YANCOAL AUSTRALIA LTD
OFFICE: Level 26, 363 George Street
Sydney NSW 2000
PHONE: +61 2 8583 5300
FAX: +61 2 8583 5399
EMAIL: info@yancoal.com.au
WEBSITE: www.yancoal.com.au
ABN 82 111 859 119

11 July 2014

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Dr Roberts

**RE: Queensland Competition Authority Consultation Paper on Queensland Rail's Western System Tariffs, June 2014**

Thank you for the opportunity to provide a further submission with regard to Queensland Rail's Western System Tariffs. I would like to acknowledge the thorough work undertaken by the QCA and their consultant B&H.

This letter provides Yancoal's response to the QCA Consultation Paper in the following sections.

**Tariff Level and competitiveness**

Yancoal's main concern is that there is a significant disconnection between the competiveness 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 rail costs. We have attached confidential information demonstrating the significant impact of rail costs on mine profitability.

The Western System is a significant 'outlier' compared to other coal railways. The Western System has the combination of low axle load, low volumes and low train payload (because of train length restrictions). If the Western System had been built to a modern standard, its single line capacity would have accommodated at least 70 million tonnes per annum and possibly as high as 100 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.

**Regulatory Asset Base**

Yancoal does appreciate the QCA's consideration of historic cost roll forward for the post 1995 assets. Yancoal considers the historic cost approach is consistent with the intent of Section 168A (a) of the QCA Act in the context that QR should earn a return reflective of the risk of coal specific rail investment. It avoids much of the subjectivity inherent in the 'DORC' method. Indeed Yancoal could 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.

While Yancoal supports historic cost roll forward of the post 1995 assets as a sensible and transparent way forward, there is a significant concern that the value of the post 1995 assets does not reflect efficient planning and construction activities. The B&H report correctly points out that QR's infrastructure strategy has not been consistent with an outcome such as uniform 20 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 adjust the value of the historic cost downwards on the basis that QR could not have fully met prudency of scope, prudency of standard and prudency of cost for investments since1995. There also appears to be no mechanism to provide incentive for QR to reduce costs or otherwise improve productivity as contained in the QCA Act pricing principles Section 168A (d).

**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 to eight million tonnes per annum which cannot be supported at current 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 could expand.  Cameby's expansion plans are from 1.4 to 8 million tonnes per annum.  Pricing on the basis of scale economies in future would improve competiveness with other systems and could facilitate investment and higher volumes.

It is acknowledged that QR would need to price below current levels impacting on its' short term returns. However, lower access pricing does reduce the likelihood of further mine closures.

**Costs and Returns**

Yancoal considers that the QCA (supported by the B&H report) have objectively assessed maintenance and operating costs.  However, Yancoal is of the view 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 did not previously comment on the WACC proposed by QR.   On reflection, QR is not exposed to significant risk within a regulatory period due to take or pay contracts and the ability to earn higher returns if actual volumes exceed forecast volumes.  One could argue it is all upside risk.  This seems very favourable compared to likely more risky benchmarks used to determine the risk premium.

Yancoal would appreciate the QCA considering the extent of risk faced by QR in the context of their risk avoiding access agreements.

**Suburban System Asset Base**

The suburban system is configured for passenger train operation. Coal and freight services are marginal and lower priority users of the system.

Extending the Western System tariff across the suburban system is understandable but considered heavy handed given there is very limited coal specific infrastructure in that system.

We ask that the QCA consider the possible future split of assets between ARTC and Queensland Rail and separate the asset bases now to avoid future problems.

**Summary**

Yancoal appreciates the extent of consideration of the Western System tariff by the QCA. The QCA's alternative historic cost roll forward approach is constructive and appreciated.

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.

Yours Sincerely,

[redacted]

Mike Dodd

General Manager Infrastructure

Yancoal Australia Limited

[redacted]