



26 October 2012

Mr John Hall

Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

By Email: To: rail@qca.org.au

Dear Mr Hall,

Draft Amending Access Undertaking – Goonyella to Abbot Point Reference Tariff

I refer to the QCA's invitation to provide submissions regarding QR Network Pty Ltd's (**QR Network**) Reference Tariff for the GAPE system Draft Amending Access Undertaking (**DAAU**) dated 5 September 2012. Vale Australia Pty Ltd (**Vale**) appreciates the opportunity to provide this submission as part of the consultation process.

Capitalised terms in this letter have the meaning given in the 2010 Access Undertaking (**Undertaking**) unless otherwise defined.

Vale commenced coal operations in Queensland in 2007 through the acquisition of certain coal interests of AMCI. These coal interests included two operating mines that utilise the Goonyella rail system to transport coal to export through the Dalrymple Bay Coal Terminal. Vale has a large pipeline of future coal projects throughout the state and wants the Undertaking to develop in a way that maintains a clear framework for allocation of economic benefit for future expansions of the Central Queensland Coal Region (**CQCR**) to provide certainty in the future logistics costs. This certainty regarding logistics costs is an important consideration regarding Vale's future projects.

Background

The CQCR has generally been considered four separate systems being the Newlands and Goonyella systems in the north and Blackwater and Moura systems in the south. This separation has resulted from the geographic location and the limited cross system traffic that operates between each system and has allowed a clear framework for the allocation of economic benefits and cost reflective tariffs.

The two systems affected by QR Network's proposal are the Newlands and Goonyella Systems located in the Northern Bowen Basin. The Goonyella System is an electrified system that predominately transports coal to the Port of Hay Point, whilst the Newlands System transports coal to the Port of Abbot Point via a diesel traction system. These systems were physically separated as there was no rail infrastructure connection between Newlands on the Newlands System and North Goonyella on the Goonyella System. The missing rail infrastructure connection was commonly referred to as the Northern Missing Link (**NML**) and the construction of this rail infrastructure and the connection of the two northern systems was completed as part of the Goonyella to Abbot Point Rail Expansion (**GAPE**).

The GAPE project was commenced to provide rail capacity to the proposed expansion of the Abbot Point Coal Terminal. The original design of the GAPE project contemplated a fully duplicated electrified rail line from North Goonyella to the Abbot Point Coal Terminal but due to various factors the original interest from Access Seekers declined and after significant negotiations between the remaining Access Seekers and QR Network they agreed to a reduced scope to optimise the capital required for this expansion.

Prior to GAPE project the Newlands System had a Reference Train Service using diesel traction with a maximum length of 1380 metres and a maximum axle load of 20 tonnes. The Goonyella System operates on the basis of an electrified rail corridor with a Reference Train Service of a maximum length of 2082 metres with 26.5t axle loads. With the development of the GAPE project QR Network have proposed the Reference Train Service for Newlands be increased to a maximum length of 1402 Metres and a maximum axle load of 26.5 tonnes. No adjustment is required to the proposed Reference Train Service for Goonyella as it already exceeds the requirements of the proposed Reference Train Service for the GAPE System.

QR Network's proposal for the development of a tariff for this project is to not just provide a new Reference Tariff but rather establish a new coal system. The new GAPE System will be used to capture all the incremental capital and operating costs associated with the Rail Infrastructure from the GAPE customer mines to the Port of Abbot Point. Due to the desire to create a new system QR Network is submitting the GAPE Reference Tariff as a DAAU and not in accordance with the existing requirements of Clause 6.4.2 of the Undertaking.

Vale has assessed the QR Network submission and outlines below its views for consideration by the QCA when assessing the GAPE Reference Tariff DAAU.

1. Separate GAPE System

The GAPE project was commenced to provide rail capacity to match the proposed expansion of the Abbot Point Coal Terminal to 50Mtpa, with the GAPE project itself being contracted to a capacity of 33Mtpa. To enable this QR Network has completed upgrades on the existing Newlands and Goonyella Systems and the construction of a 69Km Greenfield rail line connecting these two systems. Vale assumes, based on the Capital Expenditure Allocation presented in Figure 6 of the explanatory notes, that approximately 24Mtpa of the new capacity has been created for Access Seekers originating in the Goonyella System.

Vale notes that this Expansion was developed via commercial negotiations and not through the existing Coal Rail Infrastructure Master Planning (CRIMP) process. Vale is not aware of the terms and conditions or any tradeoffs agreed by the parties during this commercial approach so can only assess the proposal in relation to the existing Undertaking. As QR Network have not expressly outlined the benefits of establishing a separate coal system, Vale assumes that the commercial decisions made during the negotiations are driving the behaviour of QR Network to establish a new coal system.

The proposal to create a separate coal system moves away from the historical geographic allocation of a system and will result in a Train Service effectively traversing three Systems to travel from the Goonyella System to the Abbot Point Coal Terminal. It appears to Vale that the only reason for the establishment of a new system is to create a GAPE Tariff separate from the provisions of section 6.4.2 and Schedule F of the Undertaking. This appears to allow QR Network to choose which tariff principles and methodologies it would like to apply in developing the GAPE tariff. QR Network have noted in the explanatory notes that QR Network proposes that the GAPE tariff would not be considered under section 4.1.2 of Schedule F on Cross System Train Services.

As the planning and development of this project was conducted only with the proposed Access Seekers, with limited, if any, involvement of other Stakeholders the principle of allocating Incremental Costs is appropriate to reflect a "user pays" approach to cost allocation. However, Vale believes in minimising the Capital Expenditure on the GAPE rail line it has become

intrinsically linked to both the Goonyella and Newlands Systems and in effect is not a traditional standalone operating system which is likely to pose many difficult questions when trying to establish a future “user pays” approach. For example in the Goonyella System only two minor Extensions were completed which on their own does not provide enough physical track to connect to the NML. Therefore GAPE Access Holders will be reliant on the existing Rail Infrastructure in the Goonyella System to transport coal to the Port of Abbot Point. Vale believes this raises some issues on how the future pricing, operation of the system, and the interaction with the two other northern systems will be determined due to the strong interdependency on these existing systems.

The difficulty of separating the systems is apparent in the proposed drafting amendments in section 9 of the Undertaking on reporting. Under this section QR Network is proposing to not separately report on the GAPE System and include the NML within the Newlands reporting. This is likely to highlight future allocation issues for the development of items such as any future draft incentive mechanisms, master planning processes and general accountability for Capacity and costs.

2. Utilisation of Goonyella Capacity

The Goonyella System has been developed over many years with a contracted capacity of approximately 140Mtpa. Generally this Capacity refers to the constrained section of the system between Coppabella and the Port of Hay Point. The branch lines feeding the mainline generally have latent Capacity to allow the mainline Capacity to be optimised. However, the capital costs creating this latent Capacity, is still included in the system RAB, and therefore, forms part of the tariff paid by the Access Holders. Vale believes that this latent Capacity is inherent in the RAB and effectively part of the tariff paid by Goonyella users.

The ILC modelling, which has been generally agreed by stakeholders in the Goonyella System, has identified that the GAPE system will reduce the Capacity available to Goonyella users. Vale believes that, if a GAPE System is established, this utilisation of the existing Goonyella System should be reflected in any proposed separate coal system. This situation will be compounded when Goonyella users wish to increase Capacity as it is likely that they will be required to construct more Rail Infrastructure, to replace the Capacity that will be utilised by the GAPE users, to create that Capacity and will effectively have to pay for this Capacity twice. Vale believes the current proposal for the GAPE Tariff does not recognise and value the Capacity that GAPE Train Services will utilise.

3. Contribution to Common Costs

The effect of the GAPE project on the two northern systems will be different due to the current configuration of each of the systems. The Goonyella System already is a highly developed electrified system with Capacity for approximately 140Mtpa to travel to the port of Hay Point. The Newlands System is not electrified and had an existing capacity of approximately 25Mtpa prior to GAPE. The Goonyella System Reference Train Service is already of a higher standard than that being proposed by the GAPE System and required very minimal upgrades for increased Capacity whereas the Newlands System required significant upgrades to allow for the larger Reference Train Service and increased Capacity. Vale assumes the proposal to establish a GAPE System, and therefore a new GAPE tariff is important to existing Newlands users due to the significant affect the Capital Expenditure would have on their tariff if it was included in the Newlands RAB. Vale believes the purpose of this is to ensure that the existing Newlands users maintain the same position as they were before the project commenced.

This situation is opposite in the Goonyella system where the proposed GAPE Reference Train Service is smaller and the capital Expansions are only minor. QR Network has outlined that one of the key objectives in the negotiation with coal customers was the minimisation of capital and operating costs. QR Network have stated, on page 7 of the explanatory notes, that they traded off capital costs with rolling stock configurations and operational parameters to minimise overall infrastructure required, whilst providing the most cost effective above rail solution. Therefore,

Vale believes, this implies that trains operating on this system are dependent on the existing infrastructure and Capacity for the operation of GAPE Train Services. Vale would argue the value of this dependency should be included as part of a contribution of common costs to reflect QR Network's proposal of a standalone system. Vale believes the GAPE project is likely to have a negative impact on the Goonyella System as the GAPE users will be using shorter trains than the Goonyella Reference Train Service and based on Capacity modelling completed by the ILC. Vale would argue that unlike the situation in the Newlands System where QR Network are leaving users in the same position, Goonyella users would be left in a worse position. Vale believes the result of this is likely to cause a reduction in the competitiveness of existing and future users of the Goonyella System due to a loss of Capacity and no subsequent reflection of this cost in the GAPE tariff.

QR Network has stated on page 25 of the explanatory notes that it does not believe the GAPE users pay for any Common Costs of either Goonyella or Newlands System as the existing tariff is already more expensive than the tariff on these two systems. Vale believes this appears to be contradictory to the remainder of the submission which does not consider if the tariff is too high but rather does it reflect a "user pays" approach. Vale believes the level of tariff in relation to other systems should not be relevant in the consideration of whether there should be a contribution to Common Costs but rather it should be based on the cost impact that the additional Train Services have on the existing systems to ensure it is cost reflective and maintains a "user pays" principle. Vale notes that in a similar situation of setting tariffs for the Indicative Access Service in the Hunter Valley the ACCC in its decision paper, (dated 17 October 2012, page 3), stated that "if producers were paying supply chain costs that did not accurately reflect the consumption of capacity by that producer, competition in the export of coal may be distorted". Further to this the ACCC noted that whilst this answer may contribute to a higher supply chain cost for some producers in the short term, to not do this would have a distortionary effect on competition in related markets. The upgrades to the Goonyella System were minimal which, Vale believes, implies that Capacity from the Goonyella System is being transferred to the GAPE users and therefore a reflection of this value should be allocated to the GAPE tariff if QR Network is proposing a standalone system.

4. Consistency in approach to tariff determination

Vale believes that some of the approaches that QR Network is proposing for the GAPE tariff application appears to be inconsistent with the approach they are proposing to take in the proposal for the Electric Traction Service DAAU (ETS) for the Blackwater System. The ETS amendment by QR Network is looking to find a solution to the increasing cost of the electric tariff for the Blackwater System due to the upgrade of the electric assets.

The GAPE tariff is proposed to be capped with lost revenue to be capitalised and recovered at a later date when the system allows via increased tonnes. Vale believes this approach could be considered further in the ETS discussion as a possible solution to encourage electric traction utilisation in the short term

One of the arguments put forward as a concern by QR Network in the ETS discussion is the potential increase in diesel traction in the Goonyella System. Vale notes that the commercial outcome that was agreed with QR Network on the GAPE project is likely to facilitate this opportunity. QR Network has agreed to not only allow further diesel traction utilisation on the Goonyella System but also for smaller Train Services to operate. Vale notes that the Arup submission that has been provided to the QCA as part the ETS consultation process on its draft decision indicates that in general terms a system's Total Cost of Ownership model considers that a system should be electrified when the tonnage hauled is between 12 and 37.5Mtpa. Given that approximately 24Mtpa appears to be contracted from the Goonyella System and 50Mtpa is contracted from Newlands to the Port of Hay Point, Vale believes this implies that, this rail line should be electrified as per the Total Cost of Ownership model. To avoid a future claim for socialisation of electrical assets, Vale believes it is important to clearly identify at this point that the decision to not electrify is based on a desire to minimise capital costs and does not generate any advantage to Goonyella users.

Vale also notes that QR Network is concerned in the Blackwater System about the additional cost and time of running diesel traction on an electrified system but does appear to consider this in the GAPE tariff discussion.

One item that QR Network appears to be consistent with the ETS is to again raise the issue of stranding risk at the commencement of a project. This issue continues to be pursued by QR Network which is difficult to understand in this case, when they have completed a process which they claim involved "very close consultation with customers". Given QR Network have sought to complete this Expansion under a commercial arrangement, any future risk allocation should be considered in the context that a commercial agreement has been reached. Vale believes that QR Network cannot seek additional risk allocation at a later period when it has already developed a commercial agreement with stakeholders.

Vale believes these issues are important to be considered in determining the outcome of both proposals before the QCA as any future developments of the GAPE System will likely prompt a call for electrification and therefore establishing a consistent approach now will provide greater certainty to future Expansions of the Northern Bowen Basin.

5. Unrelated Amendments

On Page 33 of the explanatory notes QR Network outlines a change to section 8.3 of the Undertaking in relation to the recovery of costs relating to the Standard Rail Connection Agreement. As this issue is being dealt with under a separate DAAU, Vale believes this should be directed to the QCA as a further amendment to the existing process underway with the Rail Connection Agreement rather than inserted in this unrelated amendment and as such Vale believes it is not appropriate to comment on this issue at this time.

CONCLUDING REMARKS

Based on the information presented Vale's view would be to request the QCA to not approve the GAPE Tariff Draft Amending Access Undertaking and seek a contribution to Common Costs on the Goonyella System. Whilst Vale is not specifically opposed to the establishment of a separate GAPE System, although it does have some concerns on how this operates in practice, it believes that the determination of the tariff should not only include the incremental costs of the Capital Expansion but also some contribution to Common Costs to reflect the value of the Rail Infrastructure assets that are necessary to run the Train Services for the GAPE users as if it was a standalone system. Vale believes this is critically important in the Goonyella System where only minor upgrades have been completed and the proposed Reference Train Service is less efficient than the existing Reference Train Service on the Goonyella System. Vale does not believe the proposed tariff provides a true "user pays" approach to the service in light of the current modelling that suggests GAPE services may reduce the current Goonyella System Capacity. Vale believes the pricing principles should encourage better outcomes for System Capacity and should be aligned to the customers with the economic benefit.

Vale also believes that some of the issues that have been raised within the GAPE System DAAU appear to be inconsistent with the approach that QR Network is proposing to take in the Electric Traction Services DAAU. Vale believes that it is important for the future development of the network as a whole that it is progressed in a consistent manner to provide certainty to all stakeholders.

For further information regarding this advice please contact myself on (07) 3136 0911.

Yours sincerely,


Bob Skuza
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Vale Australia Pty Ltd