



SUBMISSION MAY 2007

Port Waratah Coal Services Limited ('PWCS') Medium Term Capacity Balancing System ('CBS')

1. Introduction

This submission responds to:

- ξ the draft determination of the ACCC dated 4 April 2007;
- ξ the submission from the CFMEU to the ACCC dated 20 April 2007; and
- ξ provides a brief update of matters for the ACCC since the original submission was lodged.

2. Background - why was the CBS re-introduced

Hunter Valley Coal Producers have been operating under allocation systems since 2004 due to capacity constraints in the Coal Chain. During this time PWCS, other logistics providers and the Hunter Valley Coal Chain Logistics Team ('HVCCLT') have kept the industry informed of their future expansion plans and timing. Significant capacity increases arising from major infrastructure investment takes years to complete.

Current and future estimates of Coal Chain capacity have not significantly deviated from earlier announcements.

In September 2006, HVCCLT published its declared Coal Chain capacity for 2007 in the order of 90 Mt, prior to Producers voting on whether to continue the CBS into 2007. At present, PWCS' capacity is in the order of 102 Mtpa, which is above the overall capacity of the Coal Chain.

PWCS had also published the existing demand nominations submitted by Producers for 2007 totalling 118 Mt and advised that they substantially exceeded planned Coal Chain capacity.

Following the Producer vote to remove the CBS in September 2006, Producers were given the opportunity to revise down their existing demand nominations. The revised demand nominations totalled 106 Mt and still exceeded Coal Chain capacity (90 Mt) in 2007 by more than 15 million tonnes.

Due to continued high demand in late 2006 and early 2007, vessel queues reformed at unprecedented levels. With overwhelming support from Hunter Valley Coal Producers, PWCS sought authorisation from the ACCC to have the CBS reinstated only for the period to the end of 2007.

3. Response to submissions

No impact of the CBS on overall throughput

Certain submissions have a factual misapprehension when claiming that the CBS reduces coal throughput and therefore overall employment. The CBS does not affect the overall amount of coal that is actually exported through the Port of Newcastle. The Coal Chain will continue to operate at full capacity so that coal exports can be maximised during the year.

What the CBS seeks to do is match vessel arrivals to the capacity of the Coal Chain, so that overall capacity can be fully utilised but without excessive vessel queuing. Vessel queuing results in substantial cost to the industry (which flows to employment¹), including demurrage which is currently estimated at more than \$1 million per day.

When Operational Allowance adjustments are applied to the loading allocations of Producers, it is intended to reduce vessel queuing by limiting further vessel arrivals for a period of time. Overall Coal Chain capacity and throughput are not reduced.

It is also noted that the PWCS facility is designed to operate as a cargo assembly Port. This means that coal is delivered to PWCS and assembled into cargoes just in time for the vessels to load. PWCS does not have stockpile capacity to enable coal to be stored at the Port on a longer term basis.

On a "with or without basis", if the CBS was not in place for 2007, the Coal Chain would not be able to move any more coal. The CBS in no way affects or reduces the capacity of the train, track or port infrastructure. Rather, the CBS provides a proportionate allocation of the available capacity to each Producer against which vessel arrivals can be co-ordinated with greater certainty. Without the CBS, vessel queues and wait times would be even longer with Producers seeking to maximise individual sales by maintaining their respective individual production levels in excess of the overall Coal Chain capacity.

¹ In previous submissions PWCS has noted that the reduction in deadweight demurrage payments is a public benefit as money spent on these costs for vessels to remain idle is otherwise spent on productive uses including employment generating commercial activities in Australia.

Equality of pro-rata reductions to loading allocations and impact on Small vs Large Producers

Under the CBS, both Large and Small Producers receive equal pro-rata reductions and have the same tonnage flexibility. For 2007, the initial pro-rata reduction applied to each Producer's demand nomination for the year was increased to 18%, as compared to the pro-rata reductions of 13% in 2006. The increased pro-rata reduction from 13% to 18% is in response to new and expanding mines coming on line and requiring access to Port capacity, as well as the impact of increases in individual Producer's demand nominations as a result of greater projected export sales for 2007.

Whilst the reductions are applied to Producers' demand nominations on a pro-rata basis, the actual tonnage reduction is greater on the Large Producers than Small Producers because of their proportionate size. In addition, the impact on existing Producers that are not expanding is also greater as these Producers make way for new and expanding mines. This has resulted in some Producers having less loading allocation in 2007 compared to their actual performance in 2006.

One submission suggests that the CBS acts unfairly on Small Producers. This is not the case. The tonnage flexibility represents a greater proportion of the loading allocations of Small Producers when compared to the loading allocations of Large Producers. This particularly assists Small Producers in the transition back to a CBS, as the likely impact of any demand fluctuations will be lessened by the flexibility amounts taking up a greater proportion of Small Producers' loading allocations.

Small Producers continue to operate on a quarterly allocation system. Large Producers were moved to a monthly allocation system. PWCS submits that Small Producers have greater flexibility to manage vessel arrivals on a quarterly basis compared with a monthly system to which the Large Producers (BHP Billiton, Peabody Pacific, Coal & Allied (Rio Tinto) and Xstrata Coal) agreed to move.

Impact of CBS at an individual Producer level

While the overall impact of the CBS is not to reduce the amount of coal actually exported as this is determined by the overall Coal Chain capacity, at an individual Producer level the CBS will crystallise the amount that an individual Producer is going to be able to export.

The crystallisation of individual Producer's loading allocation provides greater certainty to Producers in regard to matching ongoing production levels and vessel arrivals. It is also true that this provides greater certainty as to what a Producer is not likely to be able to export. As such, it facilitates decision making and provides Producers with the factual information needed for decisions regarding their production and sales for 2007. This will provide a guide for the most efficient production levels and may have implications for some Producers in terms of their workforce.

As to the timing of production decisions, PWCS is unable to comment on the production plans of specific mining operations in the Hunter Valley. However, based on Producers' activities and the historical usage of the Coal Chain for 2006 and earlier, PWCS' submits that some of the key factors for decisions regarding production and export sales for 2007 include:

- ξ Forecast demand for coal handling services in 2006 did not eventuate. Throughput for 2006 totalled 80 Mt, whilst demand nominations totalled 102 Mt and the Coal Chain delivered capacity of 85 Mt.
- ξ In 2006, significant amounts of additional loading allocation were available to Producers that wished to export more coal through transfers, conditional allocation and physical compensation (due to under use by other Producers).
- ξ Over the past few years the timing and loading allocation requirements of some new mines had been deferred and therefore reductions to existing Producers to make way for new mines did not eventuate.
- ξ Each Producer's individual belief that prior to the reinstatement of the CBS, notwithstanding the constraints across the Coal Chain, they would be able to export their required amount of coal.
- ξ Changes in domestic and export sales mix.

Accordingly, the CBS will have an effect of crystallising production plans which may lead to some Producers changing their production levels. However, as previously stated the CBS does not reduce overall export coal throughput, it just reduces demurrage by matching vessel arrivals to the capacity of the Coal Chain. The CBS provides a mechanism to proportionally share Coal Chain capacity and provides certainty to individual Producers as to the amount of their Port loading allocation.

PWCS acknowledges that employment may be impacted if individual Producers reduce their production levels. However, this is almost certainly to be the case even without a CBS given the current capacity constraints across the Coal Chain. It is also noted that while some Producers are reducing their workforce, other new entrants are adding to their workforce. PWCS submits that in any case Producers may have to reduce production as vessels wait even longer to load coal and allow stockpile capacity at mine sites to be exhausted. On a "with or without basis", without the CBS, employment would still be impacted as Producers would not be able to export more coal. Hence, the CBS does not of

itself create the employment reduction detriments which one submission suggests. The loss of coal throughput and any employment at an individual Producer level results from other bottlenecks in the Coal Chain. PWCS itself is doing all it can to facilitate coal exports.

4. Operation of the CBS 2007 to date.

With the reinstatement of the CBS, vessel queues were expected to fall to approximately 25 vessels by the end of June 2007. At the end of April 2007, there were 69 vessels queued off the Port of Newcastle. To date the use of the flexibility provisions by Producers and issues across the Coal Chain have resulted in the vessel queue remaining high.

While the CBS has not resulted in the level of anticipated reduction to the vessel queue that was hoped for at this stage, without a CBS, vessel queues would theoretically be in excess of 100 vessels at the end of April 2007 with increased demurrage costs.

Importantly, PWCS forecasts to the end of June 2007 indicate that the queue will reduce and will be in the high 30s at that time. PWCS is working closely with Producers to ensure that targeted vessel queue levels are reached, however this may not be until July 2007. PWCS estimated demurrage savings for 2007 to be in the order of A\$215 million in its submission dated 27 February 2007. As a result of the additional time taken to reduce the vessel queue, PWCS now estimates that demurrage savings for 2007 to be in the order of A\$175 million. This is still a substantial saving in deadweight costs.

5. Conclusion and clarification of certain matters relating to capacity expansion

PWCS also wishes to clarify the following facts having regard to some material put to the ACCC in one submission:

- ξ PWCS actually completed its \$170 million expansion of its facilities to a capacity of 102 Mtpa, nine months ahead of schedule. The new facilities have been fully operational since 24 March 2007.
- ξ PWCS has invested \$900 million over the last decade in expanding the capacity of its facilities.
- ξ PWCS has invested \$24 million to date in detailed studies to further expand its facilities to address future demand.
- ξ Approval of PWCS' Development Application for further expansion was announced by the State Government on 13 April 2007.

ξ PWCS continues to work with other Hunter Valley Coal Chain logistics providers to maximise Coal Chain capacity and gain commitments for complimentary capacity investment.

It is therefore not correct to suggest that PWCS has not expanded capacity at the coal loading terminal or has not itself invested in the Coal Chain. There are complex issues associated with overall Coal Chain capacity and the reasons it has not expanded.

For the current purpose of assessing the CBS under the authorisation application, PWCS believes it is important to note that the amended CBS is for a short period of time, is still anticipated to deliver substantial savings in demurrage costs to the end of 2007, and the reasons for any loss in employment or exports for individual Producers are not associated with the CBS in particular.

Port Waratah Coal Services Limited
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