



Useful Life of DBCT Assets

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EXECUTIVE SUMMARY

DCBT distributes coal from mines in the northern and central Bowen Basin. The best estimate of net saleable reserves in the *DBCT catchment area*¹, derived from Government reported sources is 2,790 Mt. At DBCT's current capacity of 56 Mtpa this represents throughput at current capacity of a maximum of 49.8 years.

There is no mine currently operating, or which has capital committed which will have a life of longer than 50 years.

Coal from the DBCT catchment area faces numerous challenges over the long term, including:

- Use of alternative materials to steel.
- Use of alternative steel making technology.
- Use of alternative energy sources.
- Introduction of punitive government imposts.
- Emergence of new supply sources.

Forecasting the market position for a period greater than 50 years is therefore extremely difficult. There is no basis for assuming with any level of certainty that the economic life of DBCT will be longer than the current identified resource base is able to support.

Underestimation of the economic life of the assets is likely to have a less detrimental economic effect on the DBCT catchment coal industry as a whole than overestimation of the economic life, given the market conditions and competitive advantages currently enjoyed by Bowen Basin coal producers. Trying to remedy an overestimation of economic life through accelerated depreciation at some future point in time would lead to an increase in competitive pressure on the DBCT catchment producers at the very time when they are under most cost pressure, and may in fact lead to an exacerbation of the asset stranding risk. In estimating the economic life it is prudent to err on the side of underestimation.

There are a significant number of coal industry assets which have suffered exactly the asset stranding risk which could be faced by DBCT. These assets are in regions with strong resource bases and previously buoyant outlooks similar to that which the DBCT catchment area currently enjoys. Examples include the Port Kembla Coal Terminal, Los Angeles Coal Terminal and the Ridley Island Coal Terminal.

In these circumstances, for assets at DBCT with a physical life longer than 50 years, it would be prudent to adopt an economic life of 50 years for future return of capital calculation purposes.

¹ Defined as resources where the least cost export pathway will likely be through DBCT rather than Abbot Point or Gladstone terminals and excluding mines/deposits operated by BHP Billiton (which would use Hay Point terminal)



1. INTRODUCTION

The background to this document is as follows:

- As part of the regulated revenue setting process which drives regulated tariffs, a number of factors are considered, including the setting of a depreciation allowance (effectively a return of capital).
- The regulator must decide on a methodology to apply to determine the appropriate depreciation allowance, including determining the useful life of the asset for depreciation purposes.
- Regulatory precedent and the relevant Australian Accounting Standard requirement is to use the shorter of economic or physical life of the asset to determine the useful life of the asset.
- Prime Infrastructure (DBCT) Management Pty Limited (Prime) submitted a Draft Access Undertaking (DAU) to the Queensland Competition Authority (QCA) on 20 June, 2004 in respect of the Dalrymple Bay Coal Terminal (DBCT).
- In that draft, the following approach was proposed:
 - o Straight line depreciation to apply.
 - o A maximum economic life of DBCT assets of 50 years.
 - o For assets with a physical life less than 50 years, the physical life should be used in calculating the return of capital.
 - o For assets with a physical life greater than 50 years, the economic life of 50 years should be used in calculating the return of capital.
- The QCA released a draft decision in October 2004 which did not approve the DAU submitted by Prime. In calculating the return of capital (or future depreciation) component, the QCA did not apply an economic constraint, with assets with a remaining physical life greater than 50 years depreciated over their physical life.

At the request of Prime, Barlow Jonker Pty Ltd (BJ) has prepared this briefing document which analyses the appropriate method for determining the useful life of the DBCT assets for return of capital purposes.

2. DETERMINATION OF ECONOMIC LIFE

The determination of the economic life of the DBCT assets must consider the potential for commercial obsolescence, both of the assets themselves, and of the product which they handle: coal from coal mines in the DBCT catchment area. There would be no alternative use for the assets that would deliver a greater value than scrap value should coal mining in the region cease.

There is a large range of possible outcomes for production from the DBCT catchment area over the period of the physical life of the longest-lived DBCT assets (per Maunsell, 70 years). These range from failure of production in the near future due to some unforeseen shock, to continued strong growth for the entire 70 year period. Neither of these outcomes, or any particular outcome in the range between these extremes can be forecast with certainty, however factors influencing the selection of the appropriate period over which capital should be returned to DBCT investors are provided below.

It should be noted that most published forecasts of production are carried out over timeframes only up to 20 years, and thus do not consider the effects of potential structural changes in the market, or exhaustion of mine resources after this period.

2.1 Physical Exhaustion of Bowen Basin Resources

The northern and central Bowen Basin region from which DBCT draws its customers contains a very large, well explored resource of metallurgical and thermal coal which has enjoyed steady production and export growth over the last two to three decades. Presence of a resource does not, however, guarantee the continuation of viable mining operations. This is discussed further in section 2.3 below. Notwithstanding this issue, the following section considers the size of the resource in the DBCT catchment area.

Forecasters generally predict that growth in the Bowen Basin will continue over the next two decades. Despite this, the resource is not inexhaustible. An analysis of Department of Natural Resources reported figures for current and potential customers within the DBCT catchment area (ie excluding BHP Billiton operated mines and deposits which can use the Hay Point Coal Terminal, and those which are or would be serviced by Abbot Point or Gladstone ports) reveals that the current resource will provide only 50 years of throughput at DBCT at its current capacity as shown in Table 2.1 below.

In this analysis, government reported figures for measured and indicated resources have been compiled. Where uncertainty arises, the analysis takes the position which is likely to result in the longest reasonable estimate of remaining life:

1. It has been assumed that each deposit identified and reported by the DNRM will be developed. However as time progresses it is likely that a number of these resources will be found to be unsuitable for development.
2. It has been assumed that 100% of the output from these operations is exported through DBCT and none is lost to competitors or domestic consumption. The actual position is likely to be lower than this because the link between the Goonyella and Newlands rail systems may be developed and completed within



the forecast period, and historically a proportion of coal from the DBCT catchment has been used domestically.

3. It has been assumed that the conversion rate for indicated resources to measured resources is approximately 80%. Although there is no completely reliable surrogate for exploration, this conversion rate is an appropriate approximation. The actual conversion rate is likely to be lower than this because the Bowen Basin is generally a highly structured geological setting, and significant discounting of resources is likely to be required as borehole spacing is decreased.
4. It has been assumed that 80% of measured open cut resources are recoverable and 60% of measured underground resources are recoverable. Some operations achieve results higher than this because their seam geometry is uncomplicated and fuller recovery is possible. Others achieve results lower than this due to selection of mining horizons which do not match the seam contours. This is typically a result of quality issues in open cuts, and geotechnical issues coupled with limitations on equipment size in underground operations. The actual recovery rates seen in the Bowen Basin are likely to be lower than the assumptions because these numbers assume that all underground resources are recovered using longwalls, the most efficient technology currently available.
5. Finally it is assumed that average washing yield is 80% across the basin. Some deposits do not require washing and thus have a yield of 100%. Others require heavy washing, resulting in lower yields of around 60%. Based on historical precedent, the actual yield is likely to be slightly lower than the 80% used in this estimate. The average yield in Queensland for the last 10 years was 78%, and total yield generally falls over time.

At its current capacity of 56 Mtpa throughput this analysis indicates that there are currently 49.8 years of resources remaining in deposits and mines likely to export through DBCT. It should be noted that while the assumptions underlying this analysis as discussed above leave some room for an increase in this figure, they also provide more significant downside potential.

Table 2.1: Saleable Resource Estimates

Mine / Deposit	Resources (million tonnes)				Total
	Measured		Indicated		
	Open Cut	Underground	Open Cut	Underground	
Blair Athol	95		3		98
Burton	35	54		75	164
Clermont	197				197
Codrilla	42	3		15	60
Coppabella	69	74	36	48	227
Daunia	75		24		99
Foxleigh	74			28	102
Foxleigh South	14			71	85
German Creek	4	202	4	38	248
German Creek East	37		26		63
Grosvenor		205	20	110	335
Hail Creek	430			540	970
Hillalong	10	11	1	41	63
Lake Lindsay	45	9	29	33	116
Liskeard	6				6
Middlemount	23	100	3	33	159
Millenium	19			30	49
Moorvale	37		8		45
Moranbah North		166		95	261
Moranbah South				465	465
Mt Fort Cooper			70		70
North Goonyella	21	154			175
Olive Downs	15		19	268	302
Oaky Creek	9	160	13	106	288
Rugby				180	180
Vermont	80	195			275
Wards Well		331		289	620
Winchester South	90				90
Total	1427	1664	256	2465	5812
Assume 80% conversion rate of indicated to measured.	1427	1664	80% 205	80% 1972	5268
Assume 80%/60% (OC/UG) conversion rate of measured to recoverable.	80% 1142	60% 998	80% 164	60% 1183	3487
Assume 80% yield.	80%	80%	80%	80%	
Estimated Net Saleable Reserves	913	799	131	947	2790

As the assets at DBCT are used solely for exporting coal from the central and northern Bowen Basin, and the operations and deposits likely to use DBCT have resources which are limited to 50 years at current throughput capacity, the economic life of the assets should be limited to 50 years.

Although the potential exists for further resources not listed above to be discovered in the Bowen Basin:

1. The Bowen Basin is a well explored region, and it is likely that the majority of coal resources in the DBCT catchment area have already been discovered.
2. The return of capital from the DBCT assets should not be contingent on discovery of resources which are currently unknown or are currently not

economically viable as this would require investors in the DBCT infrastructure assets to assume exploration and/or resource development risk.

2.2 Individual Mine Considerations

Mines currently exporting through DBCT have varying mine lives. Closure of German Creek Central, Riverside, Blair Athol and Burton is likely within the next 5 years. On the other hand, Hail Creek has a life of up to 50 years. On current resource estimates (using the analysis in Table 2.1) and estimated saleable capacities, there is no mine currently operating in the DBCT catchment area which has a life of over 50 years of operation at full capacity.

Similarly, there are no mines for which construction has begun or for which construction capital has been committed which have lives sufficient to result in them remaining open in 50 years time even after allowing for delayed start up due to construction time.

Thus for DBCT to avoid obsolescence in the long term, it must rely on changes in the market which result in commitment of capital by owners to develop new deposits. As mine owners commit capital in an economically rational way, it is reasonable to assume that deposits which have not yet been developed are not considered by their owners to generate sufficient economic returns on current market projections.

It is inappropriate for investors in DBCT assets to be required to rely on changes in the market for return of their capital as such changes cannot be forecast with any certainty. Having regard to the physical, technical and commercial facts surrounding the lives of existing operations in the DBCT catchment area, and having regard to the appropriate level of risk which investors in DBCT should be required to assume it is unreasonable to rely on deposits which are currently uneconomic for return of capital.

2.3 Market Considerations

Global demand for coal from the DBCT catchment area is currently at historically high levels. However there is considerable risk that, even if supply was available from the DBCT catchment area for a period longer than 50 years, demand for coal from the DBCT catchment area would not be sustained at current levels.

2.3.1 Use of Alternative Materials to Steel

Coking and PCI coal is used almost exclusively for steelmaking. Any reduction in demand for steel will result in a reduction in the demand for coking and PCI coal. Although steel is a good general purpose, versatile building material, the use of alternative materials to steel (ie alternative construction materials, alternative manufacturing materials) is growing as a proportion of total material use.

Changes in building materials have occurred in the past (eg change from stone to wood, change from wood to steel, introduction of aluminium, carbon fibre). Alternatives to steel in manufacturing are currently being introduced (eg use of magnesium and/or aluminium alloys in engine manufacture, use of carbon fibre for lightweight applications).

Forecasters generally see increased use of steel in the next two decades, however even this timeframe presents considerable difficulties for forecasters. There is no way of forecasting with any certainty that steel use will continue at current rates into the longer term future.

It is a commercial fact that the use of alternative materials to steel is continually and heavily researched, and increasing use of alternatives would result in a reduction in demand for steel and thus a reduction in demand for coal.

2.3.2 Use of Alternative Steel Making Technology

The majority of current steel production is carried out in blast furnaces which use a combination of coke derived from coking coal and pulverised coal directly injected into the oven. A number of alternative technologies exist for making steel which do not require coal, or require significantly reduced quantities or qualities of coal. Examples include direct reduction in electric arc furnaces, Corex, Finex and Hi-Smelt technology. Increased adoption of these technologies is likely to result in a decrease in demand for coal from the DBCT catchment area.

The introduction of low volatile matter PCI coal has occurred over the past ten years from a base of approximately 1 Mtpa to around 15 Mtpa, illustrating that steel making technology is far from settled. EAF and alternative technologies currently account for 33% of steel produced. Alternative technologies such as Corex and Finex require lower quality coal which may be sourced from alternative regions to the Bowen Basin.

It is a commercial fact that alternative steel making technology is being continually and heavily researched, and increasing use of alternative technology would result in a decrease in the demand for coal from the DBCT catchment area.

2.3.3 Use of Alternative Energy Sources

Thermal coal is used predominantly for power generation. Thus any decrease in the market share of coal resulting from adoption of alternative energy sources (eg nuclear, renewables, hydrogen, natural gas) will result in a decrease in the demand for coal.

Environmental awareness and political support for renewable energy sources is increasing, and government incentives to use fuels which have a lower greenhouse gas emission intensity are becoming more widespread. Global production of energy from renewable sources is increasing steadily. Hydrogen shows signs of emerging as a viable fuel source in the long term. Natural Gas and LNG are being developed at an increasing rate.

It is a commercial fact that alternative fuel sources are being continually and heavily researched, and increasing use of alternative fuel sources would result in a decrease in the demand for coal from the DBCT catchment area.

2.3.4 Introduction of Punitive Government Imposts

The demand for coal is based to a large extent on its price attractiveness compared to other fuels. A component of the price is government taxes / levies / duties on the supplier, the importer and the end user. Introduction of a punitive regulatory environment (eg through carbon taxes, emission limits and trading schemes, differential import duties, increased royalties etc) may distort the competitive environment in which the coal industry operates, leading to a decrease in the competitive advantage currently enjoyed by coal.

Japan has already introduced a regime of increased taxes on coal imports. A proposal is currently before the Colombian senate to place an environmental levy on coal exports through Santa Marta ports. Cap and trade emission trading schemes have been introduced in various regions of the world, notably the European Union. Ratification of the Kyoto Protocol will likely see an increase in the use of such systems.

In Australia, the planning process for approval of new or expanded coal mines is becoming more onerous. A recent decision by the Victorian Civil and Administration Tribunal (VCAT) has suggested that investors need to consider not only the direct greenhouse emissions from projects in which they invest, but also the indirect downstream effects on climate change. The decision related to the Hazelwood Power Station expansion application. The application was considered by a planning panel, which was instructed by the Victorian Planning Minister to consider only the greenhouse gas emitted by the mining of coal, and not the subsequent burning of it. The VCAT ruled that there was a sufficient nexus between the two activities and that downstream emissions by end users should have been considered in the planning process. This has the potential to significantly increase the regulatory burden on the development of new or expanded resources in the DBCT catchment area if this decision is adopted in Queensland.

It is a commercial fact that measures to decrease the emission of greenhouse gases are being progressively implemented around the world. It is a physical fact that the burning of coal produces significant quantities of greenhouse gas emissions which make coal a target for regulators.

2.3.5 Emergence of New Supply Sources

The DBCT catchment area is currently a leading supplier of coal to the world. However it faces competition from other supply regions. Emergence of alternative suppliers, especially in locations close to major consumers would undermine the competitive position of DBCT customers.

The physical facts surrounding the introduction of new supply sources are as follows:

In the past 20 years, Colombian coal exports have grown from essentially nil to around 40Mtpa. In the same time frame, Indonesian coal production has grown from around 1 Mtpa to around 100 Mtpa. Meanwhile exports from the USA, a well established exporter, over the same timeframe have decreased from 74 Mtpa

in 1984 to 39 Mtpa in 2003 in response to competition from emerging sources. China is the world's leading coal producer and currently consumes most of its coal domestically, but in 50 or more years time this capacity could potentially be directed to supplying the international market. The Russian and Polish industries are currently undergoing restructuring but over a 50+ year timeframe may be in a position to compete into Asia and Europe respectively. New coking coal deposits are being explored and/or developed in Mozambique and Indonesia. Botswana has over 4 billion tonnes of thermal coal resources which could be competitive into Europe if a rail link to the west coast is developed.

2.4 Determination of Economic Life

The entire resource base of the DBCT catchment area considered together is only sufficient to sustain DBCT at its current level of throughput for a period of 50 years. No operation or deposit within the DBCT catchment area considered in isolation has a resource base capable of sustaining production at full capacity for a period of more than 50 years.

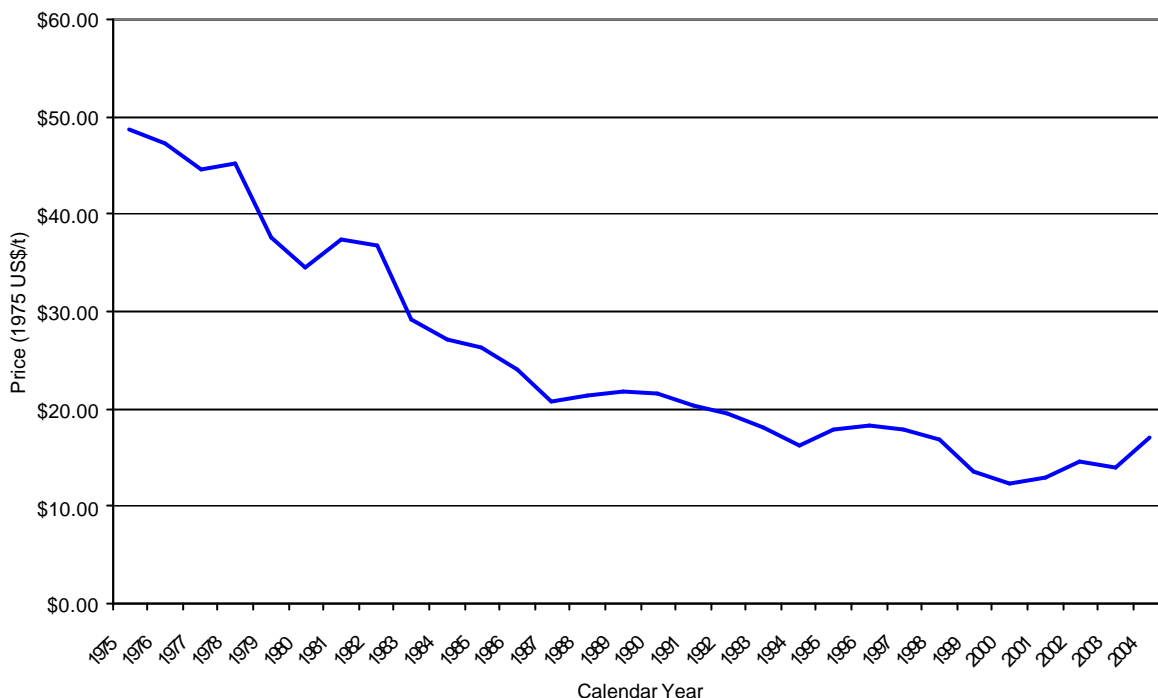
Thus on publicly available information, the best estimate of the economic life of DBCT cannot exceed 50 years without relying on resources which are as yet undiscovered (i.e. are not listed as measured or indicated resources by the DNRM), or are currently not considered sufficiently economic to justify commitment of capital by their owners (i.e. are listed by the DNRM but have not yet had capital committed by their owners).

The DBCT catchment area is relatively well explored and it is likely that the majority of resources have already been identified. Consequently, for the economic life of the DBCT assets to be longer than the 50 year period indicated by this analysis would require a strengthening of the economic viability of coal from the DBCT catchment area in the future to allow resources which have been identified, but are currently sub-economic, to be developed.

Long term increases in the real price of coal are not supported by trends in the market as shown in Figure 2.1 below.



Figure 2.1: Long Term Real Hard Coking Coal Benchmark Price (Constant 1975 US dollars)



Use of alternative building materials to steel, use of alternative steel-making technologies, and use of alternative power generation technologies have all seen increases in the past two decades and it is a commercial fact that research into replacing coal as both a fuel source and a reducing agent in blast furnace technology will continue in the future. Public and governmental attitude to carbon dioxide producing activities is increasing the regulatory and financial burdens on coal exporters. This effect is expected to increase in the long term. It is a fact that alternative supply sources will continue to be developed, and will compete with sources from the DBCT catchment area.

Considering the physical, technical and commercial facts, there is no basis for assessing an economic life for the DBCT catchment area (and thus the DBCT assets) beyond the 50 years indicated from analysing the resources which are currently known to exist in the region.

3. ANALYSIS OF RISK OF ERROR

In deciding on an economic life for the DBCT assets there are two potential error scenarios:

1. Overestimation of the economic life.
2. Underestimation of the economic life.

Each of these is analysed below.

3.1 Overestimation of the Economic Life

If the economic life is overestimated, the capital invested in the DBCT assets will not be fully recovered from coal exporting activities. As the terminal has no viable alternative use, this would result in DBCT becoming a stranded asset.

Attempting to guard against this outcome by implementing a policy of accelerated depreciation in the later years of the terminal's life, with the increased depreciation costs passed on to users as increases in the regulated tariff after the overestimation is detected, would not result in a reduction in the risk of stranding.

If DBCT is facing a reduced economic life, then by definition it will not be shipping the capacity it was designed to ship. On the analysis in section 3 this is likely to be because coal from the DBCT catchment area is under competitive pressure from use of alternative building materials, use of alternative steel making technologies, use of alternative generation technology or alternative coal supply sources. By passing accelerated depreciation charges onto the DBCT catchment producers at that time, the competitive pressure on the producers would be increased, resulting in an acceleration of the reduction in economic life of the port. Thus the above solution to the asset stranding risk resulting from the overestimation of economic life would in fact exacerbate the issue which it is trying to address.

3.2 Examples of Overestimation of Economic Life

There are a number of examples of assets related to the coal industry where the economic life of the asset has been overestimated and the asset has become stranded. These are identified below. Each of the issues which has resulted in asset stranding or early closure of a coal related asset has the potential to affect DBCT and the DBCT catchment producers.

3.2.1 Port Kembla Coal Terminal

In this case, a coal terminal with a nominal capacity of around 16.5 Mtpa (expanded in the mid-1990's) has a current throughput of approximately 7.5 Mtpa. This is due to changes to the local steel making industry, removal of government assistance, switching of suppliers to the domestic market and changes in market requirements. These issues were unforeseen when the expansion in the 1990's was undertaken, and the structural changes occurred despite the Port Kembla catchment area having a significant resource base and a long history of profitable coal mining.



3.2.2 Los Angeles Coal Terminal (LAXT)

This terminal was sponsored by Japanese trading houses in order to ensure security of supply. The coal in the LAXT catchment area, however, was uncompetitive into Asia in the face of competition from new supplies, particularly from Indonesia. This issue was not foreseen during the decision making process to proceed with LAXT. Consequently exports through LAXT have been well below the expected level resulting in the stranding of this terminal.

3.2.3 Ridley Island Coal Terminal

Ridley Terminal is located in the Port of Prince Rupert it was built to service a number of export coal mines in North East British Columbia established in the early 1980's with a large resource base capable of sustaining long mine lives. The Ridley Terminal has a coal export capacity of 16 Mtpa, however by 1999 the level of coal shipments was down to 6 Mt and by 2001 it had fallen to 2 Mtpa as mines servicing the terminal became uncompetitive with competitors. In April 2003 the last mine using the terminal (Bullmoose mine) was closed. The terminal is attempting to diversify its bulk handling facility to other commodities to help improve the viability of the terminal, however it is meeting with limited success and is effectively stranded.

3.2.4 Selby Coal Fields

The Selby coalfields were mooted as a major long term producer in the UK. The operators received subsidies from the UK government, and over the past two decades production increased steadily. Despite this, due to depressed markets, increased competition from other supply sources and unforeseen geological issues, the last 5 years have seen the Selby coalfields progressively closed. This has resulted in the stranding, not only of the mining assets, but infrastructure assets which relied on the Selby complex for throughput and revenue.

3.3 Underestimation of Economic Life

If the economic life is underestimated, the capital invested in the DBCT assets will be fully recovered before coal exporting activities through the terminal have ceased. Once the total amount of capital had been returned, this component of the regulated tariff would reduce to zero, resulting in a decrease in port costs and an improvement in the competitive position of the DBCT catchment producers at that time.

The corollary to this is that there would be an overpayment of depreciation costs by producers exporting earlier in the life of the assets. The market for coal is currently buoyant in historical terms, resulting in increased margins for coal producers. Furthermore, Bowen Basin producers currently enjoy a favourable cost position in the global market. An overpayment of depreciation costs would thus be unlikely to have a significant detrimental effect on the current competitiveness of DBCT catchment producers or introduce any production distortion into the market.



3.4 Conclusion

The effect of overestimation of economic life would be much more detrimental to DBCT catchment producers as a group, and to the Bown Basin coal industry as a whole (as well as to DBCT Management), than the effect of underestimation of the economic life. There are numerous examples around the world of areas which, despite having large resource bases and buoyant market outlooks, experience sustained, unpredicted decreases in output.

Although the current market for coal is strong, it is impossible to state with certainty the characteristics of the market for coal from the DBCT catchment area in 50 years. Thus there is no basis for applying a greater economic life to the DCBT catchment area than is indicated by its resource base (i.e. 50 years).