



Australian
Competition &
Consumer
Commission

Draft Determination

Applications for authorisation

lodged by

**Tarong Energy Corporation Limited,
New Hope Corporation Limited and New Acland Coal Pty Ltd**

in respect of

a coal supply agreement

Date: 2 November 2006

**Authorisation no.: A91009
A91010**

Public Register no.: C2006/1709

Commissioners: Samuel
Sylvan
Martin
McNeill
Smith
Willett

Summary

The ACCC proposes to grant authorisation to certain restrictions contained within a coal supply agreement between Tarong Energy Corporation Limited, New Acland Coal Pty Ltd and New Hope Corporation Limited until 31 December 2035.

The authorisation process

Authorisation is a process under which the Australian Competition and Consumer Commission (ACCC), in response to an application, can grant immunity on public benefit grounds against action under the competition provisions of the *Trade Practices Act 1974* (the Act) except misuse of market power.

Generally, the ACCC can grant immunity from the application of the competitive provisions of the Act if it is satisfied that the public benefit from the conduct outweighs any public detriment. The ACCC runs a public consultation process to assist it to determine whether a proposed arrangement results in a net public benefit.

The applications for authorisation

On 25 August 2006 Tarong Energy Corporation Limited (Tarong) lodged two applications for authorisation. The applications concern a coal supply agreement between Tarong, New Acland Coal Pty Ltd (New Acland) and New Hope Corporation Limited (New Hope) (the Agreement). On 20 October 2006 New Hope and New Acland were joined as applicants to the two applications.

Under the Agreement, which is dated 13 June 2006, Tarong has been granted an option to buy 5.7 million tonnes of coal annually from the New Acland mine for 25 years. The coal will be used by Tarong as a long term source of fuel for its two power stations located in the Kingaroy/Nanango region of Queensland.

The option must be exercised on or before 30 June 2007. If the option is exercised, the supply of coal will commence on 1 January 2011 and continue until December 2035.

The Agreement limits the quantity of coal that New Acland can sell each year from the New Acland mine to parties other than Tarong and also imposes restrictions on Tarong's ability to on-sell coal purchased under the Agreement to third parties (together referred to as 'the restrictions').

Public detriment

The restrictions have the potential to limit the amount of coal that might otherwise be available to users other than Tarong.

The ACCC considers that the public detriment generated by the restriction on New Acland's ability to sell coal to parties other than Tarong as well as the restriction on Tarong's ability to on-sell coal to third parties, is limited because:

- the restriction on New Acland appears to be motivated by the desire to ensure that there will be sufficient coal available to Tarong for the life of the Agreement;

- New Acland is not restricted in selling to other users any coal produced in excess of that contracted by Tarong;
- New Acland may increase the quantity of coal it sells to third parties if Tarong does not take its allocated annual quantity of coal; and
- surplus coal acquired by Tarong has the potential to be made available to other purchasers.

Public benefit

The ACCC is satisfied that the restrictions will generate a benefit to the public by providing Tarong with a secure and efficient long-term supply of coal for its production of electricity.

However, the ACCC considers that with or without the restrictions, Tarong would obtain long-term supply of coal for production of electricity. Accordingly, the ACCC considers the public benefit is small and resides in the additional efficiencies and security the restrictions may provide.

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 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. In this instance, the ACCC notes that the coal supply agreement will commence on 1 January 2011 and continue until December 2035.

Conclusion

The ACCC proposes to grant authorisation until 31 December 2035 to the restrictions in the coal supply agreement between Tarong, New Acland and New Hope which limit New Acland's ability to sell coal to parties other than Tarong as well as limit Tarong's ability to on-sell coal purchased under the Agreement to third parties.

Should Tarong, New Acland or New Hope wish to extend the life of the coal supply agreement the ACCC would expect a further application for authorisation at that time.

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1. Introduction

Authorisation

- 1.1. The Australian Competition and Consumer Commission (the ACCC) is the independent Australian Government agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act 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 Act, 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. 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 runs a public consultation process when it receives 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.
- 1.5. After considering submissions, the ACCC issues a draft determination proposing to either grant the application or deny the application.
- 1.6. Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference provides all parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite the applicant and interested parties to lodge written submissions on the draft.
- 1.7. 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 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.

2. The applications and industry background

The applications for authorisation

- 2.1. On 25 August 2006 Tarong Energy Corporation Limited (Tarong) lodged two applications for authorisation (A91009 and A91010) with the ACCC. On 20 October 2006 New Hope Corporation Limited (New Hope) and New Acland Coal Pty Ltd (New Acland) were joined as applicants to the two applications.
- 2.2. The applications concern a coal supply agreement between Tarong, New Acland and New Hope (the Agreement). Under the Agreement, which is dated 13 June 2006, Tarong has been granted an option to buy 5.7 million tonnes of coal annually from the New Acland Coal Mine (the New Acland mine) for 25 years. The option must be exercised on or before 30 June 2007. If the option is exercised, the supply of coal will commence on 1 January 2011 and continue until December 2035.
- 2.3. Some aspects of the Agreement potentially raise concerns under the anti-competitive conduct provisions of the Act. In particular, the Agreement limits the quantity of coal New Acland can sell from the New Acland mine each year to parties other than Tarong and imposes restrictions on Tarong's ability to on-sell coal purchased under the Agreement to third parties (referred to as 'the restrictions').
- 2.4. Consequently, Tarong, New Hope and New Acland (the Applicants) have lodged the applications for authorisation with the ACCC. Under application A91009, the Applicants seek authorisation 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 Act. Under application A91010, the Applicants seek authorisation to engage in conduct that constitutes or may constitute, exclusive dealing.
- 2.5. The Applicants have not specified the term of authorisation they seek.

Chronology

- 2.6. Table 1.1 provides a chronology of significant dates in the consideration of these applications.

Table 1.1: Chronology of applications for authorisations A91009 and A91010

DATE	ACTION
25 August 2006	Applications for authorisation lodged with the ACCC.
6 October 2006	Closing date for submissions from interested parties in relation to the substantive applications for authorisation.
2 November 2006	Draft determination issued.

The applicants

Tarong

- 2.7. Tarong, a Queensland Government Owned Corporation, was established in July 1997 to hold power generating assets owned by the Queensland Government as part of its energy industry reforms. Tarong is a competitor in the National Electricity Market, generating about one quarter of Queensland's electricity supply and approximately 8.7% of the total number of megawatts (MW) dispatched through the National Electricity Market.
- 2.8. Tarong owns or has an interest in a range of electricity assets including:
- The Tarong Power Station located in the Kingaroy/Nanango region of Queensland which has a generating capacity of 1400 MW and consists of 4 units. The estimated replacement cost of the Tarong Power Station is in excess of \$2 billion.
 - The Tarong North Power Station located in the Kingaroy/Nanango region of Queensland which has a generating capacity of 443 MW and consists of 1 unit. The estimated replacement cost of the Tarong North Power Station is in excess of \$750 million. Tarong owns 50% in joint venture with TM Energy (Aust) Pty Ltd, owned by The Tokyo Electric Power Company Inc and Mitsui & Co Ltd.
- 2.9. The Tarong Power Station and the Tarong North Power Station (collectively 'the Tarong Stations') are coal fired power stations fuelled by low grade thermal coal which is low cost coal with low energy output. The process of generating electricity starts by crushing the coal into fine particles and then igniting those particles. The heat produced during the burning process heats water which in turn creates steam which then powers the turbines driving the generators and creating electricity. Once created, the electricity is transmitted into the electricity network and transported to consumers. As base load power stations, the Tarong Stations operate at a steady rate.
- 2.10. Tarong currently purchases almost all of its coal for the Tarong Stations under a coal supply agreement with Rio Tinto Coal Australia Pty Ltd and Queensland Coal Pty Ltd. This agreement commenced in 2001 and is due to expire on 31 December 2010. The coal is sourced from the Meandu Mine adjacent to the Tarong Stations and transported to the Tarong Stations on a conveyor system approximately 1.5 kilometres long.
- 2.11. The Meandu Mine is nearing the end of its economic productive life and, consequently, Tarong will require a new source of coal from 2010.

New Hope and New Acland

- 2.12. New Hope's interests include coal mining, port operations and resource based activities in Queensland. Its coal mining operations include three operating open cut mines in Southern Queensland, including the New Acland mine which is located near the town of Acland, west of Brisbane.
- 2.13. New Acland is a wholly owned subsidiary of New Hope and owns the mining tenements which make up the New Acland mine. The New Acland mine currently produces 2.5 million tonnes of coal per year which is sold to the domestic and export markets. The

New Acland mine is currently undergoing a stage 2 expansion which will increase production capacity from 2.5 million tonnes per annum to 4 million tonnes per annum.

The coal supply agreement

2.14. Tarong, New Acland and New Hope have entered into an agreement under which Tarong has been granted an option to buy 5.7 million tonnes of coal annually from the New Acland mine for 25 years, commencing on 1 January 2011. The option must be exercised on or before 30 June 2007. The coal will be used by Tarong as a long term source of fuel for the Tarong Stations. The New Acland mine is approximately 70 kilometres south of the Tarong Stations.

2.15. If Tarong exercises the option:

- New Acland must be able to deliver up to approximately 5.7 million tonnes of coal per year to Tarong from 1 January 2011 to 31 December 2035.
- Tarong will order coal on a month by month basis but the quantity of coal ordered each month cannot be less than 90% or more than 110% of the previous month's order.
- The coal must comply with certain specifications to ensure the smooth operation of the Tarong Stations.
- Unless otherwise agreed with Tarong, and to ensure consistent specifications, the coal must be sourced from the New Acland mine.
- Tarong will be responsible for taking delivery of the coal at the New Acland mine and delivering it by transportation infrastructure (still to be constructed but likely to be a rail line) to the Tarong Stations.
- The Agreement limits the quantity of coal New Acland can sell from the New Acland mine each year to persons other than Tarong to ensure that the quantity of coal contracted to Tarong for the term is not compromised. The Agreement provides a mechanism to allow New Acland in certain circumstances to sell more than this quantity, if Tarong does not take its allocated annual quantity of coal.
- Tarong may on-sell coal to entities associated with Tarong (for example, related body corporates or entities with which it is in joint venture including its co-owners in the Tarong North Power Station for the Tarong North Power Station).
- If Tarong wants to on-sell coal to entities which are not associated with Tarong, it must first offer to sell that coal back to New Acland.
- New Acland is not an exclusive supplier of coal to Tarong. Tarong is able to source coal from other entities.
- There are certain grounds set out in the Agreement on which Tarong may terminate the Agreement.

2.16. Tarong advises that the methodology used to calculate the cost of coal under the Agreement is designed to ensure:

- amortisation of the capital cost of the mine expansion over the term of the Agreement; and
- cost efficiency and transparency via periodic reviews of the mining costs.

- 2.17. In order for Tarong and New Acland to carry out their obligations under the Agreement, the following is required:
- the stage 2 expansion of the New Acland mine with a capital investment of approximately \$60 million and a stage 3 expansion, the cost of which is still to be determined; and
 - the construction of transport infrastructure between New Acland mine (a distance of 75 to 80 kilometres), a coal loading facility at New Acland mine and a coal unloading facility at the Tarong Stations. The type of transport infrastructure is still being determined but it is likely to be a railway line.
- 2.18. As well as the capital costs associated with the New Acland mine expansions and the transport infrastructure, Tarong will also incur costs associated with:
- the transition from the current conveyor delivery system which delivers coal at a steady stream to the new transport infrastructure; and
 - ensuring the Tarong Stations operate effectively and efficiently with coal from the New Acland mine, which has different specifications to coal from the Meandu Mine and which will include changes to the crushing mills.

The electricity industry

- 2.19. Australia's electricity industry has been significantly restructured since the early 1990s. Commonwealth, State and Territory Governments have all undertaken reforms to establish competitive wholesale and retail electricity markets.
- 2.20. The reforms included breaking up State and Territory-owned energy authorities and separating the potentially competitive upstream supply and downstream retailing assets from the non-competitive transmission and distribution facilities. In some jurisdictions electricity generation utilities and electricity retail assets were further separated into competing businesses. Ownership and management structures have also been reformed. In some cases this has involved privatisation; in others, greater commercialisation has been introduced within public ownership.
- 2.21. A major objective of the reforms was to create a national electricity market (NEM) through the interconnection of State and Territory electricity transmission grids. The NEM commenced operation in December 1998 and now supplies electricity to over 7.7 million Australian customers through an interconnected national grid that runs through Queensland, New South Wales, the Australian Capital Territory, Victoria, South Australia and, most recently, Tasmania.¹
- 2.22. The NEM is governed by the national Electricity Law and Rules and the day to day operation of the market is managed by the national Electricity Market Management Company Limited (NEMMCO).

¹ Western Australia and the Northern Territory are not part of the NEM.

- 2.23. The NEM pools output from all significant generators, such as Tarong, into a single wholesale market. Generators bid to supply given quantities of electricity into the grid. Based on these bids, and subject to any physical constraints on the transmission system, NEMMCO schedules which generators will operate for each five-minute period.
- 2.24. One way in which customers can purchase electricity is at the average half-hour (spot) market price. To protect against the financial risks associated with the spot market electricity retailers and generators enter into financial hedge contracts which operate outside the NEM. The contracts vary in term, but generally the parties agree a fixed price for electricity and depending where the spot price falls either below or above the fixed price then one party pays the difference to the other.
- 2.25. NEMMCO, along with various governments and the recently established Australian Energy Market Commission, all work at ensuring long term electricity reliability and supply security. One factor involved in this planning process is ensuring that there is sufficient generating capacity and reserved generating capacity within the system to meet current and future demand projections.
- 2.26. Electricity retailers purchase electricity out of the NEM and on-sell to end users. Electricity is transported from generators to end users through the transmission and distribution system.²

The coal industry in Queensland

- 2.27. In 2004-05 sales of coal from Queensland totalled 172.43 million tonnes, of which 145.47 million tonnes was sold for export and 26.96 million tonnes was sold in domestic markets. The main domestic use for coal is electricity generation, with 89.6% of the domestic sales being used for this purpose. Generally, lower grade thermal coal is used domestically while better quality thermal coal and coking coal are exported.
- 2.28. There are a large number of coal producers in Queensland which compete in the domestic and export markets. These include Anglo Coal Australia, Peabody, Rio Tinto Coal Australia, Xstrata Coal Queensland Pty Ltd, Ensham Resources Pty Ltd, BHP Billiton Mitsubishi Alliance and Macarthur Coal. In 2004-05, coal from Queensland was shipped to 31 countries. Japan is the largest importer of Queensland coal.³

² In Queensland the high voltage transmission system which transports electricity from the generators is owned by Powerlink Queensland, a government owned corporation.

³ "Queensland's World Class Coals: Mine Production and Developments", QLD Government, Department of Natural Resources and Mines, December 2005 (Annexure E)

3. Submissions received by the ACCC

- 3.1. The Applicants provided a supporting submission with the applications for authorisation. The views of the Applicants are outlined in the ACCC's evaluation of the restrictions for which authorisation is sought in Chapter 5 of this draft determination. A copy of the Applicants' submission is available on the ACCC's website (www.accc.gov.au) by following the 'Public Registers' and 'Authorisations Public Registers' links.
- 3.2. The ACCC sought submissions from 21 interested parties potentially affected by the applications, all of whom are participants in the Queensland electricity or coal industries. No submissions from interested parties were received.

4. The net public benefit test

- 4.1. The ACCC may only grant authorisation where the relevant test in section 90 of the Act is satisfied.

Application A91009

- 4.2. The Applicants lodged application A91009 under section 88(1) of the Act:
- 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 Act; and
 - to give effect to a provision of a contract, arrangement or understanding where the provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the Act.
- 4.3. Section 88(12) of the Act states that the ACCC does not have the power to grant an authorisation to a corporation to make a contract or arrangement, or to arrive at an understanding, if the contract or arrangement has been made, or the understanding has been arrived at, before the ACCC makes a determination in respect of the application. The coal supply agreement between Tarong, New Hope and New Acland was entered into on 13 June 2006.
- 4.4. With respect to the application to give effect to a provision of a contract, arrangement or understanding where the provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the Act, the relevant test is found in section 90(7) of the Act.
- 4.5. Section 90(7) of the Act states that the ACCC shall not authorise a provision of a contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:
- the provision of the contract, arrangement or understanding would result, or 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 result, or be likely to result, if the provision was given effect to.

Application A91010

- 4.6. The Applicants lodged application A91010 under section 88(8) of the Act to engage in conduct that constitutes or may constitute, exclusive dealing. The relevant test for this application is found in section 90(8) of the Act.
- 4.7. Section 90(8) states that the ACCC shall not authorise the proposed exclusive dealing conduct unless it is satisfied in all the circumstances that such conduct would result or be likely to result in such a benefit to the public that the proposed conduct should be authorised.

Application of the tests

- 4.8. There is some variation in the language in the Act between the tests in sections 90(7) and 90(8). However, sections 90(7) and 90(6) share similar wording.
- 4.9. The Australian Competition Tribunal (the Tribunal) has addressed this issue with reference to the tests in sections 90(6) and 90(8).
- 4.10. The Tribunal has found that the tests are not precisely the same. The Tribunal believes the test under section 90(6) is limited to a consideration of those detriments arising from a lessening of competition but the test under section 90(8) is not so limited.⁴
- 4.11. However, the Tribunal has previously stated that regarding the test under section 90(6):
[the] fact that the only public detriment to be taken into account is lessening of competition does not mean that other detriments are not to be weighed in the balance when a judgment is being made. Something relied upon as a benefit may have a beneficial, and also a detrimental, effect on society. Such detrimental effect as it has must be considered in order to determine the extent of its beneficial effect.⁵
- 4.12. Consequently, when applying either test, the ACCC can take most, if not all, public detriments likely to result from the relevant conduct into account either by looking at the detriment side of the equation or when assessing the extent of the benefits.
- 4.13. Given the similarity in wording between sections 90(6) and 90(7), the ACCC considers the approach described above in relation to section 90(6) is also applicable to section 90(7).

Definition of public benefit and public detriment

- 4.14. Public benefit is not defined in the Act. 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.⁶
- 4.15. Public detriment is also not defined in the Act but the Tribunal has given the concept a wide ambit, including:
...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.⁷

⁴ *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004. This view was supported in *VFF Chicken Meat Growers' Boycott Authorisation* [2006] ACompT9 at paragraph 67.

⁵ *Re Association of Consulting Engineers, Australia* (1981) ATPR 40-2-2 at 42788. See also: *Media Council case* (1978) ATPR 40-058 at 17606; and *Application of Southern Cross Beverages Pty. Ltd., Cadbury Schweppes Pty Ltd and Amatil Ltd for review* (1981) ATPR 40-200 at 42,763, 42766.

⁶ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677. See also *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242.

⁷ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

Future with-and-without test

- 4.16. The ACCC applies the ‘future with-and-without test’ established by the Tribunal to identify and weigh the public benefit and public detriment generated by arrangements for which authorisation has been sought.⁸
- 4.17. 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’.

Length of authorisation

- 4.18. The ACCC can grant authorisation for a limited period of time.⁹

Conditions

- 4.19. The Act also allows the ACCC to grant authorisation subject to conditions which the ACCC considers necessary in order to satisfy the net public benefit test.¹⁰

Future and other parties

- 4.20. Applications to make or give effect to contracts, arrangements or understandings that might substantially lessen competition or constitute exclusionary provisions may be expressed to extend to:
- persons who become party to the contract, arrangement or understanding at some time in the future¹¹
 - persons named in the authorisation as being a party or a proposed party to the contract, arrangement or understanding.¹²

⁸ Australian Performing Rights Association (1999) ATPR 41-701 at 42,936. See also for example: Australian Association of Pathology Practices Incorporated (2004) ATPR 41-985 at 48,556; Re Media Council of Australia (No.2) (1987) ATPR 40-774 at 48,419.

⁹ Section 91(1).

¹⁰ Section 91(3).

¹¹ Section 88(10).

¹² Section 88(6).

5. ACCC evaluation

- 5.1. The ACCC's evaluation of the Agreement is in accordance with the net public benefit test outlined in Chapter 4 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 Agreement.

The market

- 5.2. The first step in assessing the effect on competition of the conduct for which authorisation is sought is to consider the relevant market(s) affected by that conduct.
- 5.3. The Applicants have not made a submission concerning their view of the relevant area of competition affected by the conduct for which authorisation is sought.
- 5.4. Under the coal supply agreement, Tarong has been granted an option to buy coal from the New Acland mine. At present, the New Acland mine produces 2.5 million tonnes of coal annually and approximately 60% of this production is exported. Should Tarong exercise its option to purchase coal from the New Acland mine and the associated expansions of the New Acland mine go ahead, production will increase substantially. While the majority of this increased production (5.7 million tonnes per year) will be supplied to Tarong, a portion will be exported and a smaller quantity will be supplied to domestic customers.
- 5.5. Given authorisation is sought for arrangements and conduct which restrict the supply of coal mined at the New Acland mine, market analysis could focus on the potential impact of the proposed restrictions on existing or new acquirers of coal from the New Acland mine. In general, the proposed restrictions foreclose the ability of other purchasers to buy a significant quantity of coal from the New Acland mine. Information has not been provided to suggest that there are alternative purchasers of significant quantities of coal from the New Acland mine.
- 5.6. More broadly, market analysis could encompass alternative sources of coal for the Tarong stations. The Tarong Stations are located in the Tarong Basin which contains substantial coal deposits. Additionally, certain coal mines within the Surat and Clarence-Moreton Basins are within a feasible geographic distance of the Tarong Stations to be considered alternative sources of supply.
- 5.7. Market analysis could also encompass the alternative uses of the additional coal from the New Acland mine to be acquired by Tarong. Rather than being used by Tarong Stations, the coal could possibly be used by other power stations, or be exported, or be used for some other purpose.
- 5.8. Given New Acland's current supply of coal to other customers, both domestic and export, a broader market with the restraints imposed by commodity markets appears more likely to be appropriate.
- 5.9. In any event, the ACCC is of the view that it is not necessary to comprehensively define the relevant market in this matter. It is the ACCC's view that its assessment will not be overly affected by the possible variations in precise market definition.

The counterfactual

- 5.10. As noted in Chapter 4 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’.
- 5.11. Without authorisation, it would appear that Tarong will not exercise its option under the agreement. Under this scenario, Tarong may seek to re-negotiate an agreement with New Acland and New Hope that the parties do not consider requires authorisation. Alternatively, Tarong may seek to obtain coal from a different source.
- 5.12. The ACCC therefore considers that the counterfactual is the situation in which Tarong does not exercise its option under the current coal supply agreement between Tarong, New Acland and New Hope. With or without authorisation, Tarong is likely to secure a long-term supply of coal from either New Acland or another provider.

Public detriment

- 5.13. The Applicants believe that the supply and acquisition of coal pursuant to the Agreement will not result in any detriment to the public.
- 5.14. Under the agreement, limitations are imposed on the quantity of coal that New Acland can sell each year from the New Acland mine to parties other than Tarong. This restriction has the potential to restrict the ability of other parties to obtain coal from New Acland. This in turn may restrict the ability of such parties to operate in downstream markets such as that for electricity production.
- 5.15. In this instance, the anti-competitive detriment resulting from this restriction is limited by the following:
- The restriction appears intended to ensure that there will be sufficient coal available to Tarong for the life of the Agreement. Tarong submits that it will experience significant financial consequences if the operation of the Tarong Stations is disrupted due to insufficient coal supply.
 - The Agreement allows New Acland in certain circumstances to increase the quantity of coal it sells to parties other than Tarong if Tarong does not take its allocated annual quantity of coal.
- 5.16. The Agreement also restricts Tarong’s ability to on-sell coal purchased under the Agreement to third parties. In essence, Tarong may only on-sell coal to:
- entities it is related to, or has an interest in, or is in partnership with; and
 - third parties provided that Tarong has first offered to sell the coal back to New Acland at the price Tarong purchased it.
- 5.17. It would appear that Tarong would only on-sell coal if it had surplus to its requirements. Tarong has indicated that its preference is to sell any coal in excess of its needs back to New Acland. Tarong is not and does not want to be a coal trader.

- 5.18. Any coal in excess of Tarong's requirements has the potential to be available to any one who wants it in the event that New Acland does not buy it back. Any coal that New Acland does buy back from Tarong is likely to be re-supplied to Tarong at a later date, unless Tarong does not purchase its allocated annual quantity of coal, in which case the surplus coal could potentially be available to a third party. In these circumstances, the anti-competitive detriment arising from the restriction on Tarong's ability to on-sell coal to third parties is limited.
- 5.19. In summary, the restrictions seem to do no more than guarantee that New Acland will be in a position to supply Tarong with its coal needs over the life of the Agreement. The detriment generated by the restrictions would appear to be low.

Public benefit

- 5.20. The Applicants submit that the coal supply agreement will deliver a number of public benefits, a summary of which is provided below.

Security of electricity supply

- 5.21. The Applicants submit that the Tarong Stations provide approximately 25% of Queensland's electricity needs and a secure long term supply of coal to the Tarong Stations will ensure the continued supply of reliable low cost electricity in Queensland.
- 5.22. The Applicants submit that any sudden or unplanned disruption to the coal supply of the Tarong Stations could result in a significant imbalance between electricity supply and demand which could disrupt the operation of the NEM, increase the cost of electricity for end users and effect the reliability of electricity supply in Queensland.
- 5.23. The ACCC notes that any disruption to the supply of coal to the Tarong Stations as a consequence of Tarong not exercising its option under the coal supply agreement will not be sudden or unplanned. Under the coal supply agreement, Tarong will not commence supply of coal from the New Acland mine until 2011.
- 5.24. The Applicants also submit that any change in location of the generating capacity of the Tarong Stations would require significant capital expenditure for new generation and transmission infrastructure. They note that if the Tarong Stations were to discontinue generation within a timeframe shorter than the time it would take to commission replacement base load generation in Queensland, there would be significant impacts on the reliability of electricity supply in Queensland.
- 5.25. The ACCC acknowledges the position of the Tarong Stations in the context of Queensland's generation capacity and the NEM more generally and accepts that any disruption to the operation of the Tarong Stations is likely to have flow-on effects to the operation of the NEM. The ACCC considers that there is a clear public benefit in minimising disruptions to the operation of the NEM. To the extent the notified conduct does this, it generates public benefit.

Community benefits

5.26. The Applicants submit that the proposed expansion of the New Acland mine and the associated construction of transport infrastructure will produce benefits for the community around the mine including:

- employment opportunities (both during the expansion/construction phase and longer term) for around 700 people;
- increased long term employment security for current employees of the New Acland mine;
- increased demand for products and services from support industries and suppliers in the Rosalie and Toowoomba districts; and
- improved transport infrastructure in the region.

5.27. The ACCC accepts that the creation of employment opportunities and employment security is a public benefit. The ACCC also accepts the expansion of the New Acland mine and the construction of associated transport infrastructure will likely stimulate demand for products and services from support industries in the local region (and possibly beyond). The ACCC considers this potential increase in economic activity constitutes a public benefit.

5.28. The proposed construction of a rail line to allow the delivery of coal from the expanded New Acland mine to the Tarong Stations will clearly result in more transport infrastructure in the local region. However, it is not proposed that the rail line be used for other purposes (such as freight or passenger services). Given the dedicated nature of the proposed transport infrastructure, the extent to which it generates a benefit to the public in its own right would appear to be limited.

Continued operation of the Tarong Stations

5.29. The Applicants submit that the coal supply agreement will ensure the long term security of the Tarong Stations with associated benefits to the surrounding community. These benefits include employment related opportunities as well as direct economic contributions to the local region (as discussed above). In 2002 Tarong commissioned a study by the Centre for Australian Financial Institutions at the University of Southern Queensland which found that in 2001/02, the Tarong Stations spent approximately \$4.1 million on goods and services from local businesses while employees of Tarong spent approximately \$14.5 million on goods and services from local businesses. As noted above, the ACCC considers that the creation of employment opportunities and increased economic activity are public benefits.

Increased government revenue

5.30. The Applicants submit that the coal supply agreement will contribute to:

- increased Government revenue through royalties and taxes as a result of increased coal production at the New Acland mine; and
- continued financial viability of Tarong which as a Government Owned Corporation returned \$68.68 million to its shareholding ministers in the 2004/05 financial year.

5.31. The ACCC accepts that increased revenue to the government as a result of the expansion of the New Acland mine and continued revenue to the government as a result of the ongoing financial viability of Tarong both constitute a public benefit because this revenue forms part of the funds available to government to support its provision of a wide variety of programs and services to the Australian public.

The benefits with or without authorisation

5.32. While noting the public benefits associated with the expansion of the New Acland mine, as discussed earlier in this section the ACCC questions the extent to which the restrictions are required to ensure the expansion. The ACCC considers that with or without the restrictions, the benefits seem limited to those associated with increased certainty and security of coal supply. Consequently, the benefits are small.

Balance of public benefit and detriment

5.33. The ACCC may only grant authorisation if it is satisfied that, in all the circumstances, the restrictions for which authorisation is sought are likely to result in a public benefit that will outweigh any public detriment.

5.34. The ACCC considers that the public detriment generated by the restriction on New Acland's ability to sell coal to parties other than Tarong as well as the restriction on Tarong's ability to on-sell coal to third parties, is limited because:

- the restriction on New Acland appears intended to ensure that there will be sufficient coal available to Tarong for the life of the Agreement;
- New Acland may increase the quantity of coal it sells to third parties if Tarong does not take its allocated annual quantity of coal; and
- surplus coal acquired by Tarong has the potential to be made available to other purchasers.

5.35. The ACCC is satisfied that the restrictions will generate a small benefit to the public by contributing to the reliability and security of the coal supplied from the expanded New Acland mine thereby:

- minimising disruptions to the operation of the NEM;
- creating employment opportunities;
- enhancing employment security;
- stimulating local economic activity; and
- increasing revenue to the government.

5.36. On balance, the ACCC considers the public benefit is likely to outweigh the public detriment.

Length of authorisation

- 5.37. 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.
- 5.38. In this instance, the Applicants seek authorisation for an indefinite period. The coal supply agreement will commence on 1 January 2011 and continue until December 2035.
- 5.39. The ACCC proposes to authorise the restrictions within the coal supply agreement until its termination, being 31 December 2035. Should the Applicants wish to extend the life of the coal supply agreement the ACCC would expect a further application for authorisation at that time.

Variations to the coal supply agreement

- 5.40. The ACCC notes that any amendments to the coal supply agreement during the proposed term of this authorisation would not be covered by the proposed authorisation.

6. Draft determination

The applications

- 6.1. On 25 August 2006 Tarong Energy Corporation Limited (Tarong) lodged applications for authorisation A91009 and A91010 with the Australian Competition and Consumer Commission (the ACCC). On 20 October 2006 New Hope Corporation Limited (New Hope) and New Acland Coal Pty Ltd (New Acland) were joined as applicants to the two applications.
- 6.2. Application A91009 was made using Form B Schedule 1, of the Trade Practices Regulations 1974. The application was made under subsection 88(1) of the Act 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 Act.
- 6.3. Application A91010 was made using Form E Schedule 1, of the Trade Practices Regulations 1974. The application was made under subsection 88(8) of the Act to engage in conduct that constitutes or may constitute, exclusive dealing.
- 6.4. In particular, Tarong, New Acland and New Hope seek authorisation for restrictions within a coal supply agreement they have entered into (the Agreement) which limit the quantity of coal that New Acland can sell each year from the New Acland mine to parties other than Tarong and also limit Tarong's ability to on-sell coal purchased under the Agreement to third parties.

The net public benefit test

- 6.5. For the reasons outlined in Chapter 5 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.
- 6.6. The ACCC therefore **proposes to grant** authorisation to applications A91009 and A91010.

Conduct for which the ACCC proposes to grant authorisation

- 6.7. The ACCC proposes to grant authorisation until 31 December 2035 to the restrictions in the Agreement which limit New Acland's ability to sell coal to parties other than Tarong as well as limit Tarong's ability to on-sell coal purchased under the Agreement to third parties.
- 6.8. Further, the proposed authorisation is in respect of the restrictions within the Agreement as they stand at the time authorisation is granted. Any changes to the restrictions within the Agreement during the term of the proposed authorisation would not be covered by the proposed authorisation.
- 6.9. This draft determination is made on 2 November 2006.

Further submissions

- 6.10. 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 Act.