



Port Waratah Coal Services Limited

Submission in Relation to Australian Rail Track Corporation's Proposed Hunter Valley Rail Network Access Undertaking

25 October 2010

Introduction

Port Waratah Coal Services (PWCS) makes this submission in response to the Australian Competition and Consumer Commission's (**ACCC**) 16 September 2010 Consultation Paper inviting submissions on Australian Rail Track Corporation's (**ARTC**) proposed 2010 Hunter Valley Rail Network Access Undertaking (the **Proposed HVAU**).

Although not a party to the contractual arrangements between the ARTC and users of the rail network, PWCS believes that its perspective on these issues is highly relevant, as the arrangements impact both on PWCS and its customers. For example, if producers are uncertain as to their ability to secure rail capacity following the terminal allocation process, it may constrain their willingness to nominate for additional capacity at PWCS in the first place. In the extreme, if a producer could not secure adequate rail capacity to match their terminal commitment it might result in their facing financial distress, which would have a flow-on impact on PWCS and its other customers.

Operationally, PWCS must work closely with ARTC, other service providers and producers to ensure the Contractual Alignment principles outlined in the Implementation Memorandum, as reflected in the ACCC-authorized Capacity Framework Arrangements, are given full effect. That is, it is critical that there is a set of protocols across the industry that ensure that the coal chain is expanded to meet coal producers capacity requirements, operated as efficiently as possible, and that the contractual rights of all parties are upheld.

In the context of the Hunter Valley coal chain, contractual alignment is a multi-faceted concept. For contracts to be fully aligned there must be alignment along three key dimensions:

- Alignment of modelled capacity: that is, a common set of System Assumptions for calculating system capacity
- Alignment of contracted capacity, such that producers securing capacity in one component of the coal chain are able to match that commitment with capacity along other aspects of the coal chain.
- Alignment of the management of capacity: there is an integrated approach to identifying and managing gains and shortfalls of capacity

Along with the principle that producers should have the ability to utilise their terminal load point allocation without being infringed upon by the actions of other producers or their service providers, these provide a framework for the scope of contractual alignment.

The ARTC indicates in the Explanatory Guide to the HVAU (page 3) that it has engaged in a series of discussions with PWCS over the past year or so, aimed at addressing concerns over issues of contractual alignment. PWCS appreciates that effort and acknowledges that a number of the amendments that have been made reflect the alignment concerns raised in the course of those discussions.

For example, the alignment of the duration of the contracts (10 year evergreen) and the ability for smaller producers to secure quarterly allocations represented essential changes to align key terms in the PWCS Long-Term Ship or Pay contracts with the proposed below-rail contracts.

However, there remain a number of concerns regarding the alignment of the Proposed HVAU and other aspects of the new Contractual Framework Arrangements now in place in the Hunter Valley Coal Chain.

There are three key areas in which PWCS believes that the Proposed HVAU falls short of achieving an acceptable level of contractual alignment. These are listed below and outlined briefly in the following sections of this submission.

1. The Proposed HVAU provides **no guidance as to how the existing terminal allocations will be considered in transitioning** from the existing arrangements to the new HVAU
2. Even after the transitional arrangements are sorted out, the HVAU **does not provide certainty as to how ongoing requests for additional capacity** will be handled
3. The proposed HVAU **does not facilitate appropriate “operational alignment”** to ensure that losses (or gains) in capacity across the coal chain are identified on a timely basis and managed in an efficient, co-ordinated manner

These issues are discussed briefly in turn below.

1. Lack of Transitional Arrangements

The Proposed HVAU has no framework for transitioning from the current rail access arrangements (with access rights typically held by the rail operator) to the new arrangements. PWCS finds this surprising and unusual, as we understand that most new undertakings provide for a transition from existing arrangements.

The lack of transition arrangements is particularly significant in the case of the Hunter Valley coal industry, as the capacity allocation process at the terminals is already well underway and PWCS customers have to date committed to take-or-pay obligations without the assurance of matching below-rail capacity.

Under the Capacity Framework arrangements agreed in September 2009 and authorised by the ACCC, PWCS has conducted two rounds of annual nominations for terminal capacity, one in late 2009 and another, now underway. In late 2009, PWCS allocated tonnages to producers for contracts beginning in 2010, 2011 and 2012. Certain nominations were “suspended” in accordance the Allocation Protocols, as they were dependent on whether NCIG Stage 2 was committed.

By the 1st December, 2010 (i.e. within 6 weeks or so), producers will be informed of their allocations for the balance of their 2009 nominations and for their 2010 nominations. At that point, it is very likely that allocations (and thus, within a short period, firm contracts between PWCS and producers) will be in place encompassing at least the full development of the two existing PWCS terminals (approximately 140 Mtpa). It is our understanding that NCIG has signed contracts for up to 53 Mtpa.

Given that a minimum of **almost 200 Mtpa of terminal capacity will be under firm take-or-pay contracts by the end of the year**, it is urgent that producers have the opportunity to match these commitments with below-rail capacity.

As noted earlier, the Proposed HVAU is silent on transition arrangements, which leads PWCS to conclude that in the event the Proposed HVAU was implemented, all producers would need to apply for rail track capacity under the process outlined in HVAU Section 3 (Negotiating for Access). This would then lead to the application of the processes outlined in Sections 4 and 6, the outcome of which, it appears to us, would be quite uncertain, particularly as the approach to dealing with mutually exclusive applications requiring Additional Capacity is not defined. In fact, it is not even clear that applications would be treated as “competing” – perhaps they would be treated on a “first-come first-served” basis. The process outlined in Sections 4 and 6 is quite complex and uncertain, but there appears to be a risk that allocations of rail capacity would not be aligned to producers’ terminal allocations.

PWCS would suggest that a separate process be implemented to handle the transition to the new arrangements. Although not wishing to be overly prescriptive as to the approach to this process, as it is a matter to be settled between the producers and ARTC, we would suggest principles such as those below guide its design:

- All producers treated equally if nominations for rail capacity submitted by an agreed deadline;
- Nominations for track capacity submitted with firm terminal contracts (or other Network Exit Capability) be given priority over nominations from others without firm Network Exit Capability;

- If all nominations having firm Network Exit Capability can be satisfied (after considering the “feasibility” of expansions) then all such capacity nominations will be matched;
- If there is not enough capacity available (or able to be built) to satisfy all nominations with Network Exit Capability, then an agreed set of protocols for scaling back track access would be applied (but those scaled back would have first rights to Additional Capacity when it becomes available).

It is vital that producers holding contracts for terminal capacity can gain certainty as to whether – and to what extent – they can match those contracts with rail capacity, and that the processes for doing so are fair and transparent, so that they can act to align their contracts across the coal chain.

2. Inadequate Certainty in Negotiating for Additional Capacity

Once the transitional arrangements are sorted out, as outlined in the previous section, the Proposed HVAU needs to provide certainty as to how ongoing requests for additional capacity will be handled. Obviously, this is of paramount importance to PWCS, as its customers (current or potential) may be constrained in their willingness to nominate for capacity entitlements at PWCS if there is uncertainty as to the process to determine whether and when they will get the necessary rail capacity to access their terminal allocation.

PWCS believes that the Investment Framework set out in the Proposed HVAU falls short in a number of areas:

- Clause 3.13 dealing with mutually exclusive applications has been narrowed to address applications for Available Capacity, but does not describe how competing applications requiring Additional Capacity will be prioritised;
- Although “user funding” is an option under the Proposed HVAU for an Access Seeker to ensure Additional Capacity is funded, the investment framework is incomplete in dealing with user-funded expansions:
 - The ARTC still has a great deal of discretion to choose not to build Additional Capacity, even if the project is funded by users;
 - The time frame in which the ARTC has to make a decision on whether or not to fund Additional Capacity is unclear; there is a concern that the ARTC can delay a fund/build decision until it might be too late for the Access Seeker to fund/build in time to meet its capacity requirements;

- It is not clear whether, when or how an Access Seeker considering whether to fund an expansion will know the extent to which the expansion being funded will be allowed in the RAB, and thus have some or all of its costs spread across all users.

The PWCS contractual arrangements provide a much greater level of certainty to producers. Essentially, subject to having a Development Consent, PWCS is required to fund and build expansions to meet all nominations, subject to very limited exceptions. The conditions in the PWCS contracts are somewhat unique, and PWCS would not suggest that similar “fund and build” requirements be built into the ARTC arrangements.

On the other hand, to provide producers with certainty, the “right to fund” arrangements for track capacity must be strong and transparent. If an Access Seeker is uncertain as to their ability to fund (and thus ensure the construction of) track capacity, the entire intent of the new Contractual Framework is weakened. At its core, the intent of the Contractual Framework was to ensure that existing and new producers could secure access to the infrastructure necessary to facilitate industry growth on a fair and transparent basis. If this is not achievable on the track, it will lessen the value of the certainty that PWCS provides to producers nominating for capacity at the terminals.

3. Lack of Operational Alignment

The new Capacity Framework Arrangements anticipate a close working relationship amongst the various participants in the coal chain in order to achieve efficient operation, and to protect participants’ contractual rights. The Implementation Memorandum, developed by the Contractual Alignment Working Group during the development of the new CFA, envisaged an independent HVCCC coordinating investment planning across the coal chain, and this is consistent with the process outlined in Sections 6.3 and 6.4 of the Proposed HVAU.

Further, the Implementation Memorandum (Schedule 5, Para 6.4 - Contractual Alignment Principles) noted that excessive ship queues would be addressed by ensuring:

Producers whose performance varies from their agreed System Assumptions which form the basis of their contracted Access Rights directly and individually incur the capacity increase or decrease as a result of their individual performance.

It was envisaged that an individual producer’s right to coal chain capacity would not be affected by the performance of another producer (or their service provider), and that those responsible for causing losses in system capacity would wear the impact of doing so. This intent was then reflected in the Long-Term Ship or Pay contracts entered into between PWCS and producers.

The Proposed HVAU falls short of this objective in a number of areas:

- Clause 6 in the IAHA and Clause 5.5 in the Proposed HVAU propose an approach for addressing Capacity Shortfalls on the track. Firstly, PWCS believes there should be a stronger, more positive obligation on ARTC to identify shortfalls in the first instance; the current wording suggests the ARTC only needs to act if they identify a shortfall, but does not obligate them to continually monitor track operations to ensure shortfalls will be recognised as and when they occur;
- Secondly, and perhaps more significantly, the Clauses noted above provide ARTC with effectively total discretion to allocate shortfalls relating to events with a shortfall of five days or less. In PWCS' experience, nearly all track shortfalls are cleared within five days or less, so the Clause has the effect of enabling ARTC to distribute capacity losses as they see fit, regardless of the cause of a loss, or the producers affected.
- Clause 11.6 of the IAHA, dealing with Cancellation of Services should be carefully reviewed to ensure there are no practical problems in its implementation:
 - If the services cancelled in a given week have an impact on rail Capacity or Coal Chain Capacity in that week, and if the producer at fault for the cancellation of services is also the one that had their allocation reduced under clause 6 of the IAHA, the application of Clause 11.6 – which results in the loss of paths in the following month – should be checked to ensure that there will be no “double penalty” for the producer. It may be necessary to refine the drafting of Clauses 6 and 11.6 to ensure that Path Usages are removed once (and only once) in various circumstances.
 - The mechanism for reallocating Path Usages removed from the “at fault” producer to the affected producer should be transparent, so that the affected producer has the maximum opportunity to utilise these reallocated paths in the subsequent Period.

More generally, PWCS would like to ensure that there are clear protocols for measuring and assigning accountability for performance across the coal chain.

Finally, PWCS does not believe that the proposed review of the policy and processes for identifying and allocating losses of Capacity, proposed in Section

5.9, is appropriate. This review should be conducted on an industry-wide basis, not led by a single service provider. PWCS supports the concept of a broad-based review, as outlined in Clauses 5.9 (b) and (c) but suggests that the review be led by the HVCCC, which would in turn engage a wide range of stakeholders. PWCS would be willing to participate in a review on that basis.

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The ACCC's Consultation Paper invited submissions covering a wide range of matters related to the Proposed Access Undertaking. PWCS has chosen to focus on a subset of issues around which PWCS has a particular perspective and interest. It should be noted that PWCS's lack of comments in particular areas does not indicate that its customers might not have valid concerns with other aspects of the Proposed HVAU.

The issues on which PWCS has chosen to comment are, however, central to promoting the efficient use of, and investment in, the Hunter Valley coal chain, and the rail network in particular. Given the relatively short period between the issuance of the Proposed HVAU, the ACCC's Consultation Paper and the preparation of this submission, PWCS has not been able to meet further with ARTC to discuss the issues raised here. PWCS is, of course, willing to meet with the ARTC, or the ACCC, to discuss any aspect of this submission or any other matter relating to the proposed HVAU.



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