



Pacific National (NSW) Pty Limited, QR Limited and Port Waratah Coal Services Limited applications for authorisation [A91068-A91070] – request for interim authorisation

REASONS

DECISION

The Australian Competition and Consumer Commission (the ACCC) has decided not to grant interim authorisation at this time in respect of the applications for authorisation lodged by Pacific National (NSW) Limited, QR Limited and Port Waratah Coal Services Limited (the Applicants) on 16 November 2007.

BACKGROUND

The Applicants are seeking authorisation for a proposed Vessel Queue Management System (VQMS) to address the imbalance between the demand for coal haulage and coal loading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain in 2008.

The proposed VQMS is intended to replace the Medium Term Capacity Balancing System (CBS) currently operating at the Port of Newcastle which is due to expire on 31 December 2007. The Applicants seek authorisation of the proposed VQMS for one year from 1 January 2008 to 31 December 2008.

The rules for the operation of the proposed VQMS are detailed in the *Vessel Queue Management System Objectives, Principles and Protocols*.¹ The VQMS is proposed to operate as follows:

The capacity of the Hunter Valley coal chain would be calculated by the Hunter Valley Coal Chain Logistics Team (HVCCLT).

- The forecast coal chain demand is determined by reference to the lesser of each coal producer's port or rail contracted volumes (that is, the lesser of the sum of an individual producer's contracted volumes with rail providers or that producer's demand nomination at the port). It is proposed that an independent party will collate this information.

The annual coal chain capacity is initially allocated to each rail provider on a monthly basis. An Administration Panel, consisting of one representative from each of the Applicants, will determine each rail provider's share of available capacity on a pro rata basis according to the aggregate of their respective customers' contracted volumes.

¹ PN, QR and PWCS applications for authorisation lodged on 16 November 2007, Attachment G.

- The rail providers then determine their respective customers' individual rail allocations based on their commercial haulage agreements and PWCS loads such amounts provided they are within the customers' binding port nominations.
- The proposed VQMS contains a procedure for transferring allocation between producers. In particular, producers may transfer their rail allocation to:
 - another producer with the same rail provider
 - another producer with a different rail provider or
 - another rail provider.

Rail allocation may only be transferred provided that:

- rail provider(s) do not object to the transfer (within two business days) on the grounds that the transfer may adversely impact coal chain capacity (as determined by the HVCCLT)
- there is no adverse impact on the rail allocation of other producers not party to the transfer
- the rail provider that will provide the rail haulage services in respect of the transferred rail allocation has sufficient capacity.

Under the current Medium Term CBS, producers received an allocation of coal chain capacity based on their annual demand nominations at the port. The VQMS seeks to change the way allocations are determined, from being based on producer demand nominations to one based on the lesser of port nominations and rail contracts.

The Applicants requested urgent interim authorisation of the proposed VQMS so they can commence the necessary steps to implement the proposed VQMS on 1 January 2008, following the expiry of the current Medium Term CBS.

On 11 December 2007 the Applicants wrote to the ACCC requesting it to defer its consideration of the request for interim authorisation until 31 January 2008. A copy of this letter is available from the ACCC's website (www.accc.gov.au).

The Applicants claim deferral of a decision by the ACCC would enable them to consult the industry about concerns raised in submissions from interested parties during the ACCC's consultation process. In addition, the Applicants note that legal proceedings have been instituted by certain coal producers against Pacific National. The Applicants believe that deferral of a decision by the ACCC would allow Pacific National to further engage with those producers.

Notwithstanding the Applicants' request for the ACCC to defer making a decision, the ACCC has now considered the request for interim authorisation of the proposed VQMS. Given the imminent expiry of the Medium Term CBS, the ACCC believes that the Hunter Valley coal industry will benefit from a transparent process and certainty about the ACCC's position in relation to the request for interim authorisation.

Further, the ACCC notes that it may consider the issue of interim authorisation at any time. In this regard, the ACCC would be able to reconsider the Applicants' request following its provision of further information in early 2008 as it had suggested.

THE AUTHORISATION PROCESS

The ACCC can grant immunity from the application of the competition provisions of the *Trade Practices Act 1974* (the Act) if it is satisfied that the benefit to the public from the conduct outweighs any public detriment. The ACCC conducts a public consultation process to assist it to determine whether a proposed arrangement results in a net public benefit.

INTERIM AUTHORISATION

Section 91 of the Act allows the ACCC to grant interim authorisation without making a decision on the merits of the application.

The ACCC will only grant interim authorisation in appropriate circumstances. In many circumstances it is not appropriate to do so because interim authorisation allows an applicant, for a limited period, to engage in conduct before the ACCC has been able to fully assess whether the conduct satisfies the authorisation test.

Some of the key factors typically taken into account by the ACCC when assessing an application for interim authorisation include:

The urgency of the need for interim authorisation.

- Whether, on a preliminary consideration, the arrangements involve highly anti-competitive arrangements.
- The extent to which the relevant market will change if interim authorisation is granted. Interim authorisation is more likely to be granted when it will maintain the market status quo. Interim authorisation is unlikely to be granted if doing so would permanently alter the competitive dynamics of the market or inhibit the market from returning to its pre-interim state if final authorisation is later denied.

The possible harm, if any, to the applicant if a grant of interim authorisation is denied.

- The possible harm to other parties (such as customers and competitors) if a request for interim authorisation is granted or denied.
- Any possible benefit or detriment to the public that the ACCC could assess at the time of considering the request for interim authorisation. However, the ACCC is not required to determine whether the relevant conduct would satisfy the authorisation test.

CONSULTATION

Upon receipt of the authorisation application on Friday 16 November 2007, the ACCC undertook interested party consultation on an urgent basis in order to consider the request for interim authorisation. The ACCC received public submissions from a number of producers, the Australian Rail Track Corporation, prospective new rail providers in the Hunter Valley and others. While certain interested parties support the grant of interim, a number of parties have raised significant concerns with the ACCC.

Copies of public submission are available on the ACCC's website (www.accc.gov.au).

REASONS FOR DECISION

Urgency

At the time of lodging the application for authorisation, the Applicants noted that the authorisation for the current Medium Term CBS expires on 31 December 2007. At which time, it is possible that there will be no system in place to manage the vessel queue at the Port of Newcastle. The Applicants believe that a large vessel queue will begin to re-form. The Applicants considered that the imminent expiration of the Medium Term CBS authorisation supported a claim for urgent interim authorisation.

As mentioned previously, the Applicants have since requested the ACCC to defer its consideration of the request for interim authorisation until 31 January 2008. This would appear to discount the Applicants' claims in relation to urgency.

The ACCC accepts it is possible that absent the introduction of the VQMS from 1 January 2008, the parties will choose to not implement alternative capacity allocation arrangements leading to consequential increases in the queue and significant additional demurrage costs.

While the ACCC proposes to consider the request for interim authorisation against the counterfactual involving the absence of an allocation system and increasing queues, the ACCC notes that it has been, and is open to the parties to seek to continue the Medium Term CBS on a short term basis as a means of avoiding consequential queue increases and demurrage costs. This is a choice for industry. The ACCC notes that an application for authorisation was lodged by the Newcastle Port Corporation (NPC) on 4 December 2007² which – if granted – could assist in facilitating the continuation of the Medium Term CBS beyond 2007, should industry participants choose to do so. The ACCC received a second application for authorisation effectively seeking to extend the operation of the Medium Term CBS from Donaldson Coal Pty Limited (Donaldson) on 7 December 2007.³ The ACCC is giving both applications urgent consideration.

The ACCC notes that the Newcastle Port Corporation cannot say at this time that it will consent to the VQMS. Further, the ACCC understands that the NSW Government considers that introduction of the VQMS will result in a breach of the lease that PWCS has with it that requires it to provide open access to the terminal.

Industry has long known that the current Medium Term CBS will expire at the end of 2007. The ACCC acknowledges that during the year the Producer Working Group tried to develop an agreed solution to manage ongoing capacity constraints in 2008 and beyond. In the absence of reaching an agreed outcome, the proposed VQMS was developed by the Applicants.

² Applications for authorisation (A91072-A91074) lodged by Newcastle Port Corporation on 4 December 2007.

³ Applications for authorisation (A91075-A91077) lodged by Donaldson Coal Pty Ltd on 7 December 2007.

Nevertheless, the parties chose to lodge their application late on the afternoon of Friday, 16 November 2007.

Claimed savings

If no system is in place, the Applicants submit that the vessel queue could increase to levels in excess of 70 ships, generating an estimated \$600 million in demurrage costs at current demurrage rates for producers for the period until 31 December 2008.⁴

In this regard, the ACCC notes that queues remained at relatively high levels throughout 2007 under the Medium Term CBS. The ACCC understands that the queue is expected to reach 56 vessels by mid December 2007.

Accordingly, it appears that with or without authorisation, in the short term a large queue will exist with resultant demurrage costs. This is not to say that some demurrage savings would not arise from immediate introduction of the proposed VQMS.

Potential impact on competition

As described above, under the proposed VQMS, the full volume of available coal chain capacity for 2008 will initially be allocated to Pacific National and QR, as the current rail providers. Concerns have been expressed that the effect of the VQMS would be to 'lock in' the existing market shares of the current rail providers and producers (in terms of export volumes). This 'sharing of the market' and ongoing market co-ordination between Pacific National and QR under the proposed VQMS will reduce the level of competition between them.

While the Applicants have only sought authorisation of the proposed VQMS for 2008, concerns have been expressed that its operation in 2008 would send strong signals that a similar scheme is likely to be implemented for 2009 and possibly 2010. Further, this could encourage producers to seek to sign additional rail contracts in excess of their requirements to seek to maximise their share of export volumes through the port in future years – and that current rail providers would be able to tie up producers' future rail haulage volumes.

The ACCC has been advised that there is a real possibility of a new rail provider entering the Hunter Valley in 2008. Significant concerns have been expressed that the proposed VQMS would prevent or at the very least delay the entry of potential new rail providers to the Hunter Valley.

While the Applicants argue that the VQMS allows for reallocation of capacity in the event of a new rail entrant, it seems that this would require a reallocation of capacity from Pacific National or QR to that new entrant. Concerns have been expressed that attempts to transfer capacity could be frustrated by existing rail providers under the proposed VQMS.

⁴ Pacific National, QR and Port Waratah Coal Services supporting submission to the applications for authorisation (A91068-A91070) lodged on 16 November 2007, p38.

Degree of change to the market and possible harm to industry participants

The VQMS would involve a significant change to the way port capacity is allocated to producers. A number of producers submit that the VQMS is likely to reduce their expected export volumes for 2008.

Some producers submit that if they are forced to accept a lower allocation of capacity, they will have to decrease production levels – which may involve retrenchment of workers, potential loss of reputation with customers and in the extreme, mine closures.

Resultant changes to mine operations would be difficult and costly to reverse. If mines had to be mothballed, they may not easily be reopened. Some producers are worried that if interim authorisation is granted for the VQMS, their jobs would immediately be at risk.

If interim authorisation is not granted, a number of parties have submitted that the vessel queue is likely to increase rapidly and as a consequence, demurrage costs to producers will also rise. This issue has been addressed in the Urgency section above.

More generally, a number of producers have questioned whether allocation of constrained capacity on the basis of rail contracts is appropriate or efficient. In this regard they note the often subjective nature of rail contracts and the prospect of different interpretation leading to different allocations. Indeed the ACCC understands some producers are considering or have commenced legal proceedings over this issue. Other producers note investment and contractual decisions made in an environment where no VQMS existed and/or where the Medium Term CBS was present and consequential inequities and inefficiencies arising from an immediate introduction of the VQMS. For example, some producers are concerned that having contracted for rail capacity to match their expectation of actual port capacity allocation, their allocation for 2008 would now be subject to an additional reduction due to the use of the ‘lesser of rail or port’ methodology.

These kind of changes can impact investment decisions and the reputation of both individual producers and the Port of Newcastle as a whole. Any resultant underperformance or termination of sales contracts would result in substantial penalties to producers.

It would appear that the introduction of the VQMS could have an immediate and irreversible impact on the market and industry participants (including workers).

Conclusion

While the ACCC has not formed a concluded view with respect to the arrangements on the information currently available, a number of concerns have been raised by interested parties that the introduction of the VQMS could have immediate and permanent detrimental effects.

In particular, the ACCC notes concerns in relation to:

- impacts on competition in the provision of rail services, including the potential for the VQMS to inhibit competitive entry
- the immediate and irreversible impact on the market and industry participants including producers and workers
- uncertainty and possibly inefficient signals for investment and contracting decisions beyond 2008
- concerns as to whether allocation of constrained capacity on the basis of rail contracts is appropriate or efficient
- whether the proposed VQMS would be consistent with lease requirements.

Further, the ACCC notes the letter received from the Applicants on 11 December 2007 seeking it to defer its consideration of interim authorisation until 31 January 2008. Among other things the Applicants submit this would enable them to consult the industry about concerns raised in relation to the proposed VQMS.

Having regard to all of these matters, the ACCC does not consider it appropriate to use its discretion to grant interim authorisation at this stage.

Reconsideration of interim authorisation

The ACCC notes that, despite numerous requests, complete information such as the allocation of capacity to each producer under the proposed VQMS, has not been forthcoming from the Applicants. The Applicants have indicated that in addition to responding to the concerns of interested parties, they will seek to ensure the ACCC is provided with complete information.

The ACCC may consider the issue of interim authorisation at any time. In this regard, the ACCC would be able to reconsider the Applicants' request following its provision of further information in early 2008 as they had suggested. The ACCC's decision in relation to interim authorisation should not be taken to be indicative of whether or not final authorisation will be granted by the ACCC.

