



11th December 2007

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Mr Scott Gregson
General Manager - Adjudication Branch
Australian Competition & Consumer Commission
23 Marcus Clarke Street
CANBERRA ACT

Dear Mr Gregson

Application for Authorisation of CBS by Newcastle Port Corporation (A91072 - A91074)

We refer to the Commission's letter dated 4 December 2007 asking for public submissions on Newcastle Port Corporation's ("NPC") application for authorisation and interim authorisation of the proposed capacity balancing system ("CBS") lodged with the Commission on 4 December 2007. As the Commission is aware, Pacific National ("PN") is a joint applicant to the application for authorisation and interim authorisation of the Vessel Queue Management System ("VQMS") (A91068 - A91070).

PN considers the VQMS to be superior to the CBS the subject of the NPC authorisation application, in terms of the public benefit which forms the basis of the Commission's consideration of the authorisation application.

The reasons for this are set out in detail in the submission in support of the VQMS authorisation application. In this letter, PN wishes to highlight three principal reasons why VQMS would deliver significantly greater public benefit than CBS.

1. VQMS better manages the vessel queue

In the NPC submission in support of its CBS authorisation application, NPC identified as a public benefit of CBS that it *"ensures the vessel queue operates at a more efficient level"* (p.16).

While this statement is correct in comparison to likely vessel queues absent any capacity allocation system, the CBS would nonetheless result in vessel queues being significantly higher than under the VQMS.

As noted in the NPC submission (at p.16), as at 26 November 2007, the vessel queue at the Port of Newcastle was 40 vessels with the current CBS in place. As at 11 December 2007 the vessel queue was 54. The proposed CBS the subject of the NPC application is substantially the same as the current CBS, and as such, the current level of vessel queue can be expected to remain were the NPC application successful.

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The anticipated average vessel queue level under the CBS is significantly higher (about 30-40 vessels) than the industry generally accepted "efficient" queue of approximately 15 to 20 vessels. In contrast, the VQMS will result in a reduction of vessel queues to this efficient level.

The reason for this relates to the provision under the CBS and use by producers of tonnage flexibility, along with allocation usage being based upon arriving vessels rather than coal delivered to the port for loading. Currently, the CBS provides for tonnage flexibility of 180,000 tonnes for each producer which equates to around 2.5mt in aggregate for all producers. This flexibility allows a producer to bring allocation forward or push it back into the next period. This has resulted in frequent spiking of the vessel queue at the beginning or end of each period corresponding to increased demand.

The CBS proposed by NPC would continue the use of tonnage flexibility and as such, the spiking of the vessel queue, can be expected to continue.

Under VQMS however, there are no "flex" provisions. Rather, allocations are made on a monthly "use it, trade it or lose it" basis on the basis of coal delivered to the port for loading. The inability to arbitrarily "shift" capacity between periods without reference to available coal chain capacity, together with the allocation of capacity on a monthly rather than a quarterly basis, will "smooth" demand throughout the year, thereby, reducing the spikes in demand and vessel queues. This would ensure that vessel queues remained at the efficient level of 15 to 20 vessels rather than the current 40 vessels.

On a conservative basis, the cost savings of this potential comparable reduction of the vessel queue would be approximately AUD\$240m over 2008.

2. **VQMS ensures greater supply chain system utilisation**

The HVCCLT has indicated that total coal chain capacity for 2008 will be 95mt.

It is more likely that the total supply chain system capacity will be fully utilised under the VQMS compared with the CBS.

Under the CBS, no account is taken in the allocation of port capacity, of distances from mine to port and other upstream system capacity constraints. Capacity is allocated on the basis of binding port nominations only. This has meant that rail haulage has become largely responsive to port directions as to vessel arrivals and stockpile availability, without regard to rail operational efficiency and actual haulage costs.

This situation is further exacerbated under the CBS by the practice of producers "bunching" vessels in the queue towards the start or end of the period to use up allocated capacity. By doing so, the rail providers, on instruction from the port, redeploy rolling stock from other parts of the network to haul coal for that producer in order to meet the grouped vessels at the port. This "crowding" of rolling stock in a particular part of the network has an operational efficiency cost in that it may "clog" that part of the network which will have operational efficiency ramifications elsewhere in the network.

For these reasons, it is less likely that the total system capacity will be fully utilised under the CBS.

In contrast, as the VQMS allocates overall system (rather than just port) capacity with reference to rail contracts, rail providers are better able to manage rail haulage demands proactively rather than purely in response to port directions as to vessel queues and stockpile availability. This enables rail providers to better manage rail operations by taking into account total rolling stock utilisation and efficiency.

In addition, the smoothing out of demand under the VQMS through the monthly "use it, trade it or lose it" allocations, will result in more efficient utilisation of the network as network capacity will not be "clogged" through periodic rail demand spikes. Also, the need for spare system capacity to accommodate demand spikes will be minimised under the VQMS.

For these reasons, VQMS is more likely to result in maximum system utilisation compared with CBS.

3. **VQMS improves incentives to invest**

In its submission, NPC notes as a public benefit that the CBS *"increases incentives for coal producers to invest in the Hunter Valley coal production and handling facilities"* (p.16).

Arguably however, the more crucial issue, is that of improving incentives to invest for the port, rail and track infrastructure service providers so as to address for the longer term, the issue of system demand exceeding supply.

The CBS does not provide effective incentives for the infrastructure service providers, particularly rail providers, to invest in new capacity. This is because (as discussed above), rail haulage under the CBS has become responsive to dispatch orders from the port which reflect vessel arrivals and stockpile availability. This has resulted in an erosion of the perceived need by some producers for rail contracts that accurately reflect and commercially accommodate required demand for rail haulage.

Investment in rolling stock is significant and rail providers require a reasonable level of underlying customer contracts to support that investment. Under the CBS, the preparedness of producers to enter into "foundation" type haulage contracts to support new investment by rail providers has diminished. In such circumstances, timely investment in rolling stock is less likely to occur.

In contrast, under the VQMS, what is allocated is system capacity rather than rail or port capacity in isolation. Going forward, infrastructure service providers envisage contracts reflecting the provision of system capacity, rather than just rail/port or track component parts. This will give both producers and infrastructure service providers greater certainty that the capacity the subject of contracts will in fact be delivered and paid for. With firm and certain contracts more likely to follow from a whole of system capacity allocation system such as VQMS, the incentives to invest in infrastructure will also be improved.

For these principal reasons, PN submits that the public benefits arising from VQMS would be significantly greater than under the proposed CBS.

If you would like to discuss this submission further, please do not hesitate to contact me.

Yours sincerely



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