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Mr John Hindmarsh
Chief Executive Officer
Queensland Competition Authority
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Dear Mr Hindmarsh

Yancoal's submission to the Queensland Competition Authority on Queensland Rail's 2015 Draft Access Undertaking including QCA's request for comments on QR's approach to the tariff from 1 July 2013

Thank you for the opportunity to provide a submission with regard to Queensland Rail's (QR's) 2015 Draft Access Undertaking (DAU). This matter is of vital concern to the viability and investment in Yancoal's Cameby Downs Mine.

Yancoal Australia is one of the largest independent coal producers in Australia and through its managed Cameby Downs Mine, located in Chinchilla, is one of the users of QR's Western System. Yancoal is always seeking to be a responsible miner, utilising the most technologically advanced mining methods to ensure maximum utility to its stakeholders and shareholders alike.

This letter provides Yancoal's submission concerning QR's 2015 DAU and the QCA's request for comments on QR's approach to the tariff from 1 July 2013.

QR 2015 Draft Access Undertaking Comments

1. Tariff Level and Competitiveness

Yancoal notes that QR has proposed an excessive regulatory asset base valuation, significant capital expenditure and very high maintenance and operating costs. Yancoal's main concern is that there is a significant disconnection between the competitiveness of the access pricing and the quality of service which imposes significant inefficiencies on above rail operators. Clause 69E of the QCA Act specifies the Object of Part 5 of the Act including …. "promoting effective competition in upstream and downstream markets". The current access charges and impact on above rail services does not, in our opinion, promote effective competition as our competitive position shifts significantly from low cost at mine to high cost on arrival at the port due to excessive and inefficient rail costs.

[redacted]

[redacted]

The Western System is a significant 'outlier' compared to other coal railways. The Western System has the combination of low axle load, low volumes, low speed and low train payload (because of train length and axle load restrictions). If the Western System had been built to a modern standard, its single line capacity would have accommodated at least seventy million tonnes per annum and possibly as high as one hundred million tonnes per annum. The maximum line capacity is, in effect, a small fraction of a modern standard. On that basis, there is an argument that the majority of the assets are significantly underutilized as the majority of the assets are the single line sections between passing loops.

On the North Coast Line where QR has similar train length restrictions, the track and bridges have been upgraded to 20 tonne axle load. In that case, the shortfall of revenue from access fees is made up from Government funding via a Transport Service Contract. It would seem somewhat selective that on one part of the network customers are expected to fully fund the network while on other parts of the network customers are deemed to have a lower capacity to pay and hence partially contribute to the cost of the infrastructure. It is also understood that other higher value commodities have lower access charges than coal.

Based on the proposed tariff, we estimate Cameby Downs' access charge will be approximately $11.60 per tonne. This is approximately 7 times the cost of access for the inner Hunter and 2-3 times Moura or Blackwater tariffs. There is also an above rail disadvantage with Western System payload only around one quarter of that of the Hunter Valley, Moura or Blackwater systems. This leads to the Western System customers having a significant competitive disadvantage with both higher below rail and above rail costs due to the inferior West Moreton service offering.

The PWC analysis paper, *Reference Tariff for the West Moreton Network,* is clearly designed to support QR's position as PWC's client. Yancoal has no objection to the concept that a reference tariff can be set below a ceiling. This will be consistent with other QR corridors such as the Mount Isa Line. Table 1 on page 12 of the PWC paper indicates a significant loss of non-coal services. After accounting for the Westlander passenger service, this suggests there is only one non-coal freight service per week. This significant loss of business leading to significant underutilisation of assets should not be compensated by coal.

Page 13 of the PWC document considers evidence of access agreements being renewed or signed validates the negotiate/arbitrate model. If access agreements were renewed or signed it would be on the understanding that the tariff would be ultimately approved by the QCA rather than an endorsement for QR access pricing.

2. Regulatory Asset Base

Yancoal supports the QCA's draft decision (October 2014) to not allow QR to earn a return on life expired assets. The UNIQUEST paper of 8 April 2015 supports this argument. QR's consultant PWC does not add any compelling arguments to justify QR's position. Table 1 of PWC's Asset Valuation of the West Moreton Network appears to be selective and reflect networks that are generally build to a more modern standard. Similarly references to Dalrymple Bay and Aurizon's coal network on page 11 ignore the relatively modern engineering standards of those assets and the significant scale economies associated with those assets.

There is significant subjectivity inherent in the 'DORC' method, particularly where standards are far from modern engineering equivalents. Yancoal could also argue that DORC does not fully consider the optimisation of the service including the impacts on above rail. We again reiterate that this is an extreme outlier system in terms of scale, standard and impact on above rail efficiency.

In addition Yancoal also has a significant concern that the value of the post 1995 assets does not reflect efficient planning and construction activities. The QCA's B&H report correctly points out that QR's infrastructure strategy has not been consistent with an outcome such as uniform twenty tonne axle load and that in some cases recently procured assets have been replaced prematurely. In addition, the use of QR workforce bound by restrictive work practices combined with inefficient possession planning is certain to have led to higher historic costs. Conservative asset strategies and absence of competition for construction and maintenance activities is likely to have led to higher cost infrastructure.
Yancoal seeks the support of the QCA to take account of QR's inability to have fully met prudency of scope, prudency of standard and prudency of cost for investments since 1995. There also appears to be no mechanism to provide incentives for QR to reduce costs or otherwise improve productivity as contained in the QCA Act pricing principles Section 168A (d).

3. Maintenance and Operating Costs

Yancoal is aware of a number of benchmarks publically available that suggest QR's maintenance costs per kilometre of track are very high. This would suggest that more significant maintenance and operating cost savings are possible with more efficient practices. QR is government owned and does not expose itself to competition to drive innovation and competitiveness.

Yancoal also argues that QR has over-recovered costs in the previous regulatory period and that there should be compensation for this excess access revenue in this regulatory period. Yancoal would appreciate the QCA seeking further independent review of these costs.

4. Capital Program and Asset Management Plan

Yancoal is pleased to note that QR has prepared an Asset Management Plan (2015/16). The Asset Management plan appears to be a work in progress and would benefit from:

- clear commercial context of the end customers including affordability. Currently the Asset Management Plan appears to be more of an engineer's 'wish list';
- clearly articulated asset strategy and link to customer economic benefits, e.g. marginal increase in axle load due to significant protection system investment or longer trains with selective loop extensions;
- demonstration of the optimal capital/maintenance trade-offs for an assumed demand (tonnage) level; and
- more specific detail of current asset deficiency e.g. specific location information for areas of deteriorating formation and are there less expensive options?

The graph on page 21 of the Asset Management Plan indicates the majority of expenditure in 2015/16 is for "growth". This appears to be inconsistent with other information indicating lower demand for paths.

The capital projects in Appendix 3 do not appear to deliver tangible benefits for Coal customers despite assertions that most of the works are for coal. Many of the estimates are not scoped in sufficient detail to give confidence that the scope is prudent and that the costs are efficient. The work on bridges on both up and down lines doesn't seem to fit with a coherent strategy, for example, it is possible to concentrate efforts on upgrading the loaded (down) track between Rosewood and Helidon? Yancoal suggests that the QCA obtain advice on the capital program including the 2013 to 2015 period which doesn't appear to have been scrutinised.

5. Access Agreement

Yancoal supports the concept of the tripartite agreement structure. There are a number of issues to be addressed which would enhance above rail competition including:

- the ability to engage more than one operator;
- access rights should be held by the customer (mining company); and
- access rights could not be terminated because of operator actions.

Yancoal considers risk should be borne by the party best equipped to manage the risk. The agreement appears to risk averse, e.g. passing the risk for assessing the network condition to the operator. Yancoal would appreciate the QCA considering the extent of risk faced by QR including minimum downside risk given take or pay.

6. General Comments

Yancoal considers that the QR 2015 Draft Access Undertaking should not be approved in its current form. The DAU does not give sufficient consideration to Section 138 (2) of the QCA Act. The DAU is unbalanced and provides too much emphasis to investment and QR's own interests. Yancoal has no objection to a longer term of the undertaking providing the QCA can request an amending undertaking if the undertaking has unexpected dysfunctional outcomes.

Among other things the undertaking could become more balanced if:

- QR's discretion was limited, e.g. extensions and user funding;
- a master planning process actively involving customers in the need for investment;
- more transparency, meaningful KPIs, better and more timely reporting, and the regular publication of Master Train Plans (like ARTC) were provided; and
- there was more transparency regarding the Transport Service Contract funding.

7. Joint Interests of QR and Western System Coal Companies Concerning Tariffs

There is an opportunity for a better outcome for all parties. If access was priced assuming higher scale economies, it would avoid the possible closure of Cameby Downs and lead to a more favourable case for expansion. Cameby Downs has expansion plans from 1.4 million to 4million and 8 million tonnes per annum which cannot be supported at current or proposed tariff levels.

Should another mine close, dividing QR's costs by fewer tonnes will continue the downward spiral leading to a worse outcome for all parties. Yancoal has other investment options within the Yancoal group so investment in Cameby Downs is conditional upon its competitiveness and ranking with alternative investments.

Should QR take a long term view and price at a level that assumes higher tonnage levels and scale economies, then there is a stronger chance that mines like Cameby Downs could expand. Pricing on the basis of scale economies in future would improve competitiveness with other systems and could facilitate investment and higher volumes.

QCA's Request for Comment on QR's Change in Position on the Tariff to apply from 1 July 2013

Question 1 – Expectation of an Adjustment
Yancoal expected an adjustment and was extremely surprised when it was reneged.

Question 2 – The Basis of Expectation and Reliance on that Expectation
Yancoal expected an adjustment based on past practice, statements made in the QR letters seeking extensions in May 2013, November 2013 and May 2014 and on the voluntary DAUs submitted by QR to replace the 2008 undertaking which provided for adjustments. Despite the 2008 Undertaking failing to deliver a robust methodology for the Western System Reference Tariff, Coal customers paid a 'true up' adjustment to QR. A 'true up' is neutral to both parties.

Question 3 – The Impact of QR's Position
There is a lack of regulatory certainty and a significant increase in sovereign risk in Queensland. It is also worth noting that the change in QR's position from its previous representations has caused Yancoal to be sceptical of many aspects of QR's Undertaking.

Question 4 – Stakeholder Considerations
The increased regulatory uncertainty and distrust in the commercial behaviour of QR (as a Queensland Government agency) is likely to lead to Yancoal's shareholders reassessing the risks associated with investing in Queensland and being a part of the Western System. This cannot be in the public interest.

Question 5 – Consequences of QR's Position
S 138(2) of the QCA Act provides that the QCA may only approve an undertaking if it considers it appropriate to do so having regard to a specified list of factors. Yancoal considers s138 (2) (d), s138 (2) (g) and s138 (2) (h) apply to the failure to backdate the reference tariff. It shifts the balance firmly towards the monopoly service provider who can delay the finalisation of its undertaking for the purposes of a windfall gain.

Summary

We urge the QCA to consider the holistic issues of competitiveness of the system including the cost impositions above rail and the significant economic impact on mine profitability.

Should QR's 2015 DAU as proposed be adopted, the viability of the Cameby Downs Mine would be in serious jeopardy. The operation requires assistance and cooperation from its external service providers to ensure all participants in the value chain can operate efficiently, sustainably and profitably, both now and in the future. The current QR proposal does not achieve this outcome.

Yours sincerely

Mike Dodd
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Yancoal Australia Ltd