

15 December 2010

Mr Anthony Wing
General Manager
Transport and General Prices Oversight
ACCC
GPO Box 520
MELBOURNE VIC 3001

Submission: Capacity Framework Arrangements

Dear Mr Wing,

Further to our telephone conversation with the Australian Competition and Consumer Commission (**ACCC**) yesterday, Aston Resources Limited (**Aston Resources**) requests the ACCC's urgent intervention by requiring Port Waratah Coal Services (**PWCS**) to postpone its entry into all contractual arrangements that will give effect to its allocations announced on 1 December 2010. Aston Resources believes that the ACCC should have the opportunity to review PWCS's decision-making surrounding the 2010 allocations and review the continuation of the current ACCC authorisation in favour of PWCS of 9 December 2010.

Aston Resources is an ASX-listed company focused on the development of its Maules Creek coal development project (the **Project**), a major undeveloped and significant multi-seam coal deposit in New South Wales. Aston Resources was advised on 1 December 2010 that it had received an initial coal export loading allocation for the Port of Newcastle from Port Waratah Coal Services of approximately 1.7Mtpa in 2013 and 2014 and 10.5 Mtpa from 2015. The ramp up in allocation will be provided through the delivery of PWCS Terminal Four.

Aston Resources is the first significant new entrant to seek an allocation since the Capacity Framework Arrangements were approved by the ACCC on 9 December 2009. Aston Resources had sought an allocation of 2 million tonnes in 2012, 5 million tonnes in 2013 and 10.5 million tonnes from 2014 onwards necessary to develop the project as expeditiously as possible. As the initial allocations by PWCS fall short of Aston Resources' requirements in all respects, coupled with unsatisfactory statements by PWCS about the progress of T4, Aston Resources requests the ACCC to:

1. urgently review PWCS's decision-making of its 2010 allocations, and
2. call for immediate amendments to the Capacity Framework Arrangements to apply to the 2010 allocations and resulting contracts;

as the present arrangements have failed to facilitate new entry. Facilitation of new entry and certainty of outcomes for new producers were the key public benefits underpinning the ACCC's authorisation of 9 December 2009.

Aston Resources is of the opinion that many of the incumbent producers have over-nominated for port capacity and will prove unable to fully utilise their allocations in the short to medium term. Modeling conducted by independent market analysts supports Aston Resources' view. If this is true, then the actions of these incumbents have effectively frustrated the Capacity Framework Arrangements and created a significant barrier to entry for new entrants. Further support for this view can be found in a recent press report that suggested that one of the major producers has over-nominated in the PWCS nomination process by allowing for a general margin of safety above existing projects and planned expansions (*Australian Financial Review, Dec 2, 2010*). The Capacity Framework Arrangements should be re-structured immediately to ensure that producers not only have the capacity to fully utilise their port allocation, but also intend to fully utilise their port allocation – and if they subsequently fail to do so, then the capacity is efficiently made available to other parties who will.

Aston will continue to seek access to the port and rail capacity necessary to meet its projected production profile. However, without the development of new terminals to handle this capacity, Aston will be reliant on the highly uncertain redistribution of the capacity allocated to incumbent producers. This provides low levels of security and makes it more difficult to sanction an investment of approximately \$500m to construct the Maules Creek mine. It is possible that emerging coal producers in the Hunter Valley and Gunnedah Basin could be forced to scale back or even delay what would otherwise be strong economic developments, with the government foregoing significant revenue through royalties and other taxes.

Aston Resources acknowledges that the ACCC, New South Wales Government and various stakeholders undertook a significant amount of work to prepare and review the Capacity Framework Arrangements. Aston Resources agrees that it is important for producers to be able to enter into long-term access agreements to underpin future mine planning and investment in the region. However, Aston Resources considers that certain aspects of the Capacity Framework Arrangements clearly disadvantage access seekers, in particular the rules for when mandatory compression will apply (at both NCIG and PWCS).

This submission provides a brief overview of Aston Resources and then outlines the company's key concerns with respect to the Capacity Framework Arrangements. As a new entrant and a current access seeker, Aston Resources has particular concerns that the Capacity Framework Arrangements fail to ensure that:

1. incumbent producers are adequately required and/or incentivised to transfer unused capacity;
2. additional capacity will be delivered (on time) to meet growing demand in the Hunter Valley; and
3. new entrants are given sufficient access to existing and/or additional capacity.

Aston Resources is concerned that the cumulative impact of the draft ARTC Hunter Valley Access Undertaking (**HVAU**) and the Capacity Framework Arrangements (in particular, the fact that capacity is rarely resumed or "cancelled") is that incumbent producers will be able to "hoard" capacity to the exclusion of new entrants. The comments raised in Aston Resources' October submission on the draft HVAU are equally relevant to this letter.

This concern is explained in more detail below (with reference to specific sections of the Capacity Framework Arrangements). This letter provides only a relatively short overview of Aston Resources' concerns and can be followed with a more detailed response if required.

Aston's key recommendations in relation to the Capacity Framework Arrangements are as follows:

1. Anti-hoarding compression should be automatically triggered in the event of under-utilisation, not (as is currently the case) only when there is a delay or shortfall in a triggered expansion. This resumed capacity should then be made available, on a priority basis, to new entrants seeking access to port capacity. This is broadly consistent with what has been proposed for the HVAU.
2. There should be increased transparency in relation to nominations, throughput and resumption (at both NCIG and PWCS). Requiring producers at both terminals to report to the coal chain at large on throughput and proposed and actual resumptions would incentivise producers to trade unused capacity and would provide new entrants and competitors with valuable information on the availability of excess capacity. Aston recommends that the entire nomination, allocation and scheduling process should be overseen/reviewed by a truly independent body. Currently, the process is controlled by the PWCS board with input from the HVCCC – both of these bodies are controlled or significantly influenced by the major coal producers. Increased data transparency and oversight by an independent body or independent Chairman would aid in ensuring that the interests of new entrants are adequately protected under the Capacity Framework Arrangements.
3. The terms of take or pay agreements should ensure that incumbent producers are required to transfer unused capacity. Such a requirement, coupled with increased transparency, should ensure that capacity is not left unused at either NCIG or PWCS. Aston is firmly of the opinion that, alone, the

existence of a take or pay obligation does not provide sufficient incentive for large producers to offload excess capacity. The penalty is in effect simply the cost of the port charge (approximately \$4.05 per tonne at PWCS), whereas the upside is the current margin per tonne for the relevant coal (up to \$60.00 per tonne). This leads to a situation where incumbent producers had the opportunity for an asymmetric bet – which effectively incentivised them to over nominate for port capacity during the 2009 and 2010 PWCS nomination rounds. Currently there is no clear incentive for PWCS or producers to ensure that access holders “use” or “lose” capacity.

4. Terminal Four, as a greenfield expansion, must be delivered in the four year timeframe contemplated in the initial ACCC authorisation decision (i.e. by the start of 2015). This four-year period was intended to include the time required to obtain necessary development consents and PWCS should be required to enter into binding commitments starting in 2015.

Aston Resources is particularly concerned that PWCS has already indicated an intention to apply to NPC for an extension of the targeted 2015 delivery date for T4. The initial ACCC authorisation decision contemplated a four-year delivery period for greenfield expansions (including time for obtaining development consents).

Further, Aston Resources is firmly of the opinion that it is premature for:

- PWCS to be indicating that a 2016 start date is more realistic; or
- NPC to be considering an extension,

when the expansion has only just been triggered and the Part 3A application has not yet been lodged.

If Newcastle Port Corporation extends the delivery period, then:

- mandatory compression of under-utilised allocations should be triggered from 2015 rather than any revised delivery date; and
- the New South Wales Government should consider whether it would be appropriate to approve the construction of a new independent terminal at the port.

When the Capacity Framework Arrangements replaced the “common user” provision in the PWCS lease, protections for new entrants undoubtedly decreased. Aston Resources is concerned that there is a significant risk that new entrants will be unable to obtain necessary access to the Hunter Valley Coal Chain on a fair and timely basis. Whilst Aston Resources acknowledges the importance of contractual certainty for producers and infrastructure providers to facilitate capacity growth, it is important for the ACCC to assist new entrants to obtain access to infrastructure that is by its nature essential and incapable of being replicated.

Company overview

On 18 February 2010, Aston Resources completed the acquisition of the Project from Namoi Valley Coal Pty Ltd, a subsidiary of ASX-listed Coal & Allied Industries Limited (which in turn is a subsidiary of the Rio Tinto Group). The Project is a large scale undeveloped coal project located in the Gunnedah Basin in New South Wales.

Aston Resources currently holds two mining tenements (CL375 and A346) over approximately 5,816 hectares in the Gunnedah Basin. A 610Mt JORC Resource and JORC Coal Reserves of 356Mt have been identified within these tenements. The Project’s current JORC Resource is expected to support a large open-cut mining operation for in excess of 30 years at an average saleable coal production rate of 10.8Mtpa. Subject to the timely delivery of necessary governmental approvals, Aston expects that the Project will be commissioned and first coal production will commence in the second half of 2012, with saleable production exceeding 10Mtpa from 2014. It is expected that the Project will produce a majority of high value metallurgical coal as well as a premium low ash, high-energy thermal coal.

It is important to note that the initial allocation of 1.7Mtpa of port capacity is unlikely to be sufficient to underpin the proposed development of Maules Creek.

CAPACITY FRAMEWORK ARRANGEMENTS

1. Capacity resumption / compression

Under the Capacity Framework Arrangements, PWCS and NCIG are required to mandatorily compress for under-utilisation in the event of a capacity shortfall. As noted above, this provision protects new access seekers when there is a delay in the construction of additional capacity.

Aston Resources considers that there are a number of problems with the current provisions:

1. Compression is only triggered when there is an expansion delay or expansion shortfall, not simply in the case of under-utilisation. So, for example, Aston Resources is unable to benefit from compression in 2012, 2013 and 2014 (and most likely 2015 onwards if the T4 start date is extended) despite being allocated below its requested tonnages. Even if other producers are not using their allocated tonnages in these years (or if they fail to obtain necessary rail capacity), Aston Resources will have no effective means of obtaining access to capacity.
2. Whilst the utilisation threshold of 95% is reasonably high – the period over which it is assessed, 18 months, is far too long.
3. The reasons that can be provided for avoiding compression are too broad – as an example, delays in expansions should not be used to avoid capacity being reallocated to other mines that may already be in production at the time.

Aston Resources submits that the most appropriate approach is likely to be a tiered system that is triggered by the mere fact of under-utilisation. As an example only:

- In the event of a capacity shortfall or delay, PWCS and NCIG should be **obligated** to resume pathways for under-utilisation (at the higher threshold of <95% over 6 months) subject to strict force majeure (excluding operational reasons such as delays in mine expansion). Those affected by the relevant shortfall or delay should then be notified and, to the extent practicable, be given access to the capacity.
- Where there is no capacity shortfall or expansion delay, there should simply be a mandatory “show cause” for under-utilisation (at the slightly lower threshold of <90% over a quarter). PWCS and NCIG could have a discretion as to whether to resume capacity and could consider all legitimate operational reasons.
- Where a Producer has had to “show cause” twice in a 12-month period and the cause has not been outside of the Producer’s control, PWCS and NGIC should be **obligated to resume capacity**.
- For repeated under-utilisation, the under-utilisation threshold could be increased over time or PWCS/NCIG could announce an intention to resume in the event that usage does not increase within a specified period.
- If there is a lower under-utilisation threshold, then resumption should be mandatory (subject only to force majeure).

2. Transparency

Aston Resources is also of the opinion that increased transparency in relation to resumption and utilisation levels would be of significant benefit. Reporting to the chain at large on proposed and actual resumptions would:

1. incentivise producers to trade unused capacity; and
2. inform new entrants and competitors of new capacity becoming available.

Over time, this should increase actual usage of the coal chain.

In addition to data transparency, Aston Resources is of the opinion that the system would benefit from increased independent oversight. As noted above, the PWCS board and the HVCCC are controlled by major exporters. This creates an unavoidable conflict of interest when PWCS assesses producers’ nominations, requests for information and any requests for exemptions from mandatory compression under clause 5(d)(i)(A) (for example).

3. Positive obligation to transfer

Aston Resources submits that, under the current long-term ship or pay contracts, exporters are not sufficiently incentivised and/or obligated to transfer unneeded capacity. Large exporters can afford the penalty of an unnecessary port access charge and this encourages such producers to prepare their nominations with a comfortable "margin of safety". Coupled with the lack of effective "use it" or "lose it" compression provisions, this gives incumbent producers the ability to hoard capacity to the exclusion of new entrants.

4. Delivery of T4 in 2015

This start date is very important to emerging coal producers not only because of security of delivery but because the scheduled start date is the date on which mandatory compression under clause 5 of the Capacity Framework Arrangements should be triggered. Under Part 5 of the Capacity Framework Arrangements, compression will not be triggered if NPC grants an extension to the scheduled delivery date – there is no restriction on the number of extensions that could be granted.

Aston Resources is currently placed in the impossible position of being asked to make a binding commitment for a ten year take or pay contract that has a completely uncertain start date – PWCS has already informally indicated that the 2015 target is more likely to be 2016 at the earliest, and there is no certainty that this may not slip to 2017, 2018 or in fact later. The start date has the potential to be extended multiple times without any recourse under the Capacity Framework Arrangements. This is a critical issue – it means that, in effect, the incumbent producers have secured all of the 'certain' growth capacity at PWCS and relegated new entrants to the 'highly uncertain' growth capacity at T4.

Refusing to grant an extension to the delivery date for T4 would dramatically reduce the risk that new entrants face because they can then rely upon compression to ensure that all unused capacity is reallocated. No extensions to the four-year timeframe will also incentivise incumbent shippers to trade their excess capacity in 2013 and 2014 to avoid the effects of compression in 2015 – providing grounds for a more efficient spot market in these years. As soon as an extension is granted, Aston Resources' allocation above 1.7 Mtpa becomes a contingent allocation and the protection of compression as contained in the Capacity Framework Arrangements disappears completely.

We are available to discuss these significant issues in more detail with you and your team.

Sincerely,



Todd Hannigan
Chief Executive Officer

Level 10, AMP Place
10 Eagle Street
Brisbane QLD 4000
Phone: +61 7 3235 6000 | Fax: +61 7 3235 6699 | Mobile: +61 425 445 550
www.astonresources.com