PWCS

Non Confidential Version

7 December 2004

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

Attention: Mr David Hatfield / Ms Jaime Norton

Dear Mr Gregson

Port Waratah Coal Services Limited authorisation applications (A30236-A30238) Response to Issues Raised during meeting with the NCIG on 25th November 2004

Introduction

Thank you for providing PWCS with the public record of the meeting on the 25th of November 2004 with the Newcastle Coal Infrastructure Group (NCIG). Several issues were raised during this meeting in respect of which PWCS believes it is important to place a factual response on the public record.

Again, as set out in our submission of 30 November 2004, PWCS would like to note that PWCS respects the views of the NCIG as a customer, but PWCS wishes to set out its perspective on these issues as the operator of the coal terminal at Newcastle.

1. Underuse of Allocation at the end of December 2004

NCIG have submitted that there will be approximately 1.5 million tonnes of allocation unused at the end of December " . . . due mostly to the operation of the CDS . . . as mines are unable to gear up quickly enough to take advantage of additional allocation".

PWCS wish to note the following:

- Under-use of allocation does not result in loss of coal chain capacity. In each quarter there is substantially more allocation available than the capacity of the coal chain. As previously explained, PWCS builds in an "over" allocation of loading capacity to ensure that there is no export loss to the coal chain.
- Underuse results from producers either not selling the coal or not being able to produce it, and in either of those cases, also not transferring or exchanging their loading allocation to a producer who is able to use it. In either scenario, these are matters within the control of producers and outside the control of PWCS. The CDS does not restrict production or sales, but manages arrivals over each quarter to match coal chain capacity.

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

- NCIG asserts that 'mines are unable to gear up quickly'. PWCS notes that at the conference with the Commission held in Newcastle on this matter and based on usage patterns, a number of producers have successfully been able to not only use their own loading allocation, but also produce and sell additional coal to compensate for other's underuse; and

- The collective under-use of allocation has not resulted in any loss in capacity in 2004. There has been a vessel queue (an efficient working queue of between approximately 5 and 15 vessels) maintained throughout the year consistent with the objectives of the scheme.

In these circumstances, it is difficult to assert that factually, there has been any under use of loading allocation and therefore a loss in exports arising because of the CDS.

2. Incentives to Grow Coal Chain Capacity

The NCIG submitted that Rio Tinto and Xstrata did not stand to benefit as much from capacity expansion as did the NCIG members and therefore Rio Tinto and Xstrata may have a reduced incentive to support investment in new capacity.

PWCS notes the following:

- With few exceptions nearly all of the PWCS customers have indicated plans to substantially grow their export volumes over the foreseeable period. As a result, PWCS has actively been pursuing a strategy of growth as described in its recent submission to the ACCC of 30th November 2004.

- Based on the three year forecast received from all Producers, and as indicated from their own public submission, approximately 30% of the demand growth over this period is from the six members of the NCIG collectively.

As the Commission is aware from the three-year forecasts, the NCIG account for only approximately 30% of the demand growth for Hunter Valley coal chain capacity. Further confidential data is contained within the Attachment.

3. Low Financial Incentive to Invest

The NCIG suggested that the low fixed rate of return for PWCS creates a low financial incentive to invest.

PWCS note the following:

- The current shareholders of PWCS receive a CPI-indexed dividend stream based on the capital value of the facility in 1990. This provides PWCS with a low cost of capital making it an ideal vehicle to raise funds for the purposes of investment in new capacity. This ability to cost effectively raise funds has been used to fund capital investment in the past and there has been no suggestion from PWCS that the low cost of capital is a barrier to future investment.

- This low cost of capital benefits all PWCS customers as the resulting port charges keep the per tonne rates for throughput at Newcastle at very competitive levels.

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. Should this be in any doubt from a factual perspective, PWCS can share the official Board Minutes relating to this decision with the Commission on a confidential basis.

4. Triggers for Extension of the Capacity Balancing Mechanism

The NCIG submitted that PWCS can control the level of excess demand in the forecasts and can therefore determine if the capacity balancing scheme should proceed from year to year. This implies that PWCS can either adjust the demand or the capacity figure.

PWCS notes the following:

- PWCS do not control or participate in any of the demand forecasts obtained from customers and is therefore not able to influence the level of excess demand. The suggestion that customers collude in the preparation of forecasts also appears unreasonable and is inconsistent with their commercial imperatives as well as the financial implications under the take or pay provisions.

- The capacity forecast is based on HVCCLT advice, which involves all coal chain logistics providers.

- In addition to the 3Mt excess demand test, PWCS has also, at the request of the NCIG, included an industry support test that requires support by at least 75% of the volume or more than 50% of producers by number before the scheme can be extended. The combination of the excess demand test and the industry support test mean that PWCS cannot control and is not the determinant of whether the capacity balancing mechanism is extended into any future years.

In any event, as a factual matter, both demand and capacity forecasts are subject to review and audit by independent third parties to ensure their reasonableness. This provides an independent check that all forecasts are reasonable.

Conclusion

PWCS appreciates that some of these matters may have been addressed in earlier submissions, but believes that it is important to set out its position on these matters for the public record. Some data which is confidential on allocation usage in the Short Term CDS is included in the Confidential Annexure.

PWCS will endeavour to discuss these issues with the NCIG members and all of its customers and industry stakeholders to explain its perspective and PWCS will continue to seek to ensure that they are commercially satisfied with its approach as to seeking to operate the Newcastle coal terminals in the most efficient manner for all coal exporters.

PWCS appreciates the opportunity to respond on these issues and would be pleased to discuss any of these matters with the Commission if that would be helpful.

Yours sincerely,

John Barbagallo

JOHN BARBAGALLO
GENERAL MANAGER

Attachment - Confidential

[Confidential - information deleted]