PWCS

9 March 2005

Mr Scott Gregson
General Manager, Adjudication Branch
Australian Competition & Consumer Commission
PO Box 1199
DICKSON ACT 2602

Attention: Mr David Hatfield / Ms Jaime Norton

Non-confidential version of submission

Dear Mr Gregson

Port Waratah Coal Services Limited authorisation applications (A30236-A30238)

1 Introduction

On 16 December 2004, the Australian Competition & Consumer Commission ("**Commission**") issued its draft determination in respect of these authorisation applications, and gave interim authorisation to the commencement of the Medium Term Capacity Distribution System ("**MTCDS**") to operate from 31 December 2004.

The Commission has now sought comments on its draft determination from interested parties.

No interested party requested a pre-determination conference. However, the Newcastle Coal Infrastructure Group ("**NCIG**") had a private meeting with the Commission on 7 February 2005 (the Commission has published a note of the discussions) and made a written submission dated 8 February 2005.

The purpose of this submission is to comment on and provide further information on issues raised by the Commission in its draft determination and also to respond to a number of issues raised by the NCIG.

Overall, PWCS would like to note that irrespective of people's views on minor operational aspects of the MTCDS, with the high levels of demand, the imperative is now to focus on a commercially sound expansion of the Port of Newcastle to more than 100 Mtpa, and then further expansion as required by customers on a long-term commercial basis. PWCS has already taken significant steps towards an expansion to 102 Mtpa and believes it is now appropriate to focus on the implementation of this plan across the coal supply chain. This is a task that requires considerable focus and teamwork from a broad range of parties in a spirit of co-operation to achieve an outcome that is in the interests of all parties and the Australian economy in general.

PORT WARATAH COAL SERVICES LIMITED
A.B.N. 99 001 363 828
PO Box 57, Carrington Newcastle NSW 2294 Australia
Telephone: (02) 4907 2000 Facsimile: (02) 4907 3000

PWCS will send a separate email with details of the timeframes involved in the assessment of environmental impact statements, as this information is not yet finalised.

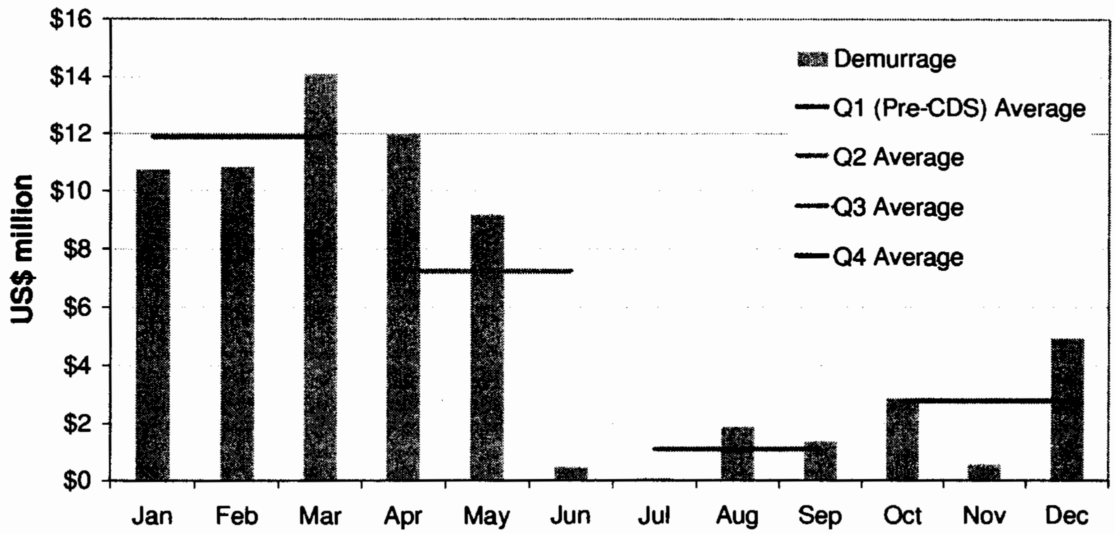
2 Public benefit – reduced deadweight demurrage charges

In its draft determination, the Commission found that the key public benefit of the MTCDS was that it will substantially reduce economically inefficient demurrage charges that flow from having an excessive queue of vessels off the Port of Newcastle.

This finding is necessarily based on having to estimate what the queue of vessels would be without the MTCDS in place. When demand for world coal surged in early 2004, the queue of vessels at the Port of Newcastle quickly rose to 56 vessels. The operation of the short term capacity distribution system ("**STCDS**"), allowed the queue to be reduced substantially.

The following graph shows the demurrage charges PWCS estimates were incurred at the Port of Newcastle during 2004 before and after the implementation of the STCDS in April 2004:

Table One - Estimated demurrage incurred at Newcastle (2004)
(Note: includes period from January to March 2004 before implementation of STCDS)



Source: Accenture

PWCS believes that Table One demonstrates that with the introduction of the STCDS, actual deadweight demurrage costs were vastly reduced.

In these circumstances, however, it is difficult to be certain of what the queue length would be without the MTCDS, and then what demurrage charges would be likely. Accordingly, as PWCS wishes to take a conservative approach, PWCS notes that it is difficult to be precise as to how much deadweight demurrage will be saved due to the operation of the MTCDS.

The large queue that arose in 2004 was a result of a rapid increase in world demand for coal, resulting largely from increased demand in China and China reducing its own exports. The Commission acknowledges in its draft determination that the submissions it received indicate that demand is likely to remain high for several years. Producers' three-year forecasts bear out that most producers expect to produce more over the next three years than in 2004, which would indicate confidence in continued high demand for Hunter Valley coal. Furthermore, prices have continued at near record levels for both thermal coal and coking coal, an indication that coal supply is still in high demand.

In the absence of significant capacity expansion or substantial decrease in demand, a long queue is therefore highly likely to persist throughout at least the next three years in the absence of the MTCDS. Furthermore, the MTCDS is designed only to operate where demand exceeds available capacity by 3 million tonnes and will not operate where there is not excess demand for use of coal loading capacity at the Port of Newcastle. In that sense, the MTCDS is a self-regulating system. Therefore, it can be asserted with confidence that when the MTCDS operates, it will be because a substantial queue would otherwise form. So while the exact length of that queue, and therefore the exact demurrage savings, cannot be predicted with precision, the fact that there are savings and therefore public benefits as a result of the MTCDS is clear.

In its earlier submissions, PWCS has estimated that demurrage savings in 2004 were likely to be around US$173 million. In its authorisation of the STCDS, the Commission relied on a lower estimate of approximately $80 million savings as a sufficient public benefit. PWCS has also estimated demurrage savings in 2005 of US$162.87 million based on a queue of 56 ships.

PWCS has now produced updated estimates of demurrage savings in 2005. The following graph and table set out estimated savings based on the average queue length under the scheme compared to the potential queue without the MTCDS. For example, at the working queue of 10 vessels under the MTCDS, the estimated saved demurrage if the queue would otherwise be 55 vessels (close to peak 2004 demand before the implementation of the STCDS), is US$179 million.

Table Two - 2005 Demurrage Savings (US$ million)

CDS av. Q	Hypothetical Q Cap: 30	35	40	45	50	55	60
10	$84	$103	$122	$141	$160	$179	$198
15	$65	$84	$103	$122	$141	$160	$179
20	$47	$66	$85	$104	$123	$142	$161
25	$29	$48	$67	$86	$105	$124	$143
30	$11	$30	$49	$68	$87	$106	$125

Source: Accenture

Accordingly, even if the average queue under the MTCDS were as high as 30 vessels, the demurrage savings on an estimated non-CDS queue of 55 vessels is still US$106 million and if the vessel queue were a more likely number of approximately 10 vessels, at a queue of 55 vessels the estimated demurrage savings would be US$179 million.

3 Public detriment – reduced exports through under-utilisation of allocation

In its original submission of 19 November 2004, the NCIG raised concerns about potential under-use of allocation because of difficulties in adjusting production in the short term to take advantage of underused allocation. However, it noted that it believed the potential for under-use of allocation was limited under the MTCDS because of the 5% conditional allocation.

The Commission, however, in its draft determination, considered that the various flexibility mechanisms built into the design of the MTCDS would mitigate the potential under-use of allocation.

The NCIG has now raised a concern in its subsequent submission and at its meeting with the Commission that there was under-use of allocation in 2004 and there has already been under-use of allocation under the MTCDS in January 2005. The NCIG asserts that if that under-use continues at current levels for the whole year, it would give rise to lost exports of $65 million each quarter.

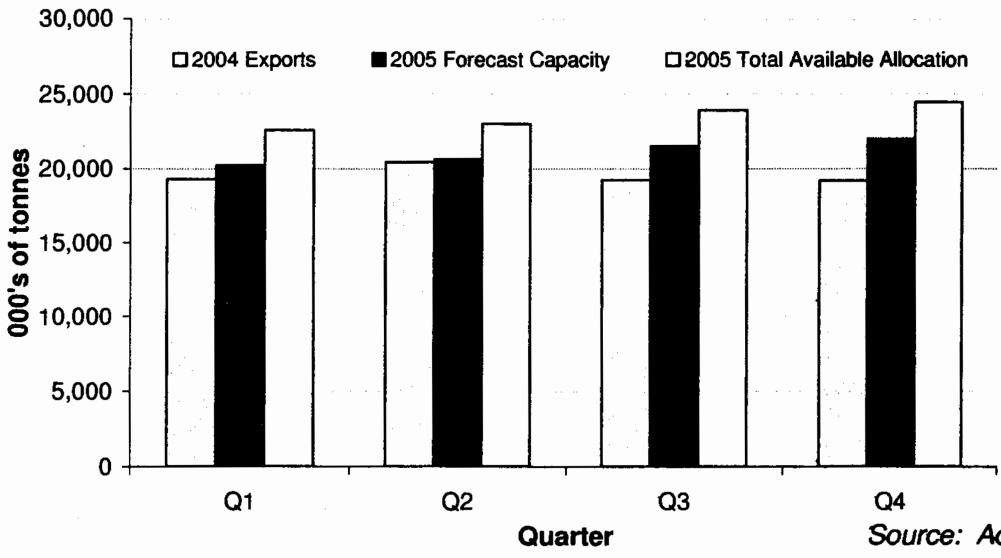
We will deal separately with the two aspects of this issue: the impact of under-utilisation of allocation on exports and the appropriate amount and use of conditional allocation.

(a) Allocation vs. capacity and throughput

It is important to clarify that *underused allocation does not mean lower throughput.* It is not the case that each tonne of allocation that is unused is a tonne of exports foregone, or a tonne of sales that must be postponed to the end of a mine's life with an NPV of zero (as the NCIG asserts). The NCIG is looking incorrectly at use of allocation as the measure of the scheme's efficiency.

The total loading allocation available for use by producers in a quarter is deliberately greater than forecast capacity. Therefore, if producers do not use some of their allocation in a quarter, the immediate impact is a shortening of the queue, not lost capacity. This is why PWCS aims to maintain a working queue of approximately 10-15 vessels. This target range anticipates that typically allocation will be used at a rate below the average rate needed to use all allocation in a quarter. The following graph demonstrates the capacity expansion at the Port in 2005 compared to 2004, and the higher allocation available each quarter.

Graph One - Exports, Capacity and Available Allocation - 2005



Source: Accenture

There would need to be significant and sustained unused allocation before the Port stopped operating at full capacity. Such a level of unused allocation is very unlikely because of the flexibility built into the MTCDS and the financial and physical compensation that applies to producers not using allocation beyond the flexibility amounts. The flexibility amounts and available allocation are deliberately biased towards higher usage rates. An additional incentive to producers avoiding under-using allocation is that the Administrator can adjust allocation if there is consistent under-use.

The situation that arose in January 2005 under the interim authorisation of the MTCDS is a good example of this effect. The lower than 'theoretical average required' arrival rate was accompanied by a shortening of the queue. The coal chain throughput (and exports) in January, however, was an all-time record. The reality, then, is that January 2005 instead demonstrates that exports may *increase* in 2005 because of improvements in capacity and efficiency, rather than decrease because of underutilisation of allocation. Certainly, based on January 2005, it cannot be surmised that exports were reduced because of the operation of the MTCDS. In fact, it is likely that, at worst, exports would be identical with or without the MTCDS since the Port is operating at capacity, and so the net benefit of the MTCDS is the reduction of the vessel queue and consequent demurrage charges. The system's design encourages use of increased capacity.

We have set out in Attachment 1 to this submission a more detailed explanation of the dynamics of allocation usage and capacity in January 2005 to demonstrate this point.

We note that in its submission of 8 February 2005, the NCIG states that it supports over-allocation of capacity to increase utilisation.

PWCS therefore strongly submits that the MTCDS is very unlikely to result in a net reduction in exports. On the contrary, the mechanisms have acted to provide a working queue as planned, while PWCS and the coal chain have sought to maximise throughput. The record coal chain throughput in January suggests there has been no loss in capacity.

(b) 5% Conditional Allocation

The NCIG members (except White Mining - see submission to the Commission dated 19 November 2004), previously requested PWCS to include a 5% conditional allocation in the MTCDS to give further flexibility to allocation usage.

This concept was agreed by PWCS and was incorporated into the design of the MTCDS. The Commission in its draft determination points to the conditional allocation as one of the mitigating factors against the MTCDS giving rise to a significant public detriment of reduced exports through underutilisation.

We note that before the draft determination was issued, one NCIG member, White Mining, argued against a conditional allocation, on the basis that it would reduce the marketability of spare allocation that other producers (particularly smaller producers) might seek to transfer during a quarter. The Commission considered in its draft determination that this was unlikely to be a concern.

The NCIG has now suggested, in its submission of 8 February 2005, that the conditional allocation should be 10%, and made available at the beginning of the quarter, in order to avoid any loss of coal chain utilisation.

There are a number of points to make arising out of the NCIG's new position on conditional allocation.

(i) When conditional allocation is available

The first point is to clarify that the conditional allocation is available throughout the quarter to schedule new vessels within the producer's allocation, as long as the queue is below a particular level. It is not necessarily the case that a producer would only seek to use conditional allocation at the last minute, without being able to plan production to take advantage of it.

The MTCDS is designed to sustain a moderate working queue. A moderate queue provides a demand buffer in the situation where there is a temporary easing in vessel arrival rate. Conditional allocation is made available to all producers when the vessel queue is less than 25 vessels (see clause 2 of Schedule 5 of Annexure 4F of the CHSA). Specifically, conditional allocation is made un-available when the average queue exceeds 25 vessels, and is made available again when the average queue has fallen to less than 15 vessels.

Conditional allocation was made available to all producers on 17 January 2005 and was still available as at 10 March 2005. One producer has already nominated vessels such that they had used their conditional allocation. It is clearly not the case that conditional allocation is only available at the end of a quarter, as the NCIG asserts.

Should NCIG or others wish to introduce further changes to conditional allocation to make it easier to use (within the terms of any Commission authorisation), it is clearly in PWCS' interest to do so as it adds to take or pay levels and provides more certainty of outcomes. On 2 February 2005, PWCS along with other logistics providers held a CEO forum to canvass this sort of suggestion and ensure that coal chain customers are happy with progress to date. No specific suggestions were received.

(ii) Conditional allocation before or after normal allocation

The usage of Conditional Allocation needs to follow the use of normal allocation, since Conditional Allocation does not attract Take or Pay consequences. Conditional allocation is automatically credited to a producer who nominates arrivals in excess of its quarterly allocation for arrival before the overlap period. Conditional allocation is credited to a producer **before** usage of its upper flexibility allowance, that is, usage of Conditional Allocation does not result in an adjustment to that producer's allocation in the following quarter.

Furthermore, usage of Conditional Allocation following usage of normal allocation discourages the allocation 'banking' behaviour, where producers will try to accumulate allocation without an intent to use it, or at significant risk that it will not be used. That is, it encourages producers to treat their capacity usage as perishable, which it is.

The other way to organise conditional allocation would be to allow a vessel to be nominated and accepted for loading under conditional allocation before normal allocation is used. This would have the effect of removing the control on usage of conditional allocation and would allow conditional allocation to be nominated at the start of the year. This would result in potentially unfair distribution of allocation and introduce the possibility, with existing flexibility provisions, of an extremely long and unworkable queue.

(iii) Amount of conditional allocation

The second point is that the industry agreed previously that 5% was the appropriate amount for Conditional Allocation. The combination of current flexibility provisions and 5% conditional allocation allows producers to plan on allocation levels close to original requests. PWCS believes a higher Conditional Allocation of 10% may result in a number of undesirable consequences, including long and unworkable queues, uneven distribution of allocation and adverse impacts on secondary markets.

In the design of the MTCDS, the amount of Conditional Allocation had to be balanced with liquidity of the allocation exchange market (especially with Take or Pay and Physical Compensation consequences for under-use of allocation). With increasing Conditional Allocation, there is less incentive for producers to exchange allocation between themselves and an increased risk that a producer with production difficulties will be unable to 'swap out' of their allocation and thus subject to Take or Pay and Physical Compensation consequences. The amount of 5% was agreed by the industry as a reasonable compromise. The fact that it is a compromise is illustrated by White Mining having concerns with a 5% conditional allocation previously; these concerns would conceptually be greater with 10%.

A higher conditional allocation may also have the effect of increasing and maintaining the length of the vessel queue for a longer period. This would negate some of the benefit of reduced demurrage charges. It might also favour those producers who rely on conditional allocation earlier than others. This might mean that the queue is pushed beyond 25 ships for some time, closing off the availability of conditional allocation to the remaining producers until (if and when) the queue reduces later in the quarter. This risk is highlighted by the fact that Conditional Allocation does not attract Take or Pay consequences until nominated.

(iv) Transparency of allocation transfer process

In their meeting with the Commission on 7 February 2005, members of the NCIG appear to have expressed a concern about the transparency of the allocation transfer system. This has led, in their view, to producers holding on to allocation as long as possible.

It has been a fundamental principle of the scheme that its design and principles are open to all for comment, but commercially sensitive information such as specific company allocation levels is kept confidential. PWCS is satisfied that, with Accenture's help, it has provided equal opportunity for consenting players to exchange or transfer allocation (within any Commission authorisation) and that arrangements and procedures to do so are completely open.

A new online tool enabling the facilitated, anonymous exchange of loading allocation was made available to all producers following training, on 1 February 2005. This site enables any producer to 'post' either a request to get additional allocation or its willingness to give away/swap allocation with another producer. Producers suggested this facility during industry consultation as a means to stimulate timely exchange of loading allocation.

Accordingly, even though PWCS believes that transparency in the allocation system is already in place under the process as employed by Accenture, as Administrator, the introduction of the new online site should overcome any perceived lack of transparency in the allocation transfer system.

Finally, the rules regarding the 'return' of loading allocation to the Administrator and the application of Physical Compensation also act as a significant incentive for the timely re-distribution of loading allocation. Under the MTCDS, the Administrator cannot accept 'return' of allocation from any producer. The loading allocation remains the responsibility of the producer to either use or transfer to another producer. Under-use beyond a producer's lower flexibility limit in any quarter results in automatic Physical Compensation. That is, the under-use amount is deducted from that producer's allocation in the following quarter and re-distributed to the other producers. Take or Pay and Physical Compensation responsibilities attach to the loading allocation, so that allocation is re-distributed to those producers who can use it.

PWCS believes this is a substantial improvement in the design of the MTCDS over the short-term capacity distribution system. In 2004, a number of producers handed back allocation close to the end of a quarter, resulting in it being largely unused. Attachment 2 sets out confidential details of allocation handed back in 2004.

As a final matter on this particular issue, PWCS notes that in January 2005, approximately 170,000 tonnes of allocation was traded, demonstrating the effectiveness of this process.

For completeness, the Administrator will provide the Commission with a separate letter with the actual logistics of vessel nomination and use of allocation and conditional allocation, so that the operational process is very clear to demonstrate that producers can and do plan to use allocation and conditional allocation efficiently.

4 Public detriment - investment in capital expansion

It would appear to PWCS that a key element of the Commission's analysis is the impact of the authorisation on investment in coal loading capacity.

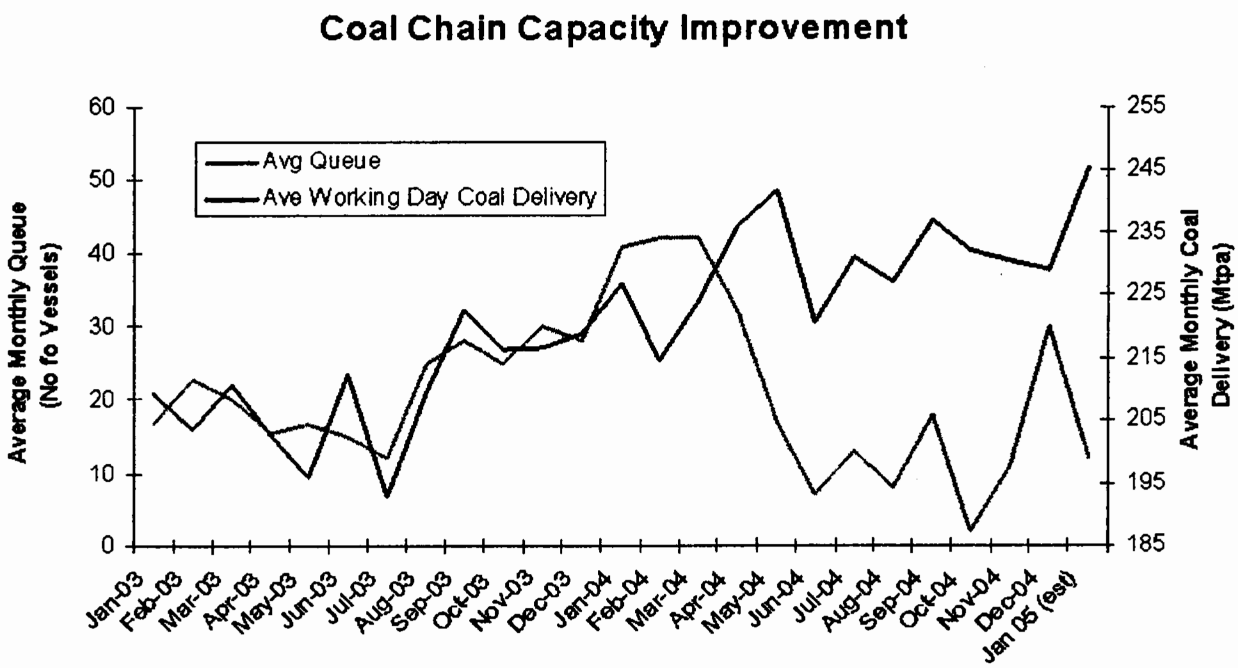
Capacity expansion plans for coal loading facilities at the Port of Newcastle are well progressed. Those plans were most recently presented to PWCS' customers on 2 February 2005. However, capacity expansion through capital investment in infrastructure will take time, due not only to technical planning, procurement and construction but also to various approval process requirements (eg E.I.S.). Attachment 3 contains relevant pages from the summary of the four-year plan and the status of the infrastructure expansion initiatives as presented to the CEOs of PWCS' customers on 2 February 2005, as well as a list of the customer representatives who accepted invitations to that meeting.

The NCIG continues to assert that the presence of a long queue of vessels at the Port of Newcastle sends a strong signal to investors of the need to enhance capacity in the Hunter Valley Coal Chain. PWCS does not believe that is the case. The presence of a long queue results in substantial demurrage charges to producers, but is not necessarily indicative of long-term capacity constraints or demand. Those charges are not borne by PWCS, the rail providers or government (each of whom are the most likely investors in expanded capacity in the coal chain). The best signal to investors of the need for capacity expansions is the financial commitment of the coal producers to demand (ie take or pay arrangements) and reliable demand forecasts. The best way forward therefore is good consultation and implementing a solution to the problem — the queue neither detracts from nor assists with that process.

As PWCS pointed out in its submission of 30 November 2004, it has a track record of capacity improvements and enhancements. Therefore, it is difficult to argue against its commitment to further expansion and to implementation of a long-term solution based on its past history.

PWCS' capacity improvement initiatives also include more immediate steps to realise capacity gains, through organisational changes in the Coal Chain Logistics Team (HVCCLT), logistics initiatives and the implementation of advanced logistics planning and management tools (amongst other steps). The efficacy of those steps is clearly evident in recent performance results:

Graph Two - Coal Chain Capacity Improvement



Source: Accenture

It is correct that indirect pressure on PWCS shareholders who are also producers, is an incentive to increase expansion, but the decision must be based on underlying financials which ultimately rests with the coal terminal operator. Examples of how these financial incentives work can be seen along the East Coast of Australia at other ports.

The NCIG also continues to assert that its members account for the majority of forecast growth in the Hunter Valley and that Xstrata and Rio Tinto (who are shareholders in PWCS) do not appear to have significant plans to expand production in the Hunter Valley.

This assertion is not borne out by the forecast demand expressed to PWCS by producers for the next three years. A confidential comparison of the forecast demand growth per producer based on forecasts is set out in Attachment 4.

5 Length of authorisation

The NCIG have again requested that the Commission only authorise the MTCDS for 12 months, although the NCIG have noted that they would support authorisation if PWCS had a firm program of committed expansion initiatives that can be implemented quickly to meet producers' forecast requirements (ie greater than 120 Mtpa).

The PWCS Coal Handling Services Agreement incorporates both an industry support test and an excess demand test for the scheme to continue year to year. The MTCDS scheme will not be in place unless it is both supported by the industry and there is a clear excess demand problem.

The rules of the scheme incorporate significant incentives for producers to maintain an even demand on the coal chain. They are Physical Compensation and Take or Pay on under-use of allocation. The Physical Compensation incentive is the greatest incentive of the two. One of the problems with limiting the duration of the scheme to a shorter period, as the Commission noted in its draft determination, is that the physical compensation incentive to maintain even demand is lost in the final quarter of the scheme.

Furthermore, the industry working with PWCS has expended significant time and effort in the design of the scheme. The industry has expressed a desire for predictability, for the benefit of both producers and their customers. A 12-month authorisation does not provide that predictability.

In its draft determination, the Commission expresses concern that the longer the duration of the authorisation, the more likely it is that it will begin to delay or hamper investment in and progress towards a long term solution. On that basis, the Commission proposes to authorise the MTCDS for a period of 3 years.

As is clear from the expansion initiatives described earlier in this submission, PWCS is making progress towards implementing a long-term solution to the capacity constraints in the Hunter Valley Coal Chain according to a four-year plan. Despite PWCS' best endeavours and diligence, the expansion plans are unlikely to be fully implemented at the end of 2007 due to external matters, when the MTCDS would expire if the Commission authorises it for three years.

PWCS has prepared detailed proposals to expand capacity to 102 Mtpa, and is scoping out what is required to move up to 120 Mtpa. A summary capacity expansion plan ("**Capacity Expansion Plan**"), with relevant milestones has been included as Attachment Five to this submission. As indicated earlier, a key reason why an increase in capacity up to 120 Mtpa will not be possible within the three year period is dependant on environmental impact statements and legislative requirements. PWCS believes that this increased capacity of up to 110-120 Mtpa and these external time delays warrant the Commission considering a longer period for the authorisation of up to four years, particularly as capacity in the order of 110 Mtpa is very close to the 120 Mtpa capacity sought by the NCIG.

The Commission acknowledges in its draft determination that it can revisit its authorisation at any time if changed circumstances warrant it.

PWCS submits strongly that in these circumstances it would be more appropriate to authorise the MTCDS for a period of four years. A period of four years will not delay implementation of a long term solution, but is more likely to allow an orderly transition from the MTCDS (which is just that - medium term) to the long term solution and allows PWCS to focus on implementation, not on a new authorisation application which would be for only one year.

For the reasons the Commission has already highlighted in its draft determination, PWCS believes that a period of four years will not carry an increased risk of public detriment:

- the scheme will still only operate in the fourth year (as in previous years) if demand outstrips capacity and there is industry support for its continuation – therefore, while there are no demand forecasts available for 2008 that the Commission can rely on to conclude that demand is likely to exceed capacity for four years, rather than three, this is not a basis for concluding that the scheme would not continue to have a significant public benefit in its fourth year;

- if circumstances change before or during the fourth year (eg there has been insufficient progress towards a long term solution), the Commission has the statutory power to revisit the authorisation; and

- if the long-term solution is not fully implemented by 2008 (as is to be expected), a four-year authorisation prevents the inefficient diversion of resources that would be involved in seeking an extension of the current authorisation after 2007.

PWCS notes that while it appreciates the reasons for the Commission's caution on the duration of the authorisation, each authorisation takes approximately six months and considerable management time from PWCS. In the STCDS and in the early stages of the MTCDS, certain parties sought a short duration for the authorisation based on the uncertainty of demand for coal. The position is now that those parties are saying that this high level of demand will continue for many years.

PWCS believes that it has approached the authorisation process with the Commission in a conservative manner and has been consistent in following through on capacity expansion. In these circumstances, PWCS believes that there are adequate safeguards for the Commission to protect the public interest in ensuring the MTCDS does not stifle investment in capacity expansion. In addition, if this would assist the Commission in relation to ensuring this investment is occurring and therefore allowing a four year authorisation, PWCS is prepared to provide the Commission on a confidential basis with the detailed engineering plans for expansion to 102 Mtpa as soon as they are available in March/April 2005, and then the EIS scope of works and supporting engineering plans for expansion to 110-120 Mtpa (which PWCS intends to commission in late April 2005), so that the Commission will have a high degree of confidence in the progress towards physical implementation of a long term solution.

If this would assist the Commission's consideration of a four year authorisation in which PWCS implements an appropriate long term solution, PWCS would also be prepared to give the Commission a detailed report on progress as against the milestones in the Capacity Expansion Plan after two years, perhaps on a six monthly basis, so that the Commission can be confident throughout the term of the authorisation that the objectives of the MTCDS are being followed and that there is continued capacity expansion.

PWCS also notes that the NCIG has requested that, if the Commission grants a longer term authorisation, the Commission should seek to impose conditions on the authorisation based on PWCS achieving capacity expansion benchmarks. PWCS believes that conditions should only be imposed in a situation where there is a real question of whether the public benefits outweigh any public detriment. PWCS submits that during the time the MTCDS has operated under the interim authorisation, there has been demonstrated substantial public benefits in relation to the vessel queue and reduction of demurrage and there has been no evidence of any actual public detriment. All that has been suggested is that there has been some under use of allocation, which as noted above, does not actually translate to any reduction in exports.

If the Commission were to seek to impose such conditions they would effectively be conditions requiring PWCS to expand to build infrastructure to a certain capacity (which would be a very unusual condition by a regulator) and could operate in a situation where it is unclear that demand exists for that capacity. For example, if there is a dramatic fall off in demand or a third party or even NCIG itself builds or announces a plan to build a new coal loading terminal, then expansion may not be required by PWCS and such conditions would either be irrelevant or could revoke an authorisation in a situation where there was a need for a system, but there was no need for PWCS itself to expand. The imposition of conditions on PWCS might also lead to wasted investment and the burden of unnecessary costs on the coal chain if there is not complementary voluntary investment in the rest of the coal chain. The objective is coal chain capacity expansion, not just port capacity expansion.

PWCS believes that the imposition of conditions such as requested by the NCIG would be likely to do more harm than good in terms of leading to inefficient outcomes for the coal industry. Increasing capacity and the commercial underpinning of that capacity expansion is a careful process of matching capacity expansion with customer demand. The conditions sought by the NCIG would carry significant risks of regulatory error. PWCS believes that a more appropriate approach, consistent with the Commission's approach in the draft determination, is to facilitate the Commission's ability to revisit the authorisation should it consider that there is insufficient capacity investment occurring by PWCS such that there is a real risk that the MTCDS is no longer producing public benefits that outweigh any public detriments to the Australian economy.

To this end, the PWCS proposal in the context of a four year authorisation, is to provide reports after 2 years on a six monthly basis as against the milestones in the Capacity Expansion Plan. In any event, given that the NCIG now appears to accept the validity of take or pay arrangements to underpin capacity expansion, the commitment of PWCS to provide increased coal loading pursuant to those arrangements is far more direct and effective than the proposed conditions. This is a more powerful and appropriate commercial outcome than arguably second best regulatory conditions, because take or pay arrangements provide a more certain outcome of use of capacity and resources for ***both*** the producer and the facility owner.

6 Take or Pay arrangements

Take or Pay arrangements between PWCS and its customers are fundamental to supporting the long term capital expansion of the port infrastructure. We note that the Commission in its draft determination accepts PWCS' earlier submission that take or pay arrangements are a commercial matter outside the scope of the authorisation, which if misused can be dealt with under Part IV.

We also note that the NCIG appears now to support take or pay arrangements and is not pressing further for any limitations or conditions to be imposed on them.

The details of the long term take or pay arrangements are currently being refined and will be presented to the PWCS Board at their next meeting in April 2005. PWCS also notes that long term take or pay arrangements also give the producer the increased certainty of loading coal for export. The take or pay arrangements will give an increased commitment to export and in that sense should also give the NCIG comfort as to capacity expansion by PWCS as it will have a more direct commitment to provide export capacity.

7 Conclusion

The MTCDS is operating successfully and efficiently under the interim authorisation granted in December 2004. The Port of Newcastle is operating at record capacity, and producers are taking advantage of the flexibility in allocation usage available to them under the MTCDS. PWCS, with the Administrator, is continuing to refine and improve the operation, efficiency and transparency of the scheme.

It is clear that without the MTCDS a long queue would persist in the coming years, given demand is likely to outstrip capacity significantly. The operation of the MTCDS in those circumstances will reduce the queue to a workable level, while maintaining sufficient flexibility in allocation usage to ensure that the facility continues to operate at capacity. The effect of this will be to substantially reduce deadweight demurrage charges for producers (a significant public benefit) without reducing exports.

While PWCS appreciates the issues raised by the NCIG members, PWCS believes that these issues have been essentially dealt with, in particular the commitment to expansion.

The NCIG's concerns in relation to underuse of allocation are misplaced and do not lead to the conclusion that the MTCDS will reduce exports or sales. Nor do there need to be any significant changes to the flexibility arrangements (such as the amount and timing of conditional allocation) to improve allocation usage.

PWCS has made significant progress towards developing and implementing a long term solution to the capacity constraints in the Hunter Valley Coal Chain. It has a four-year plan for the implementation of capacity improvements to increase capacity at the Port of Newcastle and is keeping its customers fully briefed about the progress of those initiatives.

The operation of the MTCDS will not take any pressure off the need to invest in and implement a long term solution. The Federal Government clearly will maintain pressure to achieve the national economic benefits of increased coal exports. The Commission can also revisit the authorisation if it considers that changed circumstances warrant it. There is therefore no incentive for PWCS to delay implementation of a long term solution.

PWCS therefore strongly supports the Commission's findings in its draft determination that the public benefits of the MTCDS will outweigh any public detriments. PWCS strongly submits that the Commission should authorise the MTCDS for four years, instead of the proposed three.

PWCS would be pleased to continue to work constructively with the Commission in relation to this matter.

Yours sincerely

John Barbargallo

JOHN BARBARGALLO
GENERAL MANAGER

Attachment 1: January 2005 allocation usage and throughput

The starting queue at the beginning of the year (30 vessels for 2005) acts as a demand buffer in periods of low arrival rates. The total allocation distributed to producers for each quarter in 2005 was equal to forecast capacity (note that extra allocation is available, in the form of conditional allocation and flexibility allowance). No adjustment was made for the starting queue. Therefore, if all the quarterly allocation is used in, say, Quarter 1, and if coal chain throughput is as forecast, then the queue at the end of the quarter will be the same as the starting queue (30 vessels). Similarly, the arrival rate can fluctuate down from a theoretical average rate by up to 30 vessels without exhausting the demand buffer (queue) and potentially affecting capacity.

The total available Loading Allocation exceeds both quarterly allocation and forecast capacity for a number of reasons:

Some arrivals in first five days of January were attributed to 2004 allocation, using the overlap period flexibility provisions in the revised Coal Handling Services Agreement. The affect of attributing these vessels to 2004 Loading Allocation is to increase available allocation in the first quarter of 2005 by approximately 600 kt, or approximately 8 average vessels. (Note that the treatment of those arrivals at the beginning of 2005 reduces the cumulative usage rate – the red line – at the start of the quarter in the usage of loading allocation graph below).

Conditional Allocation has been available for use by all producers since 17th January. By the end of January 2005, one producer had already taken advantage of conditional allocation and nominated arrivals beyond their Q1 quarterly loading allocation. 5% conditional allocation adds approximately 1 million tonnes of allocation (possible arrivals) in the first quarter.

Each producer may not only use their quarterly loading allocation and their conditional allocation (conditional on the queue length) but may also use up to 90 kt in excess of that in any quarter. This allowance is called flexibility. Usage of flexibility tonnes above a producer's quarterly loading allocation is deducted from their following quarter's allocation (and thus the system is self-correcting).

Finally, not only can each producer have arrivals in each quarter up to their quarterly allocation plus 5% Conditional Allocation plus their flexibility allowance, but they may have all those arrivals in the period up to 9 days before the end of the quarter. This allowance significantly increases the potential upper limit on the allowable arrival rate for all producers. Within 9 days of the end of the quarter, a producer may start to use the following quarter's allocation for arrivals.

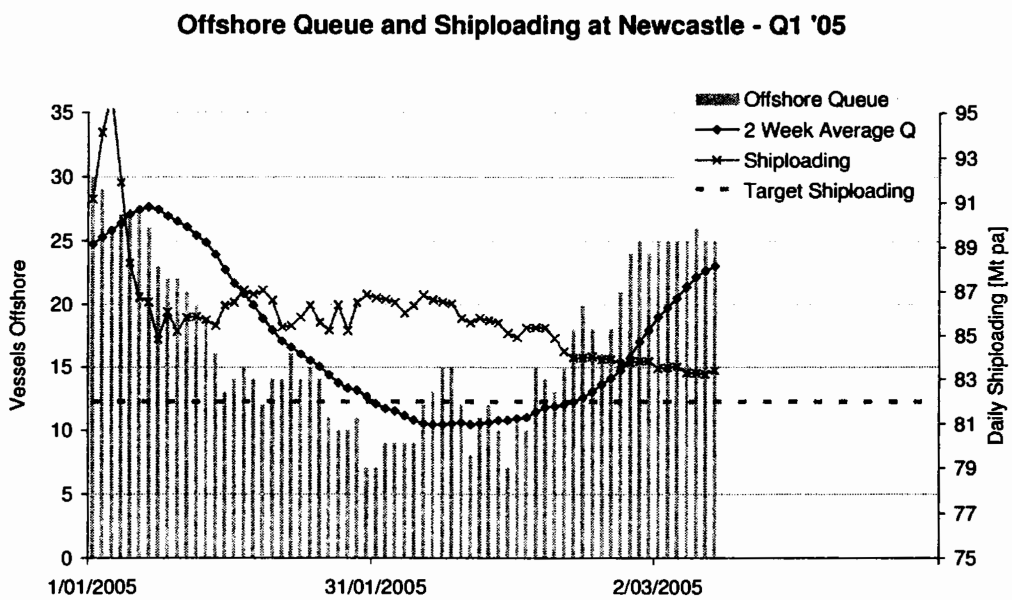
All the flexibility provisions above are incorporated in the design of the MTCDS to stimulate and maintain coal chain demand so that throughput is maximised and forecast capacity is realised.

Performance to date under the MTCDS

The performance of the MTCDS to date clearly demonstrates that the rate of allocation usage (arrivals) is un-related to coal chain throughput (within bounds).

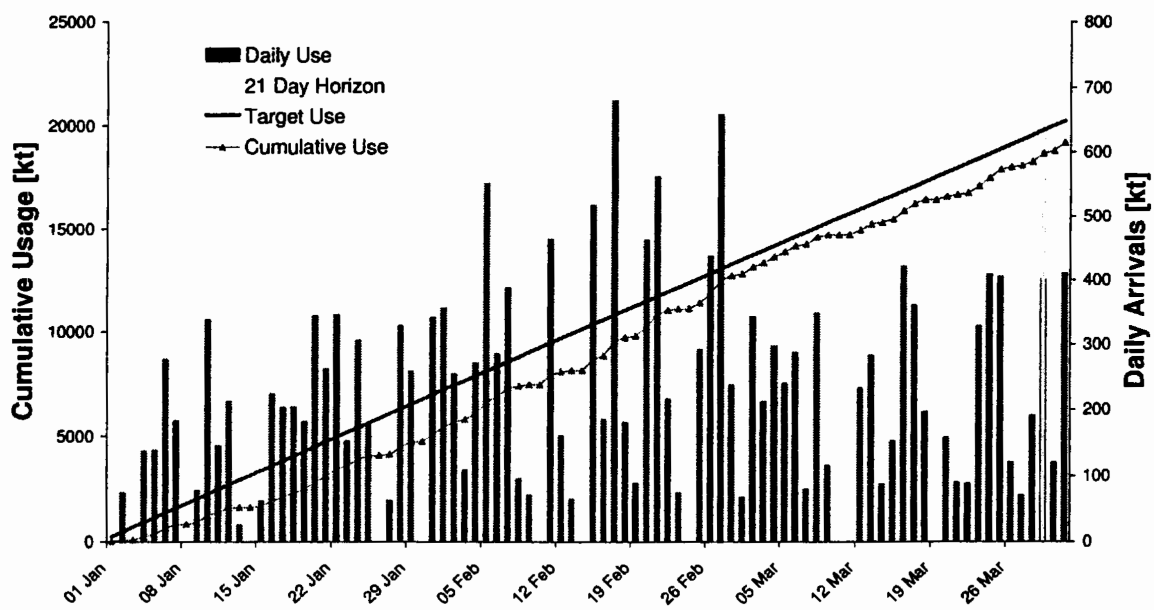
Coal chain performance in January 2005 under the MTCDS was an all time record. Shiploading in January 2005 was an annualised 86.65 Mt.

Graph Three - Offshore Queue and Shiploading at Newcastle - Q1'05



Source: Accenture

Graph Four - (All Producers) Arrivals vs Loading Allocation - Q1 05



Source: Accenture

The graph above (from the Administrator's weekly report on 8 March 2005) compares the theoretical even allocation usage rate (the black line) with actual arrivals (the red line and green bars). It shows that the actual cumulative arrival rate has been up to approximately 1.8 Mt less than the theoretical average rate, but is converging with the theoretical even usage line up to the 21 day forecast horizon. In a practical sense, this means that since the arrival rate (red line) has been less than shiploading (approximates the black line) the queue has shortened since the start of the year. 21 days is used as a forecast horizon since analysis has demonstrated that the 21 day arrival forecast is typically achieved. The deviation of the actual arrivals line from the theoretical use line beyond the 21 day horizon is typical, and is a function of the notice with which vessels are nominated to PWCS by the coal exporters.

Usage of allocation has been up to 1.8 Mt below the average rate required to use all available allocation in the quarter. Much of the initial allocation under-usage relates to the transition from the STCDS to the MTCDS (specifically the treatment of flexibility provisions at the end of 2004, which allowed a number of vessels arriving in 2005 to be treated as 2004 nominations and therefore not appearing in the cumulative figures). Coal chain throughput has been unaffected by utilisation levels, indeed throughput has marginally exceeded forecast capacity. The effect of the actual usage being lower than a theoretically even usage rate has been to reduce the length of the queue. A moderate vessel queue provides a buffer for demand in the case of a temporary easing in vessel arrival rates. Given a start queue of 30 vessels, (approximately 2.4 Mt of cargo) and the effect of arrivals attributed to 2004 allocation (approximately 0.6 Mt), the cumulative arrival rate could fall up to approximately 3 Mt below cumulative shiploading during the quarter before throughput may be affected.

Attachment 2: Confidential

Attachment 3: Confidential

Attachment 4: Confidential

Attachment 5: Capacity Expansion Plan

The following tables identify the future capacity plans for the industry that are being developed, evaluated and pursued by the current logistics services companies in the Hunter Valley. This plan has been prepared by the Hunter Valley Coal Chain Logistics Team on behalf of all its members, including PWCS.

This table has been prepared on the assumption that PWCS remains the only provider of coal loading services to the Hunter Coal Chain. If PWCS is unsuccessful for its bid for additional land, the table will need to be revised to take into account both the constraint on PWCS' capacity from its existing land footprint and any additional capacity available from other facilities.

As identified in the table, theoretical capacity options have been prepared to lift coal chain throughput to over 150Mtpa. These forecasts represent the best available information at the time of writing, and are subject to change following detailed engineering studies. The logistics companies themselves will have the obligation to separately pursue any commercial arrangements that are necessary to underpin investment decisions to deliver these capacity outcomes.

Key Initiative	Estimated Delivered Capacity	Completion By	Status as 22 February 2005
• Maintain train fleet re-powered configuration (PN) • 4 Queues stockpile planning system (HVCCLT)) • Key load point upgrades – quick wins (HV & MTO/WW) • CCT Stacker 2 & Reclaimer 1 recommissioned (PWCS) • Additional train consists (PN & QR) • Integrated Planning System (HVCCLT) • 80 km/h Running for loaded train (ARTC) • "2 week notice" track possession regime (ARTC & HVCCLT)	**85 Mtpa**	**Q3 2005**	• All initiatives approved and being implemented. • On path for completion by Q3 2005
All of 85Mtpa plus; • Sandgate Grade Separation (ARTC) • 80 km/h running for loaded train (ARTC) • Ulan CTC (ARTC) • Whittingham Branch line duplication/grade separation • Full track duplication Antiene - Muswellbrook & Muswellbrook Yard rationalisation (ARTC) • Lower Hunter Signal Box Rationalisation (ARTC) • Wambo Coal Terminal (Wambo Mine)	**92 Mtpa**	**Q4 2006**	• Sandgate approved and construction by ARTC to commence June 2005 • All other ARTC projects to ARTC Board on 23 February 2005 for concept approval • Wambo Coal terminal construction commenced February 2005
All of 92Mtpa plus; • Construct Half Pad D and Stacker at KCT (PWCS) • Extend KCT Pad C (PWCS) • Minimbah and Nundah Bank headway reduction (ARTC) • Eliminate refuelling constraints KCT (PN) • Key load point upgrades (RTCA & Xstrata)	**102 Mtpa**	**Q4 2007**	• Detail design and cost to April 2005 PWCS Board for approval • ARTC projects to ARTC Board on 23 February 2005 for concept approval • PN studying 3 option to April 2005 PN Board • Further discussion RTCA, Xstrata when HVCC model available.

Key Initiative	Estimated Delivered Capacity	Completion By	Status as 22 February 2005
All of 102Mtpe plus; • Complete KCT Stage 3 Master Plan plus 4th dump station (PWCS) • CCT Stacking upgrade (PWCS) • 1 additionel train consist • Key load point upgrades	**110 Mtpa**	**2009**	• Approval to commence detailed design study given by PWCS Board in January 2005 • Detailed modelling to commence March 2005 on load points
All of 110Mtpa plus; • Construct 4th ship loader at KCT (PWCS) • Full mainline Bi-Di signalling (ARTC) • 2 additional train consist • Key load point upgrades	**120 Mtpa**	**2011**	• Approval to commence detailed design study given by PWCS Board in January 2005 • ARTC project to ARTC Board on 23 February 2005 for concept approval

All of 120Mtpa plus;
• Complete KCT Stage 4a (new terminal) including;
   – 5th dump station
   – Pads E and F
   – Berths 5 and 6
   – 5th ship loader (PWCS)
• Construct 3rd track from Maitland to Singleton (ARTC)
• 4 additional train consist
• Key load point upgrades
	140 Mtpa	**20012**	• Approval for to commence detailed design study given by PWCS Board in January 2005
			• Preliminary concept being discussed by ARTC at 23 February 2005 Board
			• Detailed modelling to commence March 2005

All of 140Mtpa plus;
• Complete KCT Stage 4b (new terminal) including;
   – Pads G and H
   – 6th ship loader (PWCS)
• Extend 3rd track from Singleton to Drayton Junction (ARTC)
• Additional train consist
• Key load point upgrades
	150 Mtpa plus	**20014/15**	• Detailed modelling to commence March 2005

PWCS has already formally established the principle that it aims never to be a constraint for its customers. In guiding its decision-making to this end, it will take into account:

- **Real demand for increased services.** It would be unfair to its customers if PWCS did not work on the basis of reliable forecasts of demand for its services. PWCS aims to avoid both 'over expansion', which could result in unnecessary charges, and 'under expansion'.

- **Other coal loading services.** PWCS must take into account competing facilities, such as Port Kembla Coal Terminal, which currently receives some Hunter coal for export, and possible new coal loading facilities in Newcastle, which have been well publicised.

- **Equity between customers.** PWCS currently treats all Hunter Valley shippers equally and is the only provider of coal loading services in the Hunter Valley. If competition for coal loading services is introduced by the NSW Government, the Hunter Valley Coal Chain will need to adjust to accommodate new working arrangements.

- **Funding requirements.** Major expansions will necessitate higher gearing levels. It is likely that such gearing will require more commitment from PWCS' customers, as is the case at other coal ports in Australia.

Given these considerations, the key outcomes that must be achieved to underpin delivery of the capacity outlined in the table above include:

1. **Establishment of longer term Take or Pay contracts between PWCS and its customers.** These are required to provide more accurate information on demand on which to base the investment decision, as well as to underwrite the necessary capital expenditure required. PWCS have already established a one-year take or pay contract as part of the MTCDS and is currently working through the process with its Board to determine the timing by which longer term ToP contracts must be established to underpin the investment programme

2. **Clear investment signals from other coal chain participants.** Before PWCS can invest it must ensure that other coal chain service providers are also expanding their capacity (eg track and rail operators). Failure to do so may impose high costs on the coal chain through the building of redundant or under-utilised infrastructure. PWCS is working in cooperation with the other service providers to ensure the appropriate investment decisions are in place by all service providers in the coal chain

3. **Investment decisions by PWCS Board.** Subject to the two previous points, a final investment decision is required by the PWCS Board to trigger the necessary investment. PWCS has already highlighted the Board's commitment to ensure PWCS does not constrain throughput.

PWCS welcomes the opportunity to keep the Commission informed on a regular basis in respect of the achievement of these outcomes and progress/changes to the overall timetable for the creation of a new coal chain capacity in the Hunter Valley.

Approved for Public Register a ıd
tc

YES / NO

10/3/05