

April 21, 1998.

PACIFIC POWER

Industry Commission
Level 28
Collins Tower
95 Collins Street
MELBOURNE VIC 3000

Dear Sir

RE: INQUIRY INTO THE AUSTRALIAN BLACK COAL INDUSTRY

As you are aware, Pacific Power made a submission to the above Inquiry in December, 1997 - that submission was recorded as Number 39.

We have now reviewed the Draft Report dated April, 1998 and provide the following additional comments:

1) Impact of the Introduction of the National Electricity Market on the Domestic Black Coal Industry.

i) Section 2.2.3 of Volume states that "black coal is not expected to lose market share to brown coal in electricity generation".

Evidence from the National Electricity Market suggests that NSW black coal is already being displaced by Victorian brown coal.

Pacific Power has reviewed the position with regard to net electricity generation transfer from NSW to Victoria for the first nine months of the 1997/98 year.

Pacific Power estimates that the net transfer over that period was equivalent to approximately 1.07 million tonnes of NSW black coal.

Significantly, a volume estimated as 0.58 million tonnes was "displaced" during the last three months of that nine month period alone.

This trend suggests that Pacific Power's expectation of a 10% loss of annualised NSW black coal market share to Victorian brown coal (Page 2 of our December, 1997 submission) may already have been realised.

ii) Section 2.3.3 of Volume 1 states that "the full effect of electricity market reform will not be felt by coal companies until around 2000 to 2005".

While it may be the case that effects on the "nation wide" black coal industry may not peak until well into the next decade, impacts on NSW black coal suppliers have already started to take place.

As noted in i) above, the NSW black coal industry is currently losing significant tonnages to Victorian brown coal, through the net transfer of electricity generation to Victoria.

There also exists some evidence to suggest that NSW electricity generators have already taken steps to renegotiate existing long term coal supply contracts primarily to obtain lower costs (in \$/GJ).

Pacific Power endorses comments within this section of the draft report, attributed to Rio Tinto and Powercoal - generators are seeking now, within both existing and new coal supply contracts, major changes in arrangements for coal purchases.

Such changes may include:

- lower prices
- shorter contract terms
- greater flexibility (particularly with respect to volume)
- different product types (such as lower energy products which may include washery middlings and rejects)
- introduction of mechanisms whereby electricity market risk is shared between the generator and the supplier

2) Coal Rail Transport

Pacific Power currently sources around *16%* of its coal to Eraring Power Station via the NSW rail system.

Potential exists to increase that percentage to as high as *40%*, in the future.

Macquarie Generation has recently sought statutory approvals for the construction and operation of a rail unloader to service its operations. Delta Electricity has a disused rail unloader at Vales Point Power Station, which it is understood, could be relatively easily recommissioned.

In an increasingly competitive national electricity market, all three NSW generators may seek to maximise coal supply contestability through the delivery of coal by rail to increase competition with mines closer to the power stations.

This potential for increased rail delivery will continue to be constrained unless the commercial attractiveness of utilising rail is increased.

Pacific Power has, therefore, a direct interest in any actions taken to increase the attractiveness of rail including:

- the timely removal of monopoly rent from coal freight rates
- the timely introduction of effective competition into the NSW coal freight industry

3) Royalty Arrangements

Pacific Power has some concerns with the current royalty arrangements in NSW, whereby a fixed royalty (including, in some instances a super royalty) is levied on all coal produced in NSW, regardless of coal quality.

The arrangement results in a situation whereby royalties levied on a low quality coal provided to a NSW generator may be of the order of three times as high (expressed as a percentage of coal price) as that levied on an export coking coal.

A reduction in the royalty amount paid on lower quality coals would enhance the attractiveness of the purchase of such coals by NSW generators. This may in turn contribute to greater coal resource utilisation and operational and marketing flexibility for coal suppliers.

From its perspective, Pacific Power sees some merit in an *ad valorem* system for royalty calculation, which would reflect the lower quality (and value) of domestic thermal coals. There may also be merit in investigating a royalty calculation mechanism which reflects the lower thermal content of quality domestic products.

Please direct any queries with respect to this submission to the undersigned on (02)9268 8300.

Yours faithfully

R D LANG
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Operations & Marketing