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By email

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Dear Mr Hatfield

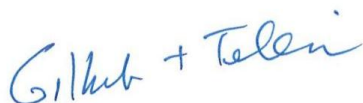
A91410 & A91411 - Rio Tinto Coal Australia Pty Ltd & Ors - submission

We refer to our letter to the Australian Competition and Consumer Commission (**ACCC**) on 14 March 2014 setting out a response to third party submissions in relation to the request for interim authorisation associated with the above applications by Rio Tinto Coal Australia Pty Limited (**RTCA**), Peabody Energy Australia Pty Ltd (**Peabody**) and Pacific National Pty Ltd (**Pacific National**) (together, the **Applicants**).

As foreshadowed in our 14 March letter, the Applicants wish to also briefly respond to further issues and comments raised in a late submission from Aurizon Network on 13 March 2014 (the **AN Submission**).

Please do not hesitate to contact us if you have any questions in relation to the matters set out in this supplementary response.

Yours sincerely



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Applicants' further response to submissions in relation to interim authorisation of the DCCC

20 March 2014

Summary of issues

The Applicants welcome the support (at page 1) of Aurizon Network for *“all initiatives designed to improve efficiency and a more even draw down of supply chain demand.”*

This is reflective of comments made also by Aurizon Network in the current UT4 process in which it similarly supports the development of “local solutions” for improved coordination of the coal chain.

While Aurizon Network does not therefore appear to object to the establishment of the DCCC, and might be understood to support direct industry initiatives of this kind, the AN Submission nonetheless makes a number of critical observations about the DCCC which require a response, and which can be summarised as being that:

- there is no urgency to implement – and therefore an interim authorisation is not needed;
- the benefits of the DCCC are “unproven” and overstated, including because the problem has been wrongly defined and because it may not have the full support of all stakeholders;
- there is an “inconsistency” between the DCCC Charter and arrangements and the existing regulatory and contractual framework;
- the potential effect of the DCCC on other participants and competitors has not been explored adequately by the Applicants in their submission; and
- there may be an alternative to the DCCC through involvement in consultation around draft “System Rules” for the Northern Bowen Basin, which have been the subject of consultation and development for some time¹, and through the ‘Integrated Planning Regime’.

Because of these factors, Aurizon Network submits that an interim authorisation is ‘not necessary’.

The Applicants will briefly address each of these objections, taking into account the factors which the ACCC has identified it will apply in determining whether to grant interim authorisation.

In summary, however, the Applicants note that Aurizon Network has not been able to point to any apparent anti-competitive detriment likely to result during any interim authorisation period. To the contrary, it argues at most that the nature of the arrangements and their benefits may be overstated and need to be proved. The Applicants submit that if the debate before the ACCC at this point is simply about the true size of the benefit to be delivered by the DCCC, then it is appropriate to enable the parties to proceed to implement on the basis of interim authorisation so that we can begin to identify those benefits.

¹ Both in the form of the ‘NBB System Rules’ and, prior to that, in the form of draft Goonyella System Rules.

The case for urgency: there are a number of important UT4 issues and other policy developments “on the table”

Aurizon Network suggests in its submission that the UT4 process has been *‘the subject of lengthy and detailed consultation’* and that therefore Aurizon Network does not presently see any need for an interim authorisation.

As the Applicants indicated both in the submission and further response on 14 March 2014, the UT4 process remains very much active and in development. This is acknowledged by Aurizon Network (at page 7). The QCA has indicated that it does not intend to make a final decision in relation UT4 until December 2014.²

There are a considerable number of elements of UT4 that relate to matters about which the DCCC could play a useful role, including:

- **‘Operator capping’ of take or pay rights** – Aurizon Network has proposed a form of pooling of contractual entitlements by access holders, which it refers to as ‘operator capping’. This enables rail operators that haul for multiple customers to ‘offset’ take or pay requirements between customers and/or locations (within limits).

First, it is important to note that “operator capping” is a form of pooling different to that being proposed by the DCCC. The DCCC does not relate to management of ‘take or pay’ entitlements, but only to the scheduling of train paths by Aurizon Network. Aurizon Network accounts for the consumption of train paths for contractual purposes separately (and, at times, differently) to the way they are accounted for when determining what take or pay charges are payable.

A number of industry participants, including some Applicants, have made submissions to the QCA about perceived problems with the operator capping model proposed by Aurizon Network in UT4 and have offered alternative solutions. The need for greater flexibility in take or pay rights in Queensland is important and urgent and so developing a workable model for pooling is important, but it is still at an early stage.

The interaction between how take or pay rights are accounted for and how these rights are then scheduled and consumed means that the DCCC would provide a valuable forum within which to discuss and develop ideas around pooling – for contributing to the UT4 process.

- **Capacity ‘swapping’** – In response to submissions received to the current draft UT4, Aurizon Network has indicated that it is also considering another form of flexible contractual use, in which producers can ‘swap’ capacity on a short term basis to help balance and align their take or pay entitlements with usage.³

Aurizon Network has indicated that this process (which exists in the Newcastle coal chain) would occur as part of the weekly train ordering process – and would have an impact on both the treatment of take or pay rights and the consumption of paths for scheduling purposes. This makes the design of the capacity swapping mechanism something which would be of direct and central concern to the DCCC and which practical experience with the coordinated pooling of requests could provide useful input to develop.

² See Letter from Mark Gray (QCA CEO) to Mr Alex Kummant (Aurizon Network), 5 November 2013 setting out a revised timetable for assessment (available at: [http://www.qca.org.au/getattachment/f76feccc-e15a-45c8-8bbc-4656188616b4/Correspondence-re-2013-DAU-Assessment-Process-\(1\).aspx](http://www.qca.org.au/getattachment/f76feccc-e15a-45c8-8bbc-4656188616b4/Correspondence-re-2013-DAU-Assessment-Process-(1).aspx)).

³ See *Aurizon Network Response to Industry Submissions*, 29 November 2013 (at page 29).

- **Process for development of System Rules** - System Rules are a quasi-regulatory document put in place by Aurizon Network to set out its process for rail scheduling within each System. A number of respondents to the UT4 process, including some of the Applicants, raised concerns about the current System Rules processes and the way in which those rules operate within the regulatory and contractual processes.

Amongst other things, the System Rules define elements of the rail scheduling process for each system – and so any changes which are proposed (in response to current concerns) to the way System Rules are developed or operate has a direct impact on the development, operation and success of the DCCC and its Members.

- **Northern Bowen Basin System Rules process** – as Aurizon Network indicated in its response, there is a long and ongoing process underway around the development of System Rules governing the Goonyella System.

Most recently, Aurizon Network combined draft System Rules for the Newlands and Goonyella systems and released draft NBB System Rules (August 2013). Prior to combining them, Aurizon Network had separately released and withdrawn a number of versions of draft Goonyella System Rules.

The new NBB (and previously Goonyella) System Rules process has continued for over two years. Industry have raised concerns about the draft Goonyella (now NBB) System Rules at various points over this time, including that Aurizon Network has sought to use them to *reduce* flexibility in the way that rights are scheduled and handled by producers in accordance with generally accepted supply chain operating procedures at DBCT and that there is a lack of direct transparency and involvement for coal producers in the scheduling process.

Evidently, the implementation of the DCCC offers an opportunity to add considerable insight and value to the NBB System Rules development process – including testing a practical model for greater and more direct involvement by producers.

- **Performance reporting and incentives** – An important element of the existing UT3 framework which was never implemented was the development of incentives and reporting by Aurizon Network. The DCCC will gain important and shared insights into what information is ‘missing’ that could assist industry to better and more efficiently manage their infrastructure – which will prove valuable to Aurizon Network and the QCA in considering any new performance reporting or incentives scheme.
- **DBCT Pty Ltd ‘hybrid’ cargo assembly trial** – Separate to UT4 and other rail-related activities, DBCT Pty Ltd is establishing its hybrid stockpile operations trial at DBCT (discussed in the Applicant’s primary submission at page [x]).

The Queensland industry is currently operating in a ‘window’ of opportunity for meaningful regulatory reform, much of which is badly needed and overdue.

Importantly, however, each of the above initiatives is focussed on only one part of the supply chain – either below rail (UT4, System Rules, performance reporting) or port terminal (DBCT hybrid trial) and each is “owned” by an infrastructure owner (Aurizon Network, DBCT Pty Ltd), and not by producers or rail operators. As such, none of them create an alternative to the DCCC – which provides a collaborative structure involving producers and rail operators to discuss and coordinate, together with infrastructure providers, the ‘end to end’ utilisation of infrastructure.

However, the DCCC will interface with all of the above initiatives (if implemented) potentially. As an industry-led forum developing coordinated operational arrangements over coming months, the Applicants expect there to be immediate and valuable lessons which they can offer.

Examples might include:

- The DCCC Management Committee may meet with Aurizon Network to discuss problems with existing scheduling arrangements as part of improvements to the draft NBB System Rules.
- The DCCC Joint Scheduling Group could identify categories of information which are not available, and which are needed to better coordinate infrastructure requirements – and this is fed by individual Members (or the group) to the QCA as part of UT4 engagement.
- Based on early experience, the DCCC may meet with Aurizon Network, the QCA (and/or the Queensland Government) to discuss where ‘nodal losses’ are occurring and how particular parts of the process can be improved such as alignment of maintenance arrangements (across mine, rail and port), management of stockpile levels (at mine and port) etc. This may help to inform processes such as Aurizon Network performance reporting and operational improvements and activities at DBCT (e.g. the hybrid trial).

Individual Members may also take experience from the DCCC and contribute this in their own independent submissions to the current regulatory processes.

Finally, the DCCC will want to ensure that the arrangements that are ultimately put in place around issues such as operator capping/pooling and/or short term capacity swapping do not constrain the development and evolution of the DCCC, or other industry coordination arrangements, in the future.

The benefits of the DCCC

Aurizon Network argues that the benefits of the DCCC are “unproven” and overstated, including because the problem has been wrongly defined and because it may not have the full support of all stakeholders.

1.1 Defining the problem to be solved

The Applicants accept that rail scheduling inflexibility (and inefficiency) is not the only form of ‘interface loss’ in the system. Indeed, part of the rationale for the DCCC is that it enables a wider view of the coal supply chain to be taken, helping to improve coordination across coal availability and operations as well as scheduling of rail and port infrastructure.

Aurizon Network notes that the ILC has forecast only 72.1Mtpa as the maximum forecast throughput for DBCT this year. This reflects present operational arrangements and planning constraints across a range of other ‘whole of supply chain’ issues, some of which have been identified by Aurizon Network.

The Applicants do not accept that this reflects the maximum capacity which is possible from DBCT. Indeed, the DCCC’s principle objective is to help to reduce this capability gap (i.e. from 72Mtpa to closer to nameplate of 85Mtpa) through producer involvement to work with DBCT Pty Ltd to better align and coordinate:

- short to medium term prioritisation of vessels relative to system and product constraints (in line with existing Terminal Regulations);
- develop an optimised order request to assist DBCT and Aurizon Network schedulers in achieving an optimised train plan, ensuring more even, reliable and timely delivery of coal to port, better load rates, and a reduction in port dwell times; and

- “day of operations” involvement – the Scheduling Coordinator will be able to provide planning solutions for Members disrupted with an aim of quicker recovery to plan i.e. redundancy planning around Cancellations and Diversions of services.

These improvements – which go beyond merely improving the efficiency of rail ordering – should improve a number of the factors identified by the ILC as holding back maximum capacity.

1.2 Quantifying the benefit

Aurizon Network argues that the ‘optimum’ benefit may not be achievable if all producers and rail operators do not participate (page 4).

The Applicants accept that the maximum benefit is achieved by all users of DBCT participating in the DCCC. However, they do not wish to ‘impose’ the solution on industry and membership is, and will remain, entirely voluntary.

However, even if all DBCT users do not become Members and the optimum claimed benefit is not realised, the public benefits of the proposed DCCC arrangements remain substantial and outweigh any detriments (if any).

Based only on their own initial contribution of tonnes to the DCCC, the Applicants have anticipated that a 1-3% increase in throughput is achievable during the first six month period if interim authorisation is granted and that this would equate to increased coal revenues for all users of the DBCT Coal Chain of up to \$22 million per month, or up to \$132 million during the first six month period. This benefit does not rely on all other stakeholders participating – but it does generate benefit for them.

1.3 Sharing the benefit

The Applicants note that the benefits identified will be shared by all users of the DBCT Coal Chain, and are not limited to Members.

This sharing may occur in a number of ways, examples include:

- To the extent that variability is better managed by Members and there are fewer cancelled train services, these paths are then ‘freed up’ for use by other users, including non-Members.
- Any reduction in dwell times at the port will improve the cycle times of other users, with trains not being delayed at port.
- Any increased flexibility in the vessel queue or operation of the terminal more generally should reduce vessel queues, reducing demurrage costs for all users (in line with existing Terminal Regulations).
- Improved throughput across the DBCT Coal Chain will reduce the below rail tariffs paid by all users, which are calculated on a system-wide basis.
- To the extent that increased throughput reduces the need for further capital investment in port or rail infrastructure, these savings will be shared with both existing and potentially any new users.

There is no “inconsistency” between the DCCC Charter the existing regulatory and contractual framework

The Applicants agree that the DCCC is not a ‘scheduler’ and does not undertake scheduling functions.

In this regard, the Applicants also agree with the characterisation of the conduct made by Aurizon Network, which describes it in relation to rail scheduling as *“at most, coordinated train ordering for those users of the Goonyella System who choose to be members of the DCCC Charter.”* (at page 3).

The Applicants also agree with the late letter of support provided by DBCT Management that the DCCC does not – and is not intended to – cut across the functions of either DBCT Pty Ltd or Aurizon Network, as the schedulers of rail rights (and this is explicit in the submission and the Charter).

The Applicants made clear in their original submission, but reiterate in response to the concern raised by Aurizon Network:

- the proposed DCCC arrangements have been developed within existing contractual and regulatory arrangements;
- the DCCC does not schedule train paths, it coordinates the train paths that are ordered for Members by the Scheduling Coordinator – which then lodges those orders as part of the scheduling process managed by Aurizon Network and DBCT Pty Ltd;
- as a result of the above, the final decision about rail scheduling will continue to be made by Aurizon Network and DBCT Pty Ltd; and
- by developing the DCCC within existing arrangements real public benefits will arise because the arrangements can be implemented quickly, and without the need for broad industry consensus to be achieved across disparate stakeholders.

For completeness, the Applicants also note in response to comments made by Aurizon Network about inter-system traffic that the DCCC process does not cut across or limit Aurizon Network’s ability to continue to manage and schedule cross-system traffic. The DCCC simply ensures that orders for Members at DBCT are optimised and best reflect the ‘whole of coal chain’ view of Members.

If anything, a reduction in cancellations and variability within the DBCT Coal Chain should improve the overall reliability of the Goonyella System for everyone – including cross-system users.

Potential impact on other participants in the DBCT coal chain

We understand that there may be an assumption or concern that for DCCC Members to obtain a benefit, others in the coal chain must lose. However, that is not the rationale that supports the establishment of the DCCC. The DCCC Members will more efficiently manage their infrastructure requirements – for the benefit of all users of DBCT, including non-Members.

It also follows that as membership grows, the ability to efficiently coordinate requirements also expands – and this further increases benefit, providing a strong incentive for the Applicants to encourage future participation by all producers and rail operators.

In the earlier response to concerns raised by Anglo (on 14 March 2014), the Applicants set out the range of protections that have been included in the Charter and DCCC structure to ensure that:

- the Scheduling Coordinator acts in the best interests of all Members;
- scheduling requests are managed in a fair, equitable and non-discriminatory manner, and with the object of achieving transparent and well-defined outcomes;
- there is clear oversight and governance of the Joint Scheduling Group (and Scheduling Coordinator) by the Management Committee;

- the Scheduling Coordinator can be replaced, including by an independent Scheduling Coordinator after the first 12 months, if the Members agree;
- information which is shared within the DCCC is limited (mostly to information which is already available to Members) and is subject to strong confidentiality obligations – including specific obligations binding the Scheduling Coordinator.

However, in addition to these ‘structural’ protections, there are a number of attributes of the DCCC which mean it is unlikely to have any detrimental effect upon other rail operators:

- The Scheduling Coordinator does not select or choose what haulage provider is used in relation to any scheduled path.
- The DCCC will have no visibility of, or involvement in, any commercial terms associated with above rail haulage activities.

This means that there is nothing restricting a coal producer that uses Aurizon or any other non-Member rail operator from participating in the DCCC. Any commercial or contract information about haulage terms or arrangements is not required to be shared within the DCCC and the Member retains the responsibility of selecting which rail operator is used to haul.

Aurizon’s above rail operator is also very welcome to join the DCCC.

For the purpose of the ACCC’s assessment of the Applicants’ request for interim authorisation, it is also important to note that during the first 3 months at least, DCCC only comprises PN paths, so the assumed ‘conflict’ issue does not arise.

The draft NBB System Rules and IPR do not provide an alternative to the DCCC

Aurizon Network argues that the Applicants do not fully disclose that industry participants already have the opportunity to have a direct input into the way in which train services are scheduled through both the proposed System Rules and Integrated Planning Regime (**IPR**). The matters of concern raised by the Applicants can potentially be matters raised in the development and approval process for the System Rules.

With respect, this submission simply demonstrates one of the concerns that the DCCC is designed to resolve, being that solutions for the ‘end to end’ coal chain cannot be driven or ‘owned’ by solutions which focus only on one element – such as rail scheduling. Aurizon Network has itself argued that this is the case, as part of its supporting submission for the draft UT4 undertaking, in saying that it should not be responsible for managing coordination of the wider coal chain.⁴

In relation to the specific industry mechanisms referred to:

- Coal producers do not have any ability to participate directly in the IPR, which has a membership limited to the rail and port operators. This is in fact an example of the kind of arrangement which the DCCC is designed to overcome, by providing a forum within which coal producers can directly participate (together with rail operators).
- As noted above, there remain considerable difficulties with the System Rules and their development: their development lacks transparency, there is no clear oversight or interaction with the regulatory framework and in the past they have been used to embed (not alleviate) inflexibility, such as the ‘even railings assumption’.

⁴ Aurizon Network UT4 Submissions, Volume 2, page 174.

- System Rules are understandably 'rail centric' and are a document that is owned by Aurizon Network – they are not a document capable to delivering the kind of 'end to end' operational coordination and producer involvement which is the focus of the DCCC

Minimum tonnage threshold

The Applicants note the concern raised by Vale as to the operation of the minimum tonnage threshold required in order for a Member to vote as part of the Management Committee.

Currently, the Applicants understand that there are only six long term users of DBCT, being:

- BMA/C
- Anglo American
- Peabody Energy
- Vale
- Rio Tinto
- Glencore

Lake Vermont also ships through DBCT, but on a short term assignment from an existing DBCT User and is not included in the above assessment.

The Applicants understand that:

- Between them Anglo, Peabody, Rio Tinto and Glencore collectively hold approximately 72-75Mtpa of the 85Mtpa contracted tonnage or 85-88%; and
- BMA/BMC holds a relatively small contracted entitlement at DBCT, however it also wholly owns and operates the neighbouring Hay Point coal terminal – the tonnage for which shares the Goonyella System with DBCT.

The Applicants expect that, currently, the issue identified by Vale is therefore likely to be unique to it.

The Applicants nonetheless recognise the issue which it has raised and look forward to working with it to find a means of facilitating its participation over coming months.