Submission on QCA Draft Decision: QR's AU3 Access Undertaking

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1 Introduction

This submission is provided in response to the Queensland Competition Authority (***QCA***) Draft Decision in relation to Queensland Rail's (***QR***) 2025 draft access undertaking (***DAU3***) on behalf of Yancoal Australia Limited (***Yancoal***) in its capacity as operator of the Cameby Downs mine.

Yancoal notes the QCA's strong preference for consultation between QR and other stakeholders to reach resolution and present agreed variations to DAU3 for the QCA to consider.

In relation to the wording of the Standard Access Agreement and DAU3, Yancoal considers there is greater prospects of such consultation providing some degree of progress, such that we have intentionally limited our comments on those topics to provide room for such negotiations.

However, Yancoal continues to have deep concerns about QR's proposals in relation to the West Moreton tariff and does not consider that consultation will resolve the wide gap between the expectations of QR and all other stakeholders in relation to what is appropriate in that regard in the absence of further QCA guidance.

Yancoal considers an affordability based tariff is an absolute necessity for DAU3 to be appropriate, and there is a material risk that in the absence of being provided with certainty that will occur, Cameby Downs will consider ceasing operations and all related contracting of access when its current access agreement expires [redacted].

Accordingly, Yancoal requests that the QCA provide a draft decision or interim position paper indicating it considers an affordability tariff is required to be appropriate, so the parties' negotiations can quickly focus on how to assess and set the affordability level.

2 Context: Cameby Downs investment decisions and affordability

2.1 The need for an affordable tariff

Cameby Downs is a thermal coal mine located on QR's West Moreton rail system.

Over the long term it has been, and continues to be, a marginal operation, that is anticipated to be loss making at the tariff levels proposed by QR in respect of DAU3.

That is critical both for Cameby Downs and the future of the West Moreton system, because it is facing a clear decision point [redacted] as to the future of Cameby Downs. In particular the Cameby Downs access agreement and the Cameby Downs haulage agreement expire on [redacted]

Yancoal accordingly faces a clear choice imminently as to whether it:

(a) commits to significant capital and contractual take or pay commitments to continue mining, [redacted];

(b) closes the mine; or

(c) continues operating but with no long term fixed volume commitment so that it can cease production if the coal price continues at lower levels.

In that context, Yancoal is deeply concerned that:

(d) the reference tariff QR is proposing is at an unaffordable levels which will make Cameby Downs loss making even if the full 9.6 mtpa volume forecast eventuated;

(e) there are evident threats to that volume forecast (as recognised in the Draft Decision), including New Wilkie having ceased railing and being in administration and further legal challenges to New Acland's associated water licence, and at a lower volume a building blocks tariff will be completely unaffordable;

(f) QR is not deferring the capital expenditure pending resolution of this uncertainty, but intending to proceed with a significant capital expenditure such that if the tariff is calculated on a conventional building blocks basis, there will be a very significant increase from the current tariff based on the QCA's previous assessment of affordability and the risk that volumes fall after material capital expenditure has been incurred; and

(g) The coal price outlook is relatively subdued for the proposed term of DAU3 and significantly lower than some of the pricing which prevailed during the current undertaking.

2.2 QR's incentives

The Draft Decision suggests that QR is incentivised to negotiate a tariff with West Moreton producers that ensures it recovers at least its incremental costs (to ensure volume is retained that keeps the West Moreton system viable). While Yancoal understands that argument as a matter of economic theory – that has not been its practical experience of discussions with QR in relation to tariff matters in the West Moreton system.

Yancoal considers it is not safe to assume that QR will be incentivised to act as a private rail operator would in these circumstances, because:

(a) QR knows that the State is likely to continue the line operating for the passenger and non-coal freight that is dependent on the line even if it is loss making (noting that this is occurring in multiple other parts of QR's regional rail network);

(b) unlike some other infrastructure service providers that the QCA regulates, coal traffic is a small component of what QR provides access to – such that it is not well placed to assess what actually is affordable for the remaining coal producers; and

(c) QR's submissions to date in the DAU3 process, demonstrate a clear demand for a full return on and of capital, and full recovery of costs (including for matters that were not considered prudent by the QCA in the previous undertaking) when it knows about the affordability issues from the last undertaking process and the consultation before DAU3 was lodged.

In these circumstances it is appropriate for the QCA to approve a reference tariff that is capped at an affordability level.

Accordingly, Yancoal requests that the QCA proceed to provide a clear indicative decision on its views on the appropriateness of at least the principle of an affordability based tariff, such that parties' negotiations can start from that position and focus on resolving how the affordability point will be assessed and/or set.

Such a decision is needed in the near future, with further extensions and delay on this issue, potentially leaving Cameby Downs in a position where it has to make decisions on closure or ceasing long term contracting before the QCA process has provided any certainty as the likely outcome in terms of affordability.

2.3 Affordability for Cameby Downs

Where the QCA is minded to require an affordability tariff, Yancoal confirms that it would be willing to provide to the QCA on a confidential basis, information on the anticipated financial position of Cameby Downs (including projected coal prices and anticipated sales revenue).

3 Bottom-up estimate

3.1 Bottom-up estimate of appropriate tariff remains relevant

While Yancoal believes it is absolutely imperative that an affordability based cap on tariffs is adopted, it considers that making a bottom-up estimate of the appropriate tariff remains worthwhile because:

(a) submissions from other stakeholders concerning the Mt Isa line demonstrate the practical difficulties of assessing appropriateness of pricing when there is no ability to make a meaningful bottom-up estimate of the costs of providing access;

(b) Yancoal has not completely given up hope that if QR's proposed 9.6 mtpa did arise, an appropriately reduced WACC was determined by the QCA, and an appropriate Capital Indicator and efficient operating and maintenance costs was determined by the QCA, that a bottom-up estimate might ultimately end up below any affordability cap – even though that is not the current situation based on Yancoal's assessment of likely volumes, the Draft Decision and QR's submissions to date; and

(c) while Yancoal considers an affordability based cap is an absolute necessity for DAU3 to be appropriate, in-principle it accepts that it could be appropriate for that to be coupled with a loss capitalisation regime, which may require the continued assessment of the appropriate notional tariff if the affordability based cap did not apply.

3.2 Prudency of capital expenditure

Yancoal is concerned by the magnitude of the capital expenditure program, particularly where it is not required to expand capacity and is not producing a meaningful reduction in the operation and maintenance costs.

To date it has not been provided with sufficient information by QR to be able to assess prudency.

However, it notes the assessments in the Arcadis Report that suggests a significant proportion of the capital projects may not be prudent with Arcadis finding a prudent value, even assuming QR's 9.6 mtpa volume forecast, of $225.8m relative to QR's proposed $346.9m.

Yancoal also support the Arcadis suggestion that:

Queensland Rail revises its value framework in collaboration with users to adapt a more predictive, performance-oriented asset management approach that aligns with stakeholder needs in the current economic environment

To the extent that consultation does not ultimately result in an agreed position on the capital expenditure profile, Yancoal continues to consider it will be appropriate and necessary for the QCA to conduct a rigorous assessment of the prudency of QR's capital program, particularly in the context of the materially lower volume outlook than QR envisaged at the time of submitting DAU3.

3.3 Accelerated depreciation

Yancoal remains opposed to the proposed accelerated depreciation profile that the Draft Decision indicates the QCA considers it may be appropriate to accept.

If QR is concerned that its high capital program may have a significantly shorter economic life than its physical asset life, that should raise significant questions about why, despite that, the capital expenditure is prudent.

Where the answer to that question is that the existing assets are life expired, then the question becomes whether the existing material regulatory asset base can be appropriate where QR is now saying a significant portion of it is life expired, and therefore has no value.

Yancoal is also deeply concerned that accelerated depreciation can easily lead to an economic death spiral of the West Moreton coal producers, and as a result the West Moreton system itself. In particular, the removal of New Wilkie will cause a further accelerated depreciation based on QR's proposed methodology for determining economic life, and if either of the remaining coal mine customers was to close due to the rapidly escalating cost of rail access, it is difficult to see how the other customer could ever remain solvent for long enough to provide QR with the return on and of capital sought across only that customer's own tonnes and mine life.

3.4 Prudency of operating costs and maintenance

Again, Yancoal is concerned by the high levels of operating and maintenance costs, particularly where Yancoal considers there should be a lower volume outlook than QR envisaged at the time of submitting DAU3.

Again, to date Yancoal has not been provided with sufficient information by QR to be able to assess prudency.

However, it notes the assessments in the Arcadis Report that suggest a significant proportion of QR's proposed operating and maintenance costs are not prudent (with Arcadis' findings of $69.4 million of operating expenditure being prudent relative to QR's proposal of $85.3 million and Arcadis' findings of $128.0 million being prudent relative to QR's proposal of $173.1 million).

Where consultation does not result in an agreed position on the prudent and efficient level of operating and maintenance costs, Yancoal continues to consider it will be appropriate and necessary for the QCA to determine that.

3.5 Weighted average cost of capital

Yancoal is concerned with the QCA's conclusion, based on a top-down assessment, that a return of 7.39% is reasonable, despite finding a bottom-up estimate of the appropriate WACC was materially lower at 6.70%.

The comparators being relied upon for that top-down assessment are flawed where they are based on:

(a) arrangements that include an uplift agreed by industry where the resulting tariff is still affordable and the access provider made commitments to industry that QR does not provide (as is the case for the ARTC and Aurizon Network comparators); or

(b) are ERA decisions, for which the relevant ERA decision confirm the WACC assessment was based on international comparators due to lack of appropriate domestic comparators (suggesting the ERA did not consider the West Moreton system an appropriate comparator).

Yancoal also continues to consider that the QCA's bottom-up estimate of the weighted average cost of capital is itself overstated given that:

(c) it adopts the same equity beta as applied in respect of AU2, and has not justified why that remains appropriate where DAU3 sees to introduce new regulatory mitigants to stranding and volume risk, like the accelerated depreciation profile and volume trigger. Consequently, contrary to QR's claims, it is not facing the same volume uncertainty as in AU2, removing any justification for the 'top-down' uplift; and

(d) such an assessment gives insufficient weight to the electricity and water regulated assets that Yancoal considers are the most appropriate comparator; and

Yancoal also fails to understand how it is possible to determine, on any basis, that a very generous increase in WACC is appropriate in the absence of having settled positions on numerous other pricing related issues which should go directly to the extent of systematic risk that QR faces (after its regulatory and contractual framework is taken int account).

Accordingly, Yancoal submits that the assessment of an appropriate WACC should be reconsidered, informed by:

(e) an independent economic expert report on the appropriate WACC (as occurring in the previous undertaking process); and

(f) the ultimate systematic risk allocation that the regulatory arrangements for QR give rise to.

3.6 Volume forecast

Yancoal notes that the Draft Decision indicates that QR's volume forecast of 9.6 mtpa may not be appropriate.

Yancoal is certainly conscious (as referenced in the earlier discussion on affordability) that there currently appear to be volume challenges for the West Moreton system including New Wilkie ceasing railings and being in administration, and the ongoing legal challenges regarding New Hope's associated water licence (and the usual challenges that come with ramp-up of a new project). There may also be above rail constraints given the age of Aurizon's rolling stock utilised on the West Moreton system.

There is certainty sufficient uncertainty that QR should clearly be changing its capital program until it is definitely demonstrated that all the higher forecast volumes will eventuate during the term of DAU3.

Yancoal considers that where any realistic volume forecast is adopted it will become evident that a bottom-up tariff will be unaffordable and unsustainable, such that an affordability based cap is required.

Yancoal submits that it is appropriate for the volume forecast to be set at a realistic level, such that an appropriate assessment can be made of the capital expenditure program and operating and maintenance costs that are prudent and efficient at that level. As discussed further below, Yancoal considers there is merit in volume triggers for reassessment of the tariff, which would mean that if volumes did rise significantly above the initial forecast, that QR would be protected by having an avenue to have the appropriate costs and tariffs revisited.

4 Other Tariff Issues

4.1 Private Infrastructure

Yancoal strongly opposes the decision to increase tariffs further by effectively having Yancoal pay a contribution towards New Acland private infrastructure (by increasing tariffs to account for a return on and of such private capital expenditure which is then returned to New Hope through a rebate mechanism).

It appears from the Draft Decision that that position has been recommended by the QCA in the belief that that is justified to provide equity, on the basis that Cameby Downs is receiving a rebate arrangement.

Yancoal considers it necessary to restate why that is not an equitable result, in particular:

(a) the development of the Columboola spur and loop infrastructure was effectively funded by Yancoal's payment obligations under an Access Facilitation Deed with QR;

(b) while the Cameby Downs rail loop was previously included in the QR's regulatory asset base, since tariffs have been based on affordability, [redacted];

(c) the requirement for New Hope to build a *new* rail load out was, unlike the Aurizon Network example referenced by New Hope, not imposed by a decision by the rail infrastructure manager to cease funding mine-specific spurs and loop infrastructure, but rather a condition of its approvals that it develop a rail loop to address noise issues (associated with the use of a front loader at the previous loop). It is inappropriate for a producer (New Hope) to be cross-subsidised by other users (i.e. Yancoal) paying a higher tariff to provide a discount for costs the first producer incurs in meeting the conditions of their regulatory approvals (which will differ between projects); and

(d) the intent of the previous arrangements should not be overturned by unanticipated changes to the tariff structure. To do so now, creates windfall gains and losses where QR and Yancoal have made their funding and contracting decisions in respect of the Columboola loop, and New Hope has developed New Acland Stage 3, in both cases without any indication the treatment of private infrastructure would be altered as is now being considered.

Accordingly, Yancoal submits the equity argument does not justify the imposition of higher cost, particularly in the context of the affordability issues previously noted.

Yancoal also considers it is not an appropriate position to reach in the absence of any visibility of the magnitude of the capital expenditure involved and the likely impact on tariffs. Imposing some form of prudency assessment (as the Draft Decision suggests) does not resolve that issue where it may well be prudent from New Hope's perspective to develop the private infrastructure but it is not in any way prudent for the system to increase the charges further for other users given the likely dire consequences for the West Moreton system future volumes.

To the extent that equity was still seen as overriding consideration, Yancoal requests the QCA also consider the equity of the costs which Yancoal alone bore to keep the West Moreton system operating until other coal tonnes returned to the line.

If despite all of the above, the QCA ultimately decides that it should impose the position in the Draft Decision, it is critical that any addition to the tariff (and presumably therefore any rebate to New Hope) would need to not apply to the extent it would result in the tariff being above, or the building blocks calculation of the tariff is already above, the affordability cap.

4.2 Loss capitalisation

Yancoal notes that the Draft Decision seeks for QR and stakeholders to consult on the appropriate application of loss capitalisation.

The most important issue is an affordability cap on the reference tariff. Without that Cameby Downs is likely to shut and once volumes have fallen to New Acland alone it is difficult to see how there is any prospect of volume ever recovering to the point where loss capitalisation has any relevance.

However, where an affordability based tariff is implemented, Yancoal has no in-principle objection to a loss capitalisation approach which seeks to allow QR to recover such capitalised amounts where volumes increase and it becomes affordable to do so, provided that:

(a) there is a methodology for removing the balance of capitalised losses where volumes have not recovered sufficiently within a reasonable period (Yancoal notes the previous analysis that a large unrecovered balance can become counterproductive by providing a disincentive to future contracting decisions and the QCA's decision in respect of the current undertaking that capitalised losses which were unrecovered after 5 years would then be depreciated across a further 5 years); and

(b) the 'loss' which is capitalised is measured as the difference between an affordability tariff and a notional tariff justified by a bottom-up build up of efficient costs where the elements of the building blocks are each given appropriate regulatory scrutiny.

4.3 Volume triggers

In principle, Yancoal considers there is merit, in a time of some uncertainty regarding the likely volume forecasts, in having volume thresholds which if triggered require a reassessment of the tariff.

However, to be appropriate such volume triggers should:

(a) be balanced, and therefore bi-directional.(i.e. a trigger for both significant increases and significant decreases in volume);

(b) be able to apply on multiple occasions during the term (i.e. if there are successive increases or decreases);

(c) provide for the resulting tariff from any reassessment to be capped at the assessed affordability level for West Moreton coal producers; and

(d) expressly provide for a reassessment of the capital expenditure and operation and maintenance cost profile.

4.4 Capital expenditure true-up/reconciliation

Yancoal continues to support an annual reconciliation where prudent capital expenditure is compared to the approved Capital Indicator, so that any underspend results in a reduction of tariffs during this regulatory period rather than being delayed.

Yancoal acknowledges that where an affordability cap is in place (as Yancoal considers is an absolute necessity for the undertaking to be appropriate), an underspend of capital expenditure may still not reduce tariffs, but it would result in a lower capitalised loss, such that it continue to be appropriate in that scenario.

4.5 Two-part tariff

Yancoal supports the QCA's Draft to maintain a two-part tariff for the West Moreton system reference tariff, part fixed per train path and part variable with gtk. applying the 'distance taper'.

This is a longstanding feature of QR undertakings and has supported the efficient development of coal mines, and recognises that in granting access to a closer to port mine, has an inherent opportunity cost to QR (which is seeking sufficient revenue to cover access to the entire system).

This is also an important part of preserving affordability of the tariff for Cameby Downs, as if this long-standing position was reversed the proportion of QR's revenue requirement allocated to Cameby Downs would be materially increased, and it is likely that Cameby Downs will cease operating.

5 Non-Tariff Issues

As discussed in the introduction, Yancoal has limited its comments in this submission in respect of non-tariff issues with a view that it will seek to consult with QR on those issues in accordance with the QCA's preference.

Accordingly, given the limited opportunities that have occurred for consultation to date, Yancoal simply notes the following issues as ones it continues to be strongly supportive of DAU3 being adjusted to address:

(a) customer involvement in capital expenditure assessment (which the Draft Decision indicates may be appropriate) – including meaningful information provision to producers who could then work with QR to seek to agree an appropriate approach to material capital expenditure projects, and with the QCA assessment of prudency remaining as a back-stop;

(b) greater transparency of performance reporting, to assist in identifying root causes and thereby lead to more informed investment and operating decisions, including capital expenditure consultations;

(c) an independent capacity assessment of the network (which the Draft Decisions indicates may be appropriate and the Arcadis comments about the possible capacity issues also provide justification for); and

(d) evergreen renewal rights being provided to West Moreton coal producers – as the existing producers are underwriting the economic viability of the West Moreton system, the existing producers have made substantial capital investments in developing the relevant mine on the expectation of a return over the longer term which is dependent on continued access, and there is no evident demand for coal access to the system from other access seekers (so no material risk of such material rights foreclosing future access).

6 Conclusion

For the reasons set out in its initial submission and in the further analysis above, Yancoal submits that the QCA should refuse to approve the DAU3 in its currently proposed form, principally on the basis of the inappropriately high West Moreton network reference tariff sought.

Yancoal acknowledges that the QCA would like to see issues resolved through negotiations between QR, West Moreton producers such as Yancoal and other stakeholders, and intends to engage in such negotiations.

While there has been a very limited opportunity to consult prior to this submission, Yancoal believes it is possible that some of the drafting issues in the standard access agreement and DAU3 will be able to be resolved.

However, particularly in respect of the West Moreton tariff, the parties appear to be significantly apart.

Yancoal considers it is clear that the future of the West Moreton system depends on a more affordability based approach to pricing being implemented for AU3. Submissions indicate that position is held by both submitting producers and the sole haulage operator. Yet, contrary to the incentives the Draft Decision assumes QR has, QR continues to seek a full return on and of a high capital expenditure program and full recovery of high operating and maintenance costs (including elements previously determined not to be prudent).

Accordingly, Yancoal requests that the QCA proceed as soon as practicable to provide a clear indicative decision on its views on the appropriateness of at least the principle of an affordability based tariff. That way parties' negotiations can start from that position and focus on resolving how the affordability point will be assessed and/or set prior to Cameby Downs.

As always, please do not hesitate to contact Mike Dodd of Yancoal Australia Limited on [redacted] if you have any queries in relation to this submission.