**RECORD OF MEETING WITH NEWCASTLE COAL INFRASTRUCTURE GROUP REGARDING PORT WARATAH AUTHORISATION**

**7 February 2005**

**Melbourne**

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| **ACCC:** | Stephen King |
| | Scott Gregson |
| | David Hatfield |
| | Jaime Norton |
| **NCIG:** | Tony Haggerty (Excel) |
| | Chris Urzaa (AMCI) |
| | Anthony Quin (BHP Billiton) |
| | Brendan McPherson (Donaldson Coal) |
| | Goran Stamenkovic – via telephone (White Mining) |

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The main issues raised by NCIG at the meeting are summarised below.

**Deferring investment in capacity expansion**

NCIG submitted that its primary concern in relation to the Medium Term Capacity Distribution System (Medium Term CDS) is that it will decrease the incentive to invest in necessary capacity expansion at the Port of Newcastle. At current coal prices, this represents significant public detriment in the form of foregone coal exports.

NCIG submitted that before the CDS was introduced, coal exporters faced significant demurrage costs. The costs were borne directly by exporters, not by PWCS. The only way for them to address those costs was for capacity of the port and rail system to be expanded. However, with the introduction of the CDS, the queue has been significantly reduced and hence demurrage costs have fallen. This has removed any clear signal that capacity needs to be expanded, but the underlying problem has not gone away.

NCIG members do not see demurrage necessarily as a public detriment – more as a commercial cost of doing business and a signal to industry participants that capacity needs to be increased. NCIG noted that while other ports in Australia (who also share common producers/exporters that export through Newcastle Port) have significant queuing issues and are incurring demurrage, none has applied for or introduced a demand management system to alleviate their demurrage costs. Similarly foreign ports are not immune to significant queuing problems and the costs of demurrage.

NCIG highlighted that its member coal companies account for the majority of the forecast growth in the Hunter Valley. NCIG submitted that, in the most part, Xstrata and Rio Tinto, both of which have dominant shareholdings in Port Waratah Coal Services (PWCS), have more mature operations and do not appear to have significant plans to expand production in the Hunter Valley. Those companies can, however, potentially meet additional demand from alternative coal mines they own. As such, Xstrata and Rio Tinto may have less incentive to support investment in increased coal loading capacity at Newcastle.

Further, NCIG submitted that PWCS is yet to provide firm commitments to the industry to expand capacity at the Port. It is NCIG's view that PWCS' commitment to a program of investment to increase the capacity of the coal chain to 95 – 105 million tonnes by the end of 2007 is well below the most recent forecast producer demand of approximately 127 million tonnes per annum. Significant opportunities exist to increase coal exports through Port of Newcastle that may not be realised if PWCS does not commence expansions immediately.

NCIG submitted there have been substantial recent improvements in coal chain capacity. These improvements have been achieved primarily by better utilisation of existing rail infrastructure, and these rail improvements are continuing. As a result, even if port capacity is not currently a constraint, it soon will be.

**Under-utilisation of allocation**

NCIG submitted there was 3.5 million tonnes of unused allocation in 2004. In particular, a total of 81 million tonnes of coal was allocated to producers, but only 77.5 million tonnes of coal was shipped through the Port.

The ACCC asked why the loading allocation was underused, and specifically, why coal producers did not participate in allocation trading to make up for any shortfalls in production. In response, NCIG submitted:

- The allocation system limits the amount of coal producers can send through the port as a result of the quota, and as a result producers pull back production to the level of allocation they are provided. The uncertainty of obtaining additional allocation means that producers are reluctant to over-produce.

- It is difficult to participate in allocation trading due to insufficient information being available. Producers encountering production difficulties will tend to hold onto allocation as long as possible. The market therefore lacks depth.

- It is difficult to quickly increase production at the mine in order to take up any additional allocation. Production decisions are planned with relatively long lead times, and companies also typically negotiate sales contracts 6 to 12 months in advance rather than on a quarterly basis.

- It represents sound financial management to minimise coal inventories.

NCIG submitted that based on PWCS figures for the calendar year to date, there is a trend of increasing under use of allocated capacity which appears to be between 1 Mt and 2 Mt in the first quarter of 2005. At current coal prices, the cost of these 'lost' coal export tonnes would easily exceed the demurrage savings.

NCIG submitted that practically, any foregone sales in a quarter are lost. That is, they are shifted to the end of the production life of the Hunter Valley, which in net present value terms, is effectively a zero value.

NCIG pointed to a graph supplied to producers by the Medium Term CDS Administrator (*Capacity Balancing System, Weekly Update*, Tuesday, 1 February 2005) which demonstrated there is a downward trend in the average rate of allocation usage.

**5 per cent 'conditional allocation'**

NCIG submitted that it supported the introduction of 'conditional allocation' during the design phase of the Medium Term CDS. However, it believes that the rules governing the use of 'conditional allocation', as they currently stand, have contributed to the under-use of allocation.

In this regard, NCIG outlined that a producer is only permitted to use its quarterly 'conditional allocation' after it has utilised its quarterly loading allocation and its upper flexibility amount for the quarter. This raises the practical problem that producers are unable to fix their shipping nominations that far in advance, and as a result are not able to utilise the 'conditional allocation'.

Further, NCIG submitted that 'conditional allocation' should be higher than the current figure of 5 per cent of a producer's quarterly loading allocation. It suggested an appropriate figure might be 10 per cent.

**Take or pay commitments**

NCIG submitted that it does not object to the introduction of take or pay obligations to underwrite necessary investment at the Port. However, it would oppose take or pay obligations if they were used by PWCS to prevent the entry of a competing coal loading facility at the Port of Newcastle.

**Duration of authorisation**

NCIG supports authorisation of the Medium Term CDS for 12 months only. In this regard, the ACCC referred to its comments in the draft determination in relation to the duration of the proposed authorisation. In particular, that authorisation of the Medium Term CDS for a short duration, such as 12 months, could distract the industry from developing a long term solution if it was again focusing on seeking an authorisation for a CDS to operate in 2006.

NCIG submits that it would have no objection to a short term CDS if it was sought as a "bridging" measure in the context of a committed expansion plan. Such a plan has not yet been committed. Limiting any CDS authorisation to 12 months better maintains pressure on PWCS to invest in capacity expansion. If PWCS were to have a firm program of committed expansion initiatives which are quickly implemented, sufficient to meet the requirements of producers (ie, in excess of120 Mtpa) there would probably be little if any opposition to authorisation.