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28 March 2014

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

Dear Mr Hatfield,


Aurizon welcomes the opportunity to comment on the joint-scheduling arrangement (**the Arrangement**) proposed by Pacific National Pty Ltd, Rio Tinto Coal Australia Pty Ltd and Peabody Energy Australia Pty Ltd (**the Applicants**).

Aurizon recognises that there can be value in supply-chain participants agreeing, on voluntary and commercial terms, to coordinate their activities. A substantial improvement in the performance of the Goonyella supply-chain has already been realised through the voluntary establishment of various user groups, and improved coordination of port, rail and network maintenance activities.

In its current form, the Arrangement is effectively a proposal by Pacific National to coordinate rail and port operations for some of its existing customers. Pacific National proposes to offer this service to participating producers via a new and complex administrative body, described as the “DBCT Coal Chain Coordinator” (**DCCC**). As Pacific National is not independent and the Arrangement encompasses only a small proportion of Goonyella tonnes, the Arrangement is not comparable to the Hunter Valley Coal Chain Coordinator (**HVCCC**).

In many respects, the Arrangement simply reflects the role of rail operators as the effective and natural coordinators of rail capacity. Aurizon does not therefore, in principle, object to the Arrangement, subject to:

- participation in the DCCC remaining strictly voluntary (any regulatory support of the DCCC, including in UT4, would be highly objectionable to Aurizon);
- the DCCC’s activities having no adverse impact on non-members, such as to coerce participation;
- the operation of the DCCC not having the purpose or effect of substantially lessening competition in the rail haulage market; and,
- the Applicants developing a monitoring mechanism to give non-members confidence that the Arrangement will not become an effective buying cartel of rail haulage services, or discriminate against non-member producers at the terminal.



That noted, Aurizon cannot conceive of circumstances where it would join any arrangement that involved scheduling of its services being performed by a competitor. For Aurizon to outsource the scheduling of its Goonyella fleet to its main competitor would be anticompetitive, breach its haulage contracts, and be plainly inconsistent with the interests of Aurizon's shareholders.

Aurizon expects that any party participating in the Arrangement will continue to meet its contractual obligations, including as regards the ordering and scheduling of train services.

I. Timing, Consultation and the Interim Authorisation

The DBCT Coal Chain is a complex operational environment, and it is uncertain how the Applicants propose to operate their joint-scheduling arrangement. This makes a full assessment of the impact of the Arrangement on competition difficult. Moreover, a number of expected elements of the Arrangement appear to be absent, particularly:

- further detail on the implied information sharing arrangements between the Applicants (noting a practical necessity for the Applicants to disclose commercial information to the Scheduling Coordinator), showing how and to what extent competitors propose to share potentially sensitive terms between themselves, without impacting on competition; and
- a scheduling protocol, detailing how the Arrangement will implement a joint scheduling mechanism consistently with the Network Management Principles, existing contractual obligations to rail and port operators, and co-shipping arrangements with non-members.

(a) Relevance to the 2013 Draft Access Undertaking (UT4).

The basis for seeking an Interim Authorisation is a claim by the Applicants that provisional approval is necessary as "an important input" to the QCA's consideration of Aurizon Network's 2013 Draft Access Undertaking (UT4). The Applicants have provided further elaboration on this in a follow-up submission, referring to the "important and shared insights" and "practical experience" that the DCCC must "urgently" bring to UT4.

Aurizon would seek more specific clarification on what the Applicants intend. The benefit of the Applicants providing a joint perspective to the regulator (which, in effect, is already done via the industry association) seems an unconvincing basis for Interim Authorisation. It seems unlikely that the DCCC will (particularly in its first 12 months) provide any new insights in relation to the operation of the Goonyella supply-chain that the Applicants cannot already provide. Of course, the Applicants are free to lend their expertise and commercial perspective to the regulatory process without authorisation.

For the avoidance of doubt, Aurizon would oppose any attempt to amend the Queensland regulatory framework to compel non-members to recognise or deal with the DCCC. As noted, Aurizon recognises the right of the Applicants to enter into their own commercial arrangements, but only where third parties are unaffected and existing contractual arrangements are honoured. This would not be the case were broader regulatory reform intended. As recognised in the Application itself, implementing the Arrangement does not – and should not – require the amendment of any contractual or regulatory arrangement, and is thus is of no apparent relevance to UT4.



(b) Interim authorisation of prospective members

The Applicants have sought to obtain Interim Authorisation on their own behalf, as well as on the behalf of any prospective members. Accordingly, it remains possible that participation in the Arrangement (under both the Interim and Final Authorisations) could range from the nominated Applicants to all users of the Goonyella system.

In this respect, Aurizon has a preliminary concern that, in the event the membership of the Arrangement expands, it could have the effect of substantially lessening competition in rail haulage markets. Given the lack of any compelling basis for the ACCC provisionally authorising unidentified parties to join the Arrangement, Aurizon welcomes the ACCC's decision to grant Interim Authorisation to the identified Applicants only, pending the ACCC's full consideration of the Arrangement.

II. Potential impact of expanded participation in the DCCC

Aurizon does not envisage that the DCCC will lessen competition in any market, where the Arrangement remains limited to the identified Applicants. The Applicants lack sufficient scale in terms of system throughput to adversely affect other users, or impact on rail haulage markets. However, Aurizon considers that an expanded membership could raise competition concerns, and needs to be thoroughly considered by the ACCC.

For the avoidance of doubt, Aurizon does not envisage the Arrangement (whether with an expanded membership or otherwise) lessening competition in the markets for seaborne thermal or metallurgical coal.

Aurizon's specific concerns are set out below.


(a) Possible reduction in non-price competition in the haulage market

Competition in the rail haulage market in Goonyella is characterised by intense price *and non-price* competition. The complexity of the supply-chain results in numerous variations in customer requirements, making for a diverse and rich range of different above-rail service offerings. By way of contrast, the DCCC seeks to:

- increase coordination activities in the supply-chain, implying a concomitant increase in the information divulged to the collective in order for those activities to occur. This can invariably lead to, or facilitate, a lessening of competition in the rail haulage market due to standardisation of terms or quality of service; and,
- "optimise haulage arrangements" (Charter, cl 9.3(d)), presumably such as to, in the fullness of time, standardise the offerings between different rail haulage providers, or have direct or indirect influence on the way in which members negotiate haulage services (even where those negotiations are not directly controlled by the collective).

While the members have made clear that the purpose of their Arrangement is not to jointly acquire rail haulage services, Aurizon has a preliminary concern that the envisaged information sharing and optimisation arrangements could have this effect.

When considered in conjunction with the conflict arrangements (discussed below) and the high degree of operational coordination inherent in the Arrangement, Aurizon has a concern that the Arrangement could facilitate tacit or overt collusion between buyers of rail haulage services, contrary to the purpose of the Arrangement.



Aurizon appreciates that the Applicants do not intend to coordinate their commercial arrangements with rail haulage providers, or to share information in relation to the same. In this respect, the Applicants further submission (**Supplement**) of 20 March notes that:

The DCCC will have no visibility of, or involvement in, any commercial terms associated with the above rail haulage activities.

However, Aurizon is not convinced that the Applicants have implemented sufficient protections to prevent this occurring. It is difficult to envisage how the commercial terms associated with the above rail haulage activities would not be relevant to the Scheduling Coordinator performing its functions, particularly as the Scheduler has an objective to “optimise haulage arrangements”. To perform this task optimally, the Scheduling Coordinator would require intricate knowledge of above rail resources, capacities, availabilities and other highly commercially sensitive information associated with service quality in order to achieve the DCCC objectives. Give that necessity, there would appear to be an incentive for the Applicants to share this information over time, even if their present intention is not to do so.

Aurizon would therefore request that the Commission examine whether the Applicants have put in place adequate ringfencing arrangements, such that information in relation to the activities of members in the competitive above-rail haulage market is not shared.

(b) Imposes restraints on member producers acquiring haulage services from non-member rail operators

The Arrangement contains mechanisms to deal with members who are in “conflict” with the objectives of the Arrangement. These mechanisms, amongst other things, restrict members from entering into contracts with third parties, where those contracts would put the member ‘in conflict’ with the DCCC Charter (clause 6.3).

Aurizon is concerned that the Arrangement seeks to limit producer members from holding competitive tenders for their rail haulage requirements. In particular, it is possible that a producer member looking to tender its haulage arrangements to both non-member and member rail operators, would be put into conflict with the Arrangement’s objectives, and thereby restrained from contracting with the non-member operator. For example:

- If a non-member rail operator offered a discounted haulage rate in exchange for prioritisation of rail orders from a member producer, would that producer be bound not to accept that offer if it reduced the throughput of the nominated tonnes of a member rail operator and therefore the DCCC aggregate?
- If a member producer looks to place expansion tonnes into a competing supply-chain that utilises a non-member operator, is that producer prevented from doing so if the result is demand being captured from the DCCC or the operational efficiency of DBCT reduced?

It appears to be the case that, in either of these circumstances, the Arrangement (particularly, clause 6.3 of the Charter) would impose an anticompetitive restraint of trade preventing the producer from contracting with the non-member operator. In Aurizon’s preliminary view, this is unjustified and should be amended. At a minimum, Aurizon believes that the Charter should specifically state that a producer member acquiring, or seeking to acquire, haulage services from a non-member operator, is not in conflict in relation to the Arrangement’s objectives.



(c) Uncertain impact on the competitiveness of non-member co-shipping

It is unclear how an expanded Arrangement would interact with co-shipping practices at DBCT. Where an expanded membership was able to preferentially deal with itself in relation to the assembly of co-shipped cargos, non-members might be coerced into joining the Arrangement.

In particular, given sufficient scale and concentration of member parcels within co-shipped product, there would be an incentive for the Arrangement to promote a more flexible shipping stem relative to non-members. Obtaining this flexibility via terminal operations could have a discriminatory effect on those non-members which adhere to turn of arrival berthing. In that eventuality, Aurizon would be concerned that competition in rail haulage markets might be reduced, as a non-member rail operator might be unable to offer its customers a competitive rail service. In effect, a member operator within the scope of the arrangement might be able to replicate and offer an even utilisation service, while other non-member operators would incur higher resource costs due to the need to maintain surge capacity to satisfy turn of arrival berthing.

The Applicant's Supplement also notes that the intention is to:

better align and coordinate short to medium term prioritisation of vessels relative to system and product constraints (in line with existing Terminal Regulations).

As clause 10.1 of the DBCT Terminal Regulations would appear to provide the terminal operator sufficient discretion to allow DCCC members to adjust the shipping queue, subject to not impacting on non-DCCC member vessel queue positions, then this would allow berthing out of order of arrival. Aurizon believes that this flexibility should not be denied to other non-DCCC member terminal users, who should equally have visibility of any ship re-ordering that occurs.

While the Applicants have stated their intentions are not to this effect, Aurizon considers that the Authorisation should be conditional on a suitable monitoring mechanism, particularly as regards:

- Vessel concentration of member parcels;
- Ship queue movements; and
- Any other concerns expressed by coal producers in relation to discriminatory behaviour at the terminal.

(d) Amendment of the Charter and/or the membership of the Arrangement

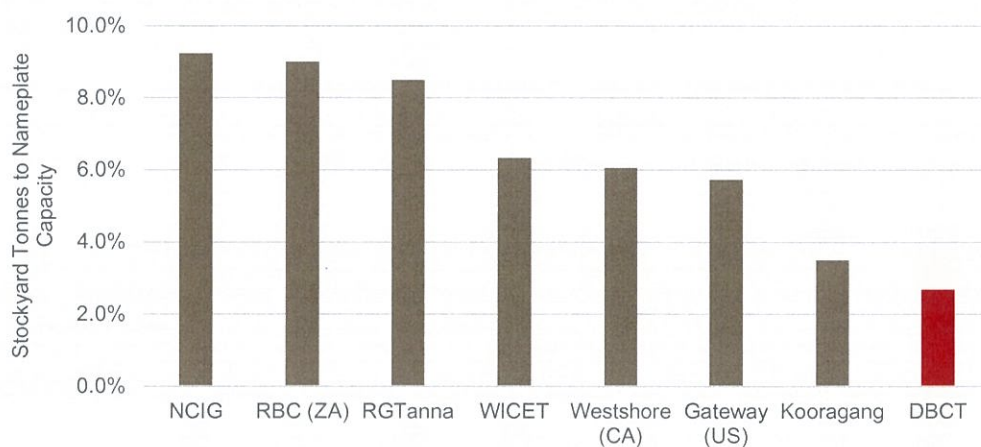
The ACCC is being asked to authorize (i) the entry of any supply-chain participant which meets minimal criteria into the Arrangement; and (ii) an ability for the members of the Arrangement to modify the Charter. As the Charter and the composition of the members forms an essential element of the authorisation, it should be necessary for material changes to the scope of the Arrangement or its membership to warrant review. Accordingly, Aurizon considers that material amendments to either the Charter or the membership, should require the Commission to reconsider the authorisation.

III. Public benefit in the Arrangement

On a preliminary view, Aurizon does not consider that the Arrangement will result in any increase in the throughput of coal from DBCT.

The Dalrymple Bay supply-chain is the most complex multi-user, multi-product coal export supply-chain in the world. In 2008, due to geographical constraints, DBCT expanded from a nameplate capacity of 54 mtpa to 85 mtpa without also substantially expanding stockyard space. As shown below, the result was that DBCT now operates with one of the smallest stockyard to nameplate capacity ratios of any multi-user coal terminal in the world. As a consequence, the terminal was required to move from a stockpile terminal to a cargo assembly mode of operation, making the actual throughput of the terminal vulnerable to variations in supply-chain performance.

Figure 1: Coal export terminals stockpile capacity (with capacity > 30 mtpa¹)



The complexity of the operations and capacity of the terminal is further strained by the blending and multi-parcel requirements of its users.

Accordingly, there are significant constraints to the terminal achieving its nameplate capacity of 85 mtpa. The fact the terminal has been able to operate close to this value is a credit to the efficiency and throughput gains which have been achieved through increased information sharing, improved service reliability and the performance of logistics providers like Aurizon, Aurizon Network, and indeed, Pacific National.

The Applicants have claimed that the operation of the DCCC will have material efficiency benefits associated with reducing interface losses and increasing the flexibility needed to address any contractual misalignment in the supply-chain. However, analysis of some underlying causes suggests that the benefits are likely to be substantially overstated by the submission accompanying the Arrangement.

(a) Interface losses and system throughput

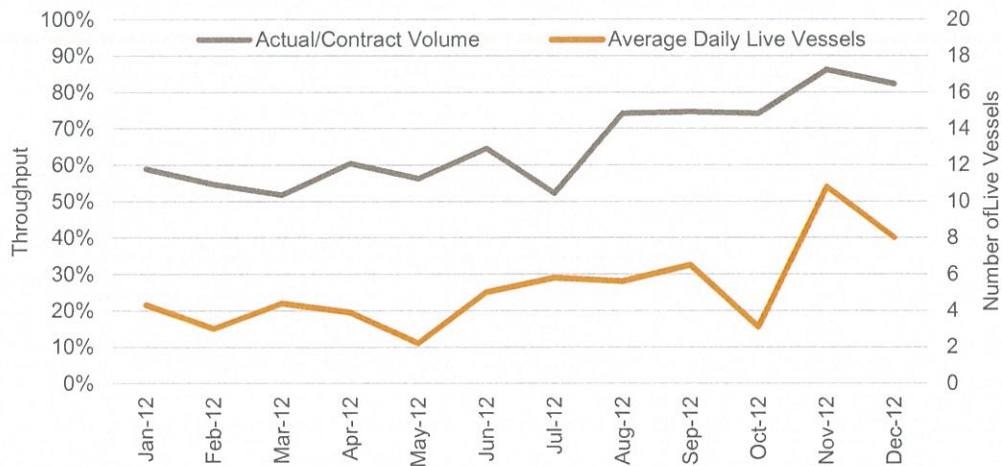
The submission in support of the application observes that the Dalrymple Bay Coal Terminal has operated materially below contracted capacity levels and suggests that this is solely attributable to interface losses.

However, the material provided by the Applicants does not demonstrate these efficiency losses, as it is not adjusted for market conditions. The submissions shows reduced throughput over 2012, without acknowledging that this was largely due to subdued demand conditions in world coal markets at that time.

¹ Gateway Pacific Terminal is a proposed terminal on the west coast of the United States.

To illustrate this, the following graph shows terminal throughput and the average daily number of live vessels in the queue (those with coal available at the mine). As the vessel queue is materially below the terminal's optimal capacity of 15-20 vessels, this suggests that the reduced throughput in 2012 shown by the Applicants is driven by demand and not supply issues.²

Figure 2: DBCT monthly throughput and vessel queue



Further, while it is true that there are interface losses in the Goonyella chain (as indeed, in all multi-user export supply-chains), it is unclear whether the Arrangement will actually reduce these losses. In particular, it is not apparent how the Arrangement will address the following major causes of interface losses in the Goonyella system:

- a common driver of train cancellations is coal not being available at the loading point due to production issues at the mine, yet a ship having already been berthed on the expectation that product would be available. This is a matter which is not addressed by coordination; and
- interface losses occur principally in the day of operations which are not within the scope of the Scheduling Coordinator and therefore are unlikely to be substantially addressed by the DCCC. For example, unload pit diversions can lead to disruptions to the rail plan for connecting services due to the substantially different unload rates at DBCT pits. A train diverted from the faster pit 3 will not meet its scheduled connecting service.³


Accordingly, it is likely that in order for the DCCC to achieve the efficiency gains it has claimed, it would be necessary for the Scheduling Coordinator to be able to direct and control the day-to-day management of train operations. Aurizon would not consent to a third party which lacked a duty to Aurizon's shareholders undertaking such a role. The efficacy of the proposed DCCC in a multi-operator corridor is therefore questionable.

(b) Contractual misalignment

The submission argues that the DCCC and increased coordination is necessary to overcome contractual misalignment between port and below rail.

² DBCTM (2009) Master Plan 2009, p.20

³ DBCT maintains 3 rail receival stations – 2 x 5,500 tph (IL1 & 2); 1 x 7,500 tph (IL3).



When DBCT expanded to 85mtpa, the removal of dedicated stockpiles occurred for all existing contracted tonnes and not just the expansion tonnes. While users of the terminal had agreed to change the fundamental nature of the contractual rights to use the terminal, there was no similar renegotiation of rail contracts. It is effectively this resource misalignment which the O'Donnell report concluded as leading to system inefficiencies.

Aurizon notes that while the train service entitlements in the below-rail contracts are specified on an even-railings basis, this remains necessary to protect the rights of users which use Goonyella system infrastructure but have invested in the stockpile ratios necessary to support even railings. However, in order to accommodate the cargo assembly mode of operation, Aurizon Network's 2010 Access Undertaking includes the ability for operators to borrow and lend their entitlements to provide the necessary operational and scheduling flexibility.

Aurizon has worked proactively with its customers to use that flexibility to optimise scheduling arrangements, minimise resourcing requirements and to reduce variation to the agreed plan. It does this as part of its competitive offer in the above rail haulage market, rather than under the auspices of a joint and complex arrangement such as that proposed by the DCCC. Aurizon does not, therefore, believe that there is any contractual misalignment between itself and its customers that would impact on throughput.

IV. Public benefit in the Arrangement

As noted, the time available to review the documentation for the Interim Authorisation, has not permitted Aurizon to reach a concluded view on the DCCC. We therefore look forward to making further submissions during the consultation period on this application.

Should you have any queries in relation to this submission please do not hesitate to contact Samuel McSkimming on (07) 3019 9024 or by email at: Samuel.McSkimming@aurizon.com.au.

Yours sincerely,



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