

05 June 2015

Dr Malcolm Roberts  
Chairman  
Queensland Competition Authority  
Level 27  
124 Ann Street  
Brisbane Q 4000

**Submission : QR 2015 DAU (Draft) Comments**

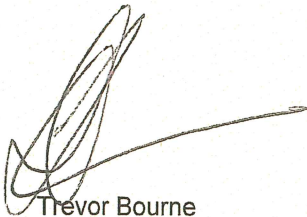
Dear Sir,

In response to the Queensland Competition Authority (QCA) issue of a Notice of Investigation of the Queensland Rail (QR) 2015 DAU, Sekitan Resources Pty Limited (Sekitan) submits its response to the QR 2015 DAU.

Sekitan has a strong interest in the QCA determination of the reference tariff for coal haulage on the West Moreton System as the significant on site operational efficiencies identified, would be to no avail if the currently proposed tariff is approved for inclusion in the QR 2015 AU.

If additional information or indeed clarification of this submission is required, Sekitan will be happy to oblige.

Yours sincerely,



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## Sekitan Resources Pty Limited Submission

### QR 2015 Draft Access Undertaking

Sekitan has undertaken a significant amount of due diligence on the risk to its proposed investment posed by the Western Rail System. It has engaged with Queensland Rail (QR) in an attempt to understand the technical, structural and operational issues of the System that may constrain the operational performance

It is against this background and further interaction with above rail providers and rail consultants that Sekitan has compiled this submission.

### Asset Valuation Methodology

The QCA sponsored Uniquist Review has identified the shortcomings associated with the application of the two models that have traditionally been used to determine asset valuations of public sector businesses. Sekitan is firmly of the view that irrespective of the model adopted, that zero value should be allocated to pre-1995 investment in the West Moreton System. The construction methodologies and associated age of the West Moreton System preclude it from being compared with any modern equivalent freight rail system such that the approach to capital depreciation and return on investment must be modified to reflect the efficiency constraints and the low maximum capacity of the system. The major constraint to the efficiency and capacity of the system is that of a maximum axle load of 15.75 t. QR is of the view that this constraint will not be relieved any time in the near future. The value of the system should be more aligned with its scrap value than the optimum cost to replace the system as many of the major components have far exceeded their useful life expectancy. Any valuation to the contrary would generate "windfall" gains to QR.

### Maximum Allowable Revenue

The valuation methodology discussed above along with depreciation, allowed rate of return and determination of efficient operating costs are the major building blocks used to determine maximum allowable revenue for the regulated business (in this case the West Moreton System).

QR has determined that its maximum allowable revenue based on a coal freight demand tonnage of 6.1 million tonnes per annum equates to a ceiling price of \$34.92 / thousand gross tonne kilometers ('000 gtk). Whilst Sekitan has a view on the efficient deployment of capital and efficient costs of maintaining the system, it also understands that the QCA is in a much better position to adjudicate the quantum allowable for these activities. Sekitan does however have a different view on just what risk QR is taking on tonnage demand in setting the ceiling price.

As noted by QR the thermal coal market is suffering considerable pricing stress that has caused significant modifications to many operations as they try to reduce their cash cost profiles. Some operations, have been closed or implemented significant reductions in output to ensure corporate survival. The short / medium term forecast for thermal coal prices would not drive a significant recovery in thermal coal production however there is a moderate rise forecast in the export demand curve over time and hence existing operations should progressively increase tonnages. On this basis Sekitan is of the view that the QR exposure to tonnage risk in relation to achieving maximum allowable revenue is negligible. It is more likely that it will be the beneficiary of tonnage upside during the currently proposed period of the access undertaking and yet there is no mechanism identified for distribution of this upside to existing users.

The West Moreton System is currently forecast by QR to operate at between 60 - 65% of the maximum coal freight capacity (6.1 Mt/y). QR also states that a measure of the proposed pricing acceptability is that it currently has application/s for significant additional tonnage access on the system. Sekitan contends, on the contrary, that any such new application interest is based primarily on the potential for coal demand on the system to exceed maximum capacity and hence suppress or extinguish acquisition, new developments or expansion potential. The ultimate determinant of whether the application/s are progressed to finality is more likely to be the quantum of the reference tariff adjudicated by the QCA. The tariff proposed by QR (\$19.41 / '000 gtk) is highly likely to nullify all of the onsite operational gains made by producers in recent times. The access tariff differential between the



West Moreton System and any other rail system in Australia will widen further under the QR proposal and hence further distort competition in the market. Sekitan is of the view that QR should use a tonnage demand of 90% of system capacity to determine the ceiling tariff as this would then provide QR incentive through commercial negotiation of access price and associated terms and conditions to maximize the coal tonnes on the System. The issue of tonnage upside would then be a less vexatious issue with producers.

## Metropolitan Blackout System Impact

The assessment of impact of the Metropolitan “blackout” on the efficiency of the West Moreton System has been rigorously put by the industry during the QCA assessment of the QR 2013 DAU (since withdrawn). Sekitan is of the view that due to a lack of marshaling yards on the outskirts of the Metropolitan system and the upgraded service timetable for commuter trains, the impact of the “blackout” is significantly higher than proposed by QR. Further it is understood that a wide “shadow” is also implemented around the blackout to account for the performance disparity between the current sole above rail operator’s train consists and the Metropolitan commuter train performance characteristics. As such it would appear that the “blackout” impact is more likely to approach the level submitted by New Hope Collieries (31%) during assessment of the 2013 DAU.

## Technology Incentivisation

The ideal business outcome for QR would be to have the West Moreton System maximum coal capacity (currently between 8-9 Mt/y) increased to encourage further development of the significant coal resources of the southern Surat Basin. This maximum tonnage is determined primarily by maximum allowable axle loading, maximum allowable train length and Government allocation of a maximum number of paths available to coal traffic.

The maximum axle load of 15.75t is essentially non-negotiable due to the significant capital required to upgrade the system and a high probability that it would not meet the “efficiency” test. The number of paths allocated by Government for coal traffic is unlikely to change in the short term particularly given the current delicate balance of power in the Queensland Parliament. This should then clearly focus expansion of capacity of the West Moreton System on train length. The traditional determinant of train length has been the length of passing loops. The introduction of modern above rail systems (distributed loco power, electronic braking, modern diesel engine technology and traction motors) has eventuated in longer trains with higher payloads successfully operating in other States and through capital city metropolitan areas.

The 2015 AU should include an “in principal” incentive pricing mechanism for any access holder to improve the system efficiency through the introduction of modern technology equipped longer trains that conform to the operational criteria of QR.

The impact of increasing the maximum capacity of the system through efficient capital investment in above rail systems, would change the motivation for access applications from that of avoiding a business constraint (no available capacity) to enabling efficient business expansion in response to developing market opportunities.