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Mr David Hatfield
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Dear Mr Hatfield

Newcastle Port Authority (NPC) Application for Authorisation A91072-A91074; Donaldson Coal Applications for Authorisation A91075-A91077; Response to ACCC's draft determination

1. Pacific National (PN) welcomes the invitation to provide a written submission in response to the Commission's Draft Determination to grant authorisation to the applications made by NPC and Donaldson Coal for authorisation of a proposed 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 (**Proposed System**).
2. In all the circumstances, PN does not disagree with the Commission's proposal to grant authorisation of the Proposed System. However, there are additional factors PN considers that the Commission should have regard to before publishing a final determination.

Executive Summary

3. PN agrees with the Commission's assessment that the detriments associated with the CBS are likely to increase the longer it continues to operate at the Port of Newcastle and it is imperative that an agreed solution is reached (6.75 of the Draft Determination). PN considers that there are two factors relevant to the detriments which are not given sufficient weight in the Commission's Draft Determination. They are:
 - (a) the reduction in commercial incentives to invest in the Hunter Valley Coal chain; and
 - (b) the likelihood that the Proposed System will result in under utilisation of total system capacity in the Hunter Valley Coal Chain.
4. In response to paragraph 6.37 of the Draft Determination, PN submits that the Proposed System is likely to reduce commercial incentives to invest in the Hunter Valley Coal Chain. This is because the Proposed System:
 - (a) ignores the need for contracted capacity under track, rail and port contracts to be aligned so as to support efficient Coal Chain operation and to foster incentives for investment;
 - (b) does not provide a clear commercial incentive for coal producers to improve efficiency over parts of the system within their control; and

- (c) may not send the appropriate incentive signals or be sufficiently transparent for above and below rail capacity expansion.

In response to paragraph 6.25 of the Draft Determination, PN submits that the Proposed System is not likely to maximise throughput of the Hunter Valley Coal Chain. The efficient operation of the Hunter Valley Coal Chain depends on:

- (a) aligning port and 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 losses in system capacity attributable to them.

Set out below are PN's detailed comments on these factors.

Investment Incentives

- 6. A reduction in the incentives to make efficient and timely investment in Coal Chain capacity is a significant detriment. PN submits that the Commission's Draft Determination does not give adequate weight to this detriment.

Rail contracts provide PN with critical signals and information as to genuine system demand and forecast demand. This is reduced or distorted under the Proposed System. Such information concerns demand, volumes and origin for haulage services; the cost profiles and service obligations of its customers; as well as where additional investment is either needed or would be most efficiently deployed. A combination of a lack of quality information and reduction or distortion in demand and investment signals has a detrimental impact on PN's investment incentives and ability to commercially justify any such investment.

- 8. Producers' incentives to enter into contracts reflective of their actual rail capacity demand are reduced under the Proposed System, as has been demonstrated historically. As a result, under the Proposed System rail haulage effectively responds to dispatch orders from the port. Similarly, the absence of firm contracts between rail operators and new or expanding producers means that there is no support by new or expanding producers for investments required by rail providers to increase system capacity. Consistent with past experience such producers may rely instead on the Proposed System to give them default access to rail capacity due to the absence of real alternatives for the rail operators.
- 9. This potential for erosion of the perceived need by producers for rail contracts that accurately reflect and commercially accommodate required demand for rail haulage and a reduction in the willingness of producers to enter into "foundation" type haulage contracts to support new investment by rail providers results in reduced investment opportunities and incentives. In particular, this compromises PN's ability to invest in a timely manner. Investment in rolling stock is significant and rail providers such as PN require a reasonable level of underlying customer contracts to support that investment.
- 10. Finally, the Proposed System will force PN to operate its business in a reactive and inefficient manner for it and in an inefficient manner in terms of rail system and total system capacity, due to the focus on turn of arrival and consumption of allocation at the port. The Proposed System does not take into account the different impact hauling each coal producer's coal has on overall system capacity (e.g. due to location and distance). Inefficient deployment of rolling stock also reduces PN's incentives to make investments in additional Coal Chain capacity.

System Capacity

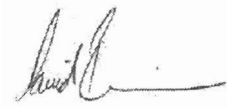
11. The Proposed System is likely to result in total system capacity being under-utilised due to system components being deployed in a suboptimal manner. PN submits that this detriment has not been given sufficient weight by the Commission in its Draft Determination.
12. The lack of alignment between contracted capacity under track, rail and port contracts is an ongoing and significant cause of reduced system capacity and vessel queuing. The Proposed System results in a mis-match between port and system demand by:
 - (a) allocating system capacity on the basis of port (rather than system) demand; and
 - (b) failing to provide any incentive for producers to align contracted rail and port capacity (component capacity) with system capacity.
13. This mismatch is suboptimal because system capacity is lower than the capacity of each individual component and therefore system capacity will be allocated on the basis of port demand in excess of actual system demand. In addition, in times of high demand and constrained system capacity, capacity for each component is likely to be over contracted (i.e. contracted in excess of system capacity). This has the effect of undermining contracts with service providers (as not all contracted volumes can be moved through the system), reinforcing the detriment discussed above.
14. A solution that ignores PN's existing contracts means that PN lacks information concerning demand, volumes and origin for its haulage services and cannot run trains in the most efficient manner with a corresponding reduction in system capacity. In addition, the Proposed System will force PN to run its trains in an inefficient manner in terms of rail system and total system capacity. In particular, PN may have to 'crowd' trains in particular parts of the system in response to instructions generated from the port. 'Peaking' of the queue is a major cause of 'crowding' rolling stock in one particular part of the system, to the detriment of system capacity as a whole. Crowding is likely to reduce overall system capacity as it effectively ignores other constraints, such as path and cycle times and is not likely to conform with contractual terms, thus further undermining commercial contracts.
15. Without a method to attribute performance losses specifically attributable to particular service providers or producers to those parties, accountability is decreased and the incentives for all participants in the system to maximise system performance and reliability also decrease. Incentives for participants in the Hunter Valley Coal Chain to invest in improvements to increase the reliability of the parts of the Hunter Valley Coal Chain within their control decrease, as there is a reduced commercial incentive for those participants to undertake that investment.
16. Finally, the Proposed System allocates large producers capacity on a monthly basis and remaining producers are allocated capacity on a quarterly basis with an overlap period. This effectively provides producers with the ability to bring forward a larger amount of allocation in each quarter, as happened in 2007 with a consequent 'peaking' of the queue.¹ As there has been no fundamental change to the Proposed System from the CBS in place in 2007, PN expects that peaking would also occur in 2008. As discussed in paragraph 14 above, peaking results in system capacity being inefficiently utilised, as well as a larger vessel queue during times when such provisions are utilised. This results in a lessening of the public benefits which would otherwise be expected to flow from the Proposed System.

¹ Producers are likely to bring forward capacity allocations from the next period in times of high demand.

Conclusion

17. PN submits that the conclusions expressed in paragraphs 6.25 and 6.37 of the Draft Determination fail to give adequate weight to the public detriments which will result from authorisation of the Proposed System. Accordingly, PN submits that the Commission's Final Determination should take into account the impact of the public detriments as outlined in this submission in determining whether to grant authorisation to the Proposed System.

Yours sincerely



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