



07 December 2008

Dr Richard Chadwick
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

By email: adjudication@accc.gov.au

Dear Dr Chadwick,

**Application for Authorisation A91110 -- A91112:
PWCS & NCIG - Hunter Valley Coal Chain**

Asciano welcomes the opportunity to comment on the application for authorisation submitted to the Australian Competition and Consumer Commission (ACCC) by Port Waratah Coal Services Limited (PWCS) and Newcastle Coal Infrastructure Group (NCIG).

This submission is made with respect to both the interim and substantive authorisation being sought by the applicants. The submission is intended to be a public document and contains no information over which Asciano wishes to claim confidentiality.

As a significant service provider in the Hunter Valley coal chain, Asciano, through its train operator, Pacific National, will be significantly affected by the ACCC's decision. Asciano's views, as explained in some detail in our submission, are based on experience over a long period of involvement in the Hunter Valley and as a key participant in the attempts to reform the way in which the coal chain works in recent years. It is Asciano's view that the most critical issue for consideration by the ACCC is whether the achievement of a long term solution for the coal chain will be assisted or hindered by the granting of the proposed authorisation. Notwithstanding any benefits that might arise in the short term for some parties, Asciano believes that the granting of both the interim and substantive authorisations will hinder the timely finalisation of the long term solution and therefore the ACCC should decline the request for authorisation.

If you require any additional information about the matters raised in this submission, please contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "David Irwin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

David Irwin
Divisional General Manager - Coal



Submission To The ACCC

Application for Authorisation

A91110 – A91112:

**PWCS & NCIG – Hunter Valley Coal
Chain Tonnage Allocation Stage 1**

December 2008

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1 EXECUTIVE SUMMARY

The applicants are seeking approval for:

- an interim authorisation;¹
- the Tonnage Allocation Stage 1 (Stage 1 Allocation); and
- any Long Term Solution (LTS) arising from current negotiations between stakeholders.²

The application for a 10 year authorisation is counter-intuitive when the details of the scheme is known only for a period of 6 months (Stage 1 Allocation) and unknown for the remaining period (the LTS).

In respect of the Stage 1 Allocation, Asciano submits that the conditions necessary for authorisation are not met. In respect of the remaining period Asciano does not believe that the ACCC can be satisfied that the conditions for authorisation are met given there is insufficient detail available in the application to the ACCC and supporting material on what is proposed for the remaining period and that future arrangement is expressly acknowledged to be uncertain.

Substantive Authorisation

Asciano agrees with the applicants' definition of the counterfactual.

Asciano believes there are significant detriments associated with an authorisation namely:

- undermining the incentive to introduce a LTS. The availability of a mechanism that mitigates the most obvious symptom of the underlying problem, ie an excessive ship queue and the consequential demurrage cost, significantly undermines the urgency that would otherwise prevail to find a workable long term solution.
- a material reduction in the throughput of coal compared to the counterfactual, as has occurred in 2008 under the CBS.
- inhibiting investment as the lack of recognition of capacity costs will continue the current uncertainty over the ability of stakeholders to contract for a meaningful quantum of capacity.

Asciano disagrees with many of the claimed public benefits flowing from the authorisation. The majority of the claimed benefits relate to the LTS (if certain assumptions about its terms are made) and not to the Stage 1 Allocation. Of the remaining benefits, only the reduction in demurrage appears to be both significant and directly as a consequence of the authorisation. The quantum of the benefit claimed appears inflated and requires careful scrutiny.

Asciano has in the past been prepared to operate outside the terms of its contractual arrangements with customers in order to try and accommodate the Capacity Balancing System (CBS). This has resulted in significant disadvantage to Asciano. It is not feasible for Asciano to absorb the operational constraints applied by the adoption of a CBS with the resulting financial detriment to Asciano. In its consideration of this authorisation, it would be inappropriate for the ACCC to assume that Asciano will continue to modify its operations to conform with a ship queue management system to its own disadvantage. The proper

¹ PWCS and NCIG, "Submission in support of the application for authorisation under sections 88(1) and 88(7) of the *Trade Practices Act 1974* (Cth)", 19 November 2008, pp 5

² Ibid p 1

assumption for the ACCC is that the contracts which Asciano has with its customers will apply according to their terms.

The application fails to address the fundamental issues facing the HVCC and, in Asciano's opinion, will hinder rather than assist in the timely achievement of the LTS. Accordingly Asciano believes that the ACCC should not grant the requested authorisation.

Interim authorisation

Asciano is of the view that an interim authorisation:

- is not urgent;
- will not impose any significant detriment if not granted;
- will result in greater public detriment than benefit if granted; and
- neither the granting nor failure to grant the interim authorisation will result in lasting impact on the relevant markets except that the further delay in achieving the LTS will delay investment and hence future system capacity and exports.

Therefore, Asciano believes that the interim authorisation should not be granted.

Authorisation not being sought

The applicants are seeking approval for:

- an interim authorisation;³
- the Tonnage Allocation Stage 1 (Stage 1 Allocation); and
- any LTS arising from current negotiations between stakeholders.⁴

The application for a 10 year authorisation is counter-intuitive when the details of the scheme are known only for a period of 6 months (Stage 1 Allocation) and unknown for the remaining period (the LTS). Further, it is unclear on what basis the applicants believe an authorisation can be granted under such circumstances when their submission acknowledges the LTS will be subject to further approval by the ACCC.

Asciano does not believe there is sufficient detail available in the application to the ACCC to allow it to form a view as to whether or not an authorisation can be extended beyond the 6 month period set-out for the Stage 1 Allocation. In these circumstances, the conditions for authorisation are not met and the ACCC must refuse the application. Therefore, this submission is focussed to consideration of the merits of the application with regards to the Stage 1 Allocation and the interim authorisation.

³ PWCS and NCIG, "Submission in support of the application for authorisation under sections 88(1) and 88(7) of the Trade Practices Act 1974 (Cth)", 19 November 2008, pp 5

⁴ Ibid p 1

3 SUBSTANTIVE AUTHORISATION OF STAGE 1 ALLOCATION

The Stage 1 Allocation is essentially an extension of the existing Capacity Balancing System (CBS) with some additional features:

- A modified allocation mechanism, giving a modest variation from the 2008 allocation.
- A commitment to provide the ACCC with a memorandum of understanding and term sheet for the LTS (MOU) by 31 March 2009.
- Monthly progress reports to the ACCC.
- Termination after 6 months.

With the exception of the modification to the volume allocation, the new features are directed specifically towards creating a structured environment for the creation of the LTS.

The applicants have identified the counterfactual as circumstances where there will be no system in place at the Port of Newcastle to align or manage vessel arrivals.⁵ This is consistent with the ACCC's 2007 Decision and Asciano agrees that this is the appropriate alternative against which to consider the granting of the authorisation.

3.1 Public Detriment

3.1.1 Authorisation will reduce incentive to deliver a LTS

In its 2007 Decision, the ACCC made it clear that the achievement of the LTS was paramount and that it was no longer sufficient to merely claim indefinite progress towards a solution to be granted further extensions⁶.

Asciano supports the ACCC's view that, while it is important to reduce wastage in the form of excess demurrage, it is no longer appropriate to support temporary solutions that do not lead directly and with reasonable certainty to the achievement of a LTS. It is important to recognise that although the authorisation for Stage I is for six months the applicants envisage extensions might be granted by the ACCC:

"Accordingly, the purpose of the reporting arrangement is to ensure a clear incentive to finalise a long term solution (i.e. without taking pressure off all industry stakeholders), but at the same time provide an ability for the Terminal Operators consulting with the ACCC to extend this timeframe if the industry cannot meet the proposed timetable due to factors genuinely outside its control."⁷

The applicants also envisage that the deadline for the delivery of the MOU might be extended: "If, having regard to this matter, the Terminal Operators are not reasonably able to submit the MOU to the ACCC on or before 31 March 2009, it is intended that the ACCC and the Terminal Operators would work together (both acting reasonably and in good faith) to determine any later date that should apply"⁸

Asciano's believes the availability of a mechanism that mitigates the most obvious symptom of the underlying problem, ie an excessive ship queue and the consequential demurrage cost, significantly undermines the urgency that would otherwise prevail amongst a number of

⁵ Ibid p 12

⁶ ACCC, "Determination Applications for authorization lodged by Newcastle Port Corporation and Donaldson Coal Pty Limited in respect of a capacity balancing system to address the imbalance between the demand for coal loading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain in 2008", April 2008, p iii

⁷ Ibid p 3

⁸ Ibid p 2

stakeholders to find a workable solution. This allows parties the luxury of seeking to defend or improve positions that they might otherwise be willing to compromise for the benefit of the system as a whole, or merely allows prevarication where participants believe that they are protected against the risk of inaction. Notwithstanding that such behaviour may be counter-productive in the longer term, it is an almost inevitable consequence of the mitigation of the immediately visible problem.

Asciano agrees that the achievement of a workable LTS for the Hunter Valley coal chain is fundamental to securing investment and operational efficiency into the future. From the original 2004 CBS, authorisations granted by the ACCC were in the context that industry needed time to achieve a LTS. It is not, therefore, a matter of serious debate whether there ought to be a long term solution, the debate is how this should best be achieved.

Industry has been working towards the LTS since 2004, having for the most part of that time the benefit of a queue management system. Despite this, and the more recent momentum provided by the Greiner Review, a solution is not imminent. If it was, one would reasonably expect the applicants' submission to contain meaningful details of its structure and content. Instead, the submission contains a broad set of criteria that the solution will need to conform to. Admirable though the efforts of the applicants and other stakeholders have been, this does not suggest that the authorisation being sought will necessarily have any more success than previous authorisations in generating a LTS.

As identified by the ACCC in the 2007 Decision, the cumulative effect from failing to move to a LTS will ultimately have a significantly greater cost than the immediate saving by a reduction in demurrage. However, such effects are less obvious and therefore less compelling to parties attempting to negotiate in a complex environment where, despite much alignment of interest, there is significant disparity of objectives and competition between many of the parties.

Therefore it is Asciano's view that the continuation of a temporary queue management system will continue to mask the imperative to conclude the LTS as the first priority. As such, the authorisation will reduce incentive to deliver a LTS.

3.1.2 Restricting aggregate coal exports from the Hunter Valley

Asciano believes that the authorisation is likely to result in a lower utilisation of available capacity in the HVCC than would occur under the counterfactual. The efficient operation of the HVCC depends on:

- a) aligning port, above and below rail capacity;
- b) smoothing demand as much as possible within the physical constraints, both across the physical system and over time; and
- c) making service providers and producers accountable for specific gains and/or losses in system capacity attributable to their actions.

Alignment Of Capacity

The applicants' submission claims that the authorisation (both immediately and under the LTS) will align contractual entitlements across the coal chain.⁹ Unfortunately this is an assertion that is not underpinned by any evidence or demonstration of the logical connection between the queue management system and contractual alignment. In fact, the Stage 1 Allocation will have the reverse effect (as has the CBS in its various forms). By its nature, the queue management system rations available capacity but does not do so in a manner that ties the allocation back to the declared coal chain capacity and its assumed mine by mine demand profile. This arises

⁹ Ibid pp 2-13

due to the allocation being based on tonnes delivered to port allocated to a producer, not a mine. Thus a producer's allocation has no correlation to any above or below rail capacity or the consumption of system capacity. Further uncertainty arises through the requirement to compress allocations to allow an allocation to a new entrant. It is an essential requirement of the LTS that it remedies this problem by requiring alignment of capacity commitments, but there is nothing in the authorisation application that imports that requirement into the Stage 1 Allocation.

Smoothing Demand & Accountability

The nature of the current CBS and the Stage 1 Allocation means that producers have a quota of available capacity that is deliverable within a specified period. This allocation is specified in terms of tonnes, and takes no account of the coal chain capacity consumed to deliver those tonnes to port. Hence a tonne is treated the same whether the mine is a short or long distance from the port, and without consideration of the mine, track and train infrastructure available to support the allocation. In addition, the allocation is based on the producer, not individual mines. As a result, where a producer controls several mines, there is no linkage between the resources required to deliver the allocated volume and the available capacity within the coal chain to allow that delivery. This gives rise to additional complexity in the system, losses in throughput created by inefficient use of infrastructure, and significant above rail operation inefficiency.

The Hunter Valley Coal Chain Logistics Team (HVCCLT) submission in 2007 suggested that, in relation to the then CBS, there was:

"nothing in the proposed CBS that would be likely to reduce or inhibit the ability of the coal chain to maximise coal exports during the year."¹⁰

However, more recently, the HVCCLT has recognised that the current CBS (on which the Stage 1 Allocation is modelled) does lead to system under-performance and has estimated that approx. 1.4 million tonnes will be lost in 2008 due to consumption of allocation varying from the demand profile assumed in the annual system capacity declaration. This accords with Asciano's assessment of the impact of the CBS.

This is directly contrary to the applicants' claim that:

"... as with the Medium Term CBS, the PWCS Tonnage Allocation Stage 1 and long term solution will not limit the total volume of coal actually shipped through the Port. The Coal Chain will continue to operate at its full capacity. ... The PWCS Tonnage Allocation Stage 1 does not change the amount of capacity available in the Coal Chain."

Asciano suggests that the applicants' proposition is inconsistent with the facts and that the authorisation is likely to result in a material reduction in the throughput of coal compared to the counterfactual. Based on an average price of \$US100 per tonne for Hunter Valley steaming coal, this represents \$US140m in lost export revenue – a significant portion of the claimed benefit from the reduction in demurrage costs.

3.1.2 Negative impact on operational efficiency

Since the initial CBS, Asciano has voluntarily adapted its operations to conform to the system's requirements in the belief that the expected short term loss of efficiency and certainty would be offset by the LTS. This cooperation has impacted negatively and significantly on Asciano's operational efficiency and commercial outcomes. For example, creating excessive peaking of demand for rail services in specific areas while exacerbating troughs in another. It is not

¹⁰ Hunter Valley Coal Chain Logistics Team, Submission to ACCC, March 2007, p 1

surprising that the rationing of system capacity based on one part of the system (ie the port) in isolation has sub-optimal outcomes on other system elements. Asciano's above rail operations are frequently used as a balancing element within the system. By agreeing to participate in the system Asciano is forced to accept additional costs for which there is no compensation. The lack of any "capacity cost" concept in the current queue management systems means that many of these additional costs are invisible to other system participants.

There are examples of coal haulage contracts where there is a long term commitment by a producer to rail a certain volume which then requires Asciano to provide a certain level of rollingstock, crew and other resources. However if the queue management system reduces the producers' entitlement to port capacity, the contracted volumes are not carried notwithstanding that Asciano has had the rollingstock and people available to meet the full contracted volumes.

To date Asciano has generally been willing to absorb the operational constraints applied by the operation of a CBS. However, it is not viable for Asciano to continue to do so. In its consideration of this authorisation, it would be inappropriate for the ACCC to assume that Asciano will continue to modify its operations to conform with a ship queue management system to its own disadvantage. The proper assumption for the ACCC is that the contracts which Asciano has with its customers will apply according to their terms.

3.1.4 Deterring investment in capacity expansion in the coal chain

In its 2008 Decision authorising the CBS, the ACCC identified a serious concern that the focus of the existing queue management system lacked the commercial incentives required to facilitate investment in the Hunter Valley Coal Chain:

"... the ACCC considers that the operation of the [CBS], with its focus on producer demand nominations and coal chain capacity, does not provide the appropriate commercial incentives for investment in additional coal chain capacity."¹¹

Asciano agrees with this view. The Stage 1 Allocation does not attempt to address the underlying issues required to overcome the current problems and therefore must be seen as perpetuating the short-comings of the existing CBS. A practical example of this is the lack of investment in trains to match the increased port capacity currently under construction. The current uncertainty with regard to any future contracted volumes undermines business cases and limits the investments Asciano has been able to make.

A key requirement for the LTS is that it results in the alignment of load-point, track, above rail and port capacity. While load-points are generally under the control of individual coal producers, relationships with the other participants in the coal chain are managed through contracts. It is essential that the contractual frameworks in each instance facilitate an alignment between the various components of the coal chain. The Stage 1 Allocation does not attempt to achieve any such alignment. As such, the Stage 1 Allocation fails to provide any basis to support port, above or below rail capacity expansion. Rather than facilitating investment, it inhibits investment as it will continue to apply the existing paradigm (eg compression of existing contracts), continuing the current uncertainty over the ability of stakeholders to contract for a meaningful quantum of capacity. All of the current expansion mechanisms (eg planning forums, contractual relationships) lie outside of the queue management system, but are held captive by it.

¹¹ ACCC 2008, p 32

3.2 Public Benefit

Many of the benefits included in the applicants' submission relate expressly to the LTS and are not benefits generated through the Stage 1 Allocation. These include:

- Improvement to the Hunter Valley's international reputation;
- Increased certainty for new entrants and existing producers;
- More efficient investment; and
- Increased coal export revenue and employment.¹²

While these benefits have relevance with regards to the urgent need to implement a workable LTS, they do not advance the case for authorisation of the Stage 1 Allocation. As discussed earlier, it requires a leap of faith contrary to the evidence of the past 4 years that the authorisation will assist in the achievement of the LTS either earlier, or with a better result, than can be achieved under the counterfactual.

Therefore, while Asciano generally agrees that the benefits claimed for the LTS will arise, it would be inappropriate to consider those benefits as part of this application as they are benefits that will also just as likely (in Asciano's opinion more quickly) arise under the counterfactual.

Barring the LTS related benefits, the short term public benefits that are claimed to arise under the queue management system are:

- Incentive to reach agreement on the LTS (discussed in detriments above)
- Environmental and safety benefits relating to reduction in the numbers of ships anchored off Newcastle
- A reduction in demurrage
- Reduced stockpiling costs

3.2.1 Environmental and safety benefits

Asciano does not dispute the recommendation from the Australian Transport Safety Bureau quoted in the applicants' submission.¹³ Asciano also accepts that the queue management system does result in smaller queues than would arise under the counterfactual in the absence of the LTS. However, the size of this benefit is unclear and the applicants have provided no evidence as to its importance.

3.2.2 Reduced demurrage

The effect of the counterfactual is that an extended queue will reform and that this will incur substantial unnecessary demurrage.¹⁴

As the authorisation is only being sought for 6 months (until July 2009), the benefits that will accrue will need to be measured across that period. It is unclear from the applicants' submission that the claimed benefit from the authorisation of \$US300m¹⁵ has been correctly calculated. This appears to be an annual benefit which would necessarily be overstating the case. Further, given the increased average queue length experienced in 2008 under the revised

¹² Ibid pp 25-26

¹³ PWCS & NCIG 2008 p 23

¹⁴ Ibid p 13

¹⁵ Ibid

CBS¹⁶ and the recent reduction in demurrage rates, the claimed benefit appears high, even for an annual calculation.

Asciano accepts that the Stage 1 Allocation will result in a reduction in demurrage charges but questions the amount claimed and the significance of the benefit compared to the direct revenues foregone from the loss of throughput and from the delay in achieving the LTS.

2.2.4 Realising Shipping Costs

Asciano accepts that benefits will arise through the reduction in logistics costs once a workable LTS is in place. However, Asciano is sceptical that the Stage 1 Allocation gives rise to this benefit. It is unclear from the applicants' submission¹⁷ how the claimed certainty of shipments will arise nor have the applicants quantified what this benefit might be. In the absence of such evidence, Asciano suggests that the benefit, if it does exist, will not be material.

2.3 Balance of Public Benefit & Detriment

Given the foregoing, Asciano believes that there are specific demonstrable public detriments arising from the authorisation. While there are some public benefits, most notably the reduction in demurrage charges, most of these are either not relevant to the Stage 1 Allocation or are of uncertain merit.

Asciano believes that the public detriment that would arise from the granting of the authorisation significantly outweighs the public benefit and therefore the authorisation should not be granted.

6 INTERIM AUTHORISATION

The basis of the submission for the granting of an interim authorisation is that this is necessary to prevent the formation of extended ship queues:

“There is an urgent need for a system to limit vessel arrivals to Coal Chain capacity and manage the queue to be in place on 1 January 2009 when the existing CBS expires. The key contributor to the vessel queue problem that existed prior to the CBS being implemented was the mis-match between demand and Coal Chain capacity.”¹⁸

In turn, the primary impact associated with such a queue identified in the applicants' submission is the cost of excessive demurrage.¹⁹ While the applicants' submission identifies other benefits from the longer term solution, these have not been argued in Section 6 of their submission which deals specifically with the interim authorisation.

Asciano supports the ACCC's view²⁰ that, while it is important to reduce wastage in the form of excess demurrage, it is no longer appropriate to support temporary solutions that do not lead directly and with reasonable certainty to the achievement of a LTS.

The urgency to grant an interim authorisation rests on the need to implement the Stage 1 Allocation from 1 January 2009 to allow continuance of the current CBS. Therefore the need

¹⁶ Ibid p 7 – the graph shows that the average ship queue during 2008 after the reintroduction of the CBS is longer on average than the queue between 2004 – 06 when the previous versions of the CBS applied.

¹⁷ PWCS & NCIG p 25

¹⁸ PWCS & NCIG, 2008, p 27

¹⁹ Ibid, p 28

²⁰ ACCC 2008, p iii

for the interim authorisation is directly connected to the merits of the case for granting the substantive authorisation.

If, as Asciano has argued above, it is not appropriate to grant substantive authorisation for the Stage 1 Allocation, then there is no obvious urgency to grant the interim authorisation, the effect on the queue will merely commence earlier and HVCC participants will have good reason to urgently redouble their efforts to agree the LTS. On the other hand, if the solution is in fact close, the detriment from an extension of the queue will be correspondingly modest and therefore it would be difficult to argue that the retention of the CBS through an interim authorisation is urgent. Thus Asciano would argue that the interim authorisation only makes sense if one accepts that the LTS is still a long way off, and the substantive authorisation is the best way to achieve the LTS.

Neither the grant, nor failure to grant, an interim authorisation will have any lasting impact on the market. As the key feature of the interim authorisation is its effect on the ship queue, there is unlikely to be any irreversible effect on matters such as investment, the on-going rights of any party, or the structure or competitiveness of the markets in which the various stakeholders participate within the Hunter Valley coal chain.

Based on the above discussion, Asciano is of the view that interim authorisation:

- is not urgent;
- will not impose any significant detriment if not granted;
- will result in greater public detriment than benefit if granted; and
- neither the granting nor failure to grant the interim authorisation will result in lasting impact on the relevant markets except that the further delay in achieving the LTS will delay investment and hence future system capacity.

Therefore, Asciano believes that the interim authorisation should not be granted.