Rio Tinto Coal Australia Pty Limited
GPO Box 391
Brisbane Queensland 4001
Australia
T +61 (0) 7 3361 4200
F +61 (0) 7 3361 4370

Mr David Hatfield
Australian Competition & Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Copy to Mr Anthony Wing
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

22 September 2009

Dear Mr Hatfield

Port Waratah Coal Services Limited (PWCS), Newcastle Coal Infrastructure Group (NCIG) and Newcastle Port Corporation (NPC) applications for authorisation A91147 – A91149 and A91168 – A91169 – interested party consultation

I refer to your letter dated 15 September 2009 concerning the request to amend the above mentioned applications for authorisation made by Port Waratah Coal Services Limited (***PWCS***), Newcastle Coal Infrastructure Group (***NCIG***) and Newcastle Port Corporation (***NPC***) (together the ***Applicants***). I also refer to my letter to you dated 8 July and telephone call on 24 July in which Coal & Allied Industries Limited (***C&A***) foreshadowed that it would wish to provide the Australian Competition and Consumer Commission (***ACCC***) with a more detailed submission concerning the substantive applications for authorisation (as now amended by the Applicants on 14 September 2009).

Summary of C&A's position

C&A is supportive of the long term goals that the Applicants are seeking to achieve in lodging their application, and supports and acknowledges the progress made by the Applicants in developing the Capacity Framework Arrangements, as reflected in the Capacity Framework Documents which C&A understands have now been executed by all the Applicants.

During the development of the long term Capacity Framework proposals, trade-offs were made which resulted in some terms that may not prove to be the best outcome for the industry. These include an obligation on PWCS to expand, regardless of the cost and financial feasibility of the outcome (which could result in significant increases in port charges which would have harsh consequences for all producers), and the decision that compression would only apply to producers whose contracted allocation exceeds 5 mtpa (as this results in an artificial and arbitrary market distortion and deters small producers from growing their operations through expansion or acquisition). However, C&A does not object to the application for authorisation on this basis, as it understands that these provisions were essential for the Applicants to arrive at an agreement on the Capacity Framework Documents.

C&A also understands that the Applicants agreed during negotiations that the New South Wales Government (either through the NPC, the Reviewer or the Minister) would have discretionary decision making authority over several key aspects of the Capacity Framework Arrangements. Although C&A is comfortable with the need to give the Government discretion on certain matters, C&A is concerned that significant harm to the industry could result if the Government does not exercise its discretion in an appropriate manner. Some of these Government discretions are described below. Also addressed below are a few additional concerns that have not been fully addressed by the Capacity Framework Documents, including contractual alignment concerns which are relevant both to this authorisation and to the ongoing ARTC process.

In summary, C&A is supportive of the Applicants' applications for authorisation. We also hope that the uncertainties that remain will be addressed appropriately as the industry solution is implemented.

C&A's concerns with certain aspects of the Capacity Framework Arrangements

On the basis of the position under the documents as C&A understands have been agreed by the Applicants, C&A remains concerned that the following aspects could potentially result in detriment to producers:

- **Common user clause:** The Implementation Memorandum signed by the Applicants contemplated the **removal** or permanent suspension of the common user clause. By contrast, the Capacity Framework Arrangements provide for the suspension only of the common user clause, with the New South Wales Government having the right to reactivate the operation of the clause if PWCS commits certain breaches of its leases. The possibility of the common user clause being reactivated creates a high level of uncertainty for all producers wanting to enter into long-term contracts, as the consequences of reactivation for producers are likely to include compression of their contracted capacity entitlements. It was the expectation of producers that in agreeing to commit to long-term contracts under the Capacity Framework Arrangements, the capacity allocated under those contracts would be certain. For as long as there is the possibility of the common user clause being reactivated, this certainty will not exist and the benefit to producers of entering into long-term contracts is undermined. C&A believes it is critical that, if the situation arises where the Government might reactivate the operation of the common user clause, it would only do so after undergoing very careful consideration of the impact such a decision would have on the industry.
- **No NCIG Stage 2 expansion commitment:** C&A understands that the final version of the Capacity Framework Documents do not oblige NCIG to maximise its Stage 2 footprint capacity prior to NCIG Producers being entitled to nominate for expansion tonnes at PWCS. Rather, the documents contemplate that NCIG may be given approval by the NPC to construct NCIG Stage 2 in more than one construction tranche, with NCIG Producers being entitled to nominate for expansion tonnes at PWCS at the time that approval is given (albeit subject to the possibility of NPC imposing limits and conditions in respect of those nominations).

  Although the PWCS Terminal Access Protocol includes a clause which clearly sets out the principle that NCIG Producers are not entitled to access expansion capacity at PWCS whilst there is available existing or potential capacity at the NCIG terminal, the enforcement of this principle is entirely within the discretion of

the NPC as part of the NCIG Stage 2 approval. C&A (and the other non-NCIG producers) have a legitimate expectation that the NPC will exercise its discretion in a manner that is fully consistent with the principles stated in the PWCS Terminal Access Protocol, as any failure by NPC to do so would result in a serious risk of non-NCIG producers being 'crowded out' of PWCS (particularly if further PWCS expansions at its existing terminals or the proposed new "T4" are delayed pending planning approvals etc), while NCIG producers retain the exclusive access to the remaining expansion tonnes at the NCIG terminal. C&A considers that such an outcome would result in real public detriment.

- **Obligation to contract for all nominations:** Under the Capacity Framework Arrangements, PWCS is also obliged to contract for **all** nominations regardless of available capacity. This obligation leaves PWCS vulnerable to the decisions of the 'Reviewer' in relation to any delays which arise in completing any expansions which are required to meet particular nominations. If the Reviewer, in exercising its discretion, decides that there is a PWCS Expansion Delay or PWCS Expansion Shortfall, producers will automatically be subject to a compression amount calculated in accordance with the rules in the proposed Terminal Access Protocols. Such a position effectively penalises producers for delays caused by PWCS and provides large producers with little certainty when entering long term contracts. C&A expects that the Reviewer will exercise its discretion on this matter only after considering the views of the industry, and without discriminating against any producers.

- **NCIG nomination process not aligned to PWCS':** The nomination and allocation process for NCIG Stage 2 is not aligned with PWCS' nomination and allocation process. PWCS has committed to informing producers by a certain date of how many tonnes they will be allocated and when. NCIG has made no such commitment and has proposed to run (and, indeed, is currently running) its nomination process so that non-NCIG producers nominate for tonnes at NCIG **before** PWCS' binding nomination date, but with NCIG notification to successful applicants only provided **after** the PWCS nomination date. Furthermore, successful non-NCIG applicants are required (if and where NCIG resolves to proceed with NCIG Stage 2 and its financing) to execute binding NCIG long term ship or pay agreements which will be held in escrow by NPC's counsel, but NCIG is not required to sign those agreements or commit to building the capacity for the nominated tonnes until up to six months after applicants have been notified of their successful nominations.

  This places non-NCIG producers in the unsatisfactory position of having to nominate for tonnes at PWCS without knowing how many tonnes they will be allocated at NCIG. Further, this outcome may result in non-NCIG producers being subject to an information disadvantage compared to NCIG producers, as NCIG producers may be fully aware when they bid for tonnes at PWCS how many tonnes they will receive at NCIG.

  Even if NCIG informs a non-NCIG producer that its nomination is successful, no certainty is provided to that 'successful' producer as NCIG may then resolve not to proceed with construction of Stage 2 or, if it does resolve to proceed, final confirmation that construction is to proceed might only follow six months later. This uncertainty may result in non-NCIG producers choosing not to contract any of their capacity with NCIG and instead contracting all of their capacity with PWCS. Such an outcome would, in turn, place increased pressure on the

capacity at PWCS' terminals and also allow NCIG producers (at the time that NCIG does commit to construct Stage 2) to contract for the 12mtpa of NCIG Stage 2 capacity intended for non-NCIG producers.

C&A does not believe that this was the intent of the proposed Capacity Framework Arrangements and considers this behaviour to be contrary to clause 3.1(c) of the Implementation Memorandum, which states that 'before conducting the NCIG Nomination and Allocation Procedure, NCIG must notify PWCS and must coordinate with PWCS to ensure that [...] the NCIG Nomination and Allocation Procedure is conducted before or in conjunction with the PWCS Nomination and Allocation Procedure where reasonably possible.' As the coming months unfold, C&A hopes that NCIG and PWCS will engage in constructive discussions with producers to coordinate their respective nomination and allocation processes, as any failure by NCIG to cause alignment could result in detriment to non-NCIG producers.

- **System Assumptions need to be implemented in a manner that maximises throughput for the whole coal chain:** Schedule 5 of the Implementation Memorandum provides that 'Producers whose performance varies from their agreed System Assumptions which form the basis of their contracted Access Rights directly and individually incur the capacity increase or decrease as a result of their individual performance.'

  Based on the Capacity Framework Documents, it is unclear to C&A how PWCS intends to vary or regulate producers' allocations according to performance against the System Assumptions applying in respect of particular producers, as is the process by which the System Assumptions are to be developed (both for the Hunter Valley coal chain as a whole and for individual load points/producers). C&A supports the adjustment of producer capacity at PWCS relative to that producer's performance against certain performance standards, but is concerned that, if different standards are applied between different PWCS customers, this may unfairly advantage poorer performing producers and disadvantage better performing producers. This aspect of the Implementation Memorandum and corresponding provisions of the Long Term Ship of Pay Contracts may also prove problematic to enforce. C&A believes it is important that the System Assumptions be implemented in a manner that ensures accountability for poor and good performance, maximises throughput availability, and provides incentives for all members of the coal chain to strive for continuous improvement in efficiency.

Achieving coal chain alignment objectives

C&A notes that a key objective of the Implementation Memorandum is to achieve contractual alignment between port and rail. C&A is aware that representatives of PWCS, NCIG and ARTC have met on more than one occasion to discuss alignment, and that some measures have been incorporated into the Capacity Framework Documents that consider entitlements to track and train capacity when nominating for capacity at PWCS. C&A believes, however, that some issues remain that may cause producers to hold terminal contracts misaligned to other coal chain components. Some of these issues were identified in C&A's response to the ACCC's Issues Paper on ARTC's access undertaking, and were discussed at the meeting on 8 September 2009 between the HRATF and representatives of ACCC, in which C&A representatives participated. These issues include:

- **Severity of ARTC's resumption clause:** Clause 11.4 of the draft Access Holder Agreement allows for ARTC to remove Path Usages from a producer if actual usage over a three month period has been less than 90%. As previously submitted to the ACCC, C&A believes this resumption clause is too severe, since normal monthly variability in production volume could often trigger the 90% threshold. Additionally, C&A is concerned that, if ARTC chooses to exercise this right, a producer may have 'stranded' terminal allocation – that is, by losing track allocation, the relevant producer will not have sufficient track capacity to match its terminal allocation (on which the producer will have take-or-pay payment commitments).

- **Access Undertaking provides insufficient accountability for performance and limited incentives to improve:** In the event of an unexpected shortfall of less than 7 days, the draft Access Undertaking provides for ARTC to distribute any available capacity at its own discretion. It is not clear whether ARTC will use this discretion to distribute capacity evenly across the whole coal chain, only to those affected, or only to those responsible for the shortfall (if applicable). C&A believes that in order to build accountability for performance within the coal chain, producers responsible for any system capacity loss must incur a penalty that is proportional to the capacity loss they have caused. C&A understands that the Capacity Framework documents do provide for such arrangements at PWCS, and believes that a similar mechanism should be implemented in the ARTC Access Undertaking.

  Additionally, the long term arrangements should ensure coal chain participants are not only penalised for under-performance, but are incentivised to improve performance. This is necessary to ensure the framework is not only a tool for dividing up capacity, but also a tool to free up additional capacity by ensuring efficient operation of the system. C&A understands that arrangements at PWCS allow a producer to permanently capture any additional capacity created by improvement of its performance; however, no such provision appears in the Access Undertaking. In fact, ARTC uses 'Path Usages' as the unit of measure for providing access to its Network, but uses gross tonnes multiplied by kilometres (***gtkm***) as the unit of measure for pricing. This inconsistency means that it is possible for the same train path to be subject to different pricing. Such a pricing mechanism provides no financial incentive for producers to maximise available track capacity by improving the performance of its above-rail services (or that of its Operator).

  C&A advocates a system of capacity allocation and charging at port and track that incentivises the most efficient use of port and track services and which includes provisions that ensure that any producer who is responsible for a delay in the coal chain bears responsibility for and the cost of that delay.

- **Certainty of receiving track capacity:** Under the current draft Capacity Framework Arrangements, producers can obtain PWCS capacity without having contractual entitlements to track services. The draft Access Undertaking, however, requires that access seekers can prove that they have 'Network Exit Capability' (or that they are in negotiation with a terminal to entitle them to Network Exit Capability). These provisions suggest that services be contracted in a specific order: terminal services, then track services. C&A is concerned that the current arrangements could lead to producers nominating for capacity and receiving binding 10 year Take or Pay commitments at PWCS and only then

being able to receive confirmation of the availability of track capacity. C&A understands that the 'Initial Review' provided for in the draft ARTC access undertaking may provide preliminary indications of capacity availability, but C&A notes that this process still provides no certainty to producers before they enter into long-term port contracts.

Such a situation is particularly concerning in the instance of 'mutually exclusive nominations'. It remains unclear as to how ARTC will decide between such nominations, and since all nominations with ARTC require a corresponding contract for terminal capacity, any rejected nomination will be liable for TOP charges at the terminal. This presents an unacceptable risk to producers.

C&A submits that a more rigorous and transparent allocation protocol should be adopted by ARTC, similar to the PWCS Terminal Access Protocols for allocation of capacity at PWCS.

- **Access Undertaking provides little transparency:** Many provisions in the draft access undertaking confer discretions on ARTC, including (but not limited to) the distribution of capacity in the event of short term delays, allocation of capacity in the circumstance of mutually exclusive nominations or the exercise of the resumption clause, as discussed above. In consultations with the industry to date, ARTC has provided some verbal indications as to how it intends to exercise these discretions. Those indications are not documented in any way (whether in the draft Access Undertaking or otherwise), and are not binding on ARTC. Accordingly, those indications do not provide C&A (or any other producer) with the certainty that would typically be required before entering into binding long term take or pay commitments. The ability of ARTC to exercise unfettered discretions in relation to various key provisions of the draft access undertaking raises the potential for misalignment across the coal chain, and C&A is particularly concerned that there is currently no transparency in relation to how ARTC may act in this regard. C&A submits that the matters in relation to which ARTC may exercise discretions under the Access Undertaking should be tightly confined, and that the factors which ARTC may take into account in exercising any such discretions should be transparent and binding.

C&A stands prepared to work with other stakeholders to ensure that contractual alignment issues are adequately addressed. In order to facilitate the effective resolution of these issues, C&A considers that the ACCC's assessment of ARTC's draft access undertaking should be conducted in conjunction with its assessment of the authorisation application to ensure that the nomination and allocation processes set out in ARTC's access undertaking align with those in the Capacity Framework Arrangements. Unless appropriate and effective mechanisms are incorporated in to the long term solution, it is unlikely that the size of the vessel queue at the Port of Newcastle can be effectively managed. The provision of long term contracts for the various components of the coal chain is insufficient alone to ensure reduced queue size, as evidenced by the long vessel queues observed off Dalrymple Bay Coal Terminal in Queensland.

As such, C&A believes that contractual alignment will result in substantial public benefit. In this regard, in response to the ACCC's Issues Paper on ARTC's draft access undertaking, C&A emphasised that the participants in the Hunter Valley coal chain need to achieve contractual alignment to:

- ensure that contractual commitments drive coal chain investment behaviours – that is, that there are no under/ over investments;

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- use contractual terms to drive system efficiency, and at the same time minimise potential loss due to commercial constraints; and
- effectively manage vessel queues.

Please contact me on 07 3029 1819 if you have any queries in relation to the matters raised in this submission.

Yours sincerely

Matt Coulter
General Manager Coal Development Group
Rio Tinto Energy & Minerals