7. Capacity

7.1 Impact of GAPE project on Capacity in the Goonyella system

Anglo American considers that the connection of GAPE has had a significant impact on the operation of the Dalrymple Bay Coal Terminal (*DBCT*) supply chain and, in particular, the connection has had a significant impact on the throughput of the DBCT/Goonyella system.

There has been a significant amount of modelling done by industry, through the Integrated Logistics Company Pty Ltd (*ILC*), and QRN itself which shows that the connection of GAPE will reduce the capacity of the DBCT/Goonyella system by approximately 6 to 8 Mtpa during periods of reasonable demand.

That work shows the following key data:

- (a) under the system assumptions that applied prior to the connection of GAPE and based on cargo assembly operation, the DBCT/Goonyella system can achieve somewhere between the ILC estimate of 77.8 and the QRN estimate of 84.6 Mtpa; and
- (b) After the connection of GAPE, the capacity of the DBCT/Goonyella system was projected to be between 72.1 and 76.4 Mtpa (a drop of 5.7 Mtpa under the ILC modelling and a drop of 8.4 Mtpa under the QRN modelling).

7.2 Requirement to conduct a Capacity Review

In accordance with clause 11.1.4 of UT3 QRN was obliged to conduct a review of Capacity and the difference between Capacity and Committed Capacity in respect of each Individual Coal System. That clause also provides that a Capacity Review must be undertaken whenever there is a Change in Existing Capacity. Clause 11.3 of UT3 provides that where Conditional Access Rights have been granted by QRN then, after the commissioning of the last relevant Infrastructure Enhancement, QRN is obliged to undertake an assessment of the change in Existing Capacity arising as a result of the Infrastructure Enhancements.

Anglo American understands that QRN has not undertaken the Capacity Reviews it was required to undertake in accordance with UT3. Anglo American believes that QRN should be required to comply with the requirements of UT3 and undertake a Capacity Review in relation to the Goonyella system.

7.3 Further Extensions to increase Capacity

Clause 7.5.4 of UT3 provides that QRN is obliged to undertake an Extension where, relevantly:

- (a) the Extension is needed to provide Conditional Access Holders with additional Access Rights equivalent to Access Rights reduced in accordance with clause 11.3 of UT3;
- (b) the Extension is needed to reduce a deficit between Capacity and Committed Capacity caused by a change in Supply Chain Operating Assumptions; or
- (c) the Extension is required to create sufficient Available Capacity to provide Access Rights in those circumstances set out in clause 7.5.4(a)(iv) of UT3.

Anglo American believes that, to the extent that a Capacity Review demonstrates that there has been a reduction in Capacity in the Goonyella system, QRN should be required to comply with the requirements of UT3 and to undertake any additional capital expenditure to ensure that Contracted Capacity can be delivered and that the reduction in Capacity of the Goonyella system as a result of the connection of the GAPE is addressed. This investment should be done at the approved WACC.

8. Equity raising costs

In section 10.3 of the Submission, QRN proposes that the Regulatory Asset Base be expanded to include any financing costs incurred by QRN in relation to seasoned equity offers.

Anglo American considers that the Submission contains insufficient information for users of the network to properly assess the merits of QRN's proposal. Accordingly, Anglo American supports the view of the QRC (as outlined in its submission to the QCA on the GAPE DAAU) that, due to the complexity of the issues involved, the question of capitalising equity raising costs into the Regulatory Asset Base should be left for consideration in the development of UT4.