

Port Waratah Coal Services Limited

Attachment G - Medium term solution industry survey results

See file: Attachment G.pdf.

1. Preferred approach for adjusting any demand/supply mismatch in 2005 & 2006



Support was divided between rules-based and market-based. There was some support for a hybrid solution incorporating both options.

Conclusion

- Responses were divided
- There were no new alternatives suggested. The only variation offered was a combination of pro-rata and an auction
- Some respondents commented that they do not think there will be a demand/supply mismatch in 2005

Survey Response

<input checked="" type="checkbox"/>	Rules Based Adjustment i.e. Pro-Rata	35%
<input checked="" type="checkbox"/>	Market Based Adjustment i.e. Auction	41%
<input type="checkbox"/>	Hybrid	12%
<input type="checkbox"/>	Do Nothing	12%

Quotes:

- "Auction based mechanism preferred to ensure allocative efficiency in distribution of available capacity. Suggest rules based mechanism (pro-rata allocation without financial compensation) be deployed only if the auction does not clear - creates incentive for producers to participate in auction."
- "We have yet to determine our preferred market approach. Our approach would also depend on the level of mismatch between actual demand and actual capacity."

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1. Preferred approach for adjusting any demand/supply mismatch in 2005 & 2006



Quotes: (continued)

- "In principle we prefer a market based approach, being an auction in preference to a rules based adjustment. However, as a first step we believe it is necessary to more accurately determine how much demand is really in the system. We believe the process to date may have resulted in over-inflated estimates. Our preference would be, as a first step, to call for further indications of demand with a clearly stated Take or Pay obligation up front. The level of the take or pay charge needs to be sufficient to minimise incentives for gaming. The need for a market based system could be reassessed at that time. If the difference between capacity and demand were marginal at that point, we would argue that there is no need for any system. This is largely because of the considerable time and effort that would need to be devoted to setting up an auction system."
- "We do not accept that there will necessarily be a mismatch in 2005. If a mismatch becomes evident, then we will agree to a rules-based adjustment."
- "Leave it to the market without intervention. Do everything possible in the short term to increase capacity and complete plans for expansion long term as a matter of urgency"
- "Not yet satisfied that an interventionist approach is needed."
- "There will need to be some recognition of base tonnes where the allocation leaves a mine in an non - operational position."

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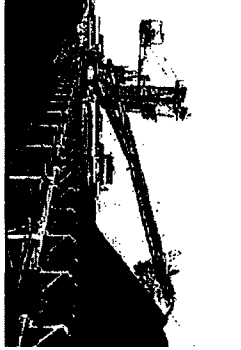
1. Preferred approach for adjusting any demand/supply mismatch in 2005 & 2006



Quotes: (continued)

- "Any short-term solution has to be simple - PWCS is a common user facility and the capacity distribution system now operating is probably the fairest and most uncomplicated solution for the next couple of years"
- "We believe that both the medium and long term solutions should be addressed concurrently to avoid opportunistic tonnage requests in 2005 that are a function of current prices to the detriment of those operations who have been projecting growth in prior years. A combination of both pro-rata and market based solution underpinned with long term take-or-pay commitments."
- "A mix of pro-rata and auction; for 2005 only subject to review - Need to understand reasons queue disappeared this year before agreeing to any changes for next year."
- "I have some reservations in respect to Auction system under current market conditions. If payment is to be funded by levy over tonnage we may find ourselves paying more than we would be for demurrage."
- "The port should never be the bottle neck for the export of coal ex Newcastle on an annualised basis. However, if production and demand exceed the capacity of the port at any given point in time then the port must have the last right of refusal to accept vessels to the maximum agreed capacity of the port. Hence a pro-rata rules based adjustment should apply. However there should also be a transparent method of being able to trade or swap the capacity to suit shipping schedules."

2. If a Market Based mechanism was implemented, what would be your preferred design?



Of those that preferred a market-based mechanism, the majority would prefer a top-down auction.

Conclusion

- Responses favoured a top-down auction if a market based mechanism were implemented
- No respondents favoured a bottom-up auction
- Some respondents were undecided
- Some respondents favoured a top-down auction **only if** there is an option for producers to "opt-out" and accept a pro-rata reduction instead.

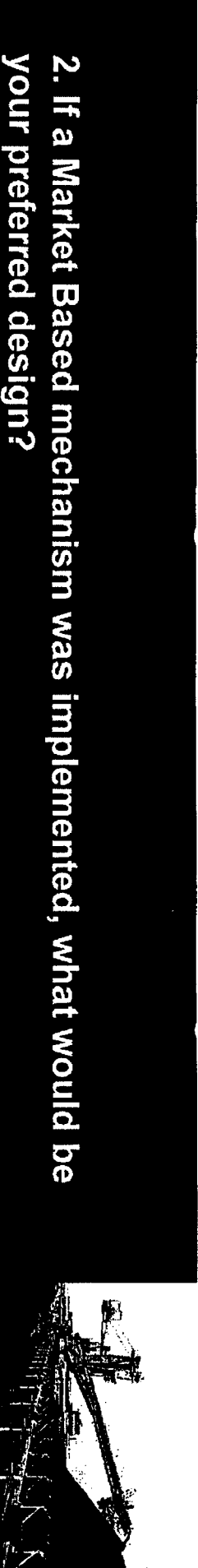
Survey Response

<input checked="" type="checkbox"/> Top-Down Auction	83%
<input type="checkbox"/> Bottom-Up Auction	0%
<input type="checkbox"/> Other	0%
<input type="checkbox"/> Undecided	17%

Quotes:

- "There should be no "Top Down" auction without a preliminary pro rata reduction across all tonnes. Once the pro-rata distribution has taken place producers may opt not to participate in any Auction. It will be impossible to identify small parcels of inflated tonnes in larger quantities. The pro rata will help to reduce the tonnes available for gaming. Gaming will be an issue in any auction - regardless of the rules and will lead to reduced system throughput."
- "Top-down auction with pro-rata allocation"

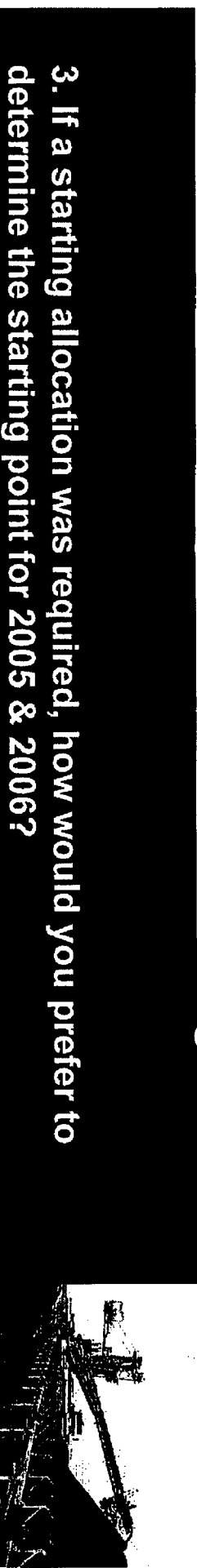
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2. If a Market Based mechanism was implemented, what would be your preferred design?

Quotes : (continued)

- "Do not support any mechanism that is counter to "common user" principles and confers exclusive rights on some producers."
- "We need to identify what the maximum level of compensation is per tonne is before the scheme is financially unviable."
- "A "bottom up" auction is not viable due to difficulties in re-distributing monopoly rent recovered by PWCS. Objective is to "buy-back" excess demand, not to sell the underlying available capacity. This can only be achieved by a "top down auction approach"
- "[We are] very wary of any market based mechanism especially the concept of an auction system either "bottom up" or "top down".
- "Strongly oppose any auction or sale/transfer process which confers "equity" rights on port capacity"
- "We are still considering the practicality of a bottom up vs a top down approach. Our view is that both systems should be examined carefully before any decision is made to favour one over the other. It is not clear to us that the top down approach is better. One issue is that if parties are compensated for giving up allocations, those parties might continue to produce and stockpile coal (the auction funds would finance the working capital). That coal might then simply be brought back onto the market in a subsequent period, compounding the allocation problem. With a bottom up auction, funds would not be used to compensate other producers. We would therefore need to decide what happens to these funds. One suggestion is that they be contributed to alleviating bottlenecks (eg, in the rail system) and off-set against access charges. A further issue with both systems is that a tonne of capacity from different parts of the coal chain won't necessarily have the same impact on overall capacity availability."



3. If a starting allocation was required, how would you prefer to determine the starting point for 2005 & 2006?

Of those that responded the majority supported a forecast in some form (either standalone, or with some historical reference). There was no support for pure historical.

Conclusion

- Responses favoured allocation based on demand nomination/forecast; many of these were conditional on independent verification or audit of nominations
- Other respondents favoured a hybrid approach combining some demand nomination with some historical (with varying weightings)
- No respondents preferred allocations based on pure historical data

Survey Response

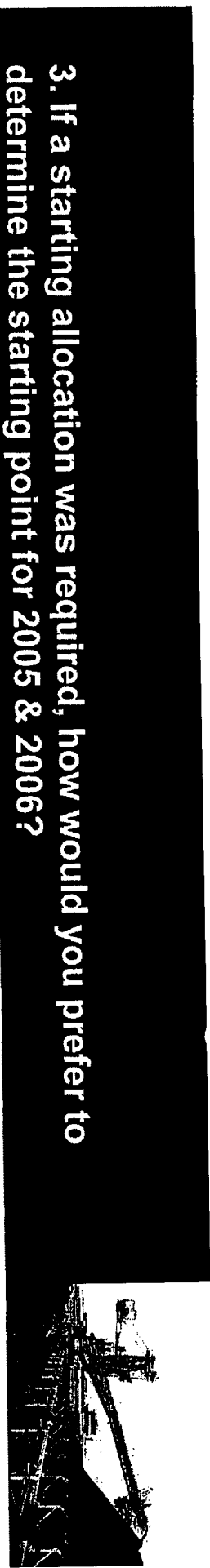
<input checked="" type="checkbox"/>	Demand Nomination/Forecast	56%
<input type="checkbox"/>	Hybrid	33%
<input type="checkbox"/>	Did not answer	11%
<input type="checkbox"/>	Pure Historical	0%

Quotes:

- "Historical allocations are largely irrelevant in a growing market. In the current market, the growth in tonnes is exacerbated by the current high prices for thermal coal exports and nearly all producers are looking to expand tonnages. The better alternative is to apply demand nominations with take or pay commitments."

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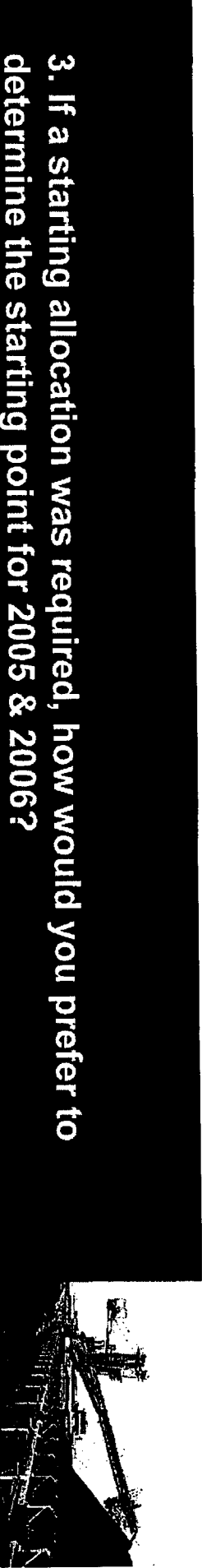


3. If a starting allocation was required, how would you prefer to determine the starting point for 2005 & 2006?

Quotes: (continued)

- "Historical should take into account the last 5 Years of actual PWCS shipments; Historical 50% and Forecast 50% weighting. - In 2006 there will need to be a larger weighting to Historical tonnes. A straight pro rata will impact the smaller producers more heavily and could leave insufficient tonnes to sustain production. The object of these proposals should not be to close any mines."
- "Demand Forecast needs to be independently audited to take into account the demand forecast versus the physical capability of each mine. Also, allocations are made on the assumption that there will be no production constraints, yet potential for these problems need to be considered and assessed at the time of nominations. I believe the current system whereby companies with more than one mine have their tonnage combined is unfair to those producers with single mines. The system should be changed to reflect a mine by mine allocation."
- "Emphasis on Historical forecast as per Barlow Jonker with minor weighting given to new forecast"
- "I think historical input is important but should include well audited forecasting"
- "Pro-Rata Allocation to those producers who can use"
- "Demand nomination/forecast would need to have appropriate checks and balances in place to ensure that no-one sought to 'game' the arrangements to advantage. Fair basis for determining starting point should be based on forecast usage, validated by potential audit of productive capacity and supported by Take-or-Pay commitment from producers. Transparency of forecasts are also critical to ensure there is confidence in the 'system' among participants. This minimises 'gaming' while ensuring equity between participants, including existing and new and expanding mines."

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3. If a starting allocation was required, how would you prefer to determine the starting point for 2005 & 2006?

Quotes: (continued)

- "Demand nomination subject to independent review as to reasonableness appears to be best out of proposals but seeking MORE/BETTER proposals that do not rely less on outside views of nominations but neither give preference to historical shipments over current"
- "A ranking in priority should be given to those operations who have invested in growth and projected that growth in prior years rather than those operations who may be seeking short term increases to optimise returns during a period of high prices."
- "Audited Forecasts to determine that pre-requisites exist (DC, ML, financing etc and that forecasts are real)"
- "Demand nominated but with take or pay consequences."



4. What controls/rules would you like incorporated to minimise gaming?



There is support for transparency, take-or-pay and technical audits as a means of discouraging gaming. A number of alternative or additional controls were suggested.

Conclusion

- There is strong support for transparency and take-or-pay. There is majority support for technical audit.
- Alternative controls that were suggested include:
 - Ability for arbitration in the event that the technical audit shows a materially different result
 - Increased flexibility tonnes, provided those tonnes cannot be sold / swapped
 - Further penalties (which need to be determined)

Survey Response

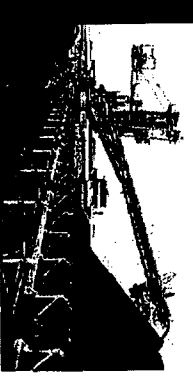
<input checked="" type="checkbox"/>	Transparency	82%
<input checked="" type="checkbox"/>	Take-or-Pay	71%
<input checked="" type="checkbox"/>	Technical Audit	65%
<input type="checkbox"/>	Other	18%

Quotes:

- “[We] strongly support the introduction of transparency, TOP commitments, audits and potential for an independent arbitrator to be appointed to settle any disputes. Collectively these measures act to minimise the benefits of gaming. Further consideration should be given to the value of the ToP charge for ‘tonnes not taken’ as a means to provide additional disincentive to gaming.”
- “Incorporation into the system of mine by mine forecasts and allocations not combined tonnages for companies with more than one mine.”

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4. What controls/rules would you like incorporated to minimise gaming?



Quotes: (continued)

- "The level of the take or pay charge will need to be considered carefully. It needs to be high enough to ensure that strong incentives exist to nominate accurately. The timing of an announcement of take or pay charges also needs to be considered. Our view is that the TOP charge should be set up front. This will avoid lobbying at a later date by those who have over-stated their forecasts to limit the extent of the charge."
- "TOP not required for Medium Term. Also problem of severe market correction in thermal coal demand (down) hence TOP should only be applicable to the long term new capacity installed."
- "Any Short-term solution would need to be transparent, particularly with the amount of objection from producers for any formal system of restraint. Take-or-pay (with some force majeure allowances and tolerances) would appear to be the best method of ensuring system rigour, but it won't solve the initial forecasting problem where producers may try to inflate figures if a CDS were to be continued."
- "Increased Flexibility tonnes could reduce gaming - provided the allocation on those tonnes cannot be sold / swapped. Consideration should be given to a scale of flexibility, with limited downside (-30k) and a top side of +150k."
- "The demand forecasts needs to be transparent and independently verified"
- "Need further ideas on alternative penalties"
- "Take or pay needs to be long term (3-5 years) not just for a single year."
- "The concept of providing firm tonnage commitments (eg take-or-pay) has some merit but the proposed form of such a commitment needs to be clearly described before it can be supported or otherwise."

5. What is your preferred process for incorporating new entrants?



A small majority favour incorporation of new entrants as per the CDS to ensure maintenance of the open access regime.

Conclusion

- The majority favoured "Similar to CDS", with strong emphasis on the open access or "common user" principle of the port.
- An alternative principle suggested by 2 respondents was that new entrants (and the expansion of existing mines) should not be allowed until increased capacity is installed

Survey Response

<input checked="" type="checkbox"/> Similar to CDS (others give way)	56%
<input type="checkbox"/> Acquire from existing holders	13%
<input type="checkbox"/> Other	31%

Quotes:

- "New entrants or "new tonnes" should have access on the same basis as existing producers/tonnes. A grandfathering approach is anti-competitive, is not consistent with the open access arrangements at the port, and would not be acceptable to [us]."
- "The Port should continue to be viewed as a common user facility and protocols established to confirm this for new entrants."
- "We believe that this [others give way] is a fundamental principle which is absolutely critical to the future of the Newcastle port."

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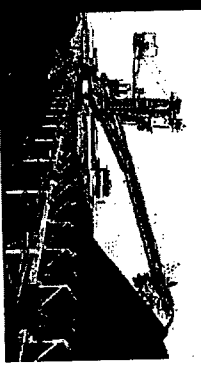
5. What is your preferred process for incorporating new entrants?



Quotes: (continued)

- "Others must give way, but with sufficient notice. Eg new entrants can join within a given calendar year by acquiring loading allocation from incumbent producers. Otherwise they must provide notice to the HVCC operators of their intention to participate in the allocation process for the subsequent year (or via the mechanism developed for the long-term solution)"
- "Preservation of the open access, common-user system. There is no problem with the underlying principles, which must be preserved. The objective should simply be to ensure that the system will provide for capacity to be installed ahead of demand. This requires high quality planning and a commitment to invest in a timely manner."
- "All others give way" appears to be a rather emotional/biased description of current system which we understand is more accurately described as "all shippers treated equally".
- "No new entrants until new capacity has been installed. Need to define "new entrant". Major additional expansion from existing mines also should not be accepted until additional capacity is installed."
- "New entrants should seek a portion of increased capacity, not be able to displace existing users."
- "This is a very difficult and controversial area. I don't believe new entrants should be allowed until increased capacity is demonstrated or installed. Nor should existing customers be allowed to increase production significantly (a level would need to be set) that would ask others to sacrifice. It's important of course to constantly test and improve current limitations so coal chain capacity would need to be regularly audited."
- "So far the questions relate to what the shippers are to give up or to be flexible (in the event of new entrants). Some accountability must rest with PWCS to do all in its power to meet the demand requirements of the coal shippers through Newcastle - whether it be port or rail related"

6. Which features of the CDS would you like to discard/retain in any future solution?



There is broad support for retention of key features of the CDS. There is some objection to the retention of one-way exchanges.

Conclusion

- The majority favoured retaining most features of the CDS

Quotes:

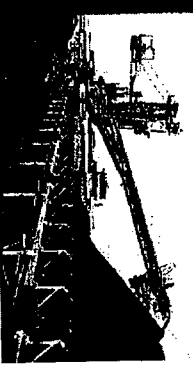
- "At least 3 months notice of an increase in the allocation pool to enable production to be adjusted as not all mines will be able to react to changes simply based on stockpiled coal Producers must not be able to short ship their allocated tonnes or hand their allocation back to the pool at the last minute. Consideration to flexibility ranges should be undertaken"
- "All changes/adjustments to the Allocation, even for small adjustments, should be clearly/promptly communicated to producers, with reason for adjustment"

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Survey Response

	Retain	Discard	No Answer
<input checked="" type="checkbox"/> Two Way Exchanges	86%	7%	7%
<input checked="" type="checkbox"/> One Way Exchanges	63%	25%	12%
<input checked="" type="checkbox"/> Facilitated Exchange	80%	7%	13%
<input checked="" type="checkbox"/> Flexibility Provisions	81%	0%	19%
<input checked="" type="checkbox"/> Rules governing unused allocations	81%	0%	19%
<input checked="" type="checkbox"/> Monthly industry meetings	81%	0%	19%

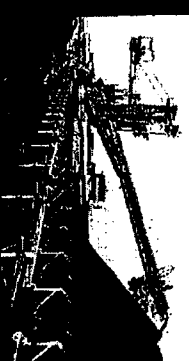
6. Which features of the CDS would you like to discard/retain in any future solution?



Quotes : (continued)

- "Industry meetings should be held at the appropriate frequency and with the appropriate representation - that is, some meetings require CEO input whilst others are for operator level. Want to see the right to sell or swap capacity - not sure whether there should be a central facilitator or individual negotiations."
- "Any short term arrangement needs to be in the context of agreed long term principles. There should be no "equity" rights created in "allocation". If exporters can't use allocation it should go back into the pool and be distributed pro-rata to those who have been cut back. Severe penalties should apply to anyone who fails to use their allocation and does not hand it back in a timely manner."
- "We do not support the CDS. We would need to consider any alternative system on its merits. We don't see any need for monthly industry meetings"
- "Ability for other mechanisms to be introduced if seen to facilitate"
- "Unsure to what "flexibility provisions" refers."
- "The answer is somewhere in all of the above."

7. What other features would you like to include in a medium term solution ?



Quotes :

- "Secondary trading under an auction system."
- "We do not believe that the CDS will necessarily need to continue into 2005. We would like to see a system developed where, for example, the port functions as it did in prior years: until the vessel queue exceeds 20 vessels."
- "Generally, leave it to the market to decide"
- "Regular reporting by PWCS to the industry on the improvements being sought by it and the capacity expansions being achieved. (and) PWCS be required to invest all monetary penalties it collects under Take-or-Pay, into capital in order to expand the capacity of the Hunter Valley Coal Chain."
- "Common-User (but excluding new entrants until capacity demonstrated) & turn of arrival"
- "Monitoring of performance by the Administrator against forecast to gauge which companies are not likely to use their allocation. This should be followed by a consultation process to allow greater leadtime of returning tonnes to "pool"
- "Better system interface between the port, the logistics chain and the shipper."

8. What other feedback, comments or preferences do you have for a medium term solution?



Quotes:

- “The principles of: Turn of arrival; Common user facility; and Common charge must prevail in any scheme”
- “Systems and reporting should be improved through consultation with coal producers. Currently, it appears that both the administrator and coal producers maintain their own records, Producers spend a lot of time keeping records and checking numbers with the administrator. This duplication should be streamlined. Perhaps we should consider: - Centralised system, accessible by both administrator and coal producers; - Reporting formats agreed with coal producers. The current CDS is already creating additional administration demands on coal producers. i.e.. there is an overhead cost to manage CDS. So, we should avoid a system that is overly complicated. For example, “monthly allocation” may sound good to evenly spread the volume. However, it will be very cumbersome to administer.”
- “The above represents our preliminary views but we are yet convinced that a blended pro-rata/auction system can work fairly and will be better in short-term that doing nothing and focusing efforts on implementing solutions to solve longer-term capacity issues.”
- “None of the proposed medium term solutions are suitable or necessary. The Hunter Valley Coal Chain should operate without regulation by PWCS. Payment of demurrage is a market solution. If a solution were to be implemented, it would need to be checked for consistency with competition laws and an authorisation obtained from the Australian Competition and Consumer Commission, if required.”

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8. What other feedback, comments or preferences do you have for a medium term solution?

Quotes:

- “We need time to get this right. The process should be carefully considered in a timeframe which enables parties to evaluate the alternatives sensibly. The current PWCS timetable is very tight, making it difficult for us to properly evaluate the alternatives given the complexities involved. This may make commitment to any form of interim system difficult. [Our] preference is for a two-stage process where:
 1. We determine the actual need for any type of system as a first step, by way of nominations with a clearly stated take or pay obligation; and
 2. Once this has been done, we would then evaluate the need for a clearing mechanism and the preferred type of mechanism without trying to limit the options at this stage. “