



# **Draft Determination**

## **Applications for authorisation**

**lodged by**

**Port Waratah Coal Services Ltd**

**in respect of**

**a Medium Term Capacity Distribution System to address the imbalance  
between the demand for coal loading services at the Port of Newcastle  
and the capacity of the Hunter Valley coal chain**

**Date: 16 December 2004**

**Authorisation no's:** A30236, A30237, A30238

**Public Register no.** C2004/1474

**Commissioners:** Samuel  
Sylvan  
Martin  
McNeill  
King  
Smith  
Willet

## **Executive Summary**

On 1 October 2004 Port Waratah Coal Services Ltd (PWCS) lodged applications for authorisation A30236, A30237 and A30238 with the Australian Competition and Consumer Commission (the ACCC).

PWCS owns and operates the Carrington and Kooragang Island coal loading terminals at the Port of Newcastle. All coal exported from the Hunter Valley and adjoining areas is shipped through PWCS.

PWCS has sought authorisation for a Medium Term capacity distribution system (the CDS) designed to address the imbalance between the demand for coal lading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain.

The ACCC granted interim authorisation on 3 November 2004 to PWCS to conduct a demand reduction auction in early November. On 30 November 2004, PWCS advised that the demand reduction auction was not conducted in 2004 due to a lack of participation by coal producers.

### **Background**

The ACCC granted authorisation to a short term CDS designed to address the vessel queue off the Port of Newcastle on 9 July 2004 (A90906 – A90908). The ACCC granted authorisation until 31 December 2004.

The short term CDS was also designed to match the amount of coal sought to be exported by Hunter Valley coal producers to the capacity of the rail and port systems to transport coal onto vessels at the Port of Newcastle.

The ACCC concluded that the key public benefit generated by the (short term) system is an improvement in economic efficiency due to demurrage cost savings.

The ACCC considered that the system would result in some public detriment from any reduction in aggregate exports due to under use of allocation. The ACCC also considered that a small but significant public detriment would result from any efficiency losses caused by increasing the amount of coal exported by higher cost producers at the expense of more efficient lower-cost producers.

The ACCC was reluctant to extend the period of authorisation beyond 31 December 2004 because of the lack of certainty whether a vessel queue was likely to persist during 2005 and consequently whether the CDS was likely to generate a public benefit in that year.

### **The situation in 2004**

The objective of the (short term) CDS was to reduce the vessel queue at the Port of Newcastle and to achieve maximum coal throughput while minimising demurrage.

The ACCC is advised that:

- from January to September 2004 coal chain capacity reached an annualised ship loading rate of approximately 79 million tonnes (up from 74 million tonnes in 2003)

- the vessel queue has reduced from a peak of 56 ships at 13 March 2004, to an average level of efficient operation of approximately 10 ships
- coal producers have saved approximately US\$47 million in demurrage from April-August 2004 inclusive, with estimated demurrage savings to the end of December 2004 of US\$173.5 million.

### **Public detriment**

The ACCC considers that any reduction in aggregate exports due to under-use of allocation will result in a public detriment. However, the ACCC is satisfied any public detriment arising from a reduction of the volume of coal moved through the coal chain is likely to be negligible, particularly due to the introduction of the five per cent conditional allocation provision under the Medium Term CDS.

The ACCC also considers a public detriment would potentially result from a reduction in efficient allocation caused by the inability of some producers to sell coal loading allocation.

The ACCC is satisfied the Medium Term CDS is unlikely to reduce incentives to invest in capacity expansion at the Port of Newcastle, at least in the short term.

### **Public benefit**

The ACCC considers the Medium Term CDS is likely to result in a significant public benefit, particularly by reducing demurrage costs for the industry and hence improving economic efficiency relative to a situation where a queue persists. The ACCC recognises there is no way of accurately predicting the level of the queue going forward if the Medium Term CDS were not in place. Nevertheless, based on the same level of queue actually reached earlier this year, the ACCC considers PWCS' estimate of US\$163 million is not unreasonable.

The ACCC considers that reducing demurrage costs is a public benefit, as all producers would be likely to face higher demurrage costs without the Medium Term CDS in place.

### **Balance of public benefit and detriment**

Overall, the ACCC considers that in all the circumstances, the public benefit is likely to outweigh the public detriment.

### **Length of authorisation**

The ACCC considers that the trigger mechanism included in the Medium Term CDS – that is, a factor determining whether the Medium Term CDS will operate in any given year is whether demand for coal shipping services on the Hunter Valley coal chain exceeds available capacity by three million tonnes - appears to address the previous concern in the short term authorisation about whether demand conditions will result in a substantial queue of vessels off the Port of Newcastle and therefore, whether the CDS is likely to generate a public benefit.

### **Conclusion**

The ACCC proposes, subject to any conference requested under section 90A of the *Trade Practices Act 1974*, to grant authorisation to PWCS for the proposed Medium Term CDS until 31 December 2007.

## **Interim authorisation**

At the time of lodging the application, PWCS requested interim authorisation for the proposed Medium Term CDS in two parts. On 3 November 2004 the ACCC granted interim authorisation to PWCS to conduct the demand reduction auction only.

The ACCC also grants interim authorisation to PWCS to:

- commence the tonnage tracking and management elements of the proposed Medium Term CDS and
- decline to load vessels that exceed the first (2005) quarter's allocation by producer.

This interim authorisation will commence on 1 January 2005 and will remain in place until the date the ACCC's final determination comes into effect.

## List of Abbreviations

ARTC	Australian Rail Track Corporation
CDS	Capacity Distribution System
CHSA	Coal Handling Services Agreement
Logistics Team	Hunter Valley Coal Chain Logistics Team
NCIG	Newcastle Coal Infrastructure Group
Protocols	Medium Term Capacity Balancing System Objectives, Principles and Protocols
Port	Port of Newcastle
PWCS	Port Waratah Coal Services Ltd
Short term authorisation	ACCC determination of 9 July 2004 granting authorisation to PWCS' short term capacity distribution system (applications for authorisation A90906 – A90908).

# CONTENTS

<b>1. INTRODUCTION.....</b>	<b>1</b>
AUTHORISATIONS.....	1
THE APPLICATIONS FOR AUTHORISATION .....	1
INTERIM AUTHORISATION.....	2
CHRONOLOGY .....	4
THE EXISTING AUTHORISATION – THE SHORT TERM CDS .....	4
<b>2. BACKGROUND TO APPLICATION.....</b>	<b>5</b>
PWCS.....	5
HUNTER VALLEY COAL CHAIN LOGISTICS TEAM .....	6
PERFORMANCE OF THE COAL CHAIN UNDER THE EXISTING (SHORT TERM) AUTHORISATION.....	6
<i>The vessel queue.....</i>	<i>6</i>
<i>Demurrage .....</i>	<i>7</i>
<i>Coal throughput at the coal chain and port.....</i>	<i>8</i>
WORLD COAL PRICES .....	8
RECENT DEVELOPMENTS .....	8
<i>The formation of the Newcastle Coal Infrastructure Group.....</i>	<i>8</i>
<i>Australian Rail Track Corporation.....</i>	<i>9</i>
<i>Modifications to the existing (short term) scheme .....</i>	<i>9</i>
<b>3. THE APPLICATIONS FOR AUTHORISATION .....</b>	<b>10</b>
<b>4. THE MEDIUM TERM CDS.....</b>	<b>11</b>
ADMINISTRATION.....	11
OBJECTIVES.....	11
THE TRIGGER MECHANISM .....	11
ONGOING OPERATION OF THE MEDIUM TERM CDS .....	11
THE OPERATION OF THE SCHEME .....	12
<i>Demand nominations by producers .....</i>	<i>12</i>
<i>Demand nominations by producers .....</i>	<i>13</i>
<i>Capacity declaration by PWCS.....</i>	<i>14</i>
<i>Demand adjustment.....</i>	<i>14</i>
<i>Management of coal loading allocations.....</i>	<i>16</i>
DISPUTE RESOLUTION .....	18

FUTURE AMENDMENTS TO THE MEDIUM TERM CDS .....	18
<b>5. SUBMISSIONS RECEIVED BY THE ACCC.....</b>	<b>19</b>
<b>6. THE PUBLIC BENEFIT TEST .....</b>	<b>20</b>
<b>7. ACCC EVALUATION.....</b>	<b>23</b>
MARKET DEFINITION .....	23
THE COUNTERFACTUAL.....	24
PUBLIC DETRIMENT .....	26
<i>Restricting aggregate coal exports from the Hunter Valley .....</i>	<i>27</i>
<i>Deferring investment in capacity expansion in the Port.....</i>	<i>29</i>
<i>Reducing incentives for coal producers to become more efficient .....</i>	<i>31</i>
<i>Public detriment arising from the design of the Medium Term CDS.....</i>	<i>32</i>
PUBLIC BENEFITS .....	37
<i>Reduced demurrage .....</i>	<i>37</i>
<i>Reduced stockpiling costs .....</i>	<i>39</i>
<i>Improved reputation of the Port of Newcastle .....</i>	<i>39</i>
<i>Other efficiencies and facilitating re-investment in the Hunter Valley coal industry.....</i>	<i>40</i>
BALANCE OF PUBLIC BENEFIT AND DETRIMENT .....	41
INTERIM AUTHORISATION – STAGE 2 .....	42
DURATION OF AUTHORISATION .....	42
VARIATIONS TO THE PROTOCOLS .....	44
<b>8. DRAFT DETERMINATION.....</b>	<b>45</b>
THE APPLICATIONS .....	45
THE PUBLIC BENEFIT TEST .....	46
CONDUCT FOR WHICH THE ACCC PROPOSES TO GRANT AUTHORISATION.....	46
INTERIM AUTHORISATION.....	46
FURTHER SUBMISSIONS .....	46
<b>ATTACHMENT A.....</b>	<b>47</b>
MEDIUM TERM CAPACITY BALANCING SYSTEM .....	47
OBJECTIVES, PRINCIPLES & PROTOCOLS .....	47
<b>ATTACHMENT B .....</b>	<b>71</b>
SHAREHOLDERS IN PORT WARATAH COAL SERVICES LIMITED.....	71
<b>ATTACHMENT C.....</b>	<b>72</b>
INDUSTRY CONSULTATION INITIATIVES AND FOUR YEAR CAPACITY PLAN INITIATIVES .....	72

# 1. INTRODUCTION

## Authorisations

- 1.1 The Australian Competition and Consumer Commission (the ACCC) is the Australian Government agency responsible for administering the *Trade Practices Act 1974* (TPA). A key objective of the TPA is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.
- 1.2 The TPA, however, allows the ACCC to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an ‘authorisation’.
- 1.3 Broadly, the ACCC may ‘authorise’ businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.
- 1.4 The ACCC conducts a comprehensive public consultation process before making a decision to grant or deny authorisation.
- 1.5 Upon receiving an application for authorisation, the ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.6 The TPA requires that the ACCC then issue a draft determination in writing proposing to either grant the application (in whole, in part or subject to conditions) or deny the application. In preparing a draft determination, the ACCC will take into account any submissions received from interested parties.
- 1.7 Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference provides interested parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite interested parties to lodge written submissions on the draft.
- 1.8 The ACCC then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a written final determination. Should the public benefit outweigh the public detriment, the ACCC may grant authorisation. If not, authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the public benefit or reduce the public detriment.

## The applications for authorisation

- 1.9 On 1 October 2004 Port Waratah Coal Services Limited (PWCS) lodged applications for authorisation A30236, A30237 and A30238 with the ACCC.

- 1.10 Authorisation is sought under application A30236 for PWCS to make and give effect to a contract, arrangement or understanding, where the provision is, or may be, an exclusionary provision within the meaning of section 45 of the TPA.
- 1.11 Application A30237 seeks authorisation for PWCS to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA.
- 1.12 Application A30238 seeks authorisation for PWCS, in concert with other persons, to engage in conduct that hinders or prevents, or may hinder or prevent, a third person supplying goods or services to, or acquiring goods or services from, a fourth person for the purpose of causing substantial loss or damage (prohibited by section 45D); to engage in conduct that hinders or prevents a third person supplying or acquiring goods or services to a fourth person for the purpose of causing a substantial lessening of competition (prohibited by section 45DA); and to engage in conduct that prevents or substantially hinders, or may prevent or substantially hinder, a third person from engaging in trade or commerce involving the movement of goods between Australian and places outside Australia (prohibited by section 45DB).
- 1.13 In particular, PWCS applied for authorisation for its proposed Medium Term Capacity Distribution System (CDS) to address the imbalance between the demand for coal loading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain.
- 1.14 The ACCC received a final copy of the protocols governing the operation of the Medium Term CDS on 30 November 2004, a copy of which is provided at [Attachment A](#).
- 1.15 Broadly, under the Medium Term CDS coal producers are provided with the option to accept a pro rata reduction in coal demand nominations (as per the current short term CDS), or participate in a demand reduction auction, in the event that demand for coal shipping services on the Hunter Valley coal chain exceeds available capacity by three million tonnes.
- 1.16 PWCS seeks authorisation for a period of at least three years and up to five years to allow the proposed long term solution to come into operation.

### **Interim authorisation**

- 1.17 At the time of lodging the application, PWCS requested interim authorisation for certain elements of the medium term proposal in two parts. PWCS sought interim authorisation under part one to conduct the demand reduction auction in early November 2004.

- 1.18 Under part two, PWCS seeks interim authorisation from 1 January 2005 to:
- commence the tonnage tracking and management elements of the proposed Medium Term CDS and
  - to decline to load vessels that exceed the first quarter's allocation by producer.
- 1.19 On 3 November 2004 the ACCC granted interim authorisation to PWCS to conduct the demand reduction auction only. The ACCC recognised:
- a large queue is likely to redevelop after 1 January 2005, with resultant high demurrage costs, if a medium term CDS is not operational by that date
  - the auction will enable producers to implement production decisions for 2005 based on capacity allocations
  - the auction itself does not appear to have any significant anti-competitive effects
  - the potential efficiency gains from the auction as a result of low cost coal producers acquiring capacity from high cost coal producers
  - any allocation transfers for 2005 that would have occurred as a result of the auction outcome could be unwound. PWCS has committed to not implement any financial consequences of the auction until such time as final authorisation is granted to a medium term CDS.
- 1.20 On 30 November 2004 PWCS advised the ACCC that, due to a lack of participation by producers, the demand reduction auction was not conducted in 2004.

## Chronology

1.21 The following table is a chronology of significant dates in the consideration of this application.

DATE	ACTION
1 October 2004	Applications for authorisation lodged with the ACCC, including an application for interim authorisation.
18 October 2004	Closing date for submissions from interested parties in relation to (part 1) of PWCS' request for interim authorisation.
19 October 2004	Submissions provided to PWCS for comment.
3 November 2004	The ACCC grants interim authorisation to PWCS to conduct the demand reduction auction.
19 November 2004	Closing date for submissions from interested parties in relation to the substantive applications and part two of the request for interim authorisation.
30 November 2004	The ACCC received the final version of the <i>Medium Term Capacity Balancing System Objectives, Principles and Protocols</i> .
16 December 2004	Draft determination issued.

### The existing authorisation – the short term CDS

- 1.22 The ACCC granted authorisation to a short term CDS designed to address the vessel queue off the Port of Newcastle on 9 July 2004 (A90906 – A90908). The ACCC granted authorisation until 31 December 2004.
- 1.23 The short term CDS was designed to match the amount of coal sought to be exported by Hunter Valley coal producers to the capacity of the rail and port systems to transport coal onto vessels at the Port of Newcastle.
- 1.24 The ACCC was satisfied that the short term CDS was likely to result in a net public benefit in 2004, and as such, did not consider the imposition of conditions appropriate. In particular, the ACCC concluded that the key public benefit generated by the system is an improvement in economic efficiency due to demurrage cost savings.
- 1.25 The ACCC considered that the system would result in some public detriment from any reduction in aggregate exports due to under use of allocation. The ACCC also considered that a small but significant public detriment would result from any efficiency losses caused by increasing the amount of coal exported by higher cost producers at the expense of more efficient lower-cost producers.
- 1.26 The ACCC was reluctant to extend the period of authorisation beyond 31 December 2004 because of the lack of certainty whether a vessel queue was likely to persist during 2005 and consequently whether the CDS was likely to generate a public benefit in that year.
- 1.27 The ACCC also concluded that the design of the short term CDS appeared reasonable.

## 2. BACKGROUND TO APPLICATION

2.1 This chapter of the draft determination focuses on:

- the performance of the Hunter Valley coal chain under the existing (short term) authorisation, and
- recent developments in the Hunter Valley coal chain and the market for coal.

2.2 Further background information on the industry participants and the operation of the Hunter Valley coal chain is contained in Chapter 2 of the ACCC's determination of 9 July 2004 in relation to the short term CDS.

### PWCS

2.3 PWCS owns and operates the Carrington and Kooragang Island coal loading terminals at the Port of Newcastle in New South Wales. PWCS provides coal handling services to Hunter Valley coal exporters, including the receiving and unloading of coal, the storage of coal and loading of coal onto vessels for export.

2.4 PWCS is owned by a number of coal producers and other participants in the Hunter Valley coal industry. Attachment B lists PWCS' shareholders, all of which are coal producers or exporters in the Hunter Valley, or importers of coal from the Hunter Valley.

2.5 PWCS leases the land on which the port is situated from the NSW Government under an agreement which states that the port is to be maintained as a 'common user facility'.

2.6 Any party who wishes to use the port to load coal may do so, provided they sign a Coal Handling Services Agreement (CHSA). The CHSA sets out the terms on which PWCS will provide a user with coal handling services.

2.7 Some of the key features of the CHSA include:

- A flat coal handling charge of \$2.70 per tonne.
- A customer must make an application for coal handling services no later than 14 days prior to the estimated time of arrival of the vessel. Provided the customer has complied with all of the requirements under the CHSA and PWCS has determined the vessel is suitable to load, PWCS will accept the application.
- Producer allocations are subject to take or pay obligations.<sup>1</sup>

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<sup>1</sup> Clause 6.1 Annexure 4E, Coal Handling Services Agreement.

- Vessels are loaded on ‘turn of arrival’. This means that vessels are loaded in the order of their actual time of arrival off the Port of Newcastle. Under the CHSA, PWCS may change the order of vessels provided that certain criteria are met, for example, that the vessel will not be ready to receive coal at the required time.<sup>2</sup>

### **Hunter Valley Coal Chain Logistics Team**

- 2.8 The role of the Hunter Valley Coal Chain Logistics Team (the Logistics Team) is to maximise coal chain throughput by generating plans for coal movement through the coal chain from loadpoint onto ship. It combines the previous separate coal chain planning functions from the various organisations. The Logistics Team plans, manages systems, reports on performance and looks for improvement opportunities.
- 2.9 The structure of the Logistics Team was formalised under a memorandum of intent in the beginning of 2004. It has its own budget and non-employee costs are funded 50:50 by PWCS and Pacific National. It comprises one manager who has responsibility to act in the interest of the entire coal chain and one representative from each of the following organisations: Pacific National; PWCS; Rail Corp; Queensland Rail; Australian Rail Track Corporation (ARTC); and the Newcastle Port Corporation.

### **Performance of the coal chain under the existing (short term) authorisation**

- 2.10 The ACCC granted interim authorisation to the short term CDS on 5 March 2004. Following this, PWCS implemented the short term CDS. The objective of the short term CDS was to reduce the vessel queue at the Port of Newcastle and to achieve maximum coal throughput while minimising demurrage. Demurrage is a function of the length of time a vessel waits in a queue. Demurrage fees are negotiated on a ship by ship basis between the purchaser and seller during contract negotiations. When vessels are required to wait longer than a specified time to load coal, the vessel owners charge demurrage on a daily basis. The ACCC understands that the daily demurrage rate is approximately US\$12 000.<sup>3</sup>

#### *The vessel queue*

- 2.11 Since the implementation of the short term CDS, PWCS submits that the vessel queue has reduced from a peak of 56 ships at 13 March 2004, to an average level of efficient operation of approximately 10 ships.<sup>4</sup>
- 2.12 Figure 2.1 details the vessel queue at the Port of Newcastle from January 2004 to September 2004.

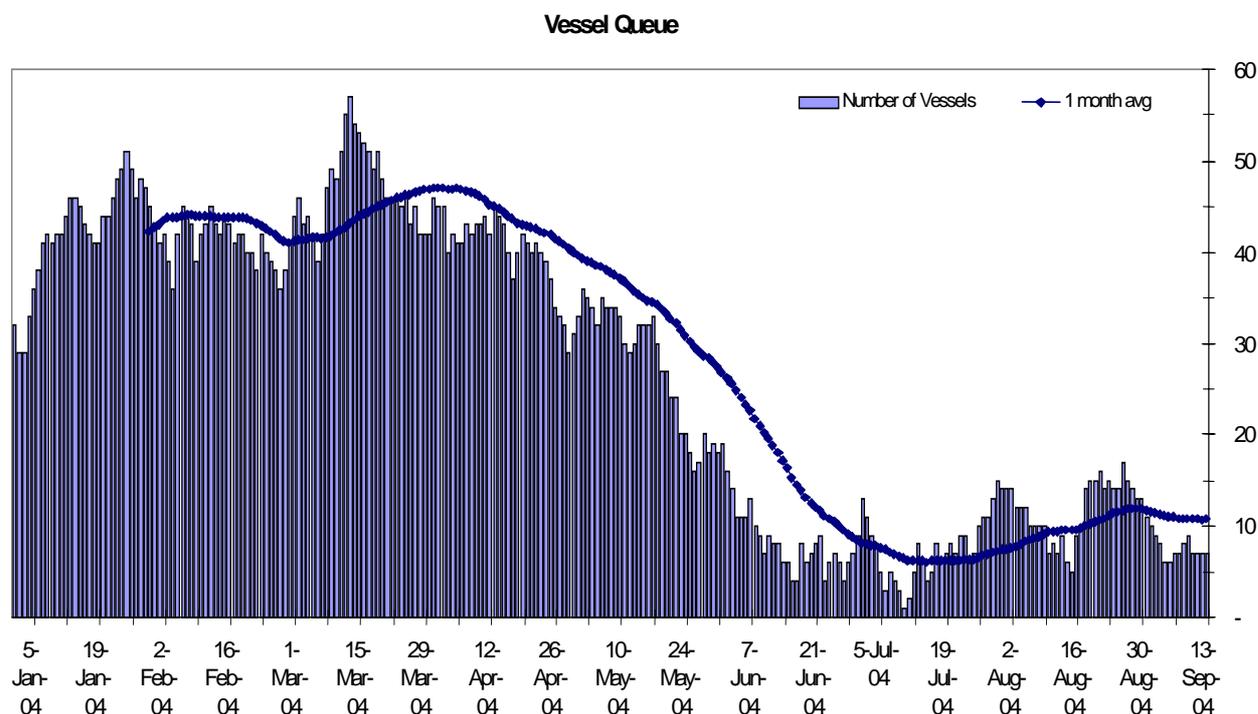
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<sup>2</sup> Coal Handling Service Agreement, Clause 3.3.5.

<sup>3</sup> ACCC’s determination of 9 July 2004 in relation to the short term CDS, p60.

<sup>4</sup> PWCS’ submission in support of the applications for authorisation, 1 October 2004, p3.

Figure 2.1: Vessel queue January 2004 to September 2004<sup>5</sup>



Source: Accenture

### Demurrage

2.13 Table 2.1 shows the estimated demurrage costs and savings over 2004 comparing the situation with and without the short term CDS. PWCS estimates that coal producers have saved approximately US\$47 million in demurrage for the period April 2004 to August 2004 inclusive, with estimated demurrage savings to the end of December 2004 of US\$173.5 million.<sup>6</sup>

Table 2.1: Queue length and demurrage 2004 (no maximum queue length assumed)<sup>7</sup>

Month	Cumulative (Average) Queue Days		Demurrage \$US million		
	Forecast (without CDS)	Actual (with CDS)	Forecast (without CDS)	Actual (with CDS)	Demurrage Savings
April	1,430 (48)	1,169 (39)	14.10	12.00	2.10
May	1,639 (53)	825 (27)	16.50	9.18	7.32
June	1,743 (58)	223 (7)	17.86	0.48	17.38
July	1,963 (63)	202 (7)	20.40	0.07	20.33
Total (average)	6,775 (55)	2,419 (20)	58.86	21.73	47.13

Source: Accenture based on a sample of actual figures provided by a number of producers

<sup>5</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p20.

<sup>6</sup> Ibid, p18.

<sup>7</sup> Ibid, p19.

### *Coal throughput at the coal chain and port*

- 2.14 PWCS submits that increased throughput was achieved during the period of authorisation. From January to September 2004 coal chain capacity reached an annualised ship loading rate of approximately 79 million tonnes.<sup>8</sup> This represents an increase of around 7 per cent on the volume of tonnes loaded in 2003, which had an annual throughput of approximately 74 million tonnes.<sup>9</sup>
- 2.15 PWCS is of the view that the ‘supply chain discipline’ created by the short term CDS allowed the port to operate more efficiently which, together with other improvements to the coal chain, contributed to the increased throughput at the port, beyond what the port would have achieved without the short term CDS.<sup>10</sup>

### **World coal prices**

- 2.16 Recent media articles forecast the high demand for coal will continue into 2005.<sup>11</sup> ABARE forecasts a 6 per cent increase in the total volume of Australian coal exports, from 218.5 million tonnes in 2004 to 231.9 million tonnes in 2005.<sup>12</sup>
- 2.17 High contract prices for coal are also predicted for 2005. The price for coking (or metallurgical) coal, used to make steel, could rise to more than \$US100 a tonne, up from \$US57.50 in 2004 and \$US46.50 in 2003-04. Contract prices for steaming (or thermal) coal, used to generate electricity, is forecast to exceed \$US50 in 2005, approximately double the 2003-04 price of \$US26.75. The spot price for steaming coal remains above \$US50 a tonne.<sup>13</sup>
- 2.18 During 2004, 84 per cent of coal exported through PWCS was steaming coal, with the remainder being coking coal.<sup>14</sup>

### **Recent developments**

#### *The formation of the Newcastle Coal Infrastructure Group*

- 2.19 On 30 August 2004 the Newcastle Coal Infrastructure Group (NCIG) was formed by Memorandum of Understanding signed by four foundation members BHP Billiton (through Hunter Valley Energy Coal), Centennial Coal, Donaldson Coal and Excel Coal. The NCIG currently consists of two additional producers, namely AMCI Australia and White Mining. None of the NCIG founding members have a significant shareholding in PWCS.<sup>15</sup>

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<sup>8</sup> Ibid, Attachment I, p65.

<sup>9</sup> PWCS 2003 Annual Report, p3.

<sup>10</sup> PWCS’ submission in support of its applications for authorisation, 1 October 2004, p38.

<sup>11</sup> See for example, *Black Gold: Asia boom heats up coal* Australian Financial Review, 8 November 2004

<sup>12</sup> ABARE, *Australian Commodities March 2004*, viewed 12 November 2004,

<<http://www.abare.gov.au/australiancommodities/comods/coal.html>>

<sup>13</sup> *Black Gold: Asia boom heats up coal* Australian Financial Review, 8 November 2004.

<sup>14</sup> *October 2004 End of Month Graphs*, PWCS, viewed 16 November 2004,

<[http://www.pwcs.com.au/about\\_us\\_statistics.asp](http://www.pwcs.com.au/about_us_statistics.asp)>

<sup>15</sup> NCIG submission, 18, October 2004, p3.

2.20 The members of NCIG currently represent 13 million tonnes per annum of coal exports through PWCS.<sup>16</sup> NCIG mines are looking to expand combined production by 30 million tonnes. In particular, NCIG aims to:

...ensure adequate long term capacity in the Hunter Valley coal export supply chain. The founding members of NCIG are significant coal producers who have sufficient coal reserves and projects to materially increase the coal they produce in response to this coal demand and anticipate increasing production by around 30 million tonnes during the next five to ten years...The sole objective if NCIG is to ensure sufficient infrastructure capacity to significantly grow the volume of coal they export, through the development of additional coal terminal facilities at the Port, various rail investment proposals, and options to improve the efficient operation of the chain.<sup>17</sup>

### *Australian Rail Track Corporation*

2.21 In September 2004 the Australian Rail Track Corporation (ARTC) took up a 60 year lease of most of the Hunter Valley rail track. The ARTC has announced an investment program of \$152 million to upgrade the Hunter Valley rail network over the next five years.<sup>18</sup>

### *Modifications to the existing (short term) scheme*

2.22 Accenture was engaged to develop a medium term solution to address the imbalance between demand and coal chain capacity. The proposed Medium Term CDS is based on feedback obtained from PWCS' customers during industry workshops and surveys conducted throughout 2004.

2.23 The proposed Medium Term CDS is similar to the existing (short term) CDS in that it involves a pro rata decrease on each producer's demand nomination. However, the Medium Term CDS incorporates some additional features, including:

- individual producer demand nominations may be subject to independent audit
- producers final allocations will attract a take or pay obligation
- producers may increase or decrease their allocation by participating in an annual demand reduction auction
- an automatic trigger mechanism for each calendar year such that the adjustment mechanism will not operate in periods where demand does not exceed available capacity at the Port of Newcastle by a determined amount.

2.24 The features of the Medium Term CDS are discussed in further detail in Chapter 4 of this draft determination.

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<sup>16</sup> Newcastle Coal Infrastructure Group submission, 19 November 2004, p1.

<sup>17</sup> Newcastle Coal Infrastructure Group submission, 18 October 2004.

<sup>18</sup> Australian Rail Track Corporation, *\$152 million upgrade for the Hunter Valley rail freight network* viewed 15 November 2004, <[http://www.artc.com.au/press\\_releases/Hunter\\_Valley\\_Rai\\_Netwrok.pdf](http://www.artc.com.au/press_releases/Hunter_Valley_Rai_Netwrok.pdf)>

### **3. THE APPLICATIONS FOR AUTHORISATION**

- 3.1 On 1 October 2004 PWCS lodged applications for authorisation A30236, A30237 and A30238 with the ACCC.
- 3.2 Application A30236 was lodged under section 88(1) of the TPA for PWCS to make and give effect to a contract, arrangement or understanding, where the provision is, or may be, an exclusionary provision within the meaning of section 45 of the TPA.
- 3.3 Broadly, an exclusionary provision exists where the proposed contract, arrangement or understanding is made by businesses (at least two of whom are competitors) for the purpose of preventing, restricting or limiting the supply of services to particular persons or classes of persons by all or any of the parties to the contract, arrangement or understanding.<sup>19</sup>
- 3.4 Application A30237 was lodged under section 88(1) of the TPA for PWCS to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA.
- 3.5 Application A30238 was lodged under section 88(7) of the TPA for PWCS, in concert with other persons, to engage in conduct that hinders or prevents, or may hinder or prevent, a third person supplying goods or services to, or acquiring goods or services from, a fourth person for the purpose of causing substantial loss or damage (prohibited by section 45D); to engage in conduct that hinders or prevents a third person supplying or acquiring goods or services to a fourth person for the purpose of causing a substantial lessening of competition (prohibited by section 45DA); and to engage in conduct that prevents or substantially hinders, or may prevent or substantially hinder, a third person from engaging in trade or commerce involving the movement of goods between Australian and places outside Australia (prohibited by section 45DB).
- 3.6 The ACCC notes that PWCS has indicated that any producer of coal for export through the Port of Newcastle or exporter of coal from the Port of Newcastle may be a party to the conduct. Under section 88(6) of the TPA, any authorisation granted to a corporation is automatically extended to cover any other party to the conduct.

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<sup>19</sup> Section 4D, *Trade Practices Act 1974*.

## 4. THE MEDIUM TERM CDS

4.1 The proposed Medium Term CDS – as set out in *Medium Term Capacity Balancing System Objectives, Principles and Protocols* (the Protocols) (see Attachment A) - is outlined below.

### Administration

4.2 The Medium Term CDS will be administered by an independent administrator appointed by the PWCS Board.<sup>20</sup> Accenture has been appointed to administer the Medium Term CDS (hereafter referred to as the Administrator).<sup>21</sup>

### Objectives

4.3 The objectives of the Medium Term CDS include to:

- achieve minimum vessel demurrage consistent with maximum export coal throughput
- efficiently distribute the available coal chain capacity among coal producers in an equitable, transparent and accountable manner.<sup>22</sup>

### The trigger mechanism

4.4 The demand adjustment mechanism contained in the proposed Medium Term CDS will only be implemented if the demand for coal loading services exceeds the declared capacity of the coal chain by three million tonnes for any year.<sup>23</sup>

### Ongoing operation of the Medium Term CDS

4.5 During September in any year, the PWCS Board will review the proposed Medium Term CDS to determine whether it should continue for part or all of the following year. Any decision to continue will:

- take into account any recommendations made by the Administrator and any submissions received from coal producers or customers prior to 1 September each year<sup>24</sup>
- will be subject to receiving support by more than 75 per cent of currently exporting coal producers by volume or support by more than 50 per cent of currently exporting producers calculated by number of producers.<sup>25</sup>

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<sup>20</sup> Clause 2.1, Annexure 4F, *Medium Term Capacity Balancing System – Objectives, Principles and Protocols* (Part A) 24 November 2004.

<sup>21</sup> PWCS submission in support of its application for authorisation, 1 October 2004, p6.

<sup>22</sup> Clause 2.3 (Part A), Annexure 4F.

<sup>23</sup> Clause 5.1 (Part A), Clause 3 (Schedule 4), Annexure 4F.

<sup>24</sup> Clause 9.1 (Part A), Annexure 4F.

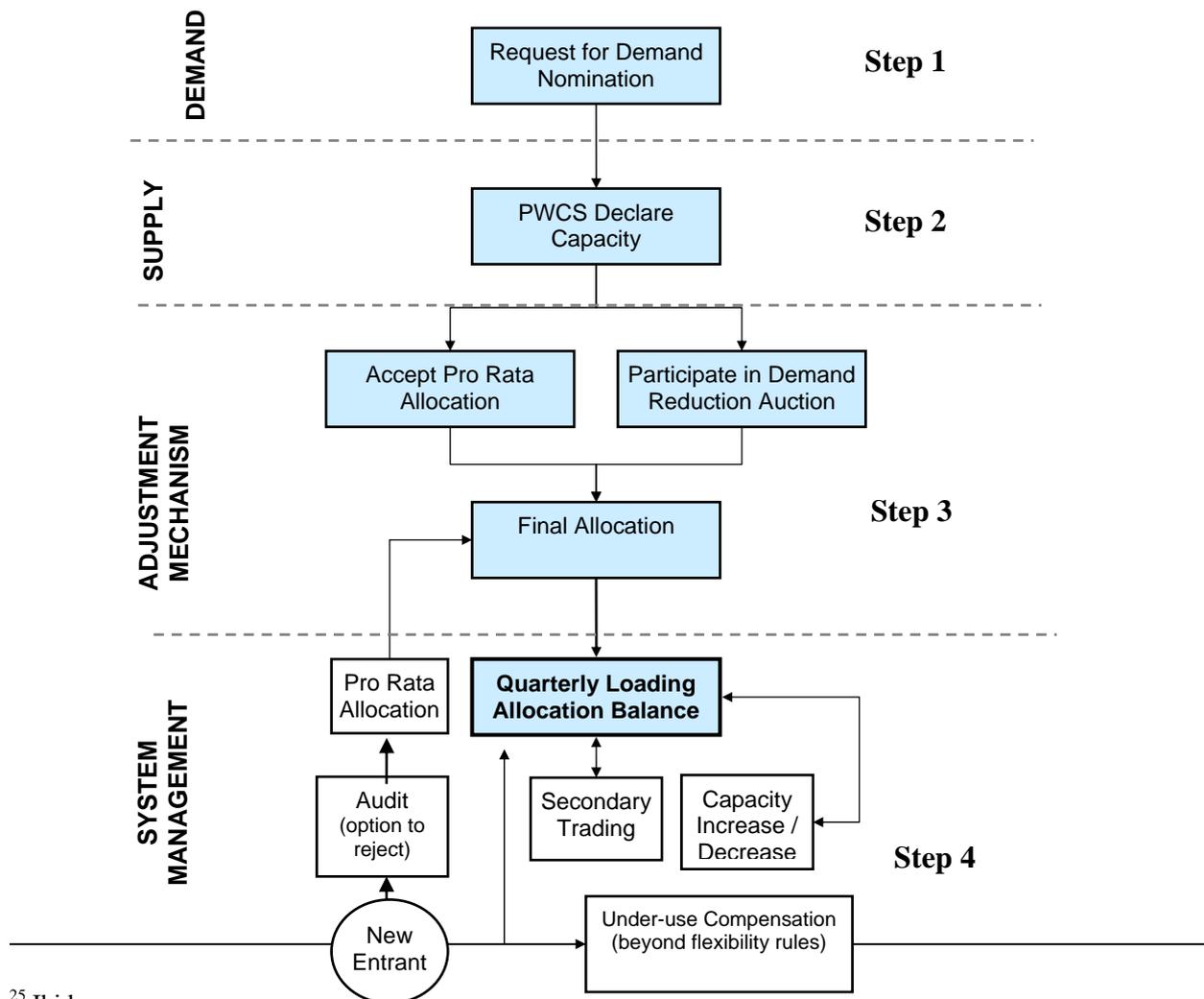
4.6 A key indicator as to whether the proposed Medium Term CDS should continue into the following calendar year will be whether the coal chain is sufficient to meet the demand without causing excessive queuing of vessels at the Port of Newcastle.<sup>26</sup>

**The operation of the scheme**

4.7 The proposed Medium Term CDS (as represented in Figure 4.1 below) has the following four key elements:

- demand nominations by producers
- capacity declaration by PWCS
- demand adjustment and
- management of allocations by the Administrator of the CDS.

**Figure 4.1: Summary of the proposed Medium Term CDS<sup>27</sup>**



<sup>25</sup> Ibid.

<sup>26</sup> Clause 9.2 (Part A), Annexure 4F.

<sup>27</sup> Source: PWCS submission in support of its application for authorisation, 1 October 2004, p27.

### *Demand nominations by producers*

4.8 Producers will be required to submit demand nominations to PWCS for each quarter of the forthcoming calendar year on a mine by mine basis.

4.9 Producer demand nominations will be subject to three controls, namely:

- **Audit:** demand nominations may be subject to independent audit to confirm the producer's capacity and intent to export the volume of coal nominated.<sup>28</sup> For example, the ACCC understands that the auditor will have regard to the capacity of the producer's mine and equipment, mine plans and budgets and the producer's train contracts and loading point capacity.

The auditor's report, together with the producer's demand nomination and any supporting information is then provided to an independent expert appointed by the industry (the 'Arbiter') who ultimately determines the producer's forecast demand amounts, which it considers best reflects the producer's intent and capability.<sup>29</sup>

If the arbiter's amount is less than the producer's nominated amount the producer can choose to either accept the arbiter's nomination as a starting point for the calculation of allocation, or reject the arbiter's nominated amount.<sup>30</sup>

A producer's decision to reject the arbiter's forecast demand as a starting point for the calculation of allocation has the following consequences:

- the producer will not be entitled to participate in any demand reduction auction as a seller and thus they will not be able to sell any allocation at the auction<sup>31</sup>
- the producer will not be entitled to engage in secondary trading (that is, any one-way trades or gifts of its allocation) throughout the year which results in a net decrease in their aggregate demand forecast allocation<sup>32</sup>
- if the producer does not use its nominated allocation on a quarterly basis (beyond the flexibility provisions), it will be liable for financial compensation to other producers for 'lost' allocation up to the arbiter's Adjustment (defined as the difference between the producer's demand nomination and the arbiter's determined amount) at a rate of \$20 per tonne.<sup>33</sup> This amount is payable within 30 days and distributed to all other producers at the end of the quarter in proportion to their loading allocations.<sup>34</sup>

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<sup>28</sup> Clause 1 (Schedule 3), Annexure 4F.

<sup>29</sup> Clause 4 and 4 (Schedule 3), Annexure 4F.

<sup>30</sup> Clause 5 (Schedule 3), Annexure 4F.

<sup>31</sup> Clause 7(b) (Schedule 3), Annexure 4F.

<sup>32</sup> Clause 7(a) (Schedule 3), Annexure 4F.

<sup>33</sup> Clause 7(c) (Schedule 3), Annexure 4F.

<sup>34</sup> Clauses 7(c) and 7(e) (Schedule 6), Annexure 4F.

- **Transparency:** the Administrator will request to make each producer's demand nomination available for inspection by other producers prior to any audits.<sup>35</sup>
- **Take or pay:** a producer's final allocations will attract a take or pay obligation, payable to PWCS. The obligation applies to both used and unused allocations (beyond flexibility limits) each quarter. The take or pay charge is the \$2.70 per tonne coal handling fee, as determined by the PWCS Board. Producers will also have an equivalent volume of unused tonnes (beyond their flexibility limits) deducted from their loading allocation in the following quarter (that is, physical compensation). If producers exchange or otherwise transfer their loading allocations, the take or pay obligation will transfer with that allocation.<sup>36</sup>

#### *Capacity declaration by PWCS*

- 4.10 PWCS, in consultation with the Logistics Team, will declare the coal chain capacity for each quarter for the year and the desired volume of an operational vessel queue at the port. The declared capacity will be based on actual historical performance, adjusted for known maintenance outages and expected performance gains.<sup>37</sup>
- 4.11 PWCS and the Logistics Team will make the rationale for the decision (together with relevant supporting information) available to the industry. If requested by a majority of producers, PWCS may arrange for an audit of the declared coal chain capacity.<sup>38</sup>
- 4.12 The Administrator may from time to time revise the available coal chain capacity for the balance of the year.<sup>39</sup>

#### *Demand adjustment*

- 4.13 As outlined previously at paragraph 4.4, the demand adjustment mechanism contained in the proposed Medium Term CDS will only apply if demand for PWCS' coal loading services exceeds the declared capacity of the coal chain by more than three million tonnes for any year.<sup>40</sup>
- 4.14 If demand does not exceed declared capacity by more than three million tonnes, the Medium Term CDS will not operate. PWCS will provide each producer with an allocation equal to its nomination. However, producers will still be required submit a demand forecast to PWCS to which take or pay obligations would attach.<sup>41</sup>
- 4.15 Where demand exceeds the declared capacity of the coal chain by more than three million tonnes, the Administrator will calculate the annual pro rata reduction for each producer that would be necessary to balance demand with available capacity.<sup>42</sup>

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<sup>35</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p 30.

<sup>36</sup> Ibid.

<sup>37</sup> Clause 1 (Schedule 2), Annexure 4F.

<sup>38</sup> Clause 3 (Schedule 2), Annexure 4F.

<sup>39</sup> Clause 5 (Schedule 2), Annexure 4F.

<sup>40</sup> Clause 3 (Schedule 4), Annexure 4F.

<sup>41</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p31.

<sup>42</sup> Clause 4 (Schedule 4), Annexure 4F.

- 4.16 Under the Medium Term CDS, each producer will have two options:
- accept the pro rata allocation and exclude itself from the auction process or
  - participate in the demand reduction auction.<sup>43</sup>
- 4.17 Participation in the demand reduction auction is voluntary, and is proposed to be conducted once a year, as required. Broadly, the auction provides a mechanism for producers to increase or decrease their allocation by bidding to buy or sell loading allocation around their pro rata allocation.<sup>44</sup>
- 4.18 A producer's annual loading allocation therefore will be either its pro rata allocation, or the allocation as determined by the demand auction. The Administrator will then determine the quarterly loading allocations for each producer which seek to match the capacity profile and the producer's demand profile.<sup>45</sup>
- 4.19 At the start of each year, each producer also receives an additional allocation for each quarter called 'conditional allocation', equal to five per cent of the producer's quarterly loading allocation. Conditional allocation may only be used by a producer after it has utilised its quarterly loading allocation and its upper flexibility amount for that quarter.<sup>46</sup>
- 4.20 However, PWCS will notify producers that conditional allocation cannot be used if the vessel queue off the Port of Newcastle exceeds an average of 25 vessels over a three week period (and PWCS may reject a new application for coal loading services that includes any 'conditional allocation' amount). It will be reinstated only if the average vessel queue falls below 15 over a three week period.<sup>47</sup>
- 4.21 The demand reduction auction will be conducted in accordance with the framework contained in Clause 7 (Schedule 4) of the Protocols. An overview of the proposed demand reduction auction process follows:<sup>48</sup>
- Participants submit a series of bids that indicate their willingness to **reduce their initial nominated amount** in return for a per tonne compensation payment (that is, the producer specifies the volume of tonnes and price by which a producer is prepared to decrease its demand forecast).
  - Any bid to decrease by **less** than the pro rata equivalent position is effectively a bid to buy additional loading allocation.
  - Any bid to decrease by **more** than the pro rata equivalent position is effectively a bid to sell loading allocation.

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<sup>43</sup> Clause 6 (Schedule 4), Annexure 4F.

<sup>44</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p32.

<sup>45</sup> Clause 1 (Schedule 5), Annexure 4F.

<sup>46</sup> Clause 2 (Schedule 5), Annexure 4F.

<sup>47</sup> Ibid.

<sup>48</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, pp32, 33.

- The Administrator will collate the bids in order from lowest to highest price. The auction clearing volume is the sum of the participants' pro rata demand reductions. The auction clearing price is the price of the marginal bid(s) at which the auction clearing volume is achieved.
- All tonnes bid at a price less than the auction clearing price are sold, (all tonnes bid above the auction clearing price are not sold) and all tonnes bid at the auction clearing price will be shared in proportion to the total tonnes sold at that price.
- The auction results in a series of transactions settled by the participants between themselves, facilitated by the Administrator.
- There are three possible outcomes from the auction:
  - A producer sells allocation to end up with less allocation than under a pro rata outcome. Sellers of allocation receive compensation at the auction clearing price for each tonne of allocation sold below their pro rata equivalent position.
  - A producer buys allocation to end up with more allocation than under a pro rata outcome. Buyers of allocation pay compensation at the auction clearing price for each tonne of allocation purchased above their pro rata equivalent position.
  - A producer neither buys or sells allocation and ends up with allocation equal to the pro rata outcome. These participants neither pay nor receive compensation as a result of the auction.
- The Administrator will determine each producer's outcome from the auction and advise each as to whether they have sold or purchased allocation, or ended up with their pro rata equivalent outcome.

#### *Management of coal loading allocations*

- 4.22 The main features concerning the management of the Medium Term CDS are summarised below.
- 4.23 **Distribution of increases or decreases in coal chain capacity:** if PWCS determines that there has been any increase in capacity during the period, then the appropriate additional allocation will be distributed on a pro rata basis according to loading allocations for the relevant period at the time of the increase. Any pro rata increase will only be distributed to producers who are willing to accept additional tonnes, as take or pay obligations will attach to those additional tonnes.<sup>49</sup>
- 4.24 If there is a decrease in available capacity (for example, as a result of equipment failures or unscheduled maintenance), then all producers' allocations will be decreased on a pro rata basis according to loading allocations for the relevant period at the time of the decrease. Take or pay obligations on those tonnes will also be withdrawn.

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<sup>49</sup> PWCS' submission in support of its applications for authorisation, 1 October 2004, p34.

- 4.25 **New entrants:** will not be required to accept allocation with the associated take or pay obligations until their mine has commenced, but will be accommodated on the same basis as all other producers once production has started.<sup>50</sup>
- 4.26 New entrants will be required to provide a demand forecast, which will be subject to audit, and will be required to provide at least one quarter's notice prior to the commencement of loading at the port. New entrants may not participate in the demand reduction auction.
- 4.27 To adjust for the additional demand for coal loading services, existing producers will receive a pro rata reduction (according to their allocation during the relevant period) to release allocation to the new entrant.
- 4.28 **Allocation transfer and exchange:** PWCS will refuse to load any shipment of coal onto a vessel from a producer that exceeds its available loading allocation for that quarter.<sup>51</sup>
- 4.29 Producers will be entitled to transfer or exchange their loading allocations throughout the year. However, as previously mentioned, producers who choose not to accept the arbiter's determination may only increase, not decrease, their annual loading allocation through transfers and swaps. In addition, conditional allocations may not be transferred or exchanged by producers.<sup>52</sup>
- 4.30 The Administrator will facilitate transfers and exchanges, including the management of an anonymous on-line trading website.
- 4.31 **Unused allocation:** subject to any force majeure events, producers who have unused allocation (beyond their flexibility limits) at the end of a quarter:
- will be required to pay the coal handling services fee of \$2.70 (the 'take or pay charge') on the unused tonnes<sup>53</sup>
  - will have an equivalent volume of unused tonnes (beyond their flexibility limits) deducted from their loading allocation in the following quarter – referred to as 'physical compensation'. The additional allocation will be distributed to producers willing to accept the allocation and take or pay obligations attached to that allocation, as determined by the Administrator.<sup>54</sup> For producers who have chosen to reject the arbiter's demand nomination, this deduction will only be applicable to under use of allocation (beyond flexibility limits) which exceeds the arbiter's adjustment
  - where the producer had also elected to reject the arbiter's determined amount, will be subject to the 'financial compensation' payment as outlined in paragraph 4.9 in relation to unused tonnes (beyond flexibility limits at the end of the quarter).

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<sup>50</sup> Ibid pp 34, 35.

<sup>51</sup> Ibid, p35.

<sup>52</sup> Clause 2 (Schedule 5), Annexure 4F.

<sup>53</sup> Clause 3 (Schedule 6), Annexure 4F.

<sup>54</sup> Clause 4 (Schedule 6), Annexure 4F

- 4.32 Producers will only be exempted from physical compensation if they notify the Administrator prior to the start of the quarter of their inability to use the allocation.<sup>55</sup> However, those required to pay financial compensation will only be released from this obligation if the allocation can be redistributed to other participants.
- 4.33 In the event that a producer who has elected to reject the arbiter's determined amount notifies the Administrator that prior to the start of the quarter of its inability to use its allocation, it will be released from the physical compensation obligations, but will still be required to pay the financial compensation.<sup>56</sup>

### **Dispute resolution**

- 4.34 The dispute resolution procedures set out in section 2.15 of the Coal Handling Services Agreement are available except in situations where the Administrator, auditor or independent expert is acting as an expert, and not as a mediator or arbiter.<sup>57</sup>
- 4.35 The situations when the dispute resolution procedures would not be available include any determination, declaration, calculation or audit by the Administrator, auditor or arbiter or independent expert<sup>58</sup> - for example, when the capacity auditor audits the calculation of the coal chain capacity, when the Administrator determines each producer's loading allocation, a declaration that conditional allocation cannot be used, or determining the forecast requirement of a new producer.
- 4.36 A producer may access the dispute resolution procedures under the CHSA if it disagrees with a decision of PWCS not to waive its take or pay obligations due to a force majeure event.<sup>59</sup>

### **Future amendments to the Medium Term CDS**

- 4.37 The Administrator will monitor the operation of the Medium Term CDS and consult with producers and customers regularly on the operation and outcomes of the CDS.<sup>60</sup>
- 4.38 The Administrator may make recommendations to the Protocols (set out in the Schedules to the Protocols) that are necessary or desirable to meet the objectives of the scheme or facilitate the scheme's effective operation.<sup>61</sup>
- 4.39 Any decision by the PWCS Board to vary the operational aspects of the Protocols will take into account recommendations by the Administrator.<sup>62</sup>
- 4.40 No material change will be made to the proposed Medium Term CDS unless it is reasonably necessary in order to achieve the objectives of the objectives of the CDS and except with the consent or authorisation of the ACCC.<sup>63</sup>

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<sup>55</sup> Clauses 4 and 7(g) (Schedule 6), Annexure 4F.

<sup>56</sup> Clause 7(g) (Schedule 6), Annexure 4F.

<sup>57</sup> Clause 10.1 (Part A), Annexure 4F.

<sup>58</sup> Ibid.

<sup>59</sup> Clause 6.9, Annexure 4E, CHSA.

<sup>60</sup> Clause 8.1 (Part A), Annexure 4F.

<sup>61</sup> Clause 8.2 (Part A), Annexure 4F.

<sup>62</sup> Clause 8.3 (Part A), Annexure 4F.

## 5. SUBMISSIONS RECEIVED BY THE ACCC

5.1 PWCS provided a supporting submission with its application for authorisation.

5.2 The ACCC also sought submissions from around 60 interested parties involved in the coal chain, including coal producers, traders, rail operators and unions. The Commission received public submissions in response from:

- Coal and Allied (a subsidiary of Rio Tinto)
- Anglo Coal
- Newcastle Coal Infrastructure Group
- Xstrata Coal
- Gloucester Coal
- White Mining

5.3 The views of PWCS and interested parties are outlined in the ACCC's evaluation of the Medium Term CDS in Chapter 7 of this draft determination. Copies of public submissions are available on the ACCC's website ([www.acccc.gov.au](http://www.acccc.gov.au)) by following the 'Public Registers' and 'Authorisations Public Registers' links.

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<sup>63</sup> Clause 8.4 (Part A), Annexure 4F.

## **6. THE PUBLIC BENEFIT TEST**

6.1 The ACCC may only grant authorisation where the relevant public benefit test in section 90 of the TPA is satisfied.

### **Application A30236**

6.2 PWCS lodged application for authorisation A30236 under sub-section 88(1) of the TPA to make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the TPA.

6.3 Section 90(8) of the TPA provides that the ACCC shall not make a determination authorising a proposed exclusionary provision of a contract, arrangement or understanding, unless it is satisfied in all the circumstances that the proposed provision would result or is likely to result in such a benefit to the public that the proposed contract, arrangement or understanding ought be authorised.

### **Application A30237**

6.4 PWCS lodged application for authorisation A30237 under subsection 88(1) of the TPA to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA.

6.5 The relevant public benefit test for this application is found in sub-section 90(6). This section provides that the ACCC may grant authorisation to a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, if it is satisfied that:

- the provision of the proposed contract, arrangement or understanding would be likely to result in a benefit to the public; and
- this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result if the proposed arrangement was made and the provision concerned was given effect to.

### **Application A30238**

6.6 PWCS lodged application A30238 under subsection 88 (7) of the TPA to engage in conduct to which sections 45D, 45DA or 45DB might apply.

6.7 Section 90(8) applies to authorisations lodged pursuant to section 88(7) of the TPA. The test set out in section 90(8) is discussed at paragraph 6.3 above.

## Application of the tests

- 6.8 While there is some variation in the language between the test in section 90(6) and the test in section 90(8), the ACCC has until recently adopted the previous view of the Trade Practices Tribunal (now the Australian Competition Tribunal) that, in practical application, the tests are essentially the same.<sup>64</sup>
- 6.9 This view has now been reconsidered by the Australian Competition Tribunal (the Tribunal) and it has found that the two tests are not precisely the same.<sup>65</sup> In particular the Tribunal considered that the test under section 90(6) was limited to a consideration of those detriments arising from a lessening of competition. It was the Tribunal's view that the test under section 90(8) was not so limited.
- 6.10 However, with respect to PWCS' applications, the ACCC is satisfied that the public detriments resulting from the Medium Term CDS arise directly from a lessening of competition. Consequently, the differences in the tests identified by the Tribunal do not affect the assessment of the current applications.

## Definition of public benefit and public detriment

- 6.11 Public benefit is not defined by the TPA. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.<sup>66</sup>

- 6.12 Similarly, public detriment is not defined in the TPA but the Tribunal has given the concept a wide ambit. It has stated that the detriment to the public includes:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.<sup>67</sup>

## Future with-and-without test

- 6.13 The ACCC also applies the 'future with-and-without test' established by the Tribunal to identify and weigh the public benefit and anti-competitive detriment generated by arrangements for which authorisation has been sought.
- 6.14 Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the 'counterfactual'.

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<sup>64</sup> *Re Media Council of Australia (No 2)* (1987) ATPR at 40-774; *Re 7-Eleven Stores Pty Ltd* (1994) ATPR 41-357.

<sup>65</sup> *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004.

<sup>66</sup> *Re 7-Eleven Stores; Australian Association of Convenience Stores Incorporated and Queensland Newsagents Federation* (1994) ATPR ¶ 41-357 at 42677

<sup>67</sup> *Ibid* at 42683.

### **Term of authorisation**

- 6.15 Section 91(1) of the TPA allows the ACCC to grant authorisation for a specific period of time.
- 6.16 The ACCC may authorise different aspects of conduct for which authorisation is sought for different periods.

### **Conditions**

- 6.17 Section 91(3) of the TPA allows the ACCC to grant authorisation subject to conditions which the ACCC considers necessary in order to satisfy the public benefit test.

## **7. ACCC EVALUATION**

- 7.1 As previously mentioned, the ACCC considered the current short term CDS designed to address the vessel queue off the Port of Newcastle in the first half of 2004. On 9 July 2004 the ACCC granted unconditional authorisation to the short term CDS until 31 December 2004 (hereafter referred to as the ‘short term authorisation’).
- 7.2 The ACCC was reluctant to extend the period of authorisation beyond 31 December 2004 because of the lack of certainty as to whether a vessel queue was likely to persist during 2005 and consequently whether the CDS was likely to generate a public benefit in that year.
- 7.3 On 1 October 2004, PWCS lodged an application for authorisation of the proposed Medium Term CDS. PWCS submits that the proposed Medium Term CDS is the next stage in the transition process for a more efficient coal chain in the Hunter Valley in the long term.
- 7.4 The ACCC’s evaluation of the Medium Term CDS is in accordance with the statutory test outlined in Chapter 6 of this draft determination. As required by the test, it is necessary for the ACCC to assess the likely public benefits and detriments flowing from the Medium Term CDS.
- 7.5 Given the short period of time that has transpired since the ACCC’s consideration of the existing (short term) CDS, the ACCC’s assessment of the likely benefits and detriments of the Medium Term CDS builds upon its evaluation of the short term CDS. In this regard, the ACCC’s evaluation of the proposed Medium Term CDS should be read in conjunction with its evaluation of the short term authorisation.

### **Market definition**

- 7.6 The first step in assessing the effect on competition of the conduct for which authorisation is sought is to consider the relevant market(s) in which that conduct occurs.
- 7.7 However, depending on the circumstances, the ACCC may not need to comprehensively define the relevant markets as it may be apparent that a net public benefit will or will not arise regardless of the scope of the defined market.
- 7.8 In the short term authorisation, the ACCC found there were two relevant markets – the global market for coal (or at least the Asian coal market) and the market for the provision of coal loading services for bulk coal carrying ships in the Newcastle area. The ACCC’s view on market definition is unchanged, noting that both markets may be potentially affected by the Medium Term CDS.

## The counterfactual

- 7.9 As noted in Chapter 6 of this draft determination, in order to identify and measure the public benefit and public detriment generated by conduct, the ACCC applies the ‘future with-and-without test’. This involves identifying a counterfactual; that is, making a prediction as to what is likely to happen if authorisation is denied. The ACCC makes a judgement as to what, on the information and evidence before it, is the most likely situation without the authorisation.
- 7.10 The ACCC then compares the public benefit and public detriment arising in the future if authorisation is granted with the public benefit and detriment arising under the counterfactual.
- 7.11 In the short term authorisation, the ACCC concluded that a substantial vessel queue was likely to persist in 2004 if authorisation was denied, as demand for Hunter Valley coal was likely to remain high, mainly due to China’s strong economic growth continuing. The ACCC also concluded that the capacity of the coal chain was likely to remain below the level of demand for coal exports, despite recent improvements in rail performance. However, the ACCC considered it was not able to properly assess whether a vessel queue was likely to persist during 2005 and consequently whether the short term CDS was likely to generate a public benefit in that year (by reducing demurrage).
- 7.12 PWCS believes world demand for coal will continue to be strong during 2005. It submits that without authorisation, the long vessel queues will begin to re-form off the Port of Newcastle from 1 January 2005, when the short term authorisation ceases operation. Consequently, Hunter Valley coal producers will again incur substantial demurrage costs arising from this vessel queue.<sup>68</sup>
- 7.13 Xstrata submitted that:
- ...if the Commission did not grant authorisation, the continued high demand for coal would mean that large producers would immediately send large numbers of vessels to the Port, within weeks creating substantial vessel queues.<sup>69</sup>
- 7.14 World coal demand is forecast to continue growing, as reflected in high coal prices (as outlined in paragraph 2.17). Hunter Valley coal producers have forecast significant increases in coal production over the next three years from around 80 million tonnes in 2004 to 96 million tonnes in 2005, 112 million tonnes in 2006 and 123 million tonnes in 2007.<sup>70</sup> The recently formed NCIG submits that coal exporters have forecast significantly higher Hunter Valley coal production by 2007 of 125-130 million tonnes.<sup>71</sup> However, the ACCC notes that the NCIG is of the view that the queue would be unlikely to be sustained at the previous high in 2004 of 56 ships.<sup>72</sup>

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<sup>68</sup> PWCS’ submission in support of the applications for authorisation, 1 October 2004, p15.

<sup>69</sup> Xstrata submission, 18 October 2004, p4.

<sup>70</sup> PWCS’ submission in support of the applications for authorisation, 1 October 2004, p25.

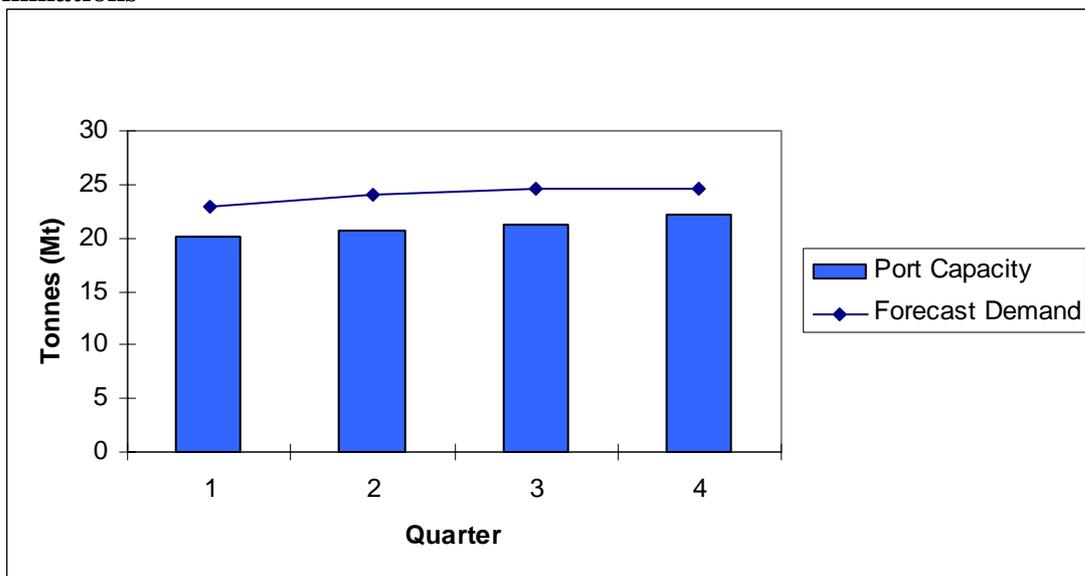
<sup>71</sup> Newcastle Coal Infrastructure Group submission, 19 November 2004, p2.

<sup>72</sup> NCIG meeting, 25 November, p1.

7.15 In contrast, coal chain capacity is increasing at a slower rate. PWCS advised that during 2004 there have been some improvements to coal chain capacity (largely through coal chain logistics). Capacity has increased from 74 million tonnes in 2003 to 79 million tonnes in 2004 (annualised as at September 2004).<sup>73</sup> The declared capacity for the coal chain is forecast to be between 82–86 million tonnes in 2005.<sup>74</sup> A program of investment to enhance the coal chain’s capacity is projected to deliver capacity of around 85 million tonnes by end 2005, 90-95million tonnes by end 2006 and 95-105million tonnes by end 2007.<sup>75</sup>

7.16 The forecast capacity and demand for each quarter in 2005 is illustrated in Figure 7.1.

**Figure 7.1: Forecast demand and port capacity for 2005 based on producer demand nominations<sup>76</sup>**



Source: Accenture

7.17 It seems clear that demand for coal loading services will exceed the capacity of the Hunter Valley coal chain for at least the next few years. In fact, excess demand has increased from 6 million tonnes in 2004<sup>77</sup> to 10-14 million tonnes in 2005.

7.18 On this basis, the ACCC is of the view that a vessel queue is likely to re-form in 2005 absent authorisation, since the proposed Medium Term CDS would not be operating. Given increased demand, the expected vessel queue in 2005 would seem, if anything, likely to be larger than in 2004. Return of an excessive vessel queue would give rise to substantial demurrage costs.

<sup>73</sup> Ibid, Attachment I, p64.

<sup>74</sup> Ibid, p4.

<sup>75</sup> Ibid, Attachment E, pp56-57.

<sup>76</sup> PWCS’ submission in support of the applications for authorisation, 1 October 2004, p13.

<sup>77</sup> Port Waratah Coal Services Determination, 9 July 2004, pp35, 51.

## Public detriment

- 7.19 As outlined at paragraph 1.25, the ACCC previously concluded that the short term CDS would result in some public detriment. In particular, it believes that any reduction in aggregate exports due to under-use of allocation will result in a small but significant detriment. The ACCC also considered that a public detriment would result from any efficiency losses caused by increasing the amount of coal exported by higher cost producers at the expense of more efficient lower-cost producers.
- 7.20 PWCS believes the proposed Medium Term CDS will produce little public detriment, and in particular, additional features of the Medium Term CDS (see paragraph 7.25) reduce the public detriment concerns identified by the ACCC in relation to the short term CDS.<sup>78</sup> In particular, PWCS submits that there will be little impact on competition for the following reasons:
- it will not impact on the total volume of coal shipped through the Port of Newcastle and as with the short term CDS, under the Medium Term CDS, the coal chain will continue to operate at maximum capacity and
  - coal exporters will continue to compete with each other for overseas customers.<sup>79</sup>
- 7.21 Generally, arrangements lessen competition when they enable firms to gain market power, which allows them to supply less and/or charge more for the same good or service.<sup>80</sup>
- 7.22 As noted at paragraph 7.8, the two most relevant markets are:
- the market for coal exports
  - the market for the receipt, storage and loading of coal onto coal vessels at the Port of Newcastle.
- 7.23 An assessment of the public detriment generated by the proposed Medium Term CDS, taking into account submissions from interested parties, follows.

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<sup>78</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p8.

<sup>79</sup> Ibid

<sup>80</sup> *Queensland Co-operative Milling Association Ltd. (QCMA) and Defiance Holdings Ltd* (1976), ATPR 40-012.

## Restricting aggregate coal exports from the Hunter Valley

7.24 PWCS believes the Medium Term CDS will not reduce the volume of coal exported at the Port of Newcastle. In particular, it submits:

...the proposed Medium Term CDS should not affect the volume of coal *actually* delivered through the Hunter Valley coal chain or the amount of coal that PWCS *actually* loads onto ships, except to a *de minimis* extent. The results of the short term CDS were that at the end of a quarter, only approximately 1% of the allocation was not used. While the Commission considered this was a detriment as there was a reduction in possible *theoretical* throughput by that 1%, due to under-use at the end of a quarter, this may not be the case in actuality. As there is significant stockpile capacity in the coal chain, notably a working stockpile range of 1Mt or 5% of quarterly throughput at PWCS alone, a minor under-use of allocation at the end of a quarter within the provided flexibility provisions will not necessarily affect the actual throughput at the coal chain, which remained at maximum capacity as evidenced by the fact that the vessel queue remained in place. [emphasis in original]

In addition, PWCS released an additional 1Mt of loading allocation in June that was available for use until September 2004.<sup>81</sup>

7.25 Notwithstanding this, PWCS believes the additional features of the proposed Medium Term CDS mean that any detriment under the Medium Term CDS, due to under-use of allocation, will be even less than under the short term authorisation. In particular, PWCS submits:

- the audit process provides additional accountability and transparency
- the take or pay system provides additional accountability, to encourage efficient re-distribution to ensure all potential unused capacity is returned earlier by producers who may not use that capacity so that figures below the previous 1% should be expected
- the auction system will facilitate the efficient allocation of capacity to those that value allocation most, an issue raised regarding the Short Term CDS
- it will have an automatic re-set mechanism for each calendar year such that the adjustment mechanism will not operate in periods where demand does not exceed available capacity at the Port of Newcastle.<sup>82</sup>

7.26 PWCS indicated that the proposed Medium Term CDS is designed to maintain the vessel queue at an efficient operating level of around 10 vessels.<sup>83</sup>

7.27 In support, Xstrata submits that the above mentioned enhancements mean that the Medium Term CDS will not result in any decrease in coal exports.<sup>84</sup>

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<sup>81</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p23.

<sup>82</sup> Ibid, pp 23-24.

<sup>83</sup> Ibid, p46.

<sup>84</sup> Xstrata submission, 18 October 2004, p6.

- 7.28 NCIG submits the potential for under-use of allocation is limited under the Medium Term CDS by the introduction of the 5 per cent ‘conditional allocation’ to producers at the start of the year.<sup>85</sup> NCIG, however, raises concerns that the Medium Term CDS may still lead to reduced exports where unused allocation cannot be filled by producers in the short term. NCIG considers that under-utilisation of allocation has occurred under the short term CDS, due to difficulties in adjusting production in the short term to take advantage of unused allocation.<sup>86</sup>
- 7.29 The ACCC notes that some producers expressed concern in relation to the short term CDS that while allocation could be released back to the Administrator, it was unlikely to be done in time for other producers to take advantage of it. It seems likely that the proposed take or pay obligations, together with the proposed allocation trading regime (and to some extent, the demand reduction system) will encourage producers to transfer allocation as early as possible, thereby enabling other producers to respond to additional allocation becoming available.
- 7.30 Furthermore, the ACCC considers the potential detriment arising from an under-use of allocation is mitigated by, in particular, the upper flexibility amount and the additional 5 per cent ‘conditional allocation’ under the Medium Term CDS (see paragraph 4.19). This increased flexibility would appear to enable any individual producer’s under-use of allocation to be taken up by other producers.
- 7.31 White Mining notes the introduction of ‘conditional allocation’ provides producers with another option to gain access to additional allocation. It is concerned, however, that this will operate to reduce the incentive for producers to participate in the transfers and exchanges of allocation. In particular, White Mining submits:
- ...the exchanges and transfer market would be significantly reduced and potentially non existent, due to the ability of other producers to exercise their positive options under the scheme without having to accept a transfer/exchange. We therefore believe that the small/medium size producer(s) will be disadvantaged and find that they have no market to transfer into...whilst the total throughput may not necessarily be affected.<sup>87</sup>
- 7.32 It appears to the ACCC that if producers decided to ‘soak up’ capacity made available by a small producer through exercising their ‘conditional allocation’, rather than negotiating to purchase it, they risk obtaining a small share of the excess capacity or missing out altogether if another producer purchases the entire volume available. Therefore, the ability to obtain excess capacity with ‘conditional allocation’ would not seem to create a large disincentive from participating in transfers/swaps of allocations.
- 7.33 Moreover, the ACCC accepts that the introduction of the audit and arbitration provisions within the Medium Term CDS are likely to encourage accurate production estimations and thereby increase the likelihood of the Medium Term CDS balancing demand for coal loading facilities with supply. These features of the Medium Term CDS are discussed in further detail later in this chapter.

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<sup>85</sup> NCIG submission, 19 November 2004, p1.

<sup>86</sup> NCIG meeting, 25 November 2004, p1.

<sup>87</sup> White Mining submission, 19 November 2004, p1.

- 7.34 Importantly, the ACCC also notes that the trigger mechanism ensures the Medium Term CDS will not operate where expected demand does not exceed capacity by three million tonnes. This, together with the re-set mechanism (providing that the scheme will continue beyond each year only with the agreement of the majority of producers) significantly mitigates against the under-use of capacity and consequential loss of exports.
- 7.35 Having regard to the submissions provided, the ACCC accepts that the small detriments identified in the short term authorisation are significantly reduced by:
- the audit process
  - the upper flexibility amount and the conditional allocation provisions
  - to some extent the auction system and importantly the re-set and trigger mechanism.
- 7.36 The ACCC considers therefore that any public detriment arising from an aggregate reduction of the volume of coal moved through the coal chain is likely to be negligible.

### **Deferring investment in capacity expansion in the Port**

- 7.37 As mentioned previously at paragraph 2.20, NCIG mines are looking to expand combined coal production in the Hunter Valley by 30 million tonnes. The ACCC understands that on the basis of three year forecasts, NCIG's members account for approximately 30 per cent of the planned growth in export output in that period.<sup>88</sup> The ACCC is advised that nearly all producers have indicated plans to substantially grow their export volumes over the foreseeable future.<sup>89</sup>
- 7.38 NCIG is particularly concerned that PWCS has not presented any detailed plans for major expansion investment to the industry to date.<sup>90</sup> In this regard, NCIG argues that:
- ...there is a serious risk of the scheme acting to defer and limit expansion of infrastructure capacity, lock in the status quo and result in the deferral of major new investment in coal mining activity in the Hunter Valley.
- Such deferral of new coal mining investment would have substantial negative impacts on export income...<sup>91</sup>
- 7.39 NCIG believes the reduction of the queue removes the strong signal that would otherwise be sent to investors of the demand for additional capacity.

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<sup>88</sup> PWCS submission, 30 November 2004, p6.

<sup>89</sup> PWCS submission, 7 December 2004, p2.

<sup>90</sup> Meeting with NCIG, 25 November 2004.

<sup>91</sup> Ibid, p2.

- 7.40 NCIG submits that PWCS appears to have a conflict of interest because of the shareholding of Xstrata Coal and Rio Tinto, which both have relatively mature mines in the Hunter Valley. As such, NCIG believes that these companies may not stand to benefit as much from capacity expansion. Furthermore, NCIG submits that it has been advised that the fixed rate of return financial structure of PWCS means that there is low financial incentive for PWCS to expand at the Port.<sup>92</sup>
- 7.41 Furthermore, NCIG claims the potential for the Medium Term CDS to dampen investment in coal loading infrastructure at the Port is exacerbated by the take or pay obligations introduced under the scheme, which it considers may deter investment in a new coal loading facility at the Port. This issue is discussed later in this chapter.
- 7.42 Accordingly, NCIG believes the period of any authorisation granted to the Medium Term CDS should be limited to 12 months to ensure that capacity expansion is not deferred.<sup>93</sup> Authorisation beyond this point should be subject to industry review and support, as the trigger mechanism under the proposed Medium Term CDS is within the control of PWCS and is not itself a sufficient test of industry support.<sup>94</sup>
- 7.43 In response, PWCS submits it is not in its commercial interest to frustrate capacity expansion or investment on the Hunter Valley or coal exports. In particular, it believes it has an incentive to ensure that its customers are satisfied with its costs, services and facilities to ensure that they do not see a commercial need to build a new competing coal loading terminal.<sup>95</sup>
- 7.44 In addition, PWCS emphasises the accuracy of calculations which lead to the coal chain capacity being determined, and therefore whether there is a 3 million tonne excess, is able to be audited at the request of producers under the Protocols.<sup>96</sup>
- 7.45 Furthermore, PWCS submits it is not seeking authorisation beyond the lead-time required for the implementation of a long term solution to the shortage of capacity in the Hunter Valley coal chain. It submits that it has already undertaken significant steps towards and committed capital aimed at increasing capacity. PWCS provided examples of initiatives already underway, including:
- formalisation of the Logistics Team to create a body with clear objectives to maximise the capacity of the existing coal chain infrastructure, with substantive industry representation and input
  - multi-million dollar investment in technology to equip the Logistics Team with tools to increase capacity by enabling more sophisticated planning and logistics management capabilities
  - detailed engineering of the investment required to increase PWCS capacity to 102 million tonnes per annum by 2007

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<sup>92</sup> Ibid.

<sup>93</sup> Ibid.

<sup>94</sup> Meeting with NCIG, 25 November 2004.

<sup>95</sup> PWCS submission, 30 November 2004, p3

<sup>96</sup> Ibid, p11.

- a detailed engineering study is expected to commence in the first quarter of 2005 to assess the cost and schedule required to increase capacity to 110 million tonnes per annum
- PWCS has bid for additional land next to the Kooragang terminal to allow PWCS to build capacity in excess of 11 million tonnes per annum
- conceptual planning of the level and nature of investment required to take the coal chain to beyond 120 million tonnes per annum
- PWCS is working with industry to consider a range of mechanisms necessary to enable long term investment to occur, including the potential for the introduction of longer term take or pay arrangements to enable clear investment signals to be provided and to underpin the necessary capital investment while providing price certainty to PWCS customers.<sup>97</sup>

7.46 The ACCC notes that all mines in the Hunter Valley, including mature mines, currently have their allocation pro-rated back, thereby reducing potential coal exports. As such, the ACCC considers that there is still an incentive for mature mines to have Port capacity increased, as this would enable them to export more coal through the Port.

7.47 In addition, the ACCC notes that PWCS has committed to a program of investment to enhance the coal chain's capacity, which is projected to deliver capacity of around 85 million tonnes by the end of 2005, 90-95million tonnes by the end of 2006 and 95-105 million tonnes by the end of 2007 (see Attachment C).<sup>98</sup> This program of investment is dependent on investment at all levels of the coal chain, including rail track owners and operators. PWCS also advised that the PWCS' Board approved funding for an expansion of PWCS that will allow coal chain throughput of a nominal 102 million tonnes per year.<sup>99</sup>

7.48 The ACCC also understands that PWCS has scheduled an industry workshop on long term planning and investment initiatives on 13 December 2004.

7.49 The ACCC considers significant detriment would arise, in the form of lost coal exports, if the proposed Medium Term CDS had the effect of delaying necessary investment to increase the capacity of the Hunter Valley coal chain. However, given the increase in coal chain capacity under the short term CDS and the scheduled program of investment, the ACCC is of the view that the Medium Term CDS is unlikely to reduce incentives to improve capacity, at least in the short term.

### **Reducing incentives for coal producers to become more efficient**

7.50 In the short term authorisation, certain interested parties submitted that the short term CDS would have the effect of 'freezing' market shares which would reduce incentives for coal producers to become more efficient to improve market shares.

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<sup>97</sup> PWCS submission, 30 November 2004, p4.

<sup>98</sup> PWCS' submission in support of the applications for authorisation, Attachment E.

<sup>99</sup> Ibid, p11.

7.51 The ACCC ultimately concluded that the short term CDS was not likely to generate significant public detriment by reducing coal producers' incentives to improve the efficiency of their operations. In particular, the ACCC concluded that the limit imposed by the short term CDS on export tonnages of individual producers is likely to be similar to that imposed by a queue (absent the authorisation).

7.52 PWCS submits that under the Medium Term CDS coal exporters will continue to compete against each other for overseas and domestic customers. In particular, it suggests:

The medium term solution is arguably pro-competitive because of the way the allocation/auction system is designed to encourage producers to choose and compete against themselves to achieve optimal allocations....<sup>100</sup>

7.53 The ACCC does not consider the Medium Term CDS will reduce producer incentives for efficiency. Producers will continue to pursue mechanisms to reduce costs for the benefit of shareholders. In fact, as discussed later, the reduction in queues is likely to generate efficiencies in exporting rather than reducing efficiencies. Further, the ACCC considers that without authorisation (and the Medium Term CDS), export tonnages are not determined by being more efficient so as to offer lower prices to buyers, but by a producer's ability to get as much of their coal as possible through the congested rail and port system. With authorisation (and the Medium Term CDS operating), more efficient producer's will have the opportunity – via the auction process and throughout the year - to acquire capacity to increase exports.

### **Public detriment arising from the design of the Medium Term CDS**

7.54 The ACCC previously concluded that the design of the short term CDS did not generate public detriment as a result of perceived inequities. In particular, the ACCC concluded that while certain elements of the short term CDS favoured some producers, removing these elements would favour other producers and there is objectively no 'right' way that such elements should be designed.<sup>101</sup>

#### *Accuracy of producer nominations*

7.55 For the short term CDS, producer allocations were based on forecasts provided before they knew their allocation would be pro-rated. However, for the proposed Medium Term CDS, producers are aware of pro-rating prior to making their demand forecasts with PWCS. Concerns were raised that this created an incentive for producers to over-estimate demand forecasts.

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<sup>100</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p45.

<sup>101</sup> Port Waratah Coal Services determination, 9 July 2004, p82.

- 7.56 In response to concerns raised in the short term authorisation about the accuracy of producer demand nominations, PWCS submits the audit, transparency and take or pay elements of the Medium Term CDS (see paragraph 4.9) should ensure the accuracy of producers' demand nominations.<sup>102</sup> It submits that this will ensure that 'gaming' through overestimation of demand nominations under the Medium Term CDS is unlikely. The effect of 'gaming' is that if one producer overstates production then other producers' allocations will be reduced.
- 7.57 In addition, PWCS submits:
- ...the proposed Medium Term CDS will have broad based industry support as it has been designed based on industry submissions and feedback during an extensive and intensive process of consultation.<sup>103</sup>
- 7.58 The ACCC notes that the take or pay provisions as they relate to the Medium Term CDS are actually introduced under Schedule 4E (Clause 6) of the CHSA, rather than the Protocols at Annexure 4F. PWCS submits that in the event that the PWCS Board determined that there was not a requirement to operate the scheme, producers would still be required by PWCS to submit a demand forecast to which 12 month take or pay obligations would attach.<sup>104</sup> In other words, take or pay obligations on producer nominations will apply irrespective of whether the Medium Term CDS is operating or not. As such, this incentive aimed at ensuring the accuracy of producer nominations would occur without the ACCC authorisation.
- 7.59 However, the ACCC notes that the Medium Term CDS introduces additional 'physical' and 'financial' compensation payments (see paragraph 4.31) and, for producers that reject the arbiter's recommendation, an inability to 'sell down' from their pro rata allocation. The ACCC believes that the incentive to 'game' the Medium Term CDS is greater if producers are able to reject the arbiter's amount. Having said that, the ACCC understands that not being able to sell allocation (either in auction or through trading during the year) is likely to provide a strong incentive to accept the arbiter's recommendation. This is due to the relatively standard risk that producers will suffer a major production shortfall, one in every three or four years. Normally, a producer that experienced such a major production shortfall would sell its excess coal loading allocation to avoid the take or pay and other penalty provisions. If the producer has not accepted the arbiter's decision then, under the Medium Term CDS, it is prohibited from selling capacity and would be exposed to very significant financial consequences.
- 7.60 There is a degree of subjectivity to forecasting producer's volumes. To the extent an external auditor disagrees with a producer's forecasts, the ACCC accepts that if the arbiter's decision was binding under the Medium Term CDS, PWCS could be exposed to litigation for a producer's forgone revenue as a result of any 'excessive' reduction in allocated capacity. This increased risk of litigation would impose additional costs on PWCS, which it would presumably seek to recover through higher port usage costs.

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<sup>102</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p40.

<sup>103</sup> Ibid, p7.

<sup>104</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p11.

7.61 Overall, it appears to the ACCC that the financial and physical penalty provisions under the Medium Term CDS should introduce a degree of accountability into producer nominations. The ACCC considers the inability for some producers to sell allocation, either at the auction or throughout the year, potentially results in a reduction in efficient allocation. However, as discussed above, given the increased production flexibility of ‘conditional allocation’ and the redistribution of allocation to participating producers in the following quarter, the ACCC considers a reduction in the aggregate quantity of coal being exported from the Hunter Valley as a result of the Medium Term CDS is likely to be negligible.

#### *Take or pay obligations*

7.62 NCIG submits that it is not opposed to the introduction of take or pay provisions in relation to the Medium Term CDS, as long as they are limited to twelve months of tonnage forecasts.<sup>105</sup> However, NCIG is concerned that the proposed take or pay arrangement survives even if the scheme is not operating and can be changed by the PWCS Board unilaterally at any time under clauses 2.12.1 and 2.12.2 of the CHSA.<sup>106</sup>

7.63 PWCS submits that the ability to introduce or change take or pay obligations is already inherent in the CHSA, and is not a new right sought to be included as part of recent changes to the CHSA.<sup>107</sup>

7.64 In addition, PWCS emphasises that:

Take or pay obligations are a common feature of coal loading arrangements throughout the world and are highly desirable for infrastructure providers to manage investment risk...Take or pay arrangements of longer than one year are common at other coal loading facilities (eg, 10 years at Dalrymple Bay in Queensland).<sup>108</sup>

7.65 As noted at paragraph 7.58, the provisions relating to take or pay are contained in Annexure 4E of the CHSA, for which PWCS has not sought authorisation. In this regard, NCIG is concerned that PWCS could change the take or pay provisions without the approval of the ACCC.<sup>109</sup> NCIG submits that creates a large degree of uncertainty for Hunter Valley coal producers. For example, PWCS could extend take or pay obligations beyond the current limit of 12 months of tonnage forecasts. This has the potential to create significant detriment if it inhibited the establishment of a competing coal loading facility at the Port of Newcastle by ‘locking in’ tonnes with PWCS, thus preventing coal producers from supporting the new coal loading facility. NCIG emphasise that there is a real prospect of establishing a competing coal loading facility. The ACCC is advised that the NSW government has invited tenders for vacant land at the Port.

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<sup>105</sup> NCIG submission, 19 November 2004, p3.

<sup>106</sup> Ibid.

<sup>107</sup> PWCS submission, 30 November 2004, p7.

<sup>108</sup> Ibid, pp5 and 6.

<sup>109</sup> Meeting with NCIG, 26 November 2004.

- 7.66 NCIG therefore submits the following condition should be included in any authorisation of the Medium Term CDS:

The take or pay elements of the scheme should be included in annexure 4F, should only be allowed to apply to forecast tonnage requirements for one year in advance, and should not be changed without industry agreement.<sup>110</sup>

- 7.67 In response, PWCS submits that it is inappropriate to seek a condition of authorisation that fetters its ability to include contractual take or pay arrangements as they are essentially a commercial matter. The take or pay obligations will continue to apply in any year when the Medium Term CDS is not in operation, as they are commercially separate from capacity distribution.<sup>111</sup>

- 7.68 Xstrata also notes that take or pay arrangements are the industry norm for logistics arrangements in the coal industry throughout the world.<sup>112</sup> It submits that if the ACCC were to impose a one year take or pay obligation as a condition of authorisation it would stultify long term investment by PWCS.<sup>113</sup>

- 7.69 In this regard, PWCS has provided a commitment under the CHSA not to change the current take or pay arrangements without consulting its customers. At the same time, PWCS has also indicated its intention to enter into longer term take or pay arrangements by the end of 2009. In particular, Annexure 4E of the CHSA states:

The take or pay provisions described in this annexure are part of the medium term solution for capacity balancing of services provided by PWCS as part of the Export Coal Chain and no change will be made to those arrangements without further consultation with Customers. PWCS intends by no later than 31 December 2009 to enter into longer term take-or-pay arrangements, in consultation with Customers, that are expected to be based on a longer time period than the one-year reset arrangement described in clause 6.1 of this Annexure.<sup>114</sup>

- 7.70 Xstrata also submits that:

...a rival terminal is highly unlikely to be built and operating within the 3-5 year timeframe requested by PWCS for its authorisation.<sup>115</sup>

- 7.71 The NCIG's concerns relate to the uncertainty arising from PWCS' ability to expand the time frame attached to take or pay obligations. The ACCC considers that this has the potential to result in a public detriment under the Medium Term CDS if it 'locked' producers into PWCS, thereby prevented the entry of a competing coal loader at the Port. The ACCC considers a potential competitor to PWCS would need commitments from producers prior to entering into construction of a coal loading facility. However, the take or pay provisions, as they relate to the operation of the Medium Term CDS, are currently limited to 12 months of tonnage forecasts. This means that producers can vary their exposure to take or pay obligations by adjusting their yearly demand forecasts with PWCS.<sup>116</sup> For example, if a new coal loader commenced operations, a

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<sup>110</sup> NCIG submission, 19 November 2004, p4.

<sup>111</sup> PWCS submission, 30 November 2004, p6.

<sup>112</sup> Xstrata submission, 22 November 2004, p3.

<sup>113</sup> Ibid.

<sup>114</sup> Clause 6.12, Annexure 4E, Coal Handling Services Agreement.

<sup>115</sup> Ibid, p2.

<sup>116</sup> Clause 6.1, Annexure 4E, Coal Handling Services Agreement.

producer could simply provide a reduced demand forecast to PWCS or completely switch to the alternate provider by providing a zero demand forecast to PWCS.

- 7.72 Furthermore, as noted above, the take or pay obligations are not the subject of the authorisation application. The applicant advises that they will exist with or without the Medium Term CDS.
- 7.73 The extent to which competition concerns are raised as a result of future changes to the take or pay arrangements under the CHSA, these concerns may be addressed under the competition provisions of Part IV of the TPA.

#### *Effect on small producers*

- 7.74 White Mining submits that the physical tonnage penalty (beyond take or pay obligations) for unused allocation will have a detrimental impact on small to medium producers. For example, a small to medium sized producer might have a quarterly allocation of 500 000 tonnes. If a cape size vessel (carrying 100 000 tonnes) did not arrive within the quarter due to circumstances beyond the control of the producer, the producer would have lost 100 000 tonnes in the quarter and subsequently penalised 100 000 tonnes in the following quarter.<sup>117</sup>
- 7.75 In addition, White Mining believes producers will be unable to avoid this penalty due to the introduction of ‘conditional allocation’ (discussed in further detail at paragraph 7.31). However, for the reasons given at paragraph 7.32, the ACCC does not consider that the introduction of ‘conditional’ allocation will remove the incentive for producers to participate in transfers and exchanges of allocation.
- 7.76 The ACCC considers the following factors would seem to minimise the risk of these producers paying ‘physical’ compensation:
- there is a 5 day ‘buffer’ at the end of the quarter for vessel arrivals<sup>118</sup>
  - producers can transfer and exchange portions of their loading allocations during the quarter<sup>119</sup> and
  - producers can avoid physical compensation in certain circumstances (that is, if they have notified the Administrator at the beginning of the quarter of their inability to use a portion of allocation).<sup>120</sup>
- 7.77 The ACCC considers that the physical penalty provisions of the proposed Medium Term CDS could result public detriment in the manner described by White Mining. However, for the reasons listed immediately above, the ACCC considers this is likely to be minimised.

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<sup>117</sup> White Mining submission, 19 November 2004, p1.

<sup>118</sup> Clause 3 (Schedule 6), Annexure 4F.

<sup>119</sup> Clause 2 (Schedule 5), Annexure 4F.

<sup>120</sup> Clauses 4 and 7(g) (Schedule 6), Annexure 4F.

## Public Benefits

7.78 PWCS submits that the Medium Term CDS will deliver substantial public benefits, including:

- demurrage cost savings
- reduced coal stockpiling costs
- improved international reputation and international competitiveness of the Port of Newcastle and Hunter Valley coal industry
- facilitating potential re-investment in the Australian coal industry, especially the Hunter Valley coal industry
- it will help to ensure the queue operates at a more efficient level
- the provision of certainty to producers regarding the volume of coal they can ship, loading times and vessel schedules, which will enable producers to manage production more efficiently
- allowing a transition to the long term solution for the Hunter Valley Coal logistics operations.

7.79 An assessment of the public benefits claimed by PWCS, taking into account the submissions from interested parties, follows.

### Reduced demurrage

7.80 In its short term authorisation, the ACCC concluded that reducing the size of the queue improved economic efficiency by reducing the cost of exporting coal and the amount of time that coal vessels sit unproductively in a queue off the Port of Newcastle. In particular, the key public benefit arising from the short term CDS is an improvement in economic efficiency due to demurrage cost savings. Depending on the length of the queue, the ACCC estimated likely demurrage savings of between US\$80 million and US\$140 million in 2004.

7.81 As outlined at paragraph 2.13, PWCS advised that actual demurrage savings between April and July 2004 totalled US\$47 million. PWCS estimates demurrage savings of US\$173.5m by the end of 2004.

7.82 PWCS estimates demurrage savings under the Medium Term CDS of US\$163 million in 2005, based on 56 ships being in the vessel queue, as was the peak in March 2004.<sup>121</sup> Table 7.1 shows the estimated demurrage savings in 2005 for various queue lengths.

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<sup>121</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p10.

**Table 7.1: Estimated demurrage savings in 2005 under the Medium Term CDS for various queue lengths<sup>122</sup>**

Queue length (number of vessels)	Annual demurrage saving with CDS (US\$m)
56	162.87
75	216.35
90	251.91
100	272.32

Source: Accenture

7.83 Xstrata submits that:

If the vessel queue was to return to its very high levels of March 2004, substantial demurrage fees would again be incurred...even after the interim authorisation was granted on 5 March 2004, these demurrage costs took quite a while to decrease as PWCS worked through the vessel queue...<sup>123</sup>

7.84 Coal and Allied submits that the Medium Term CDS ensures:

...the excessive deadweight cost that demurrage creates is minimised.<sup>124</sup>

7.85 In the short term authorisation, the ACCC considered that PWCS' model for calculating demurrage savings was sound.<sup>125</sup> The ACCC did not receive any submissions from interested parties that questioned PWCS' estimated demurrage savings under the Medium Term CDS.

7.86 The ACCC considers there is still some uncertainty about predicting the exact size of the queue for 2005, and hence the level of demurrage savings. However, given that similar conditions to those which led to a queue of 56 ships would exist in 2005, and in fact, increased excess demand means the queue would seem to be potentially larger, it considers that the level of demurrage savings is likely to be significant.

7.87 It is not clear to the ACCC at what point coal producers would stop sending ships to Newcastle, in the absence of the Medium Term CDS. Presumably at some point the demurrage cost would be so high as to discourage further ships being queued. The experience earlier this year was that a queue in excess of 50 ships did in fact occur. As a result, the ACCC considers that PWCS' estimate of US\$163 million is reasonable, since it is based on a queue size that was actually reached. Irrespective of the exact dollar value of the savings, the ACCC considers that producers would be likely to face higher demurrage costs without the Medium Term CDS in place.

<sup>122</sup> Ibid.

<sup>123</sup> Xstrata submission, 18 October 2004, pp 2, 3.

<sup>124</sup> Coal & Allied submission, 15 October 2004.

<sup>125</sup> See Attachment A to the PWCS determination, 9 July 2004.

## Reduced stockpiling costs

7.88 In the short term authorisation the ACCC concluded that the (short term) CDS was likely to reduce stockpiling costs for most producers compared to a situation where a lengthy vessel queue persisted, as it was likely that mines would build up stockpiles while waiting for their vessels to get to the front of the queue. The ACCC was also of the view that some mines might effectively choose to forgo these savings by continuing to produce at higher levels than their allocation. However, they would presumably not do this unless they believed they would be likely to derive some future benefit. The ACCC ultimately concluded that it did not have enough information to assess the size of this benefit.

7.89 PWCS claims that the Medium Term CDS will provide certainty:

...in annual share of coal chain capacity, loading times and therefore when to order and schedule ships...This certainty of logistics 'discipline' will enable producers to make more efficient business decisions and manage their production more efficiently.<sup>126</sup>

7.90 In support of this claim, Xstrata submits that the Medium Term CDS will provide:

Increased certainty in long range forecasting for coal producers as they will know their annual costs with a greater degree of certainty...<sup>127</sup>

7.91 As regards production levels and stockpiling levels, Xstrata notes:

The ability to "swap" allocation facilitates use of these allocations, provided producers plan in advance to have some stock piles available for such an opportunity...Xstrata has forward planned and has sought to keep sufficient tonnes available to meet short falls if the opportunity arose.<sup>128</sup>

7.92 The ACCC considers that the Medium Term CDS may result in a public benefit to the extent that it enables producers to more accurately forecast their likely required production levels and maintain optimal stockpiling levels. However, producers will make individual commercial decisions about whether to maintain production at higher levels in order to take advantage of any transfers of allocation.

7.93 Accordingly, the ACCC remains of the view that the Medium Term CDS is likely to reduce stockpiling costs for most producers compared to a situation where the queue persists. However, the ACCC does not have enough information to properly assess the size of this benefit.

## Improved reputation of the Port of Newcastle

7.94 In its short term authorisation the ACCC concluded that while the existence of a queue could frustrate coal buyers, it was unlikely to reduce Hunter Valley exports.

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<sup>126</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p45.

<sup>127</sup> Xstrata submission, 18 October 2004, p6.

<sup>128</sup> Ibid, p5.

- 7.95 PWCS submits that the delay caused by extensive vessel queues harms the international reputation of it, the Port of Newcastle, the Hunter Valley and the Australian coal industry. PWCS submits that increased certainty of coal delivery times under the Medium Term CDS will improve the reputation and competitiveness of the Port and the Australian coal industry, as against other coal exporting nations.<sup>129</sup>
- 7.96 Some interested parties support this view. For example, Xstrata submits:
- Prior to the introduction of the Short Term CDS, the credibility of the Port and the ability to make timely coal deliveries was low. Since the introduction of the Short Term CDS, comments from Xstrata's overseas coal customers, in particular the Japanese power companies, have been extremely positive.<sup>130</sup>
- 7.97 In addition, PWCS submits that:
- ...the reduction in vessel queues has resulted in the increase of availability of coal transportation vessels, which has had the effect of decreasing shipping costs...<sup>131</sup>
- 7.98 The ACCC did not receive any submissions from interested parties opposing this public benefit claim.
- 7.99 The ACCC considers that increased certainty with regard to coal deliveries and cost savings as a result of reduced vessel queues would appear to be factors that influence the purchasing decisions of overseas buyers. To the extent that the existence of large vessel queues would discourage overseas customers from purchasing coal from Hunter Valley producers, the ACCC considers the proposed Medium Term CDS, through the reduction of any such queue, has the potential to maintain the reputation of the Port of Newcastle and Hunter Valley coal sales. The ACCC has insufficient information to enable it to properly estimate the size of this benefit, but does not consider it to be significant for the purposes of this authorisation application.

### **Other efficiencies and facilitating re-investment in the Hunter Valley coal industry**

- 7.100 PWCS submits the proposed Medium Term CDS will ensure the queue operates at an efficient level and will increase incentives for coal producers to invest in the Hunter Valley coal production and handling facilities. It also claims that the provision of certainty to producers regarding the volume of coal they can ship, loading times and vessel schedules, will enable producers to manage production more efficiently<sup>132</sup>
- 7.101 The ACCC considers that any efficiency gains as a result of the Medium Term CDS would be a benefit to the public. The key saving already identified is the demurrage savings arising from a reduction in the vessel queue. The ACCC notes that demurrage savings could flow on to be used by the industry to invest in upgrades to, for example, the load points on the coal chain.

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<sup>129</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p9.

<sup>130</sup> Xstrata submission, 19 November 2004, p3.

<sup>131</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p21.

<sup>132</sup> Ibid, pp 45 and 46.

7.102 In addition, PWCS submits that the introduction of take or pay arrangements under the Medium Term CDS will ‘assist in sending the correct investment signals concerning capacity and efficiency upgrades.’<sup>133</sup> Given take or pay obligations will attach to producer demand nominations even when the Medium Term CDS is not operating, the ACCC considers any benefits from the take or pay arrangements will occur absent the authorisation.

### **Balance of public benefit and detriment**

7.103 The ACCC may only grant authorisation if it is satisfied that, in all the circumstances, the Medium Term CDS is likely to result in a public benefit that will outweigh any public detriment.

7.104 The ACCC is satisfied that the Medium Term CDS is likely to result in a significant public benefit, particularly by reducing demurrage costs for the industry and hence improving economic efficiency relative to a situation where a queue persists. The ACCC recognises there is no way of accurately predicting the level of the queue going forward if the Medium Term CDS were not in place. Nevertheless, based on the same level of queue actually reached earlier this year, the ACCC considers PWCS’ estimate of US\$163 million is not unreasonable.

7.105 The ACCC considers that reducing demurrage costs is a public benefit, as all producers would be likely to face higher demurrage costs without the Medium Term CDS in place.

7.106 The ACCC considers that any reduction in aggregate exports due to under-use of allocation will result in a public detriment. However, the ACCC is satisfied that any public detriment arising from a reduction of the volume of coal moved through the coal chain is likely to be negligible, particularly due to the introduction of the five per cent conditional allocation provision under the Medium Term CDS.

7.107 The ACCC also considers a public detriment would potentially result from a reduction in efficient allocation caused by the inability of some producers to sell coal loading allocation.

7.108 The ACCC is satisfied that the Medium Term CDS is unlikely to reduce incentives to invest in capacity expansion at the Port of Newcastle, at least in the short term.

7.109 Overall, on balance, the ACCC considers that in all the circumstances, the public benefit is likely to outweigh the public detriment.

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<sup>133</sup> PWCS submission in support of the applications for authorisation, 1 October 2004, p30.

## **Interim authorisation – stage 2**

- 7.110 At the time of lodging the applications for authorisation, PWCS requested interim authorisation in two parts. Section 91 of the TPA allows the Commission to grant interim authorisation without making a decision on the merits of the application.
- 7.111 On 3 November 2004 the ACCC granted interim authorisation to PWCS to conduct the demand reduction auction. On 30 November, PWCS advised that the demand reduction was not held in 2004 due to a lack of participation by producers.
- 7.112 PWCS also seeks interim authorisation from 1 January 2005 to:
- commence the tonnage tracking and management elements of the proposed Medium Term CDS and
  - to decline to load vessels that exceed the first quarter's allocation by producer.
- 7.113 In light of the assessment of the Medium Term CDS in this chapter of the draft determination, the ACCC has decided to grant interim authorisation to PWCS to commence the tonnage tracking and management elements of the proposed Medium Term CDS and to decline to load vessels that exceed the first (2005) quarter's allocation by producer.
- 7.114 This interim authorisation will commence on 1 January 2005 and will remain in place until the date the ACCC's final determination comes into effect.

## **Duration of authorisation**

- 7.115 The ACCC generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in the light of any changed circumstances.
- 7.116 PWCS seeks authorisation for the proposed Medium Term CDS for a period of at least three years and up to five years to allow the proposed long term solution to come into place. PWCS submits a longer term of authorisation is warranted because:
- the proposed Medium Term CDS includes a trigger mechanism which means that it will not operate to distribute available capacity unless demand exceeds capacity by 3 million tonnes<sup>134</sup>
  - the operation of the proposed Medium Term CDS from year to another will be subject to annual review and must receive support by more than 75 per cent of coal producers by volume of export coal tonnes *or* more than 50 per cent of the number of currently exporting producers<sup>135</sup> and

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<sup>134</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, p11.

<sup>135</sup> Part B – Schedule 1, Annexure 4F.

- there is genuine work being undertaken by PWCS on the longer term solution.<sup>136</sup>
- 7.117 Furthermore, PWCS highlights that the incentive to use allocation provided by the ‘physical allocation’ (that is, a reduction of allocation in the quarter following under-use beyond flexibility limits) would have no effect in the final quarter if the system is limited to one year. As such, PWCS submits the removal of this incentive creates an unquantifiable risk of under-use of allocation.<sup>137</sup>
- 7.118 Xstrata supports this view. In particular, it considers:
- ...to limit authorisation to one year would create risk of under-use of allocation by producers without financial penalty and would be an inefficient use of resources, time and management as a further authorisation would inevitably be sought – which would be itself a major distraction from the PWCS work on the long term solution.<sup>138</sup>
- 7.119 NCIG agree that broad industry support should be required to roll over the Medium Term CDS from one year to another. However, NCIG submits the more appropriate test is for the CDS to proceed only with support by 75 per cent of producers by volume *and* more than 50 per cent of producers by number.<sup>139</sup> NCIG is of the view that if half the industry by number is not in agreement with the Medium Term CDS, then there must be concerns with the scheme. It considers that having both 75 per cent of industry support by volume and more than 50 per cent by number ensures that small producers have an adequate voice.
- 7.120 PWCS submits that under the test proposed by NCIG, there is a risk that during a year of high excess demand (for example, in 2006 aggregate demand forecasts will exceed anticipated coal chain capacity by at least 20 million tonnes) producers with as little as 12 per cent of the throughput, but representing 51 per cent of the producers by number, could prevent the scheme from operating. The consequent demurrage costs would be imposed on the remaining producers (representing 88 per cent of throughput). PWCS submits that the test proposed in the application for authorisation (as outlined at paragraph 7.116) is more reasonable because it still achieves the desired demonstration of industry support, whilst ensuring that the intended benefits of the CDS cannot be prevented from being realised by producers with a small volume of coal throughput.<sup>140</sup>
- 7.121 The ACCC considers that the trigger mechanism appears to address the previous concern in the short term authorisation about whether demand conditions will result in a substantial queue of vessels off the Port of Newcastle and therefore, whether the CDS is likely to generate a public benefit.
- 7.122 As regards obtaining industry support for the scheme to continue to operate, the ACCC considers the precise definition does not materially impact upon its assessment of the public benefits and detriments of the proposed Medium Term CDS.

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<sup>136</sup> PWCS’ submission in support of the applications for authorisation, 1 October 2004, p11.

<sup>137</sup> Ibid, p12.

<sup>138</sup> Xstrata submission, 18 October 2004, p7.

<sup>139</sup> NCIG submission, 19 November 2004, p4.

<sup>140</sup> PWCS submission, 30 November 2004, p8.

- 7.123 The ACCC acknowledges that expansion of capacity of the Hunter Valley coal chain is dependent on a variety of factors, and not just investment at the Port. For the reason given at paragraph 7.49, the ACCC considers the Medium Term CDS is unlikely to reduce incentives to improve capacity of the coal chain, at least in the short term.
- 7.124 Significant concerns have been raised by the NCIG group of producers that the Medium Term CDS may hinder expansion at the Port and/or hinder the entry of a competing coal loading facility in the Port of Newcastle. These are significant potential detriments. As previously mentioned, PWCS seeks authorisation for up to five years. The ACCC considers that there is more likelihood of these detriments eventuating the longer the authorisation runs.
- 7.125 On the other hand, the ACCC considers granting authorisation for a short duration; say 12 months, could distract the industry from developing a long term solution if it were focusing again on seeking authorisation for a CDS to operate in 2006. As a result, the ACCC proposes to grant authorisation until 31 December 2007.
- 7.126 The ACCC notes, however, that under section 91B(3) of the TPA it is able to revoke an authorisation at any time (subject to a consultation process), if it appears to the ACCC that:
- a) the authorisation was granted on the basis of information that was false or misleading in a material particular; or
  - b) a condition to which the authorisation was subject has not been complied with; or
  - c) there has been a material change of circumstances since the authorisation was granted.
- 7.127 PWCS advises:
- The PWCS Board has demonstrated a track record of expansion decisions and has recently reaffirmed its position to ensure that PWCS has enough capacity so that it is never a constraint on Newcastle coal exports.<sup>141</sup>
- 7.128 The ACCC notes there may be a need to review the authorisation of the Medium Term CDS if it was shown to be inhibiting efficient investment at the Port of Newcastle.

### **Variations to the Protocols**

- 7.129 The ACCC notes that any amendment to the Protocols during the proposed term of this authorisation will need to be the subject of an application for minor variation of the authorisation under section 91A of the TPA, or revocation and substitution of the authorisation under section 91C of the TPA.

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<sup>141</sup> PWCS submission, 7 December 2004, p3.

## 8. DRAFT DETERMINATION

### The applications

- 8.1 On 1 October 2004, Port Waratah Coal Services Limited (PWCS) lodged applications for authorisation A30236, A30237 and A30238 with the Australian Competition and Consumer Commission (the ACCC).
- 8.2 Application A30236 was made using Form A, Schedule 1, of the *Trade Practices Regulations 1974* (TPA). The application was made under subsection 88 (1) of the TPA, and sought authorisation to:
- make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provision within the meaning of section 45 of the TPA; and
  - give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of the TPA.
- 8.3 Application A30237 was made using Form B, Schedule 1, of the *Trade Practices Regulations 1974*. The application was made under subsection 88 (1) of the TPA, and sought authorisation to:
- make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA; and
  - give effect to a provision of a contract, arrangement or understanding, a provision of which has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the TPA.
- 8.4 Application A30238 was made using Form D, Schedule 1 of the *Trade Practices Regulations 1974*. The application was made under subsection 88(7) of the TPA, and sought authorisation to:
- engage, in concert with other persons, in conduct that hinders or prevents, or may hinder or prevent, a third person supplying goods or services to, or acquiring goods or services from, a fourth person; and
  - engage, in concert with other persons, in conduct that prevents or substantially hinders, or may prevent or substantially hinder, a third person from engaging in trade or commerce involving the movement of goods between Australia and places outside Australia.
- 8.5 The applications relate to PWCS' proposed Medium Term capacity distribution system (CDS) to address the imbalance for coal loading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain.

### **The public benefit test**

- 8.6 For the reasons outlined in Chapter 7 of this draft determination, the ACCC considers that in all the circumstances the arrangements for which authorisation is sought are likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the arrangements.
- 8.7 The ACCC is also satisfied that the arrangements for which authorisation is sought are likely to result in such a benefit to the public that the arrangements should be allowed to take place.
- 8.8 The ACCC therefore **proposes to grant** authorisation to applications A30236, A30237 and A30238.

### **Conduct for which the ACCC proposes to grant authorisation**

- 8.9 The ACCC proposes to grant authorisation to the Medium Term CDS as set out in the *Medium Term Capacity Balancing System Objectives, Principles and Protocols* (the Protocols) at Attachment A until 31 December 2007.
- 8.10 Further, the proposed authorisation is in respect of the proposed Medium Term CDS as it stands at the time authorisation is granted. As a result, any amendment to the arrangements during the term of the authorisation would need to be the subject of an application for minor variation of the authorisation under section 91A of the TPA, or revocation and substitution of the authorisation under section 91C of the TPA.
- 8.11 This draft determination is made on 16 December 2004.

### **Interim authorisation**

- 8.12 At the time of lodging the application, PWCS requested interim authorisation for the proposed Medium Term CDS in two parts. On 3 November 2004 the ACCC granted interim authorisation to PWCS to conduct the demand reduction auction only.
- 8.13 The ACCC now also grants interim authorisation to PWCS to:
- commence the tonnage tracking and management elements of the proposed Medium Term CDS
  - decline to load vessels that exceed the first (2005) quarter's allocation by producer.
- 8.14 This interim authorisation will commence on 1 January 2005 and will remain in place until the date the ACCC's final determination comes into effect.

### **Further submissions**

- 8.15 The ACCC will now seek further submissions from interested parties. In addition, the applicant or any interested party may request that the ACCC hold a conference to discuss the draft determination, pursuant to section 90A of the TPA.

**Attachment A**

**ANNEXURE 4F**

**MEDIUM TERM CAPACITY BALANCING SYSTEM  
OBJECTIVES, PRINCIPLES & PROTOCOLS**

# CONTENTS

## **Part A – General Conditions**

1. Defined Terms & Interpretation
2. Scope
3. Capacity Declaration
4. Forecast Requirement
5. Demand and Supply Balancing
6. Capacity Distribution
7. Disruptions to a Producer
8. Amendments to Scheme
9. Extension of Duration of the Scheme
10. Dispute Resolution
11. Limitation on Liability

## **Part B – Schedules**

- Schedule 1 Dictionary
- Schedule 2 Capacity Declaration
- Schedule 3 Forecast Requirement
- Schedule 4 Demand and Supply Balancing
- Schedule 5 Capacity Distribution
- Schedule 6 Disruptions to a Producer
- Attachment A – List of Producers and Associated Mines

## **PART A – GENERAL CONDITIONS OF CAPACITY BALANCING SYSTEM**

### **1. Defined Terms & Interpretation**

1.1 Any terms that are defined in the Dictionary at Schedule 1 of this Annexure or the Dictionary at Annexure 4E shall, when used in this Annexure, have the meaning given to that term in the Dictionary. If there is any inconsistency between the meaning given to a term in either Dictionary, the meaning in the Dictionary at Schedule 1 of this Annexure shall apply.

1.2 The Schedules form part of this Annexure.

### **2. Scope**

2.1 The Board will as soon as possible in its absolute discretion appoint the Administrator, who will be independent of any Producer or Customer.

2.2 The Administrator will administer the Scheme according to the objectives, principles and protocols set out in this Annexure.

2.3 The objectives of the Scheme are to:

- (a) achieve minimum vessel demurrage consistent with maximum export Coal throughput;
- (b) comply with all relevant legal requirements;
- (c) efficiently distribute the available Coal Chain Capacity, in so far as it relates to the Coal Handling Facility, among Producers in an equitable, transparent and accountable manner; and
- (d) not adversely affect the efficient operation of the Coal Handling Facility.

2.4 The Scheme shall apply:

- (a) to all Coal that is the subject of an Application for Coal Handling Services which is delivered to the Terminal by rail and, subject to clause 3.16 of Annexure 4E, road from midnight on the day before the Commencement Date; and
- (b) to all Coal Handling Services provided to each Customer by PWCS in respect of each such shipment of Coal.

2.5 The Scheme will not come into operation and this Annexure will have no force or effect until such time that authorisation or interim authorisation is granted under the *Trade Practices Act 1974* in relation to applications to the Commission numbered A30236-A30238 dated 1 October 2004.

### **3. Capacity Declaration**

- 3.1 The Coal Chain Capacity and desired Operational Allowance for the Relevant Year will be calculated in accordance with the procedures stated in Schedule 2.

### **4. Forecast Requirement**

- 4.1 The Forecast Requirement for each Producer and the Forecast System Demand for the Relevant Period will be calculated and determined in accordance with the procedure stated in Schedule 3.
- 4.2 The Forecast Requirement for any New Mine will also be calculated and determined in accordance with the procedure stated in Schedule 3.

### **5. Demand and Supply Balancing**

- 5.1 The need for demand and supply balancing will be assessed and, if required, carried out in accordance with the procedure stated in Schedule 4.

### **6 Capacity Distribution**

- 6.1 The Available Capacity during the Relevant Year will be distributed amongst Producers on a pro-rata basis, in proportion to the Forecast Requirement of each Producer, which may be adjusted through the conduct of a demand reduction auction facilitated by the Administrator in accordance with paragraph 6 of Schedule 4.
- 6.2 The Loading Allocation for each Producer will be calculated by the Administrator for the Relevant Period and then notified to PWCS and each Producer in accordance with Schedule 5.

### **7. Disruptions to a Producer**

- 7.1 If, notwithstanding the other provisions of this Annexure or the provisions of Annexure 4E, a Producer is unable at any time to use its Quarterly Loading Allocation or if the Producer is a Restricted Producer, the provisions of Schedule 6 will apply.

### **8. Amendments to Scheme**

- 8.1 The Administrator will monitor the operation of the Scheme and consult with Producers and Customers regularly regarding the operation and outcomes of the Scheme. This consultation process will provide a forum by which participants in the Scheme can provide feedback, guidance and suggestions on the operation of the Scheme.

- 8.2 Throughout the duration of the Scheme the Administrator may formulate and make recommendations to the Board on proposals for variations to the operational aspects of the Scheme as set out in Part B of this Annexure that it determines are necessary or
- 8.3 Any decision by the Board to vary the operational aspects of the Scheme as set out in Part B of this Annexure will take into account any recommendations submitted to the Board by the Administrator in relation to that amendment.
- 8.4 No material change will be made to the Scheme as described in Annexure 4F unless it is reasonably necessary in order to achieve the Objectives and except with the consent or authorisation of the Commission.
- 8.7 If the Commission imposes any Authorisation Conditions in respect to, relating to or affecting any provision of the Scheme, a variation may be made to this Annexure to accommodate those conditions by resolution of the Board and, despite clause 2.12 of the Coal Handling Services Agreement, without the need for PWCS to consult with any Customers concerning the variation.
- 8.8 PWCS will notify all Customers of any variation to this Annexure.

**9. Extension of Duration of the Scheme**

- 9.1 Subject to clauses 2.4 and 2.5 of this Part A, the Scheme will apply in respect of the 2005 calendar year. During September of each Relevant Year the Scheme will be reviewed to determine whether it should continue for part or all of the following calendar year. Any decision to continue the Scheme will take into account any Authorisation Conditions, recommendations made by the Administrator and any submissions received from Producers or Customers prior to 1 September of the Relevant Year.

In any case, any extension of the Scheme beyond the 2005 calendar year will for each Relevant Year require Industry Support.

- 9.2 A key indicator as to whether the Scheme should continue during part or all of the following calendar year will be whether the Coal Chain Capacity, in so far as it relates to the Coal Handling Facility, is sufficient to meet the demand without causing excessive queuing of vessels at the Port of Newcastle.

## **10. Dispute Resolution**

- 10.1 In making or completing any determination, declaration, calculation or audit in accordance with any provision of this Annexure, the Administrator, the Auditor or independent expert (whoever is relevant in the context) is acting as an expert and not as a mediator or arbitrator. Any determination, declaration, calculation or audit by the Administrator, Auditor, Arbiter or independent expert in accordance with any provision of this Annexure will in the absence of manifest error be final and binding on PWCS and each Producer and Customer and may not be the subject of the dispute resolution procedures contained in Section 2.15 of the Coal Handling Services Agreement.
- 10.2 The provisions of clause 2.15 of the Coal Handling Services Agreement shall, subject to paragraph 10.3 of this Part A, apply exclusively in the event that there are any disputes or issues relating to the Scheme, other than in relation to any determination, declaration, calculation or audit by the Administrator, Auditor, Arbiter or independent expert as described in paragraph 10.1 of this Part A.
- 10.3 Any mediator or arbitrator appointed in accordance with clause 2.15 of the Coal Handling Services Agreement must have regard to this Protocols Document if the dispute is in relation to the Scheme or arises from its application.

## **11. Limitation of Liability**

- 11.1 Notwithstanding any other provision of this Annexure or in the Coal Handling Services Agreement or otherwise, to the extent permitted by law, neither the Administrator, the Demand Auditor, the Capacity Auditor or the Arbiter will be liable (and any such liability that may exist is hereby excluded) for any loss or damage suffered or incurred by any Producer or Customer caused by or arising from or relating to:
- (a) their participation in or use of the Scheme;
  - (b) any calculation, determination or decision made by the Administrator, PWCS, any of the Auditors or the Arbiter under the Scheme or under Annexure 4E;
  - (c) the exercise or non exercise by the Administrator, PWCS, any of the Auditors or the Arbiter of any power relating to the Scheme, whether given to them under this Annexure or otherwise;
  - (d) any failure to achieve the objectives of the Scheme;
  - (e) the administration by the Administrator, PWCS, any of the Auditors or the Arbiter of any administrative responsibility provided to any of them in relation to the Scheme or in relation to Annexure 4E and whether under this Annexure or otherwise;
  - (f) any failure on the part of PWCS to load the quantity of Coal determined as the Forecast Requirement or Loading Allocation of a Customer into vessels or to provide the level of Coal Handling Services necessary to load that quantity of Coal in any Relevant Period; or

- (g) any failure on the part of the Administrator, PWCS, any of the Auditors or the Arbiter to make any determination, exercise any power or carry out any administrative act in relation to the Scheme or in relation to Annexure 4E and whether under this Annexure or otherwise;

unless:

- (h) the event giving rise to the loss or damage is caused by the wilful misconduct or fraudulent act on the part of the party against whom the claim is made; or
- (i) the particular liability is not able to be excluded or limited pursuant to the provisions of the *Trade Practices Act 1974* and reciprocal State legislation.

11.2 The Customer must not make any claim or demand or take any action or proceeding against the Administrator, the Demand Auditor, the Capacity Auditor, the Arbiter or the Independent Expert in respect of, arising from or relating to any of the causes, matters or events in respect of which liability is excluded or limited in accordance with paragraph 11.1 of this Part A.

11.3 Notwithstanding any other provision of this Annexure or in the Coal Handling Services Agreement or otherwise, but subject to clause 2.14.1 of the Coal Handling Services Agreement and to the extent permitted by law, PWCS will not be liable (and any such liability that may exist is hereby excluded) for any loss or damage suffered or incurred by any Producer or Customer caused by or arising from or relating to:

- (a) its participation in or use of the Scheme;
- (b) any calculation, determination or decision made by the Administrator, PWCS, any of the Auditors or the Arbiter under the Scheme or under Annexure 4E;
- (c) the exercise or non exercise by the Administrator, PWCS, any of the Auditors or the Arbiter of any power relating to the Scheme, whether given to them under this Annexure or otherwise;
- (d) any failure to achieve the objectives of the Scheme;
- (e) the administration by the Administrator, PWCS, any of the Auditors or the Arbiter of any administrative responsibility provided to any of them in relation to the Scheme or in relation to Annexure 4E and whether under this Annexure or otherwise;
- (f) any failure on the part of PWCS to load any particular quantity of Coal into vessels or to provide Coal Handling Services in respect to any particular quantity of Coal in any Relevant Period; or
- (g) any failure on the part of the Administrator, PWCS, any of the Auditors or the Arbiter to make any determination, exercise any power or carry out any administrative act in relation to the Scheme or in relation to Annexure 4E and whether under this Annexure or otherwise;

unless:

- (h) the event giving rise to the loss or damage is caused by the negligence, wilful misconduct or fraudulent act of PWCS; or
- (i) the particular liability is not able to be excluded or limited pursuant to the provisions of the *Trade Practices Act 1974* and reciprocal State legislation.

For the avoidance of doubt, nothing in this clause affects the liability of PWCS under clause 2.14.1 of the Coal Handling Services Agreement.

## **PART B – THE SCHEDULES**

### **SCHEDULE 1**

#### **DICTIONARY**

<b>2005 Year</b>	The calendar year commencing 1 January 2005
<b>Allocation Holder</b>	A Producer who has allocated to it a Loading Allocation for the Relevant Period.
<b>ACCC Authorisation</b>	Any authorisation or interim authorisation granted by the Commission under the <i>Trade Practices Act 1974</i> in relation to applications to the Commission in relation to the Scheme.
<b>Annual Capacity Factor</b>	The multiplier defined in accordance with paragraph 4 of Schedule 4.
<b>Annual Pro-Rata Allocation</b>	The capacity allocation of each Producer after the Forecast Requirement has been adjusted in accordance with Schedule 2 and after the application of the Annual Capacity Factor in accordance with Schedule 4.
<b>Arbiter</b>	The person or entity appointed to determine the Arbiter's Determined Amount in accordance with paragraph 4 of Schedule 3.
<b>Arbiter's Adjustment</b>	The difference between the Producer's Forecast Requirement for the relevant Calendar Quarter and the Arbiter's Determined Amount for that quarter.
<b>Arbiter's Determined Amount</b>	This term is defined in paragraph 4 of Schedule 3, subject to paragraph 2 of that Schedule.
<b>Auction Clearing Price</b>	The auction price at which the cumulative tonnage reduction bid into the Demand Reduction Auction is equal to the required reduction amount.
<b>Auditors</b>	The Capacity Auditor (if required) and the Demand Auditor.
<b>Authorisation Conditions</b>	Any conditions imposed by the Commission on the Scheme and contained within the ACCC Authorisation.
<b>Authorisation Date</b>	The first date that the ACCC Authorisation is effective, as determined by the Commission.
<b>Available Capacity</b>	The forecast amount of Coal, expressed in tonnes, less the Carryover Tonnage, to be loaded onto vessels at the Terminal in the Relevant Period such that an operational queue is maintained as determined in

accordance with paragraph 4 of Schedule 2.

<b>Board</b>	The board of directors of PWCS.
<b>Capacity Auditor</b>	The professional audit firm(s) appointed (if required) to conduct an audit of PWCS's calculation of the Coal Chain Capacity in accordance with Schedule 2.
<b>Capacity Profile</b>	The distribution of annual Coal Chain Capacity across the Relevant Year expressed as quarterly percentages of the annual Coal Chain Capacity.
<b>Carryover Tonnage</b>	The amount of Coal loaded onto vessels at the Terminal in the Relevant Year using Loading Allocation from the year immediately prior to the Relevant Year.
<b>Coal Chain Capacity</b>	The forecast capacity of the Export Coal Chain in the Relevant Period to transport Coal to the Terminal and load the Coal onto vessels, expressed in tonnes.
<b>Coal Handling Services Agreement</b>	The agreement so titled between PWCS and each Customer for the provision by PWCS to the Customer of coal handling and other services.
<b>Commencement Date</b>	The date that the Scheme commences, being the latter of either 1 January 2005 or 14 days after the date that notice of the decision of the Board to amend the Coal Handling Services Agreement to adopt the Scheme has been given by PWCS to Customers or 14 days after the Authorisation Date.
<b>Commission</b>	The Australian Competition and Consumer Commission.
<b>Conditional Allocation</b>	This term is defined in paragraph 2 of Schedule 5.
<b>Customer</b>	A party to a Coal Handling Services Agreement, other than PWCS, who receives Coal Handling Services from PWCS.
<b>Days</b>	Calendar days unless stated otherwise.
<b>Demand Auditor</b>	The professional audit firm(s) appointed to conduct an audit of a Producer's Demand Nomination in accordance with Schedule 3.
<b>Demand Profile</b>	The percentage of the Final Demand Amount for each Calendar Quarter of the Relevant Year.
<b>Demand Reduction Auction</b>	The demand reduction auction facilitated by the Administrator in accordance with paragraph 6 of Schedule 4.
<b>Excess Demand</b>	The amount by which the Forecast System Demand for the Relevant Year exceeds the Available Capacity.
<b>Final Demand Amount</b>	The total demand of a Producer for Coal Handling Services for the Relevant Period, determined in accordance with paragraph 8 of Schedule 3.

<b>Final Notice</b>	A notice identifying each Producer’s final Quarterly Loading Allocation for the Relevant Year.
<b>Forecast System Demand</b>	The aggregate forecast demand for Coal Handling Services during the Relevant Period, determined in accordance with paragraph 1 of Schedule 4.
<b>HVCC Logistics</b>	Hunter Valley Coal Chain Logistics Team.
<b>Industry Support</b>	Support by more than 75% of currently exporting Producers calculated by volume of export Coal tonnes (determined from the Forecast Requirement of each Producer) or support by more than 50% of currently exporting Producers calculated by number of Producers shipping by rail using the Export Coal Chain.
<b>Loading Allocation</b>	The volume of Coal Handling Services, expressed in tonnes, allocated to a Producer during the Relevant Period, determined in accordance with paragraph 1 of Schedule 5 and adjusted in accordance with other provisions of this Annexure.
<b>Lower Flexibility Amount</b>	The Lower Flexibility Amount as determined in accordance with subparagraph 1(a) of Schedule 6.
<b>Lower Flexibility Limit</b>	The Quarterly Loading Allocation of a Producer minus its Lower Flexibility Amount.
<b>the Objectives</b>	The objectives stated in paragraph 2.3 of Part A.
<b>Operational Allowance</b>	A queue of vessels at the Port of Newcastle determined in accordance with paragraph 2 of Schedule 2.
<b>Quarterly Loading Allocation</b>	The Loading Allocation that is allocated to the Allocation Holder for the relevant Calendar Quarter.
<b>Railed Tonnes</b>	The actual amount of Coal, expressed in tonnes as measured by the transport provider, that is received by rail by PWCS from a Producer to be loaded on behalf of a Customer onto a vessel by PWCS under a Coal Handling Services Agreement.
<b>Restricted Producer</b>	This term is defined in paragraph 7 of Schedule 3.
<b>Schedule</b>	A schedule to this Annexure.
<b>Scheme</b>	The Capacity Balancing System described in this Annexure.
<b>Total Demand</b>	The aggregate of all Forecast Requirements for the Relevant Year.
<b>Unrestricted Producer</b>	A Producer who is not a Restricted Producer.
<b>Unused Portion</b>	The amount (if any) by which the quantity of Coal delivered to the Terminal by the Producer in the relevant Calendar Quarter is less than the Lower Flexibility Limit.

**Upper Flexibility  
Amount**

The Upper Flexibility Amount as determined in accordance with subparagraph 1(b) of Schedule 6.

## SCHEDULE 2

### CAPACITY DECLARATION

1. PWCS, with assistance from HVCC Logistics, will calculate the Coal Chain Capacity for each Calendar Quarter in the Relevant Year in accordance with the following procedures:
  - (a) Actual delivery performance data for a relevant historical period will be used to determine a base volume for capacity for the Relevant Year and for each Calendar Quarter during the Relevant Year.
  - (b) The volume will be adjusted for major planned outages (e.g. ARTC possessions, major projects) and anticipated non-operating days.
  - (c) Adjustment will be made for expected performance gains.
2. PWCS, with assistance from HVCC Logistics, will declare the volume of the Operational Allowance, expressed in tonnes, consistent with meeting the Objectives, specifically to minimise vessel demurrage consistent with maximum coal chain throughput.
3. Following the calculation by PWCS of the Coal Chain Capacity and if requested in writing by a majority of Producers, PWCS may arrange for the Capacity Auditor to audit PWCS's calculation of the Coal Chain Capacity. The decision rationale and all supporting information used by PWCS and HVCC Logistics will be made available to Producers for inspection.
4. The Administrator will determine the Available Capacity for the Relevant Period taking into account the Coal Chain Capacity, Operational Allowance and Carryover Tonnage.
5. The Administrator and PWCS, with the assistance of HVCC Logistics, will continue to monitor the performance of the Export Coal Chain throughout the Relevant Period. Following advice from PWCS, the Administrator may from time to time revise the Available Capacity for the balance of the Relevant Year in order to achieve the Objectives.
6. In order to ensure that PWCS does not make available on a take-or-pay basis more Coal Handling Services than it and the Export Coal Chain can reasonably provide, if at any time there is, or there is reasonably forecast by the Administrator to be, a material, objectively demonstrable change in the Available Capacity for a Relevant Period, the Administrator may make adjustments to the Loading Allocation of each Producer for the Relevant Period in a manner that reasonably reflects that change. Prior to implementing the adjustment, the Administrator will advise each Producer of its calculations of the adjustment.

## SCHEDULE 3

### FORECAST REQUIREMENT

1. The Administrator will determine in accordance with guidelines prepared by PWCS and the Administrator in consultation with the industry which, if any, of a Producers' mine-by-mine Forecast Requirement will be subject to audit by the Demand Auditor. The Administrator will notify the Producer of its determination.
2. The Producer may notify the Administrator within 5 days of the date of the notification provided in accordance with the previous paragraph that it declines the audit, in which event:
  - (a) the Producer will be exempt from an audit;
  - (b) the Producer's Final Demand Amount will be equal to its Forecast Requirement;
  - (c) for the purpose of calculating the Arbiter's Adjustment, the Arbiter's Determined Amount shall be zero; and
  - (d) the conditions in paragraph 7 of this Schedule shall apply.
3. The Demand Auditor will, for each Producer that is subject to audit, determine the Relevant Quantity for each Calendar Quarter and the quantity so determined, along with supporting evidence, shall then be notified to the Arbiter and the Producer. For the purposes of this paragraph, "**Relevant Quantity**" means the quantity of Coal that the Producer has the capacity and intent to produce and export through the Export Coal Chain in each Calendar Quarter of the Relevant Year.

Each Producer will supply to the Demand Auditor such information as may be reasonably required by the Demand Auditor in order to fulfil its role as the Demand Auditor. If a Producer does not provide that information, the Demand Auditor will determine the Relevant Quantity based on the information available to it and by reference to the capacity of the Producer that has already been demonstrated by its past, sustained shipping performance.
4. The Arbiter will consider the Demand Auditor's determination of the Relevant Quantity and the supporting evidence provided by the Auditor to determine both quarterly and annual amounts ("**the Arbiter's Determined Amount**"), which most accurately reflect the definition of "Relevant Quantity" in paragraph 3. The Arbiter will notify the Administrator and the Producer of its determination.
5. In the event the Arbiter's Determined Amount is less than the Forecast Requirement for the Producer and the Producer disagrees with the determination by the Arbiter of the Arbiter's Determined Amount, the Producer may by notice to the Administrator within 5 days of the date of the notification provided in accordance with the previous paragraph ("**the Relevant Date**") reject the Arbiter's Determined Amount and retain its Forecast Requirement as its Final Demand Amount, in which event for the purpose of calculating the Arbiter's Adjustment, the Arbiter's Determined Amount for that Producer shall be zero.

6. A Producer whose Forecast Requirement has been audited and who does not provide a notice to the Administrator within 5 days of the Relevant Date in accordance with the previous paragraph will be deemed to have accepted the Arbiter's Determined Amount.
7. A Producer who has chosen to decline an audit or to reject the Arbiter's Determined Amount (such Producer hereafter referred to as a "**Restricted Producer**") will be subject to the following conditions:
  - (a) A Restricted Producer may only participate in the disposal (either by a transfer or exchange) of Loading Allocation in accordance with clause 4 of Annexure 4E if, by so doing, the quantity of its Annual Loading Allocation does not fall below that of its Forecast Requirement;
  - (b) A Restricted Producer may participate in the Demand Reduction Auction as a buyer only, and thus will be excluded from bidding beyond its pro-rata reduction;
  - (c) In the event that the Restricted Producer has an Unused Portion in respect of a Calendar Quarter, the Restricted Producer must provide compensation to other Producers in accordance with paragraph 7 of Schedule 6; and
  - (d) In order to secure the obligations of the Restricted Producer under paragraph 7 of Schedule 6, within 30 days of the date that the Restricted Producer declines an audit or rejects the Arbiter's Determined Amount in respect of a Relevant Year, the Restricted Producer must provide to PWCS an irrevocable, unconditional bank guarantee, or equivalent security acceptable to PWCS, in such form and from such institution as is acceptable to PWCS, for the amount being not less than the Relevant Sum (as defined in subparagraph 7(a) of Schedule 6) multiplied by the average of the Restricted Producer's Arbiter's Adjustment for each Calendar Quarter of the Relevant Year, to a maximum amount of \$50 million. If the Restricted Producer does not provide such security to PWCS, then notwithstanding any other provision of the Coal Handling Services Agreement, PWCS may refuse to provide Coal Handling Services to the Producer. The security will be returned to the Restricted Producer by 31 January in the year following the Relevant Year, unless prior to that time PWCS has drawn down on the security in accordance with this subparagraph and paragraph 7 of Schedule 6.
8. The Administrator will determine the Final Demand Amount as follows:
  - (a) If the Arbiter's Determined Amount is greater than the Forecast Requirement, or if the Producer has not been audited, the Final Demand Amount shall equal the Forecast Requirement;
  - (b) If the Arbiter's Determined Amount is less than the Forecast Requirement and the Producer accepts the Arbiter's Determined Amount, the Final Demand Amount shall equal the Auditor's Determined Amount; and
  - (c) If the Auditor's Determined Amount is less than the Forecast Requirement and the Producer rejects the Arbiter's Determined Amount, the Final Demand Amount shall equal the Forecast Requirement and the Producer will be subject to the conditions stated in paragraph 7 of this Schedule.

## SCHEDULE 4

### DEMAND AND SUPPLY BALANCING

1. The Forecast System Demand for a Relevant Year shall be the aggregate of all Final Demand Amounts for that year, as determined by the Administrator.
2. If at least one month prior to the commencement of the Relevant Year it is determined that the Forecast System Demand for the Relevant Year is equal to or less than the forecast Available Capacity plus 3 million tonnes for the Relevant Year:
  - (a) The Loading Allocation of each Producer for the Relevant Year shall be equal to its Final Demand Amount for that year;
  - (b) Provided that sufficient additional Coal Chain Capacity is available, any Producer may apply to the Administrator for additional Loading Allocation, which will be issued on a first-come, first-served basis;
  - (c) If at any point during the year PWCS determines that the Objectives are not being met due to excess demand, then it will direct the Administrator to implement the Scheme for the remainder of the year in accordance with this Annexure. Under the Scheme each Producer will be given its pro-rata allocation of the available capacity for the year according to its Forecast Requirement, less amounts already delivered to the Terminal by the Producer in the year, distributed on a quarterly basis; and
  - (d) The remainder of this Schedule will not apply, unless the circumstances described in the previous subparagraph apply.
3. If the Forecast System Demand exceeds the Available Capacity by 3 million tonnes or more in the Relevant Year, the Administrator will determine the Annual Pro-rata Allocation of each Producer through capacity balancing in accordance with this Schedule.
4. The Annual Pro-rata Allocation for each Producer will be determined by the Administrator as follows:
  - (a) The Administrator will calculate the factor ("**Annual Capacity Factor**") that, when multiplied by the Forecast System Demand for the Relevant Year, will produce an amount that is equal to Available Capacity; and
  - (b) The Annual Pro-rata Allocation will be calculated for each Producer by multiplying the Annual Capacity Factor by the Producer's Final Demand Amount.
5. Each Producer must notify the Administrator ("**Producer Notice**") that it:
  - (a) Accepts the Annual Pro-rata Allocation as determined by the Administrator to be its Annual Loading Allocation; or
  - (b) Wishes to participate in the Demand Reduction Auction (each such Producer so participating hereafter referred to as a "**Participating Producer**").
6. If sufficient interest exists, the Administrator may facilitate the Demand Reduction Auction. The conduct of the Demand Reduction Auction and the subsequent determination of Annual Loading Allocations will be agreed between the Administrator and Participating Producers prior to commencement of the auction, however will include the following features:

- (a) Participating Producers will be required to submit a series of bids indicating their willingness to reduce demand by more or less than their required pro-rata reduction at specified per tonne prices;
  - (b) The auction clearing price will be determined by the Administrator;
  - (c) The Administrator will facilitate any redistribution of Loading Allocation around Participating Producers' pro rata allocations as required by the auction outcome. That is, Participating Producers whose required pro-rata reduction is less than their accepted bids will transfer allocation to Participating Producers whose required pro-rata reduction exceeds their accepted bids, with all transactions completed at the auction clearing price; and
  - (d) Settlement of the auction will take place as agreed between Participating Producers prior to its conduct.
7. If a Producer can demonstrate that its Final Demand Amount can be shipped without affecting the amounts exported by other Producers (for example use of a different delivery method), PWCS may instruct the Administrator that the Loading Allocation of the Producer for the Relevant Year shall be equal to its Final Demand Amount for that year.

## SCHEDULE 5

### CAPACITY DISTRIBUTION

1. The Administrator will in respect to the Relevant Year determine Quarterly Loading Allocations for each Producer in a manner which seeks to match both the capacity profile and individual Producers' demand profiles as closely as possible.
2. At the start of each Relevant Year each Producer will be provided an additional allocation ("**Conditional Allocation**") for each Calendar Quarter of that year equal to 5% of the Producers' Quarterly Loading Allocation, which may only be utilised by each Producer after it has utilised:
  - (a) All of its Quarterly Loading Allocation for the relevant Calendar Quarter; and
  - (b) Any portion of Quarterly Loading Allocation available for use from adjoining Calendar Quarters in accordance with clause 3.5 of Annexure 4E.

A Producer may only make an Application utilising a particular Calendar Quarter's Conditional Allocation during that quarter and after it has lodged Applications utilising its Quarterly Loading Allocation.

Once an Application has been accepted by PWCS using Conditional Allocation, that portion of Conditional Allocation that has been so used will be converted from Conditional Allocation to the Producer's Quarterly Loading Allocation for the relevant Calendar Quarter. This means that the Producer's Conditional Allocation will be decreased by the amount used in the nomination and its Quarterly Loading Allocation will be increased by the same amount. Once Conditional Allocation is converted to Quarterly Loading Allocation, it will be subject to the Take-or-Pay obligations in clause 6 of Annexure 4E.

If the vessel queue at the Port of Newcastle exceeds an average of 25 vessels over a three week period, the Administrator will notify Producers that Conditional Allocation can no longer be used. The Administrator will reinstate the use of the Conditional Allocation if the average vessel queue falls below 15 over a three week period.

The three week period in each case will include one week of actual queue data and two weeks of forward queue data.

For the purposes of this paragraph, the queue shall be calculated excluding vessels for which unavailability of Coal at the loadpoint is restricting vessel loading.

In the event that the Administrator advises Producers that Conditional Allocation can no longer be used, PWCS will not accept Applications that include any Conditional Allocation amount, however PWCS may not cancel any existing Shipment Contract that includes a Conditional Allocation amount, subject to the other provisions of the Coal Handling Services Agreement.

Conditional Allocations may not be exchanged or transferred between Producers.

3. Notwithstanding any other provision of this Annexure or in the Coal Handling Services Agreement or otherwise, any amount determined by the Administrator for the Forecast Requirement or Loading Allocation of a Producer, or Forecast System Demand, Coal Chain Capacity or Operational Allowance for a Relevant Period, is not a guarantee by PWCS, the

Administrator, any of the Auditors, the Arbiter or any other party that PWCS will be able to load that quantity of Coal onto vessels in the Relevant Period or that it will be able to provide the level of Coal Handling Services necessary to load that quantity of Coal in the Relevant Period.

## SCHEDULE 6

### DISRUPTIONS TO A PRODUCER

1. For the Purposes of the Scheme:
  - (a) the Lower Flexibility Amount will be determined as follows –
    - for Producers with a Loading Allocation for the Relevant Year equal to or in excess of 1,000,000 tonnes, the Lower Flexibility Amount will be 90,000 tonnes;
    - for Producers with a Loading Allocation for the Relevant Year less than 1,000,000 tonnes, the Lower Flexibility Amount will be reduced proportionally. For example if a Producer's Loading Allocation is 500,000 tonnes (50% of 1,000,000 tonnes), its Lower Flexibility Amount will be 45,000 tonnes (50% of 90,000); and
  - (b) the Higher Flexibility Amount will be determined as follows –
    - for Producers with a Loading Allocation for the Relevant Year equal to or in excess of 1,000,000 tonnes, the Higher Flexibility Amount will be 90,000 tonnes; and
    - for Producers with a Loading Allocation for the Relevant Year less than 1,000,000 tonnes, the Higher Flexibility Amount will be reduced proportionally. For example if a Producer's Loading Allocation is 100,000 tonnes (10% of 1,000,000 tonnes), its Higher Flexibility Amount will be 9,000 tonnes (10% of 90,000).
2. If during the Relevant Period there is a change in the groupings of Producers from that described in Attachment A, the Administrator may, in order to achieve the Objectives, determine that the flexibility amounts referred to in the previous paragraphs of this Schedule be changed to a different amount.
3. If at midnight on the 5<sup>th</sup> day after the conclusion of any Calendar Quarter ("**Relevant Quarter**") a Producer ("**Relevant Producer**") has an Unused Portion for that Relevant Quarter then subject to the other provisions of this Schedule the Relevant Producer must, in the manner provided below, compensate those other Producers who do not themselves have an Unused Portion for the Relevant Quarter (such Producers referred to hereafter in this Schedule as "**Participating Producers**"), for the opportunity they have lost in not being able to use the Unused Portion.
4. If the Relevant Producer is an Unrestricted Producer and has not, prior to the start of the Relevant Quarter, notified the Administrator in accordance with clause 4.3 of Annexure 4E of its inability to use the Unused Portion, then an amount equivalent to the Unused Portion will be deducted from the Producer's Loading Allocation for the next Calendar Quarter and shared among those Participating Producers who are prepared to accept the allocation and the

- obligations attaching to that allocation during that next Calendar Quarter, as determined by the Administrator.
5. The extra Loading Allocation will be shared pro-rata amongst the Participating Producers in accordance with their respective Loading Allocations at the end of the Relevant Quarter.
  6. If the next Calendar Quarter falls in the following calendar year and a Scheme exists in that year, then the deduction of Loading Allocation will be applied in that next Calendar Quarter.
  7. If the Relevant Producer is a Restricted Producer, then the Producer must compensate all Participating Producers in the following manner:
    - (a) The Relevant Producer must pay to PWCS an amount ("**Financial Compensation Amount**") calculated on the quantity (in tonnes) that is the lower of either the Unused Portion or the Arbitrator's Adjustment for the Relevant Quarter, multiplied by the sum ("**the Relevant Sum**") of \$20.00.
    - (b) The Board may prior to the commencement of each Relevant Year in its absolute discretion vary the Relevant Sum, to apply in the Relevant Year, to reflect changes in the value of the lost opportunity for Participating Producers in not being able to use the Unused Portion in each case.
    - (c) After calculating the Financial Compensation Amount, PWCS will issue an invoice to the Restricted Producer for that amount, which must be paid to PWCS within 30 days of the date of the invoice. The provisions of clause 2.3.6 to 2.3.9 inclusive of the Coal Handling Services Agreement will apply in respect of the amount so invoiced.
    - (d) If the Restricted Producer fails to pay to PWCS the Financial Compensation Amount within the time provided in accordance with the previous subparagraph, PWCS may immediately draw down upon the bank guarantee provided by the Restricted Producer in accordance with paragraph 7 of Schedule 3, in payment of the Financial Compensation Amount.
    - (e) Any Financial Compensation Amount paid to PWCS in accordance with this paragraph will be distributed by PWCS to all Participating Producers in proportion to their respective Loading Allocation at the end of the Relevant Quarter.
    - (f) Subject to the following subparagraph, should the Unused Portion exceed the Arbitrator's Adjustment for the Relevant Quarter then the amount of that excess will be deducted from that Producer's Loading Allocation for the next Calendar Quarter and pro-rata shared among the Participating Producers, in the same manner as described in paragraphs 4, 5 and 6 of this Schedule; and
    - (g) In the event that a Restricted Producer notifies the Administrator in accordance with clause 4.3 of Annexure 4E of its inability to use the Unused Portion, the compensation obligations described in the previous subparagraph will not apply to the Producer in respect of the Relevant Quarter, even if the Administrator is unable to redistribute the Unused Portion during the Relevant Quarter. Nothing in this subparagraph shall affect the obligation of the Restricted Producer to pay the Financial Compensation Amount in accordance with this paragraph 7.
  8. If in a Relevant Period there is a Unused Portion in respect of a Restricted Producer and PWCS determines in accordance with clauses 6.7 and 6.8 of Annexure 4E that part or all of the Unused Portion was not able to be delivered to the Terminal during the Relevant Period due to an Event of Force Majeure (as defined in Annexure 4E), the Producer will not, in respect of the

amount so determined, be required to pay the Financial Compensation Amount otherwise payable under paragraph 7 of this Schedule.

9. The Producer may not invoke the operation of clause 2.11.4 of the Coal Handling Services Agreement to:
- (a) affect the application or operation of this Schedule or any calculation or determination made under this Schedule; or
  - (b) avoid any obligation applying to the Producer in accordance with this Schedule, or to delay the performance of that obligation.
10. By issuing invoices to Restricted Producers, receiving payment of Financial Compensation Amounts and paying those amounts to Participating Producers in accordance with this Annexure, PWCS is acting as agent for Participating Producers.

For the purposes of the GST law:

- (a) PWCS will be treated as making the supplies to the relevant Restricted Producer or acquiring the supplies from the relevant Restricted Producer or both;
- (b) the relevant Participating Producers will be treated as making corresponding supplies to PWCS or acquiring the supplies from PWCS or both; and
- (c) in the case of supplies to the relevant Restricted Producer:
  - (1) PWCS will issue to the Restricted Producer, in PWCS's own name, all the tax invoices and adjustment notes relating to those supplies; and
  - (2) the relevant Participating Producers will not issue to the Restricted Producer any tax invoices and adjustment notes relating to those supplies.

For the purposes of this paragraph, "GST law" means the law in Australia applying to goods and services tax, including under A New Tax System (Goods and Services Tax) Act 1999 (Cth).

## ATTACHMENT A

### LIST OF PRODUCERS AND ASSOCIATED MINES

(as per September 2005 Demand Forecasts)

<b>Producer</b>	<b>Mine</b>
<b>Anglo Coal Australia Pty Ltd</b>	Dartbrook Drayton
<b>BHP Billiton</b>	Mt. Arthur
<b>Bloomfield Collieries</b>	Bickham Bloomfield Rix's Creek
<b>Camberwell Coal Pty Ltd</b>	Camberwell Open Cut
<b>Centennial Coal Company</b>	Newstan
<b>Coal &amp; Allied</b>	HVO Warkworth / Mt Thorley Bengalla Mine
<b>Donaldson Coal</b>	Donaldson Tasman
<b>Wambo Coal Pty Ltd</b>	Wambo
<b>Gloucester Coal</b>	Stratford Mine
<b>Muswellbrook Coal Co Ltd</b>	Muswellbrook Coal Co No. 1 & No. 2 Open Cut Boggabri*
<b>Glennies Creek Coal Management Pty Ltd</b>	Glennies Creek Underground & Opencut
<b>Southland Coal Pty Ltd</b>	Southland Colliery
<b>White Mining Limited</b>	Ashton
<b>Xstrata Coal Australia</b>	Cumnock United

Liddell

Bulga

West Wallsend / Teralba

Mt Owen Complex

Ulan

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<b>Lake Coal</b>	Chain Valley (Road Coal Only)
<b>Whitehaven Coal Mining Limited</b>	Whitehaven Werris Creek* East Bogabri*
<b>Resource Pacific Ltd</b>	Newpac No.1 Colliery
<b>Hunter Enviro- Mining Operation</b>	Hebburn No.3*
<b>Specialty Coal Pty Ltd</b>	Great Greta Extended*

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**\* Indicates a new mine commencing production during calendar year 2005**

## Attachment B

### Shareholders in Port Waratah Coal Services Limited<sup>142</sup>

<b>SHAREHOLDER NAME</b>	<b>%</b>	<b>NO. OF SHARES</b>
Newcastle Coal Shippers Pty Limited	36.9491%	49,001,000
Coal & Allied Industries Limited	16.0018%	21,221,250
R W Miller (Holdings) Limited	13.9982%	18,564,000
Tomen Corporation	10.0000%	13,261,750
Japan Coal Development Co., Ltd.	4.1039%	5,442,500
Bloomfield Collieries Pty Limited	3.4611%	4,590,000
Nippon Steel Australia Pty Ltd	3.3171%	4,399,108
Mitsui & Co., Ltd	2.8861%	3,827,500
Mitsubishi Corporation	1.9862%	2,634,100
Nissho Iwai Corporation	1.1745%	1,557,592
JFE Engineering Corporation	1.1006%	1,459,620
JFE Steel Corporation	1.0868%	1,441,260
Sumitomo Metal Australia Pty Ltd	1.0452%	1,386,180
Itochu Coal Resources Australia Pty Limited	1.0171%	1,348,900
Kobe Steel, Ltd.	0.6022%	798,660
Nisshin Steel Co. Ltd.	0.2146%	284,580
Taiheiyo Cement Corporation	0.1759%	233,250
Kanematsu Corporation	0.1173%	155,500
Marubeni Corporation	0.1173%	155,500
Sumitomo Corporation	0.1173%	155,500
Tokyo Boeki Ltd.	0.1173%	155,500
Ube Industries, Ltd.	0.1173%	155,500
Sumitomo Osaka Cement Co., Ltd	0.0879%	116,625
Idemitsu Kosan Co., Ltd.	0.0586%	77,750
Mitsubishi Materials Corporation	0.0586%	77,750
Nippon Oil Corporation	0.0586%	77,750
Tokuyama Corporation	0.0293%	38,875
Total Capital	<u>100.0000%</u>	<u>132,617,500</u>

<sup>142</sup> PWCS submission in support of the application 1 October 2004, Attachment A, p50.

### INDUSTRY CONSULTATION INITIATIVES AND FOUR YEAR CAPACITY PLAN INITIATIVES<sup>143</sup>

**Table E1: Industry Consultation 2004: Physical and Commercial Initiatives**

<b>Physical Initiatives</b>	<ul style="list-style-type: none"><li>• Project Enhance 120 modelling and analysis has shown that a throughput capacity of 100+Mtpa can be achieved through a combination of process improvement and Capex by 2008.</li><li>• Due to the concentrated efforts over last 18 months (ie IDT, Improvement Teams, HVCCLT etc) the scope for process improvement capacity gains is diminishing.</li><li>• Most of the capacity improvement initiatives now are capital based.</li><li>• Lifting load point capability is the most critical issue over next 18 months, key areas to be addressed include;<ul style="list-style-type: none"><li>- Increasing train/day peaking capacity to match cargo build times of all load points.</li><li>- Reducing load rate variability.</li><li>- Planning around random vessel arrival patterns.</li></ul></li></ul>
<b>Commercial Initiatives</b>	<ul style="list-style-type: none"><li>• Formalisation of HVCCLT</li><li>• Creation of System Rules</li><li>• Introduction of Long-Term Take or Pay</li></ul>

Source: PWCS

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<sup>143</sup> PWCS' submission in support of the applications for authorisation, 1 October 2004, Attachment E, p55.

**Table E2: Four Year Capacity Plan - Key Initiative Summary**

Throughput Threshold	Key Initiative	Est. Completion By (Based on 2003 Forecast)
<b>To Achieve 85Mtpa</b>	Maintain train fleet re-powering (UPTWO) configuration plus: <ul style="list-style-type: none"> <li>• New capacity/stockpile planning (4 queues)</li> <li>• Kooragang Coal Terminal process improvement (belt deviations and chutes)</li> <li>• Key load point upgrades - quick wins (HV and MTO/WW)</li> <li>• Carrington Coal Terminal Stacker 2 and Reclaimer 1 recommissioned</li> <li>• 2 additional PN consists</li> <li>• Integrated Planning System</li> </ul>	Q3 2004 Q4 2004 Q1 2005 Q1 2005 Q2 2005 Q3 2005
<b>To Achieve 90-95 Mtpa</b>	All of 85 Mtpa plus: <ul style="list-style-type: none"> <li>• Jerry's Plains Coal Terminal</li> <li>• Ulan CTC</li> <li>• Whittingham Branch line duplication</li> <li>• Hanbury Grade Separation</li> <li>• Muswellbrook Yard Extension</li> <li>• Kooragang Coal Terminal Pad C extension</li> <li>• Drayton Branch extension</li> </ul>	Q1 2006 Q1 2006 Q1 2006 Q1 2006 Q2 2006 Q2 2006 Q2 2006

Throughput Threshold	Key Initiative	Est. Completion By (Based on 2003 Forecast)
<b>To Achieve 95-105 Mtpa</b>	All of 90-95 Mtpa plus: <ul style="list-style-type: none"> <li>• Half Pad D and Stacker at Kooragang Coal Terminal (Approved within Kooragang Coal Terminal Stage 3 DA)</li> <li>• Minimbah and Nundah Bank grade reduction</li> <li>• Key load point upgrades (HV, Ulan, Liddell)</li> <li>• Eliminate refuelling constraints Kooragang Coal Terminal</li> <li>• Carrington Coal Terminal belt upgrade to 3000tph</li> <li>• PN back to BIG train fleet configuration (ie 80 and 60 wagon consists)</li> <li>• Mainline Bi Di signalling</li> </ul>	Q1 2007  Q1 2007  Q1 2007  Q1 2007  Q1 2007  Q1 2007  Q4 2007
<b>To Achieve 95-105 Mtpa</b>	All of 95 to 105 Mtpa plus: <ul style="list-style-type: none"> <li>• Musswellbrook-Antiene duplication</li> <li>• 1 additional train (60 wagon consist)</li> <li>• Upgrade secondary load points to Benchmark levels</li> <li>• Complete remaining Kooragang Coal Terminal Stage 3</li> </ul>	Q4 2007  Q4 2007  Q4 2007  Q1 2008

Source: PWCS

**Table E3: Four Year Capacity Plan - Estimated Capital Required**

<b>Estimated Capital Required to Achieve Around 95 Mtpa Throughput</b>	
PWCS	\$12.5m (\$9m approved)
RIC/ARTC	\$53.5m (\$25m approved)
Pacific National	\$56.5m (\$55m approved)
Producers (local points)	\$48m (\$45m approved)
<b>Total capital</b>	<b>\$170m (\$134m approved)</b>
<b>Estimated Capital Required to Achieve Around 105 Mtpa Throughput</b>	
PWCS	\$50m (estimate)
RIC/ARTC	\$70m
Pacific National	\$5m
Producers (local points)	\$30m (estimate)
<b>Total capital</b>	<b>\$155m</b>
<b>Estimated Capital Required to Achieve Around 120 Mtpa Throughput</b>	
PWCS	\$135m
RIC/ARTC	\$35m
Pacific National	\$27m
Producers (load points)	\$30m (estimate)
<b>Total capital</b>	<b>\$227m</b>