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For Public Register

5 December 2008

Mr David Hatfield and Ms Jaime Martin
Adjudication Branch
Australian Competition and Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Dear Mr Hatfield and Ms Martin

Port Waratah Coal Services Limited ("PWCS") and Newcastle Coal Infrastructure Group Pty Limited ("NCIG") applications for authorisation A91110 - A91112

Xstrata Coal Pty Limited ("Xstrata") welcomes the opportunity to provide its comments to the Commission in relation to applications for authorisation A91110 - A91112 lodged by Port Waratah Coal Services Limited ("PWCS") and Newcastle Coal Infrastructure Group Pty Limited ("NCIG") on 19 November 2008 and to respond to the Commission's market enquiry letter dated 20 November 2008.

Xstrata supports the applications and proposed timetable for transition to a long term solution on the basis that substantial progress has been made by industry over the last 10 months to developing a way forward to ameliorate the need for capacity balancing systems once and for all. Subject to further discussions with the NSW Government (which via the port land lease agreements in NSW are one of the keys to enabling the necessary commercial reform to be achieved), and critical participation by ARTC to align the timing of realistic track access rights with terminal access rights, Xstrata is optimistic that progress towards a final resolution of capacity allocation is possible and should be supported with an interim authorisation of the PWCS Tonnage Allocation Stage 1.

So long as the approval for Stage 1 capacity allocation is for a defined and limited period of time, Xstrata believes that there will be no public detriment and that the support for continued development of the longer-term solution would be beneficial. In doing so, Xstrata emphasises the criticality of strict adherence to the 31 March 2009 and 30 June 2009 deadlines.

Accordingly, Xstrata strongly supports the application for interim authorisation on the basis that significant public benefits will be achieved even in the short term. Xstrata considers that, in addition to the estimated savings in demurrage, the PWCS Tonnage Allocation Stage 1 will provide a structured context in which the producers will have the incentive and ability to focus their attention to finalise the long term solution. Further, the public benefits listed in the supporting submission, including improving the international reputation of the Port of Newcastle and the Hunter Valley and certainty regarding the volume of coal which Producers may ship through the PWCS Terminal are relevant in the short term.

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In contrast, without the Stage 1 Capacity Allocation, it is expected that a substantial vessel queue will re-form off the Port of Newcastle, giving rise to those additional demurrage costs set out above. Xstrata agrees with the estimate set out in the authorisation application that the queue could reach an average of 55 vessels and peak at levels higher than this. Of greater concern is that this situation may result in an absolute breakdown of negotiations between the producers as all efforts will be focused on the immediate difficulty of obtaining access to coal loading services and dealing with the vessel queue.

Xstrata is committed to supporting the necessary terminal expansions to facilitate required port capacity. However, Xstrata has previously expressed its view that the most critical issue confronting Australia's largest export coal chains over the last five years has been the misalignment between the capacity of the coal chain as a whole, and the volume of contracts entered into across the separate elements of train, track and port. To the extent that coal exporters hold contracts to transport coal that either do not specify a tonnage obligation, or are, in aggregate, in excess of the underlying capacity of the coal chain as a whole, there will be an on-going risk of excessive off-shore vessel queues forming with resultant demurrage costs being incurred, significant lost export earnings, loss of potential earnings for NSW in the form of taxes and royalties, and a risk that future investment in coal mine development will be diverted elsewhere. Xstrata considers that, in order to resolve this misalignment, incorporation of the following three fundamental concepts should be pursued with a degree of urgency:

1. Define System Capacity: Key coal chain parameters must be agreed for the system so that producers have the ability to align separate port, track and train contracts with the capacity of the coal chain. These parameters must be based on an agreed operating mode of the system so that the level of 'interface losses' can be taken into account. Such losses reduce the nominal capacity of any individual element of the system and must be understood to avoid over-contracting and consequent queuing. Similarly, the parameters need to specify the levels of planned and unplanned capacity losses associated with maintenance and day to day operations. Xstrata encourages the service providers in every coal chain to develop and implement Interface Agreements which document the agreed operating mode(s) of the system and associated coal chain parameters, together with the resulting definition of system capacity.

   Xstrata believes that lack of a defined 'Standard Coal Chain Tonne' is the root cause of many coal chain issues and must be addressed to enable contractual alignment.

2. Introduce the definition of system capacity into the Access Undertakings and Access Agreements governing access to the port and track infrastructure to ensure that the capacity being sold by the infrastructure owners is realistically deliverable through the system as a whole.

3. Ensure that Access Protocols are established within the Access Undertakings and Access Agreements which provide certainty to all coal exporters (both existing and potential future exporters) such that:
   (a) Existing users have certainty of ongoing access to contracted system capacity;

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(b) New users have a defined process/path by which to both trigger and gain access to increased, or otherwise available, system capacity; and

(c) No new/expanding producer will gain access to system capacity at the expense of contracted existing users, and service providers invest to fulfil contracted obligations.

These three fundamental reforms, together with other important initiatives to ensure efficient consumption of available capacity, must be introduced into the commercial framework of the coal chain so as to provide the basis of a long-term sustainable solution which eliminates the need for over-riding allocation systems and other regulatory intervention. It is Xstrata's view that the long-term solution will need to include the following;

- Long-term contracts with PWCS
- Long-term contracts with NCIG
- Long-term Terminal Access Protocols
- Amendments to Kooragang Lease
- Amendments to NCIG Lease and potentially Shareholders Agreement
- Agreement between PWCS and NCIG regarding Long-term Terminal Access Protocols
- Heads of Agreement with NSW Government regarding Terminal 4 Lease
- Constitution of Terminal 4
- Terminal 4 Shareholders Agreement
- Funding Agreement between PWCS, NCIG and Terminal 4
- Joint Venture between PWCS and NCIG for Terminal 4 development stages
- Interface Agreement between ARTC and PWCS and NCIG specifying;
    - Operating modes of system
    - Capacity definition
    - Coordinated Coal Chain master-planning
- Resolution of Track Access priority so as to align individual producer's track expansion allocations with port expansion allocations
- Long-term Track Access contracts between producers and ARTC
- Agreed inclusions in the ARTC Access Undertaking required to ensure consistency with the Long-term solution.

As can be seen from above, an effective long-term solution will require producers, service providers, NSW and Federal Governments and the ACCC to actively participate in the development, approval and implementation of a sustainable solution.

To support this work progressing over the next six months, so that alignment of coal chain capacity with contracts can be achieved, Xstrata agrees that an interim form of capacity allocation is required to mitigate the risk of excess vessel queuing and to facilitate the transition to a sustainable and "whole-of-coal-chain" long term solution. In Xstrata's view, it is critical that the industry does not lose the momentum and focus which has arisen during 2008 through the Greiner Review process and subsequent discussions with the NSW Government.

It is Xstrata's view that any interim system must be as consistent with the Coal Chain Principles as possible and should establish sound commercial drivers to encourage

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alignment of contracts for train, track and port capacity with the underlying capacity of the system as a whole. Such an approach is commercially sound, provides a measure of equity in the treatment of all producers and minimises the potential for distortion as a result of the operation of the allocation system.

Xstrata notes the Coal Chain Principles (Attachment 1) that were proposed by the coal exporters in Queensland in the application for authorisation regarding Dalrymple Bay Coal Terminal (A91107 - A91109). Xstrata also supports these principles as the basis for a long-term solution in NSW, noting that many of these principles are already agreed amongst the coal exporters at Newcastle. Xstrata also draws the Commission's attention to a paper prepared by Concept Economics[1], which examines the current problems within Australian coal supply chains. The paper expands on the challenges confronting our coal chains and discusses specific mechanisms for resolution of those problems. Importantly, the solutions proposed in the Concept Economics paper align closely with the Coal Chain Principles.

Xstrata therefore supports the approach set out in PWCS' and NCIG's application which effectively enables the ACCC to revoke the authorisation if Hunter Valley producers and terminal operators do not make sufficient progress in developing, and do not meet the specified timeframe for implementing, a long term solution. The approach set out in the applications also requires that the proposed Long Term Terminal Access Protocols be acceptable to the Commission. Xstrata supports this approach which provides incentive for the coal producers to continue their co-operative approach towards addressing the issue of capacity balancing within a short period of time.

In respect of the Commission's statutory test for the authorisation, Xstrata believes this is satisfied as follows:

- The operation of the PWCS Tonnage Allocation Stage 1 means that the risk of vessel queuing in the early part of 2009 is mitigated, thereby resulting in significant public benefits.

- The defined period of time with a clear end-date and trigger for self-termination means that the PWCS Tonnage Allocation Stage 1 cannot continue to be relied upon as a substitute for a more commercially sound and permanent solution, thereby addressing the Commission's concerns that the PWCS Tonnage Allocation Stage 1 may act to inhibit a long-term solution.

- No public detriments will arise from implementing the PWCS Tonnage Allocation Stage 1 for the defined period, particularly when balanced with the prospects of a long term solution being developed within the defined timeframe. In the event that the current economic downturn reduces the requirement for capacity balancing at the Port of Newcastle, the operation of the PWCS Tonnage Allocation Stage 1 should not inhibit coal exports.

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[1] Concept Economics - *Improving the Efficiency of Australian Coal Chains. Economic Principles and Perspectives*. This paper is accessible at www.concepteconomics.com.au as well as on the Queensland Competition Authority's website at http://www.qca.org.au/ral/2009-DAU/index.php

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- The progress to date on fundamental coal chain reform and the commitment of the coal exporters in the application to table a more commercially acceptable proposal by 31 March 2008 is a significant step towards addressing this coal chain challenge permanently.

For its part, Xstrata remains committed to developing a long term solution that provides certainty for all participants (including new entrants) and contains appropriate mechanisms to facilitate necessary capacity expansions and the coordination of that expansion across the coal chain.

Xstrata notes that such a solution should enable PWCS to continue to operate as an open access facility, through which producers can transport coal but subject to long term contracts (with no compression of actual requirements). In this regard, Xstrata supports the views previously expressed by the Commission that the common use arrangements at PWCS potentially restrict the ability of PWCS to enter into long term contracts with producers that seek to guarantee those producers' access to capacity and provide the certainty required for ongoing investment. Producers have indicated that they are unwilling to assume the risk of entering into long term contracts with an open ended compression impact resulting in their access to terminal capacity being continually diluted and providing no certainty to underpin investment in coal production or coal chain infrastructure.

In conclusion, Xstrata supports the applications for authorisation and interim authorisation on the above basis. Xstrata respectfully requests the Commission to reinforce the Coal Chain Principles reiterated above and the need for 'whole of coal chain' contractual reform to ensure that coal exporters can quickly move to a position whereby they can rely on their commercial contracts as a reliable mechanism to provide certainty of export volumes in future years.

Xstrata, both individually and through its representation on the Producers' Steering Committee, is committed to actively pursuing the implementation of the long term solution within the timeframes specified in PWCS' and NCIG's application to the Commission.

If the Commission has any further questions, Xstrata would be pleased to assist.

Yours sincerely

Stephen Bridger
General Manager Commercial
Xstrata Coal

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***Attachment 1:* Principles for Sustainable Operation of multi-owner, multi-user Coal Chains**

Objective:

To maximise the value of coal export industry by creating a commercial framework to provide certainty of access to coal chain capacity such that:

- Existing mines can rely on their contracted access to system capacity
- New/expanding mines have certainty of being able to contractually trigger and access increased coal chain capacity to meet future demand with reasonable notice

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Principles:

Access to capacity is based on contracts for system capacity

1. Service providers must only contract for the provision of deliverable system capacity (not standalone capacity)
2. Producers and service providers will subscribe to a common view of system capacity based on a comprehensive coal chain capacity model and standardised set of underlying assumptions (Reference Tonne) that allows for all interfaces and operating modes of the system etc
3. Each producer's access to capacity is based on contractual entitlement to each of train, track and port system capacity, with the contract for Reference Tonnes for track and port determining their entitlement to system capacity
4. Contracts for access to capacity will include Access Protocols which provide that:
    a. Existing users have surety of ongoing access to contracted system capacity
    b. New users have a defined process/path by which to gain access to system capacity
    c. No new/expanding producer will gain access to system capacity at the expense of contracted existing users (and service providers invest to fulfil contracted obligations)
5. Contracts for access to capacity will provide a mutual obligation:
    a. To use or pay for capacity on a long-term basis
    b. To make system capacity available consistent with contracted volumes

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Investment in infrastructure to be guided by Master Plan and triggered by contracts such that new/growing producers can access capacity with reasonable notice

6. The Master Plan will evaluate and identify the most efficient investment options (from loadpoints to port to system rules) for increasing coal chain capacity from a cost and risk perspective
7. Capital investments in new infrastructure:
    a. Must be guided by the Master Plan for the coal chain
    b. In the case of track and port infrastructure, must be compulsory where a commercial level of underwriting is offered via long-term take or pay contracts and agreed investment triggers are satisfied

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Contracts must provide commercial incentives for efficient planning, execution and consumption of coal chain capacity

8. The commercial framework must:
    a. Ensure each producer and service provider is held accountable for their consumption of coal chain capacity
    b. Provide for capacity to be traded and swapped between participants within the physical constraints of the system and without affecting any organisation not party to the trade
9. The coal chain is to be planned and operated as a system with an independent coal chain planning and live run coordinating body

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Transitions arrangements must be fair and equitable

10. Transition during implementation of the above principles will include equitable treatment of all producers subject to contractual entitlements to capacity and consistent with the above principles

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Xstrata is committed to supporting the necessary terminal expansions to facilitate required port capacity. However, Xstrata has previously expressed its view that the most critical issue confronting Australia's largest export coal chains over the last five years has been the misalignment between the capacity of the coal chain as a whole, and the volume of contracts entered into across the separate elements of train, track and port. To the extent that coal exporters hold contracts to transport coal that either do not specify a tonnage obligation, or are, in aggregate, in excess of the underlying capacity of the coal chain as a whole, there will be an on-going risk of excessive off-shore vessel queues forming with resultant demurrage costs being incurred, significant lost export earnings, loss of potential earnings for NSW in the form of taxes and royalties, and a risk that future investment in coal mine development will be diverted elsewhere. Xstrata considers that, in order to resolve this misalignment, incorporation of the following three fundamental concepts should be pursued with a degree of urgency:

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3. Ensure that Access Protocols are established within the Access Undertakings and Access Agreements which provide certainty to all coal exporters (both existing and potential future exporters) such that:

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These three fundamental reforms, together with other important initiatives to ensure efficient consumption of available capacity, must be introduced into the commercial framework of the coal chain so as to provide the basis of a long-term sustainable solution which eliminates the need for over-riding allocation systems and other regulatory intervention. It is Xstrata's view that the long-term solution will need to include the following;

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- Interface Agreement between ARTC and PWCS and NCIG specifying;
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As can be seen from above, an effective long-term solution will require producers, service providers, NSW and Federal Governments and the ACCC to actively participate in the development, approval and implementation of a sustainable solution.

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It is Xstrata's view that any interim system must be as consistent with the Coal Chain Principles as possible and should establish sound commercial drivers to encourage alignment of contracts for train, track and port capacity with the underlying capacity of the system as a whole. Such an approach is commercially sound, provides a measure of equity in the treatment of all producers and minimises the potential for distortion as a result of the operation of the allocation system.

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- The defined period of time with a clear end-date and trigger for self-termination means that the PWCS Tonnage Allocation Stage 1 cannot continue to be relied upon as a substitute for a more commercially sound and permanent solution, thereby addressing the Commission's concerns that the PWCS Tonnage Allocation Stage 1 may act to inhibit a long-term solution.

- No public detriments will arise from implementing the PWCS Tonnage Allocation Stage 1 for the defined period, particularly when balanced with the prospects of a long term solution being developed within the defined timeframe. In the event that the current economic downturn reduces the requirement for capacity balancing at the Port of Newcastle, the operation of the PWCS Tonnage Allocation Stage 1 should not inhibit coal exports.

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[1] Concept Economics - *Improving the Efficiency of Australian Coal Chains: Economic Principles and Perspectives.* This paper is accessible at www.concepteconomics.com.au as well as on the Queensland Competition Authority's website at http://www.qca.org.au/rail/2009-DAU/index.php

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In conclusion, Xstrata supports the applications for authorisation and interim authorisation on the above basis. Xstrata respectfully requests the Commission to reinforce the Coal Chain Principles reiterated above and the need for 'whole of coal chain' contractual reform to ensure that coal exporters can quickly move to a position whereby they can rely on their commercial contracts as a reliable mechanism to provide certainty of export volumes in future years.

Xstrata, both individually and through its representation on the Producers' Steering Committee, is committed to actively pursuing the implementation of the long term solution within the timeframes specified in PWCS' and NCIG's application to the Commission.

If the Commission has any further questions, Xstrata would be pleased to assist.

Yours sincerely

Stephen Bridger
General Manager Commercial
Xstrata Coal

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Attachment 1: **Principles for Sustainable Operation of multi-owner, multi-user Coal Chains**

Objective:

To maximise the value of coal export industry by creating a commercial framework to provide certainty of access to coal chain capacity such that:

- Existing mines can rely on their contracted access to system capacity
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5. Contracts for access to capacity will provide a mutual obligation:
    a. To use or pay for capacity on a long-term basis
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Investment in infrastructure to be guided by Master Plan and triggered by contracts such that new/growing producers can access capacity with reasonable notice

6. The Master Plan will evaluate and identify the most efficient investment options (from loadpoints to port to system rules) for increasing coal chain capacity from a cost and risk perspective
7. Capital investments in new infrastructure:
    a. Must be guided by the Master Plan for the coal chain
    b. In the case of track and port infrastructure, must be compulsory where a commercial level of underwriting is offered via long-term take or pay contracts and agreed investment triggers are satisfied

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Contracts must provide commercial incentives for efficient planning, execution and consumption of coal chain capacity

8. The commercial framework must:
    a. Ensure each producer and service provider is held accountable for their consumption of coal chain capacity
    b. Provide for capacity to be traded and swapped between participants within the physical constraints of the system and without affecting any organisation not party to the trade
9. The coal chain is to be planned and operated as a system with an independent coal chain planning and live run coordinating body

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Transitions arrangements must be fair and equitable

10. Transition during implementation of the above principles will include equitable treatment of all producers subject to contractual entitlements to capacity and consistent with the above principles