



02 October 2009

Mr. Anthony Wing & Dr. Richard Chadwick
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE, Victoria, 3001

Copy to: Mr. David Hatfield, Director, Adjudication Branch, ACCC
Mr. Simon Ormsby, General Manager Commercial, ARTC

Dear Gentlemen

Re: Draft Hunter Valley Track Access Undertaking and Agreements

This letter is submitted in response to a request for further information on the issues of Contract Alignment in the Hunter Valley Coal Chain.

Xstrata Coal is supportive of the direction being taken by both the port and track providers in developing the new form of long-term contracts, and the steps taken to ensure alignment is achieved. The attached paper sets out some further areas where we believe that amendments are required to the ARTC Access Undertaking and Access Holder Agreement in order to achieve a practical and workable level of contractual alignment to provide coal producers with the commercial certainty that they require to undertake on-going investment in mining activities in the Hunter Valley.

We have prepared a mark-up of the draft Hunter Valley Access Undertaking, and the Access Holder Agreement with some suggestions as to how the issues of capacity alignment may be achieved. These mark-ups are provided as draft only for the purposes of encouraging on-going refinement of the contractual terms to ensure these outstanding issues can be resolved, and should not be taken as a comprehensive position on these documents. We believe that further work is required jointly between the terminal operators, ARTC and producers in finalising these terms, and look forward to continuing the constructive work with ARTC.

The issue of contractual alignment is critical. The current situation in the Dalrymple Bay Coal Chain highlights the risks of entering into long-term take-or-pay agreements which are not aligned. There are two material risks which have been highlighted in recent times:

1. **Capacity needs to be calculated by reference to a common set of System Assumptions.** At DBCC there are material differences in the underlying assumptions that the train, track and port operators use when determining the investment required to deliver coal chain capacity. For example one party assumes the system operates on an even-

railing basis, while the other assumes cargo assembly. Other examples include clear difference in the amount of maintenance that takes place on the track, the level of unplanned losses across the system, and the headways between trains when running on the network. These fundamental differences mean that even though a producer may hold a contract for the same volume with each of the train, track and port providers, the reality is that the system as a whole will not be capable of transporting the capacity which has been contracted. This is the source of much of the substantial underperformance of the DBCC system compared to the level of contracts which have been entered into.

2. **There needs to be coordination / alignment in the delivery of new infrastructure.** Recent port expansions in the DBCC system have occurred up to two years in advance of the expansion of the track capacity. This results in misalignment in contracts and substantial take-or-pay charges being levied on producers for capacity which is unusable. There is no obligation between the track and port providers to coordinate investment planning, and the result is that additional costs are imposed on industry unnecessarily.

There are numerous other examples from other supply chains, however these two key risks highlight why contractual alignment and transparency in coordination must be achieved. The difficulty is that once contracts have been entered into, there is little that can be done to un-do the situation. In the DBCC example, this has resulted in all parties acknowledging the issues, but everyone holding the other elements of the supply chain accountable for addressing the problem. We must not allow a similar model to propagate into the Hunter Valley Coal Chain.

The attached paper and proposed mark-ups to the draft agreements are therefore provided to encourage further work and debate in refining the agreements to avoid repeating the mistakes of the past in other supply chains. The issues can be addressed with minimal drafting amendments. We urge the ACCC, ARTC, terminal operators and producers to continue to address these issues in the next month so that contracts can be finalised during Q4 2009. Particularly, we encourage ARTC and the terminal operators to take a leadership approach in this final coordination, as it is ultimately their contracts which must be aligned. Whilst the previous Contractual Alignment Group provides a ready reference for broader consultation with producers and haulage operators, we recommend that the primary responsibility for finalizing this task vests in ARTC and the terminal operators, and not with any broader industry group such as the HVCCC.

We acknowledge the constructive work undertaken by all parties and this submission is likewise provided in the context of seeking to be constructive. It must be emphasized that this alignment needs to be completed during Q4 2009; whilst contractual alignment has been somewhat stalled due to the 2008/09 focus on the terminal solution, there is an urgent need to now prioritise and resource this task.

Please do not hesitate to contact me on 02 9253 6752 should you have any queries or require any further information in relation to this submission.

Yours sincerely,



Stephen Bridger
Executive General Manager - Logistics
Xstrata Coal

Attachments

1. Paper: Achieving Contractual Alignment across the Hunter Valley Coal Chain (5 pages)
2. Partial mark-up to draft Hunter Valley Access Undertaking pertaining to contractual alignment (1 document)
3. Partial mark-up to draft Access Holder Agreement pertaining to contractual alignment (1 document)

Attachment I: Achieving Contractual Alignment across the Hunter Valley Coal Chain.

Contractual Alignment means that coal producers are able to enter into contracts for capacity with track, port and train providers such that they are able to rely, with a high degree of confidence, on the capacity being available to transport coal through the system. There are four key requirements to ensure alignment and provide certainty:

1. A contract for xMt of capacity on both track and port is based on a common understanding of capacity which reflects a realistic set of operating arrangements such that xMt of coal can be hauled through the system and loaded onto vessels over the life of the contract.
2. Producers are able to vary, swap or trade their entitlement via a mechanism which enables track and port capacity to be re-allocated (taking into account the physical constraints of the coal chain and preserving the commercial position of the infrastructure providers). This mechanism must ensure capacity is not lost as a result of the trade, and that entities who are not a party to the trade do not have their capacity rights impacted.
3. The operation of contracts and consumption of capacity over time is monitored such that contractual rights are enforced and parties are held accountable for their consumption of system capacity without infringing on the contractual rights of others. This means that capacity which has been contracted on track, port and train takes priority over un-contracted throughput.
4. Producers wishing to gain access to future coal chain capacity have a clearly defined process through which they may trigger capacity expansions (if required) and obtain access, such that they can coordinate their start-up of new mining operations with coordinated delivery of coal chain capacity (track, train and port).

Substantial progress has been made towards the achievement of these goals with the progress towards long-term take-or-pay contracts for track and port capacity. Many producers have also sought to renegotiate and enter into new rail haulage arrangements in the knowledge that track and port capacity will be contracted on a different basis to the historical arrangements in the Hunter Valley. Notably, progress has been made towards alignment by:

- Creating a contractual framework which provides for producers to hold long-term access agreements to track and port capacity
- Referencing the establishment of a new Hunter Valley Coal Chain Coordinator as an organisation to model and determine capacity.
- Requiring producers to hold port contracts and track contracts in alignment

It is the intent of each of PWCS and ARTC to create contracts which provide for alignment, and there has been some work to date by each of the parties to address the alignment challenge. However there are still significant risks remaining that the contracts being proposed will not achieve the outcomes outlined above, and impose significant costs and inefficiency on the industry. These risks are identified and explained below, together with suggested amendments to resolve the issue.

Attached to this document is a mark-up the ARTC HVAU and Access Holder Agreement with some suggested amendments to address these issues. This mark-up is provided as a draft for further discussion with ARTC, and is subject to further refinement and development.

1. **There is no commitment to ensure capacity is calculated based on a common set of realistic system assumptions:**

Why is this a risk?

If port and track providers, and train operators, do not sell capacity based on the same set of realistic assumptions as to how the coal chain operates, then the capacity commitments will not be deliverable by the coal chain as a whole. For example, if the port providers assumes the coal chain will incur 10 days of losses due to maintenance in a year, and the track provider assumes 20 days, then it is likely that the port will be unable to deliver its committed capacity obligation if in fact it turns out that there were 20 days of losses due to maintenance.

There is currently no obligation on ARTC or the port providers to ensure they are operating from a common set of realistic system assumptions when entering into contracts. Both entities refer to the HVCCC having some role in the process of calculating capacity but the exact nature of this role is vague, providing considerable uncertainty as to how alignment will be maintained across the system. There should be an over-arching obligation to ensure alignment at this most fundamental level is achieved, and it should be clearly stated that the role of the HVCCC is to set, monitor and administer system capacity.

Proposed solution:

Introduce into the HVAU an obligation to ensure System Assumptions are common and agreed between the port and the track providers. This should be part of an overall set of principles introduced into both the ARTC and terminal contracts to ensure coal chain alignment. The role of the HVCCC should be clearly described.

2. There continues to be some risk that allocation of capacity to time periods may not align between port and track

Why is this a risk?

If parties do not achieve aligned capacity each month or quarter, then they are forced to rely on trading and/or flexibility provisions to ensure their basic contractual rights can be utilised. It is preferable to ensure that the capacity entitlements across port and track in each time period are in perfect alignment when they are first issued.

ARTC and PWCS each refer to a process by which the HVCCC is consulted and maintenance is considered in determining how annual capacity entitlements are allocated across months. This process is insufficient as it does not oblige ARTC and the terminal providers to allocate capacity such that the aligned annual entitlements translate into aligned monthly entitlements.

Proposed solution:

Introduce into the HVAU an obligation to ensure capacity is allocated across time periods such that producers receive aligned capacity in each month/quarter. Given that the capacity calculations are to be based on a common set of system assumptions, then it is straightforward to ensure that the monthly allocation process will also result in alignment.

The Access Holder Agreement should also allow for different capacity periods depending on whether the customer is a Small or Large Producer consistent with the terminal agreement.

3. The mechanism to trade capacity needs further work to be aligned with a port mechanism.

Why is this a risk?

The ability to trade, swap or reallocate capacity is important to ensure capacity of the coal chain can be used efficiently. There is a reasonable amount of unpredictable variation in coal chain operations arising as a result of market driven events, infrastructure issues, geological issues and other factors such as weather. Managing change on a short and

long-term basis is therefore critical, and it is essential that port and track capacity can be jointly or separately traded and swapped between loadpoints and between producers.

Currently the process for trading at the port is yet to be defined. The mechanism for trading track capacity is cumbersome with specified notice periods of two weeks, which is considered unrealistic for managing short term variation. Both parties are committed to the HVCCC playing a role in the trading process. There is currently no commitment to ensure a common system is developed or to ensure that trading of port and track capacity will be enabled via a coordinated process

Proposed solution:

ARTC and PWCS are intending to work, via a Capacity Transfer System Working Group, on developing a mechanism for trading terminal capacity. This should be expanded to include the development of a coordinated system for trading terminal and track capacity, and the commitment to develop a coordinated and aligned mechanism needs to be an obligation in the contracts.

4. Flexibility provisions are not aligned between port and track agreements.

Why is this a risk?

If flexibility and tolerance limits are not aligned, then this will reduce the ability of the producers to manage their entitlements across the whole of the coal chain. Workability of the proposed flexibility arrangements is unclear

Proposed solution:

Proposed to review flexibility arrangements following an initial trial period to ensure port and track working in sympathy with one another.

5. Adjustments for unplanned capacity losses may create misalignment

Why is this a risk?

ARTC have made allowances for a level of unplanned capacity losses in determining the capacity available for sale. This helps to ensure that producers will hold sufficient capacity rights to move their contracted capacity after allowing for a reasonable level of losses which are inevitable in the day to day operation of the coal chain.

A key principle of the new commercial framework is that coal producers should be held accountable for capacity losses which they cause, or similarly to obtain the benefit of increases in capacity as a result of changes in behaviour or infrastructure. The PWCS contract provides for capacity adjustments to be allocated to the causing party, and the ARTC agreement needs to be brought into alignment with this approach. The current drafting provides ARTC will flexibility to allocate capacity adjustments as it sees fit. Principles should be introduced to ensure the allocation of capacity adjustments provides incentive for parties to consume coal chain entitlements efficiently

Proposed solution:

Amend the adjustment mechanism with an over-arching obligation to allocate capacity adjustments, to the extent possible, to the causing party.

6. There is no obligation to maintain and develop the coordinated approach to coal chain planning, and to ensure that a producer holds aligned train, track and port contracts for every train planned through the system.

Why is this a risk?

With new infrastructure coming on-line to support the growing demand for coal chain throughput, it is increasingly important that the daily planning activities be undertaken on a coordinated basis. PWCS refers to the HVCCC as the planning body, and ARTC may have regard to any planning input provided by the HVCCC. There is no obligation on ARTC and the terminal to maintain and develop a coordinated approach to planning.

Similarly, it is unclear how planning will be coordinated between the track and port operators to ensure that before coal is moved through the coal chain that there is an aligned contractual obligation in place i.e. the producer must demonstrate aligned train, track and port capacity is in place before being able to assemble a stockpile or run a train through the system. This requirement is the most fundamental mechanism to ensure contractual alignment exists and is maintained in the day to day running of the coal chain, but is not captured in any of the contracts.

Proposed solution:

A contractual obligation is required on each of the terminal and port providers to implement a planning system which seeks to ensure a coordinated approach to coal chain planning consistent with the System Assumptions and consistent with the contracted obligations of the parties. There must also be an obligation in place that before coal is allowed to pass through the system, that the producer must provide evidence of its aligned contracts for the volume of coal being transported (for example on a stockpile by stockpile basis at the port)

7. Contractual Terms are not aligned, requiring producers to hold non-aligned capacity obligation in the long-term

Why is this a risk?

Currently the terminal agreement provides for a rolling 10 year contract on an evergreen basis, where as the ARTC agreement is effectively a 15 year commitments (10 years plus a 5 year notice period). For mines reaching the end of their life, the PWCS agreement allows for short term contractual extensions to cover the uncertainty in the exact remaining reserves while the ARTC agreement has no such allowance. These differences create immediate misalignment and financial exposure for every producer.

Proposed solution:

Modify the ARTC agreement to align with PWCS and NCIG rolling 10 year agreement and incorporate a short term option to extend the [AHA] at the end of a mine's life. *[Does this need to be described?]*

8. There is no obligation on ARTC to coordinate its investment planning and time the delivery of new capacity, to the extent possible, with the port operators

Why is this a risk?

Misalignment in the delivery of new infrastructure imposes significant costs onto industry which are otherwise avoidable. Each of ARTC and PWCS intend that they will use the HVCCC to assist in planning new infrastructure requirements, however there is no explicit obligation requiring coordination. It is recognised that perfect alignment is not always possible.

Proposed solution:

Introduce an explicit obligation to coordinate investment planning between port and terminal to ensure cost, risk and timing are taken into account when planning capacity expansions.

9. ARTC are selling rail paths, but charging on the basis of tonnes throughput

Why is this a risk?

ARTC determine the number of paths required by each producer and this is the basis of the access right to the track, however producers are then only charged on a \$-per-tonne model, meaning there is no incentive on producers to consume their rail paths efficiently. The proposed arrangements appear subject to gaming, for example by nominating a smaller train size to secure a large number of rail paths, but then running larger trains to haul the coal. This does not encourage investment in efficient train sizes, nor does it align the sale of track capacity with the underlying System Assumptions.

Current pricing proposals do not provide incentives for improved productivity.

Proposed solution:

ARTC should adopt a model whereby train paths are calculated based on an efficient train size, and then charge per train path utilised. If a producer wishes to run less efficient trains, then this will require them to purchase more rail paths, thereby sending the appropriate investment signal to both ARTC and to the producer in relation to train procurement. This model ensures a more efficient allocation of capacity across the coal chain.

It is reasonable to provide for some 'grandfathering' of existing rolling stock in the system, such that capital which has already been sunk into the coal chain is not penalised. This can be in the form of some form of price adjustment for producers utilising existing rolling stock, where that rolling stock does not comply with the efficient train as defined by the System Assumptions.