

8 February 2013

Ms Patricia Scott
Productivity Commission
LB2 Collins Street East
Melbourne VIC 8003

Dear Commissioner

National Access Regime

Xstrata Coal (XC) welcomes the opportunity to make a submission in response to the Productivity Commission into the National Access Regime and the operation and terms of the Competition and Infrastructure Reform Agreement.

This review into the National Access Regime represents an important opportunity to identify enhancements that will support the international competitiveness of the Australian mining industry and benefit the Australian economy for decades to come.

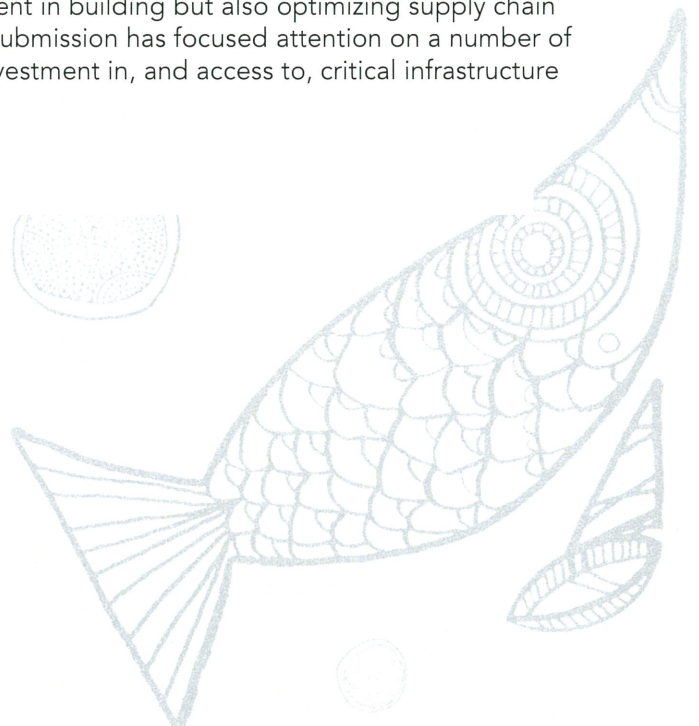
Xstrata Coal is the world's largest exporter of seaborne thermal coal used to generate electricity and one of the largest producers of metallurgical coal used in the production of steel. About 85% of the coal we mine is exported to global markets including Japan, South Korea, Taiwan, China and Europe. We continue to be a significant contributor to the Australian economy, particularly in New South Wales and Queensland.

Competitive, efficient and reliable access to port and rail infrastructure is critical to getting our products to market. In New South Wales, our coal is exported through the Port Waratah Coal Terminal and Port Kembla Coal terminal. In Queensland we operate the Abbott Point Coal terminal and also export our product through the multi user Dalrymple Bay Coal terminal and the R.G. Tanna Coal Terminal.

We support a regulatory regime that encourages investment in building but also optimizing supply chain capacity and operating it efficiently and effectively. Our submission has focused attention on a number of key priority areas we believe are impacting on efficient investment in, and access to, critical infrastructure for the Australia's mineral export industry.

Yours sincerely

Steve Bridger
Executive General Manager
Xstrata Coal





Productivity Commission Review: National Access Regime

Xstrata Coal Queensland



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1. Executive Summary

Australia's economic fortunes are heavily dependent on a competitive resources sector. The competitiveness of the Australian resources sector is in turn heavily dependent on efficient and cost competitive export supply chains.

Arrangements that are effective in facilitating the efficient investment in, and access to, critical infrastructure are therefore of fundamental importance to Australia's mineral export industry. This has never been more critical given the relative decline of Australia's international competitiveness on the back of significant supply side cost and risk increases and the emergence of new strong competition from the developing world with highly competitive cost structures and improved policy settings.

Xstrata Coal is the world's largest exporter of seaborne thermal coal and one of the largest producers of metallurgical coal. About 85% of the coal we mine is exported to global markets including Japan, South Korea, Taiwan, China and Europe. Headquartered in Sydney we have interests in over 30 open cut and underground coal mines in Australia, South Africa, Columbia and exploration projects in Canada.

Competitive, efficient and reliable access to port and rail infrastructure is critical to getting our products to market. In New South Wales, our coal is exported through the Port Waratah Coal Terminal and Port Kembla Coal terminal. In Queensland we operate the Abbott Point Coal terminal and also export our product through the multi user Dalrymple Bay Coal terminal and the R.G. Tanna Coal Terminal and we have a significant interest in the new Wiggins Island Coal Export Terminal at Gladstone..

Xstrata Coal has also invested in the Hunter Valley coal supply chain to ensure security of supply by establishing Xstrata Rail, a fleet of trains that complement existing services from Pacific National in New South Wales.

Accordingly, Xstrata Coal's focus in this submission is principally driven by the characteristics of the east coast coal chains and the regulatory settings relevant to them.

The rationale for a regime that facilitates third party access to services provided by owners of strategic infrastructure facilities remains as relevant today as when considered by the Hilmer Committee in 1993. In particular:

- mining export infrastructure occupies a strategic position in the mineral export industry and provides services required to compete in the dependent upstream seaborne coal and other mineral markets
- the 2001 Productivity Commission finding that there were cases where providers of infrastructure services would have both the monopoly power and incentive to restrict access and/or raise prices unreasonably still exists, as evidenced in Queensland through the actions of Aurizon (formerly QR National)
- export infrastructure relied upon by the coal industry exhibits both; natural monopoly characteristics, and is typically constrained by limitations on access to available land and/or the ability to obtain various approvals to develop alternative facilities.

However, regulatory regimes and policy settings must respond to contemporary challenges. The current Productivity Commission review into the National Access Regime represents an important opportunity to identify enhancements that will support the competitive position of the Australian mining industry and benefit the Australian economy and the hence standard of living of Australians for decades to come.

While there are many practical challenges associated with the current regulatory regime, Xstrata Coal submits that the existing regime requires the following minimum key enhancements which will yield national benefits that outweigh the costs that various interest groups may claim:

- I. **Clarification of Declaration Criteria** - two essential elements in protecting the competitiveness of Australia's mineral industry are:
 - addressing the consequences of the recent Pilbara Rail decision of the High Court, which has increased the risk of regulated service providers seeking revocation of declaration or undermined the authority of regulators who may be more cautious in interpreting the act against infrastructure owners; and
 - adding weight to the practicality of duplicating facilities when considering declaration applications

However, as a matter of principle privately funded single user integrated facilities should not be required to provide access to competitors. However, where there is absolutely no practical alternative and the broad economic benefits outweigh the cost any such access should include charges that compensate the owner for; the risks and opportunity cost inherent in their initial underlying investment in the infrastructure, and the costs (generally manifested through reduced efficiency) imposed on them as a result of a single user system becoming multi-user.

- II. **Mandated coordination in Multi User – Multi Owner Systems** - substantial economic efficiency gains from multi user-multi owner infrastructure chains could be had through reforms which seek to replicate the efficiencies seen in single user integrated export chains.

Regrettably, commercial interests of non aligned parties repeatedly act to stymie attempts at voluntary coordination regimes with the result that; throughput is compromised, inefficient costs are incurred, unnecessary investments are made or critical investments are delayed.

Regulatory oversight and determinations should therefore extend to an ability to impose obligations on multi user-multi owner infrastructure facility owners, operators and participants within an export infrastructure chain to, cooperate towards ensuring coordinated planning, operations, investments and performance processes.

- III. **An effective extension determination process** – limitations on the ability of a regulator to direct an extension of a facility have resulted in market failures in Queensland (for example the Aurizon Network Goonyella to Abbot Point "missing link" extension and the Aurizon Wiggins Island Rail Project).

Regulators must be able to direct extensions to declared facilities without infrastructure owners hiding behind ill defined and un-balanced interpretations of "legitimate business interests", "no cost to the infrastructure owner", "no change in ownership" terminology to frustrate attempts to introduce genuine user funding alternatives for such extensions.

While arguably outside the scope of the Productivity Commission review of the National Access Regime, Xstrata Coal submits that a fundamental policy position of state and federal governments should be that; essential multi user infrastructure should be controlled by those that rely on that infrastructure to compete in global markets, not by

unaligned parties that seek to profit from that infrastructure at the expense of Australia's global competitiveness.

Aligning owner and user interests to optimise infrastructure investment and operation would assist in addressing many of the inherent deficiencies in the national access regime. In the absence of such a policy and where essential supply chain infrastructure is already held by unaligned parties, a robust access regime is essential to avoid market failure and misuse of monopoly power. This is particularly the case where former government owned export infrastructure has been privatised. These infrastructure facilities continue to exhibit the natural monopoly characteristics that justified (or required) the initial government investment to develop them as opposed to initial private sector investment. Typically this infrastructure is multi-user and part of a multi-owned chain and the challenges posed warrant special consideration.

We recognise that developing and implementing policy often necessitates balancing various interests. Accordingly, Xstrata Coal believes the Productivity Commission should give consideration to whether tailored approaches are required under the National Access Regime which will permit an effective response to the nuances inherent in complex mineral export infrastructure chains.

2. The Economic Imperative for Effective Regulation

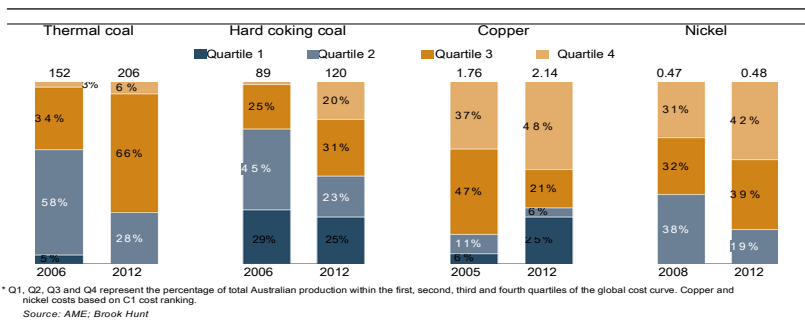
In 2001, at the time of the last Productivity Commission review of the National Access Regime, mineral and fuel exports totalled around \$40 billion and accounted for around 33% of Australia's total exports. By 2011 Australia's mineral and fuels exports totalled \$158.7 billion and accounted for around 50% of Australia's total exports.

Australia's economic fortunes are therefore heavily dependent on a competitive resources sector. The competitiveness of the Australian resources sector is in turn heavily dependent on an efficient and cost competitive export supply chain and delivery of timely and coordinated (across the chain) export infrastructure. As noted by Henry Ergas and Joe Owen "ensuring efficient and effective regulation of export infrastructure constitutes a ... priority area for reducing supply side constraints."¹

This has never been more critical given the relative decline of Australia's resource industries international competitiveness on the back of: significant supply side cost increases arising from labour, energy and transportation costs and taxation imposts, expected price stabilisation or declines together with the decoupling of the previously inverse exchange rate-commodity price relationship. Australia is no longer cost competitive as "more than half of Australia's mines have costs above the global averages" as can be seen from the following:²

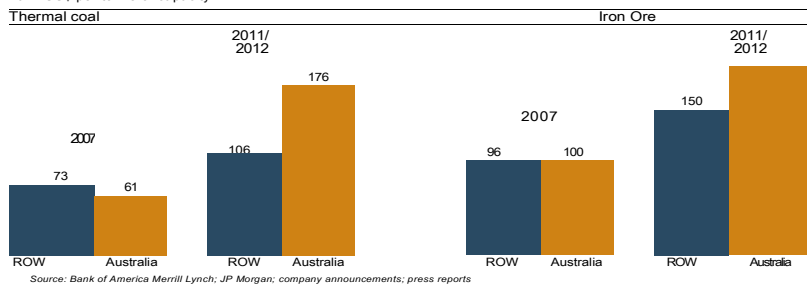
Competitiveness of Australian Mines – Cash Operating Costs

Percent of production by cost curve quartile, Mt of production; coal delivered to China; metals costs net of by-product revenue



Capital Spend to Build a Tonne of New Capacity

2011 US\$ per tonne of capacity



While the mining industry can and should drive initiatives to rebuild its competitiveness, many of the levers rely on getting the policy and regulatory settings right. One element of this is ensuring export infrastructure regulatory settings support the industry rather than those that seek to profit in the short term from exploiting the monopolistic position of the infrastructure.

¹ Minerals Council of Australia, Rebooting the boom: Unfinished business on the supply side, December 2012, p.43

² Minerals Council of Australia, Opportunity at risk: regaining our competitive edge in mineral resources, September 2012, p25

The importance of getting the regulatory setting on infrastructure access right in order for Australia to maintain or grow its share of global demand for coal cannot be understated. Export coal mines in Queensland have until recently had rail and port charges that constituted 20% - 30% of Free on Board (FOB) costs. In Xstrata Coal's experience, the rail and port charges associated with recent expansions to the rail network or new port developments have shifted the proportion to around 40%-50% of FOB costs. Infrastructure charges for greenfield mines reliant on high cost extensions or new port developments are expected to represent more than 50% of FOB costs.

In 2011 coal exports accounted for around 15% of total Australian goods and services exports. Coal exports rely on access to multi user infrastructure facilities which have traditionally been developed on that basis due to; individual users lacking the scale to support development of a dedicated facility and/or due to various approvals, land access or government policy positions preventing development of multiple facilities or requiring mandated shared access.

The multi user infrastructure relied upon by the coal industry is generally regulated as open access either via voluntary undertakings, conditions of government concessions or land tenure arrangements or by other historic means.

Investments have been made in coal mines on the basis that it is expected already regulated facilities will continue to be regulated. If the regime is amended or reinterpreted such that regulated entities can now opt out of regulation, this may render existing mines unable to compete internationally. It would also add weight to the growing concern amongst global capital providers that Australia's sovereign risk profile has become too great relative to the benefits of investing in Australia. This poses a number of broad economic implications for the Australian economy via reduced royalties and taxation receipts, rising unemployment which will be magnified by the trickledown effect on direct and indirect beneficiaries of mining.

Leaving access to vital export infrastructure to market forces or commercial negotiation will result in an inferior outcome to regulated access. Australia's standard of living would be expected to decrease in the medium to long term due to short sighted profit shifting by infrastructure owners. Such an outcome would result in allocative inefficiency as monopoly pricing would eventuate. Productive inefficiency would arise due to; Australian coal exports becoming more costly (for no net change in risk profile of the service provider), and the costs of duplication of natural monopoly infrastructure assuming it would even be possible to duplicate.

Until recently Australian coal export volume growth has largely been effected through relatively low cost/small scale incremental expansions of infrastructure at regulated charges. New mine developments (and existing users) have been able to access the benefits of economies of scale provided by expansions to such infrastructure. This era is essentially over as expansion of east coast rail networks, electricity generation and transmission infrastructure, water supply and port developments increasingly requires greenfield or large brownfield capital investment as the incremental expansion opportunities become exhausted.

The requirement for substantial extensions has brought into stark relief the ineffectiveness of the current regulatory regime, where access to infrastructure cannot be obtained without installation of additional capacity. Ensuring such extensions can be triggered in a timely manner, competitively procured and funded and that owners of infrastructure cannot use investment strikes or protracted arbitration processes to extract monopoly rents must be a key focus of the current review of the National Access Regime.

3. Relevance of the National Access Regime

State versus Federal Considerations

The current approach of having a national access regime which informs state based regimes and which acts as a failsafe if the state regime is ineffective continues to have merit.

Relying purely on state based regimes (without an overarching framework) or state sponsored bilateral arrangements between the state and the proposed or current infrastructure facility owner (for example through the terms of leases, concession agreements or planning processes) is ineffective. Such approaches; fail to take into account the broad range of stakeholder considerations, risk not being derived through sufficient consultation and risk capture by interest groups.

While many comments and examples in this submission are made in the context of infrastructure services declared under the Queensland Competition Authority Act 1997 (Qld) (QCAA), Xstrata Coal is of the view they are still relevant to the Productivity Commission review given the extent to which the state regimes follow the Competition and Consumer Act 2010 (Cwlth) (CCA).

Relevance of the objective of economic regulation

The objective of economic regulation to “promote economically efficient operation of, use of, and investment in, the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets”³ remains sound.

Extrapolating the sentiments of the 1993 Hilmer Committee report, the Central Queensland Coal Network, Dalrymple Bay Coal Terminal and the Hunter Valley Coal Chain continue to occupy strategic positions in the Australian export coal industry and they continue to provide services which are required to compete in upstream markets (ie seaborne coal). Accordingly, the rationale for regulation espoused in 1993 continues. In fact, given the privatisation of previously government owned natural monopoly infrastructure the case for effective regulation has never been greater.

While much is made of the driving force for the introduction of regulation via a national access regime being the prospective privatisation of government owned infrastructure, the fact of government ownership (current or former) is less relevant than the fact that the relevant infrastructure exhibits natural monopoly characteristics and was principally paid for by the users of that infrastructure. The fact that the infrastructure was once government owned or remains government owned is most likely reflective of the fact the infrastructure could not be provided cost effectively or economically by the private sector at the time it was established, or it was impractical or inefficient to have multiple versions of it. While these characteristics remain, the case for a national regulatory regime remains.

In its 2001 review the Productivity Commission found that cases where providers of infrastructure services would have both the monopoly power and incentive to restrict access and/or raise prices unreasonably still existed. This situation continues today and has recently been experienced by Xstrata Coal in the context of various negotiations with Aurizon Network in Queensland.

³ Productivity Commission, National Access Regime Issues Paper, November 2012, p. 1

- In recent negotiations for access rights with Aurizon Network (AN) which required extensions of the existing regulated infrastructure, the absence of a viable alternative framework by which Xstrata Coal could fund the extensions itself and the practical limitations on constructing a wholly duplicated facility resulted in AN extracting charges in excess of the regulated tariff for in effect no additional risk.

It was impracticable to construct a duplicated facility due to: practical constraints on obtaining access to approximately 400km of land to construct a competing railway, the time required to obtain approvals to construct an alternative would have been prohibitive even assuming they could be obtained, the cost of construction would have rendered the mine uneconomic. Similar practicalities arose in considering whether to construct parts of facilities that would then connect to the AN network (presuming AN would permit this).

The fact that this situation arose in respect of a regulated infrastructure service reveals both the need for regulation to be retained but also improved.

- Aurizon is a vertically integrated service provider and has a strong potential to deny access to competitors or extract monopoly rents to protect its position in an upstream or downstream market (haulage, track construction etc). Recent arguments posed by AN to the Queensland Competition Authority (QCA) and the coal industry in respect of issues with cost recovery of its electric network appear to be more about protecting AN's investment in electric locomotives and hence its competitive position as a haulage operator as about protecting its track investment interests.⁴

Natural Monopoly characteristics are still abundantly evident in rail and port infrastructure. Existing multi user systems can serve demand in the long term at a significantly lower cost than two or more firms offering competing facilities given the economies of scale inherent in linear infrastructure and the significant broader social costs that come from development of large scale export infrastructure.

Existing infrastructure facilities have generally reached or are nearing minor incremental expansion capacity limits which means existing regulated infrastructure requires significant expansions. Regulation must therefore be effective in addressing:

- the circumstance where it is not economically efficient (from whole of society perspective) or practicable to build a new facility. This is surely the case when considering the Central Queensland Coal Network and the Hunter Valley Coal Chain and is increasingly the case for ports given scarcity of suitable terminal land and the increased focus on the environmental impacts of such developments (for example the current focus by UNESCO on port developments in Queensland and calls for moratoriums on development of new port precincts)
- government policy decisions taken in the broader public interest may mean new infrastructure must connect to existing regulated infrastructure which in turn requires expansion. This has arisen in Queensland where the opening of the Surat coal basin relies on the development of the Surat Basin Railway (SBR) which the state has mandated must connect to existing Aurizon Network. This means users of SBR have no choice but to negotiate with AN which is therefore in a position to extract monopoly rents where new investment in extensions is

⁴ Aurizon Network, Electronic Traction Services DAUU, Dec 2011 to 22 Jan 2013 via <http://www.qca.org.au/rail/2010-DAUamend/ETS-DAAU/>

required (in the absence of a viable user funding process for such extensions or an ability of a regulator to direct investments).

- the delay costs experienced by protracted negotiations, unaligned feasibility study and investment horizons, or lengthy approval processes in respect of assessing the capacity to develop an alternative facility.
- the overall cost-benefit to society of a regulatory outcome that results from the only alternatives being duplication of infrastructure or loss of investment in mines and the attendant loss of economic benefit to the Australian economy.

4. The Declaration Criteria

Very few if any infrastructure facilities appear to have been declared as a result of applications being made for access and that access being denied by the infrastructure owner. The majority of declared facilities appear to have come about through voluntary undertakings or via legislative instruments. Accordingly, the actual effectiveness of the declaration criteria has not been effectively tested on multi user export infrastructure.

However, the recent Pilbara High Court decision regarding interpretation of criterion (b) as a private profitability test, including whether the infrastructure owner themselves could duplicate, has raised the significant risks that either existing regulated infrastructure service providers will seek to revoke declaration, or that regulators, through fear of this being an outcome, will adopt a light handed approach to interpreting application of their powers.

There are multiple examples where it has been privately profitable to duplicate a similar facility or part of a facility such that those entities could now argue that they should no longer be regulated notwithstanding they hold infrastructure that occupies a natural monopoly position. By way of specific examples:

- the extension of the test to the facility owner itself could be used by AN to argue that because it has been privately profitable for it to construct the Goonyella to Abbot Point “missing link” (which they only agreed to do at above regulated returns), that piece of infrastructure should not be regulated or the entirety of the Newlands system or their network should no longer be regulated.
- the same argument could be made by AN in respect of the extensions that are currently underway known as the Wiggins Island Rail Project (WIRP1) which AN only agreed to carry out if users either funded the extensions themselves, or executed agreements that provided AN with above regulatory returns. AN argued it was not sufficiently profitable for them to invest at the regulated rate. In this and the previous point it is important to note that there was no practical alternative open to the users beyond simply not developing or expanding their mines.
- the owners of DBCT could argue that because it was privately profitable for BHP to develop its Hay Point coal terminal and for WICET to develop its terminal so it must be privately profitable to build an alternative coal export terminal in Dalrymple Bay and accordingly DBCT should no longer be regulated.
- the same arguments could arguably also be applied by ARTC

The risk arises in that while all five declaration criteria must be satisfied to become declared it follows that only one need be failed in order for a currently regulated entity to seek to revoke an existing declaration. This would fundamentally undermine the objective of a regulatory regime where that facility is a natural monopoly and have devastating implications for the Australian coal industry and hence the broader Australian economy.

Alternatively, in the event immediate revocation is not sought, there is the risk that the decision has undermined the authority of regulators who will be more reticent to interpret their powers broadly for fear of regulated entities seeking such revocation. Even if revocation applications are not immediately made it is expected that future undertakings by regulated entities will seek to claw back hard fought protections necessary to protect the competitiveness of the supply chain.

Private profit motivated owners of currently regulated infrastructure may seek to exploit the uncertainty created by the High Court decision. Any future privatisation of the Australian Rail Track Corporation (ARTC) under these circumstances could operate to the detriment of the coal industry in New South Wales.

Xstrata Coal agrees with the sentiment expressed by the National Competition Council that the High Court's construction of criterion (b) "allows for duplication of a facility in circumstances that are wasteful of societal resources and which reduce productivity by requiring multiple facilities be developed when a single facility could have provided sufficient services at a lesser cost".⁵ However, we submit that in the same vein insufficient weight is given to the practicality of developing alternative facilities in the absence of declaration being made.

Accordingly, it is suggested that an overarching determinative criteria should be considered in deciding whether to declare critical export infrastructure that exhibits natural monopoly characteristic, that of whether it is Impractical to Duplicate due to social, environmental or physical factors. This is particularly important where land use or environmental approval limitations prevent duplication or there is a government policy position of not duplicating infrastructure due to the deleterious effects on communities or the environment.

In determining whether it is impractical to duplicate a facility a regulator and/or Minister should have regard to:

- a. the availability of land for construction of a duplicated facility and the broader economic implications of invoking compulsory acquisition powers to obtain land if it cannot be obtained by negotiation;
- b. the likelihood of obtaining any consents, approvals or authorisations required from local, State or Commonwealth governments or other persons for the construction or operation of a duplicated facility; and
- c. the extent to which the owner or operator of a duplicated facility would be likely to be dependent or reliant on the owner or operator of the existing facility in order to be able to provide the service.

In addition Xstrata Coal believes the following key principles should guide application of or inform development and interpretation of the declaration criteria generally:

- a. An **existing** privately funded integrated (ie single owner-single user) infrastructure chain should not (or an element of it should not) be subjected to declaration of the services unless:
it is **impracticable** for a third party potential user to duplicate all or the relevant part of the chain; or
- b. the economic benefit of granting access outweighs the economic detriment. The economic benefit versus cost analysis is viewed from the total Australian economy perspective not a profitability assessment of the individual protagonists involved in the application;

The risk of deterring infrastructure investment must be addressed via regulated pricing policies that recognise and reward the infrastructure facility owner for the risks and opportunity cost of capital borne by them in initially developing the facility which the third party user will then get the benefit of. As a guide this could be set at the cost the third party user would have

⁵ National Competition Council, Letter to Productivity Commission dated 1 November 2012, p, 8

incurred had they been able to develop the alternative facility but for the impracticality.

Any costs arising from inefficiencies imposed on the single user system should be borne by the third party access seeker.

2. Any **proposed** privately funded integrated (ie single owner/single user) infrastructure chain should be declared if it meets the declaration criteria and if it is assessed that:
 - a. it would be impracticable to duplicate all or a part of the infrastructure; and
 - b. the economic cost of duplication exceeds the economic benefit of not declaring the facility

To address the risk of deterring infrastructure investment the same pricing principles should apply to third party access seekers as proposed above for existing regulated integrated chains along with “make whole” charges to compensate for the inefficiencies that inherently arise from multiple users on a system

To avoid any chilling effect on investment, any decision regarding declaration must be made prior to the point of investment by the asset owner and once made should not be able to be revisited.

3. Any **existing multi user** infrastructure that is currently regulated should not be able to seek revocation of declaration if:
 - a. there would be a market failure as a result of such revocation; or
 - b. natural monopoly characteristics continue to exist; or
 - c. it would be impracticable to duplicate that infrastructure by any one of, or group users.

Natural monopoly characteristics should be presumed to exist where multiple users are or were required to deliver the economies of scale and diversification sufficient to economically and commercially develop the infrastructure. In the absence of such an assumption no one individual coal mine would be able to compete in the international market if it had to develop the infrastructure itself.

This should be distinguished from the situation where a proposed single mine does have the scale and substance to develop infrastructure as part of an integrated production process, with the presumption being that a single user system is part of a production process and therefore exempt from regulation unless the criteria in 2 above are determined prior to the point of investment by the miner (this would therefore require strict adherence to decision timeframes by regulators).

The overriding consideration should be that in circumstances where there is practically only one supplier to multiple users, there is no market and accordingly market forces cannot be relied upon to ensure competition in mineral export markets is facilitated.

Whether it is economically efficient or practicable for multiple facilities to service the needs of users is a threshold question. Where the answer is no the presumption should be that regulation is required if the facility, or expansion of the facility exhibits, natural monopoly characteristics.

5. Determinations Directing Investments

The pricing principles under Part IIIA fail in an extension scenario. The experience of Xstrata Coal is that the limitations imposed under Part IIIA (by inference given that they are mirrored in the provisions in the QCAA) fail to prevent the misuse of monopoly power which was the very purpose of regulating the entity in the first place and undermines the pricing principles.

While there is sympathy for not compelling the owner of declared infrastructure to invest in extensions there must be a viable alternative framework for the users requiring access to the extended facilities to make the investment. Where the owner does elect to invest rather than permit users to fund an extension, they must be obliged to do so at the regulated rate.

Ineffective user funding models or models where infrastructure owners can threaten investment strikes if users don't agree to pay monopoly rents and/or accept uncommercial terms will result in market failures. If the user funding model is made commercially unacceptable, the pricing ultimately extracted by the infrastructure owner to invest will approximate the opportunity cost of the user (and potentially higher given risks associated with a user funded investment in a multi user system). However, the infrastructure owner will continue to enjoy the relatively low risk profile inherent in regulated access determinations (e.g no volume risk, limited inflation or cost risk, low asset stranding risk etc) whereas miners are price takers in a global market generally fully exposed to volume risk, foreign exchange risk and a range of other risks. The end result would be a flight of mining investment.

Specific examples of the failure of the current regime in regards directing investments include:

1. In order to undertake the Goonyella to Abbot Point "missing link" extension in 2010, AN (QR Network at the time) sought, and by virtue of the relevant customers having no other viable option to have the extension completed, obtained, above regulated returns to undertake the extension. QR Network also reportedly sought through this process to prevent the relevant customers from involving the QCA in the process via use of confidentiality undertakings.
2. AN has taken a position that it will no longer invest in the extension of its rail network at regulated rates of return (other than for minor value extensions).

In order to finalise the current Access Undertaking (UT3) ahead of the privatisation of QR National, AN and the QCA agreed to include: a specific process to enable the QCA to review and approve Access Conditions (ie above regulated returns or non standard terms and conditions), and an investment framework with a requirement for AN to develop and submit for approval by the QCA a Standard User Funding Agreement (SUFA) within 3 months of approval of UT3

3. Xstrata Coal's experience in 2011 in negotiating for capacity from the WIRP1 project required for the expansion of our Rolleston mine and participation in the Wiggins Island Coal Export Terminal initial development was that the Access Conditions process in UT3 was easily circumvented by AN.

However, more critically the absence of any viable alternative funding options for the extensions effectively left AN able to extract rates of return well in excess of the regulated tariff for little or no additional risk.

4. AN has relied on section 119 of the QCAA (similar to Section 44V of the CCA) to assert that it cannot be obliged to invest in extensions to the network and that no other party can become the owner, or one of the owners, of the facility without the existing owners consent. In finalising the principles to be applied to the development of the SUFA, AN also relied on section 119 to require that its "legitimate business interest" could not be affected by the application of the SUFA model.

The original SUFA model submitted by AN in 2010 was completely unworkable and was withdrawn by AN and an alternative model was submitted in late 2011. Since that time protracted negotiations have been ongoing with AN, resulting in AN submitting a revised suite of User Funding Agreements to the QCA in December 2012.

The revised SUFA suite contains a number of elements that will make it impossible to use including fundamental conflicts of interest where AN contracts with AN under limited liability regime, limited rights for users to replace AN where they are failing to deliver the extension on time or where substantial cost blow outs are arising, ineffective protection for funders in the event of insolvency of AN, insistence on stapling access rights to funding. An overriding concern is the extreme complexity of the arrangement and the lack of "control" over the potentially billions of dollars required to be handed over the AN.

It is therefore recommended that Section 44V of the CCA is amended to provide greater discretion to regulators to make access determinations requiring extensions and permitting user funding to ensure a monopoly facility owner cannot abuse their position and extract monopoly rents. Greater clarity on the interpretation of the terminology in that section and greater weight being given to the legitimate business interests of users of monopoly infrastructure is required. The following would be key elements of such amendments:

- enabling the regulator to make an access determination resulting in the access seeker or someone else, becoming the owner, or one of the owners, of the facility, without the existing owner's agreement where the existing owner is seeking above regulated returns to undertake the investment (as opposed to demonstrating it does not have access to the capital to expand or has realistic alternative investment opportunities for its capital)
- in respect of that part of the facility to be funded by the access seeker or someone else, if the access provider has refused or failed to agree to invest in an extension of the facility (other than on terms the regulator considers unreasonable in the circumstances), and the access seeker or someone else is willing to fund the costs of the extension, the regulator should be permitted to make an access decision requiring extension of the facility if funded by the access seeker.
- in imposing a requirement on a person other than the access provider to pay the costs of extending the facility, the regulator must seek to do so in a manner that is cost effective for the person funding the costs, including permitting third party debt financing of such costs.

Extensions to regulated multi user infrastructure must be able to be triggered in a timely manner and competitively procured and funded (where the owner will not invest or seeks above regulated returns).

6. Importance of Coordination in Multi User Systems

Experience with the Hunter Valley Coal chain and issues with capacity constraints through the Dalrymple Bay Coal Chain in the latter half of the last decade highlighted the critical importance of the coal supply chain being planned and where possible managed in a coordinated manner.

The most efficient bulk commodity chains are those that are single user systems operated in an integrated manner with production and the end market. Adding multiple users to a system presents challenges in terms of efficient design and operation of those systems. The addition of multiple owners of component parts of a chain with multiple users increases the challenge exponentially and creates significant inefficiencies.

Given this is an unavoidable feature of Australian coal export chains due to legacy issues, it is imperative that a proxy process of managing the system as an integrated whole is applied to ensure economically efficient outcomes. Application of coordinated planning and operating principles can avoid substantial lost export revenue, demurrage costs, decreased market confidence and lost investment opportunities in Australia.

This issue was identified by the previous NSW Government and the Australian Competition and Consumer Commission (ACCC) in respect of the Hunter Valley Coal Chain, which was experiencing significant lost opportunities and costs through vessel queuing and uncertainty as to capacity. It took legislative amendments and coercion via the ACCC authorisation process to compel the industry and coal chain infrastructure providers to agree to, and implement, a totally coordinated system. The Hunter Valley Coal Chain Company (HVCCC) was established as a result of this process and has proven to deliver on the objectives with resultant investment in mines, infrastructure and improved coordination of planning on a short and long term basis.

The experience in Queensland has been disappointing. Despite the creation of the Integrated Logistics Company to manage the DBCT chain, progress has been slow with limited discernable improvement in coordination and looming capacity shortages should industry production equate to contracted levels (the recent floods and market conditions are the only reasons an estimated 15Mtpa shortfall in the system did not eventuate) in 2011-2012

There is negligible incentive for third party infrastructure providers to address these issues (there is no or limited disincentive for "over-contracting") as there is little risk from under-investment given Take or Pay Agreements. In addition to this, there are various vested interests amongst producers which are not served by a transparent and coordinated planning and investment framework; it will therefore require legislative force to avert a capacity crisis or sub-optimal use of existing infrastructure and scarce port development land.

Xstrata Coal believes the following are key requirements for sustainable coal chains:

1. Coal Chain Master Planning
 - a. Ensure current and future coal chain capacity is planned for in a holistic and coordinated manner, bottlenecks are properly identified and the most efficient expansion pathways are evaluated and identified
 - b. System Capacity should be defined by use of agreed system assumptions to determine efficient and deliverable system capacity

- c. Ensure measurement of system capacity is consistent across all infrastructure providers
- 2. Access Protocols
 - a. Establish clear open access protocols for multi user infrastructure to provide a consistent basis for access
 - b. Ensure new mine development can be aligned with infrastructure expansions so that existing operations do not have to be scaled back to accommodate growth
- 3. Commercial Frameworks
 - a. Create a commercial framework such that the efficient operation and expansion of multi user coal infrastructure is facilitated and under-pinned by long-term commercial contracts (not forecasts)
 - b. Ensure clearly defined expansion triggers are included as part of the commercial framework that compel infrastructure providers to proceed with infrastructure expansion once a pre-determined set of criteria have been met
- 4. Infrastructure Delivery
 - a. Ensure those managing the delivery of expansion projects are commercially aligned/incentivised to deliver projects in a coordinated manner, on time and budget
 - b. Access to additional coal chain capacity for new/expanding producers should not be at the expense of existing users
- 5. Performance Management
 - a. Ensure those managing the operational performance of the coal chain are aligned and incentivised to drive operational performance
 - b. Ensure that under-performance is clearly and objectively identified and that the under-performers bear the true cost of under-performance

Governments have a policy imperative to ensure that development and use of strategic coal chain infrastructure is done in a manner that promotes efficient industry growth and minimises and optimises investment. The economic benefits of coordination are less capital investment for unit of output, a competitive coal export industry, the right investment signals, and reduced gaming and the inherent inefficiencies this brings.

History and current experience has shown that self interest on the part of some participants in the coal chain will ensure that voluntary establishment of independent coal chain planning and coordination functions will not work. In an increasingly competitive market with increased stakeholder pressure on not developing expanded export facilities due to environmental concerns, it is imperative that existing systems operate efficiently and to their maximum capacity and that expansions are optimised.

Xstrata Coal therefore recommends that the National Access Regime should require the establishment of independent export chain coordination bodies with the objective of ensuring coordinated, independent and impartial system performance assessment, reporting and recommendations in relation to investments in export infrastructure capacity in the relevant system. The following suggested approach could be adapted for other export chains or made applicable on specific basis to coal:

1. All owners and operators of coal supply chain transport infrastructure should be obliged to negotiate in good faith with all other coal supply chain participants within each relevant coal supply chain and use their best endeavours to reach agreement within a specified time period (nominated by the Minister or regulator) to:
 - a. the establishment of an independent coal supply chain coordination body for the coal supply chain;
 - b. principles for measuring system capacity of the coal supply chain and alignment of capacity that can be contracted in respect of each facility constituting coal supply chain transport infrastructure in the coal supply chain;
 - c. a common system of long term capacity planning and a process for analysing optimal investments in the coal supply chain;
 - d. a process for coordinating maintenance and other planned outages on each facility constituting coal supply chain transport infrastructure in the coal supply chain;
 - e. a process for determining common system assumptions for the coal supply chain;
 - f. measurement of actual performance of coal supply chain participants against system assumptions and allocation of system losses; and
 - g. a process for coordinating scheduling and day of operations scheduling decisions.
2. If there is not agreement among coal supply chain participants on the establishment of an independent coal supply chain coordination body for a coal supply chain within the timeframe required the regulator or Minister should have the reserve power to:
 - a. establish such a body having regard to best industry practice; and
 - b. require all owners and operators of coal supply chain transport infrastructure within the coal supply chain to comply with directions and decisions of the body in connection with the matters described in point 1 above subject to the body not being able to give directions or make decisions which:
 - (i) prevent an owner or operator of coal supply chain transport infrastructure from complying with its existing legal or contractual obligations; or
 - (ii) require an owner or operator of coal supply chain transport infrastructure to invest in an expansion of that infrastructure.

The negotiations required as part of this process and the provision of information in such negotiations, and any resulting agreement, between coal supply chain participants should be specifically authorised for the purposes of section 51(1)(b) of the CCA.

7. Conclusion

The Australian mining industry faces a significantly more challenging environment than ever before in its history. Export supply chain inefficiencies in Australia together with facilitative policy settings in competing mining countries and substantially lower cost structures demand a renewed and revitalised policy framework to make our mining projects cost competitive. The required revised policy settings extend beyond infrastructure regulation to the labour market, approvals processes and taxation stability. The current Productivity Commission review of the National Access Regime represents an important first step in addressing these challenges.

The essential elements of the regulatory regime that must be addressed to ensure a viable east coast coal export industry include:

- ensuring existing regulated natural monopoly infrastructure cannot opt out of regulation;
- recognising and giving weight to whether or not it is practicable to provide duplicate infrastructure;
- balancing the rights of privately funded single user integrated infrastructure chains with the benefits to the broader economy of competition;
- mandated coordination of planning, operations and performance measurement across multi user – multi owner coal chains;
- removing the limitations on regulators to effectively direct an extension.

Aligning owner and user interests to optimise infrastructure investment and operation would assist in addressing many of the inherent deficiencies in the national access regime. In the absence of such a policy and where essential supply chain infrastructure is already held by unaligned parties, a robust access regime is essential to avoid market failure and misuse of monopoly power. This is particularly the case where former government owned export infrastructure has been privatised or where privatisation is mooted. These infrastructure facilities continue to exhibit the natural monopoly characteristics that justified (or required) the initial government investment to develop them as opposed to initial private sector investment. Typically this infrastructure is multi-user and part of a multi-owned chain and the challenges posed warrant special consideration.

8. About Xstrata

Xstrata Coal is a business unit of Xstrata Plc, one of the world's largest mining and metals companies, and a major producer of seven commodities including copper, coking coal, thermal coal, ferrochrome, nickel, vanadium and zinc. Xstrata Plc has operations in more than 20 countries and employs more than 70,000 people globally.

Xstrata Coal is the world's largest exporter of seaborne thermal coal used to generate electricity and one of the largest producers of metallurgical coal used in the production of steel. About 85% of the coal we mine is exported to global markets including Japan, South Korea, Taiwan, China and Europe.

Headquartered in Sydney we have interests in over 30 open cut and underground coal mines in Australia, South Africa, Columbia and exploration projects in Canada. We employ more than 17,000 globally including contractors – with the majority of employees in Australia working out of the New South Wales Hunter Valley and Queensland's Bowen Basin.

Competitive, efficient and reliable access to port and rail infrastructure is critical to getting our products to market. In New South Wales, our coal is exported through the Port Waratah Coal Terminal and Port Kembla Coal terminal. In Queensland we operate the Abbott Point Coal terminal and also export our product through the multi user Dalrymple Bay Coal terminal and the R.G. Tanna Coal Terminal.

Xstrata Coal has also invested in the Hunter Valley coal supply chain to ensure security of supply by establishing Xstrata Rail, a fleet of trains that complement existing services from Pacific National in New South Wales.

Our mission is simple. It defines our role in society. We deliver natural resources that are at the heart of everyday life and are central to the development of society. We extract these products profitably, efficiently and responsibly. In the process, we create value for our shareholders, minimise our environmental impact and contribute to communities and the economy.