



Australian Government

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Mr Scott Gregson
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

Dear Mr Gregson

Ref No: C07/10542

DALRYMPLE BAY COAL TERMINAL (DBCT) PTY LTD APPLICATION FOR AUTHORISATION OF EXTENSION OF THE QUEUE MANAGEMENT SYSTEM

I refer to your letter of 27 September seeking comments on the application by the DBCT Pty Ltd for a re-authorisation of the current Queue Management System (QMS) operating at the Dalrymple Bay Coal Terminal.

I note that the DBCT Pty Ltd is seeking a re-authorisation of the QMS to address what it considers to be a continuing imbalance between demand for coal loading services at the terminal and the capacity of the Goonyella coal chain to deliver coal. DBCT Pty Ltd considers ACCC approval of this application will provide a number of public benefits, including a reduction in demurrage costs for coal companies, and improved economic efficiencies pending completion of longer term capacity expansions in the Goonyella coal chain system. I also note that DBCT is seeking approval to extend the QMS without any alterations to the current QMS operating arrangements, **until the later of:**

- *The date of completion of Phases 2 and 3 of the terminal expansion; and*
- *The date when system capacity reaches or exceeds on a sustained monthly basis the aggregate of monthly tonnages of coal which users wish to ship through the coal terminal on a sustained basis;*

But in any case no later than 31 December 2010.

I also note that DBCT states that it has consulted with all coal company users of the terminal whom support the application for re-authorisation of the QMS beyond the end of 2007.

As the only change to the current QMS proposed by DBCTPL is an extension, my comments are focussed on five issues that are relevant to whether the re-authorisation of the QMS for a further period will provide net public benefits compared to a situation where the QMS is discontinued.

These include:

- The demand outlook for coal, and in particular coking coal, and whether the Goonyella coal supply chain system capacity is likely to be less than expected demand for coal services at the DBCT;
- Whether an extension of the QMS will act as a disincentive (by suppressing export demand and coal mine output) to longer term investment in additional system infrastructure capacity;
- The potential impact of extending the QMS on coal throughput and the operational efficiency of the Goonyella coal supply;
- The impact of the QMS on the management of vessel queuing arrangements at the DBCT compared to a situation where the QMS is not operational; and
- The length of a potential ACCC re-authorisation.

These issues are addressed at Attachment A.

Queue management or rationing systems should only be used as a short term measure to help manage a situation where the demand for coal exceeds the capacity of the coal supply chain to deliver the quantity demanded. The optimal solution to this issue is for the providers and users to work together to manage system capacity through investing in expanding the physical infrastructure and improving the operational efficiencies of individual infrastructure components and the coal supply chain as a whole. In this regard, I understand that following the O'Donnell report a central coordinator has been funded to oversee, and if necessary coordinate, all activities across the Goonyella coal supply chain.

While noting that it is difficult to judge the precise impact of the QMS in reducing the vessel queues given the range of impacting factors, on balance there is a reasonable probability that the QMS will provide a net public benefit through management of the vessel queue. Against a background of ongoing capacity constraints, the QMS will also help facilitate improved economic outcomes through creating greater certainty for both buyers and coal mining companies to plan their business operations. Overall, DITR supports the application to extend the QMS on the following basis:

- That it is extended to the earlier of the dates at which “sustainable system capacity” exceeds sustained system demand for coal or 31 December 2010;
- That “sustainable system capacity” be defined to provide greater guidance to the terminal operator and users;
- That the current operating arrangements including the ability to swap or trade quota allocations is retained; and

- DBCT continue to be required to report on the matters set out in the ACCC 2005 authorisation, including throughput performance, and progress in increasing coal chain infrastructure capacity to meet forecast demand for coal.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C. Stamford', written over a light grey rectangular background.

Chris Stamford
General Manager
Mining Industries Branch
Resources Division
1 November 2007

AUSTRALIAN GOVERNMENT DEPARTMENT OF INDUSTRY, TOURISM AND RESOURCES (DITR) - COMMENTS ON THE PROPOSED EXTENSION OF THE CURRENT DBCT QMS

Demand Outlook for Australian Coal

The DBCTPL application states that the demand for coal exported from the Bowen Basin through the Dalrymple Bay coal terminal will continue to be high given forecasts for continuing strong demand growth in international coal markets. This is consistent with the general outlook for Australian coal demand. The Australian Bureau of Agricultural and Resource Economics (ABARE) forecasts that world thermal coal trade is projected to increase at an average rate of around 3 per cent a year to total nearly 727 million tonnes (Mt) in 2012 compared to 619 Mt in 2006. The key drivers of growth in world thermal coal trade over this period are expected to be increased imports by key Australian markets, including Japan, the Republic of Korea, Taiwan, India and China. Australian thermal coal exports are projected to be around 150 Mt in 2011-12: up from around 115 Mt in 2006-07 as a result of strong world demand.

The global demand for metallurgical coal is also expected to be strong with metallurgical coal trade forecast by ABARE to increase by 3.5 per cent per year between 2006 and 2012 to reach over 251 Mt. The supply of Australian metallurgical coal for export exports is projected to increase from nearly 126 Mt in 2006 to over 155 Mt in 2012. This is being driven by the global production of steel (particularly in countries such as China and India) which ABARE forecasts will increase by 4.8 per cent a year to over 1.6 billion tonnes per annum over the six years to 2012¹. Metallurgical coal is the main coal type exported through Dalrymple Bay. The Queensland Department of Infrastructure is also forecasting that the global demand for Queensland coal will continue to increase by in excess of 5 per cent annually to 2009-2010².

In light of these forecasts it is likely that the export demand for Australian coal, including that from the central Bowen Basin, will remain strong for the at least the period of the extension applied for by DBCTPL.

Capacity Constraints in the Goonyella Coal Supply Chain

While it is not possible to precisely determine the level of demand that would occur in the absence of the current QMS, there is general agreement amongst users and infrastructure providers that there will be insufficient capacity in the Goonyella coal supply system over the next few years to meet the demand for coal exports. In his independent review of the Goonyella Coal Chain undertaken for the Queensland Government and the Queensland Resources Council, Stephen O'Donnell, former CEO of Pacific National, noted that in the last few years "*the export coal market has experienced a sustained increase in demand, in excess of the supply chain*" of the Goonyella system. He noted that even with the current investment program there were ongoing doubts whether the supply system will be able to deliver 85 Mt per annum when the DBCT phase 2 and 3 expansions reach that capacity at the end of 2008.³ In this regard we note system throughput in 2006-07 was less than the current capacity of the DBCT.

¹ ABARE, *Australian Commodities*, March Quarter, 2007.

² http://www.coordinatorgeneral.qld.gov.au/infrastructure/coal_taskforce.shtm

³ S O'Donnell, *Letter to Queensland Resources Council and Queensland Department of Transport*, 29 July 2007.

There are likely to be ongoing system capacity constraints in the Goonyella coal supply chain despite recent strong infrastructure investment and, as DBCT notes, there are likely to be capacity constraints at the port itself as the next expansion phases are implemented. If the QMS extension is re-authorised, DITR considers that it is important that the extent of such constraints, including the total supply chain system capacity and coal throughput be constantly monitored to determine when system capacity exceeds sustainable demand, and therefore no longer requires the QMS to operate.

Infrastructure Investment Issues

Queue management (quota/rationing) systems can act as a disincentive to new investment in infrastructure by artificially suppressing demand to bring it into line with the capacity of the coal chain to deliver. This can mask existing capacity constraints in the coal chain and reduce market signals to invest in additional infrastructure capacity and more efficient operations.

There are, however, a range of other factors that can contribute to underinvestment. These include the accuracy of future coal demand and coal price forecasts, company risk profiles, potential rates of return on investment in new or expanded infrastructure, the level of access charges and the existence of take or pay contracts with coal customers to underpin investments. For example, the O'Donnell Review noted that the decision by coal producers, through the regulatory process over the two year period from 2004 to 2006, to question the financial details underpinning the proposed price of the port expansion, contributed to delays in the DBCT port expansion plans.⁴

Across Australia, investment plans will see an additional 100 MT of coal port terminal capacity in place by 2012. The Goonyella coal supply chain is the beneficiary of substantial recent investments infrastructure. In relation to the DBCT, expansion work is well advanced. This will see terminal capacity increase from around 54.5 MT per annum in 2005 to 68 MT per annum by the end of 2007 and to 85 Mt per annum by the end of 2008. This represents an increase of around 55 per cent in nameplate port terminal capacity over 3 years.

Other coal port expansion investments are also taking place, some of which might provide alternative ports for Goonyella based coal companies. For example, the adjacent privately owned Hay Point Coal terminal is in the process of completing its expansion from 36 Mt per annum to 44 Mt. Consideration is also being given to expanding this capacity to around 55 Mt per annum which, if it proceeds, would see a total increase of 52 per cent in terminal capacity. The completion of the "Northern Missing Link" rail track and the proposed expansion of Abbott Point to 25 Mt per annum by 2010 (and later to 50 Mt per annum) will also provide better access to an alternative enlarged coal port for some Bowen basin coal producers. Similarly the Wiggins Island coal terminal planned for the Port of Gladstone (with a proposed initial capacity of around 25 Mt per annum by 2010-11 and a projected long term capacity of up to 70 Mt per annum) might also provide a potential port option for some Goonyella producers in the medium to longer term.

There is also considerable investment taking place in increasing the capacity of the Goonyella coal rail system to meet the expected increase in port terminal capacity. Most recently QR National announced it had commenced a \$612 million program to purchase some 40 locomotives and 1190 additional wagons over the next 3 years. In-principle agreement has also been given to purchase a further 920 wagons by 2010-11 which will see its total carrying capacity increased to around 260 Mt per annum, representing a 59 per cent increase in coal carrying capacity over

⁴ *Loc. cit.*

2006-07.⁵ In its 2006 master plan QR National notes it is progressing plans to increase rail track capacity on the Goonyella system from 92 Mt per annum in 2006 to around 140 Mt by 2011 to cater for the increases in port capacity.⁶ All of these investments are taking place with the QMS in place.

In light of the above investment plans and noting that the QMS has been operating since April 2005, it does not appear that that the QMS has been a serious impediment to investment in expanding system wide infrastructure capacity to meet forecast demand. However, if the ACCC approves an extension of the QMS, then the current QMS requirement that the applicant report annually on a range of operational and investment issues including the performance of the supply chain and the level of progress in increasing the capacity of the infrastructure supply chain to cater for future demand for coal, should continue. This will provide the ACC with further information to monitor the potential impact of the QMS on future infrastructure investment.

Impact of the QMS on Coal Throughput

A key objective of the QMS is to maximise the efficient use of the existing infrastructure. The level of coal throughput at the DBCT is largely the product of the physical capacity, the operational efficiency of the various infrastructure components of the Goonyella coal supply chain (load points, rolling stock, rail track capacity, terminal unloading, etc) and the effectiveness of the interfaces between each network component. Other factors outside the control of the supply chain can also impact on system throughput, e.g. disruptions caused by bad weather.

In 2006-07, the DBCT had a throughput capacity of 55.53 Mt per annum. However, total throughput that year was only 49.97 Mt. This was the result of several factors including load point problems, bad weather and stockyard constraints. The O'Donnell report highlighted rail deficiencies, and in particular the lack of sufficient rolling stock, as being the principal bottleneck that resulted in lower levels of terminal throughput. The QMS was not referred to by O'Donnell as being a contributing factor.

Nevertheless, the QMS operating arrangements should retain measures that promote economic efficiency and maximise throughput. These include features that enhance the redistribution of unused allocations, including the flexibility provisions and the ability to trade quotas. In addition, given the high cost of any lost potential exports, DITR supports arrangements whereby QMS operating arrangements err on the side of over allocating capacity by maintaining an operating goal of a queue of 15 vessels to help minimise potential under use of terminal capacity.

Impact of the QMS on the Length of Vessel Queue

The major argument advanced by DBCT for extending the current QMS is that it will reduce the coal vessel queue and thereby potentially significantly reduce demurrage costs. The applicant assesses potential demurrage cost savings for 2008 from extending the QMS at around \$273.2 million.

These estimated cost savings may be at the high end given, as acknowledged in the DBCT application, that a range of factors, including system capacity limitations, weather, higher than expected vessel arrival rates etc all impact on the length of the vessel queues. These factors operate regardless of the existence of a vessel management system. This is highlighted by the fact

⁵ Qr National , *Press Release*, 11 October 2007

⁶ QR Network Access, *2006 Coal Rail Infrastructure Masterplan*, September 2006, p.22.

that despite the operation of the QMS the vessel queue has remained higher than the desired operating level throughout 2007. The demurrage savings identified by DBCTPL are also based on a best case scenario for the QMS and a worst case scenario for the open market approach. An outcome somewhere in between appears more likely.

Notwithstanding our reservations on the extent of the cost savings estimated by DBCT as being possible under the QMS, the extension of the QMS is likely to contribute to reductions in vessel queue lengths, waiting times and demurrage costs, particularly where infrastructure capacity remains insufficient to meet demand for coal exports. In this regard DITR notes that at Newcastle, the lifting of the Capacity Balancing System (CBS) – the equivalent of the QMS - in late 2006 led to a rapid increase in vessel arrivals, and a lengthening of the vessel queue and waiting times together with large increases in demurrage costs. The CBS was restored several months later.

For how long should the QMS be re-authorised?

The implementation of queue management systems should only be seen as a temporary transitional measure pending additional system infrastructure capacity being brought on line. Investment in additional infrastructure capacity (and/or improving the operational efficiency and capacity of existing infrastructure) is the only option to optimise economic outcomes and ensure Australia takes full advantage of the continuing strong growth in the international demand for coal. The QMS should therefore be terminated at the earliest opportunity.

In this case the applicant has sought ACCC agreement to reauthorise the QMS until the **later** of the completion of phases 2 and 3 of the DBCT expansion or the date when system capacity reaches or exceeds on a monthly sustained basis the aggregate of monthly tonnages which users wish to ship through the terminal on a sustained basis. Of concern is that under the proposed reauthorisation proposal, it is possible (albeit highly unlikely) that spare capacity may become available in the supply chain (say if export coal demand drops), yet the QMS would remain in place until the phase 2&3 expansions of DBCT are complete or until 31 December 2010.

There may be an argument for not terminating the QMS after phases 2 and 3 of the terminal expansion are complete if the total coal chain capacity is not sufficient to meet demand for coal. The critical trigger for lifting the QMS will be when capacity exceeds sustainable throughput. In that context, the DBCT Pty Ltd application is not clear about how this is to be determined. As part of any re-authorisation the ACCC should obtain a clear and transparent definition of how DBCT Pty Ltd will determine that system capacity has reached or exceeded on a sustained monthly basis the aggregate of monthly tonnages of coal which users wish to ship through the coal terminal on a sustained basis.

Overall DITR believes that the QMS should be extended until the **earlier** of either the date that it is determined that system capacity exceeds system demand on a sustainable basis or 31 December 2010.