ARTC 2011 HUNTER VALLEY ACCESS UNDERTAKING

RATE OF RETURN

1 BACKGROUND

Prior to withdrawal of the 2010 Hunter Valley Coal Network Access Undertaking (2010 HVAU) and lodgement of the 2011 Hunter Valley Coal Network Access Undertaking (2011 HVAU), ARTC has lodged two previous versions being the 2009 Hunter Valley Coal Network Access Undertaking (2009 HVAU) in April 2009, and following its withdrawal, the 2010 HVAU.

ARTC also provided to the ACCC a revised version of the 2010 HVAU (Revised 2010 HVAU) for further consultation.

The table below shows ARTC's Rate of Return proposals in relation to each of the above versions and, where applicable, the export coal industry (as represented by the Hunter Rail Access Task Force (HRATF)) and ACCC response, in real, pre-tax terms.

	ARTC proposal	HRATF proposal	ACCC response
2009 HVAU	10.47%[1], 10.67%[2]	6.40%[3]	7.00%[4]
2010 HVAU	9.16%	None	8.57%[5]
Revised 2010 HVAU	9.10%	9.10%[6]	None

1 Applicable to assets commissioned prior to the commencement date
2 Applicable to assets commissioned after the commencement date
3 NSWMC Submission to ACCC Issues Paper on behalf of the HRATF, 18 August 2009
4 ACCC Draft Decision, March 2010
5 ACCC Position Paper, December 2010
6 NSWMC Submission to ACCC Issues Paper on behalf of the HRATF, 20 May 2011, subject to certain actions being taken by ARTC.

Throughout consultation on various revisions of the undertaking since 2009, ARTC has noted a common submission by major Hunter Valley export coal producers that the Rate of Return proposed by ARTC could be supported if ARTC were to take on the greater risks inherent in satisfactorily addressing the issues and concerns raised by the industry at the time[1]. Throughout the period ARTC has continued to engage with industry and the ACCC in order to address these issues and concerns.

ARTC has not noted any substantive position in relation to Rate of Return taken by parties other than export coal producers.

In its response[2] to the ACCC Position Paper (essentially the Revised 2010 HVAU) ARTC provided further advice in relation to the proposed Rate of Return, as follows.

- ARTC expressed strong concerns with the position taken in the ACCC December 2010 Position Paper relating to the value of the asset beta and hence the maximum rate of return allowed in ARTC's Hunter Valley Access Undertaking (HVAU). ARTC's concerns with the ACCC's position on asset beta were:
    - Despite ARTC having amended the HVAU substantially in order to address industry and ACCC concerns, and in doing so accepting greater risk (as recognised by the export coal

[1] Coal & Allied Submission 25 October 2010, s6.3 and Xstrata Submission 25 October 2010, p9.

[2] Revised 2010 HVAU Supporting Document – Rate of Return, April 2011.

industry in submissions above), the ACCC position reduced asset beta from the March 2010 Draft Decision (which was largely supported by stakeholders).
    - If the position is maintained it will put at risk investment that underpins substantial export earnings.
    - The consequences of an inappropriately low decision are disproportionately large compared to adopting a more reasonable (but still justifiable) value for the asset beta.

It is ARTC's intention to develop the Hunter Valley network to meet export coal transport requirements where all of the forecasts see volumes doubling over the next few years. ARTC's 2011-21 Corridor Strategy sets out projects totalling $850m over the next 3 years to provide capacity needed to support anticipated growth in export coal volumes. Substantial growth and investment is also anticipated beyond this period. This is in addition to an existing network asset base valued at around $940m.

ARTC has concerns about approving these major investments where there is a perception that returns are "too fine" when all risks are considered, particularly as there is no 'upside' given the regulated maximum returns. ARTC also has significant concerns that setting a maximum return too low will jeopardise its ability to secure financing for these projects. While it is certainly the case that ARTC intends to partly secure these investments by long term contracts with a high level of take-or-pay, this does not fully cover ARTCs risks. In particular, the HVAU increases ARTC's commercial risk position compared to the current contractual position under the NSW Rail Access Undertaking.

Industry is seeking ARTC to invest heavily over the next few years to provide the increased network capacity to support the doubling of volumes. Regardless of who its shareholder is, ARTC is a commercial organisation with a Board that is required to invest prudently, and too low a return will make it more difficult to attract funds and approve investments. The cost to coal producers from a modest increase in the rate of return is a tiny fraction of the loss of revenue that would occur if coal cannot get to port.

A higher Rate of Return will not affect all users of the 2011 HVAU Network. Affected users will fall into two categories:

- Firstly, those users whose price is constrained by the Revenue Ceiling Limit under the 2011 HVAU pay the maximum regulated return and so will experience a marginal increase in access price as described above. This currently includes coal users with hauls operated entirely within the HVAU Network bounded by the Newcastle ports, Muswellbrook and Ulan.
- Secondly coal users operating in the Gunnedah basin are expected to have pricing constrained during the term of the 2011 HVAU as volumes in that region increase. In any event, these users are also indirectly affected now by virtue of the application of loss capitalisation which has the affect of slightly increasing earlier losses to be recovered in the long term.

ARTC considers it extremely unlikely that any users of the 2011 HVAU Network other than those described above will be affected by an increase in Rate of Return during the Term of the 2011 HVAU. In particular, non-coal user pricing is constrained by affordability relative to market position and, as a result, non-coal users are currently not priced at a level that will recover full economic cost. This position is unlikely to change in the foreseeable future.

2 CURRENT HUNTER VALLEY EXPORT COAL INDUSTRY POSITION

ARTC provided a revised Rate of Return proposal as part of a package of consultation documents supporting the Revised 2010 HVAU provided to the ACCC in April 2011.

ARTC notes the most recent position of the Hunter Valley export coal industry (as expressed in the NSW Mineral Council (NSWMC) submission to the ACCC dated 20 May 2011) is:

'It is NSWMC's position that, if ARTC does not:

(a) make NSWMC's proposed amendments to section 5.1(d)(ii) of the Revised April 2011 HVAU; and

(b) before the ACCC issues its final decision, make a public announcement about the transitional arrangements based on the suggested arrangements included in Attachment 4, or some other wording as agreed with NSWMC,

then NSWMC will only support acceptance of the Revised April 2011 HVAU if it includes a real pretax WACC of no higher than the 8.57% proposed by the ACCC in its December 2010 Position Paper. If, however, ARTC agrees to NSWMC's approach, then NSWMC would not object to a higher real pre-tax WACC as proposed by ARTC.'

ARTC is not aware of any recent submission made by another party related to Rate of Return other than a few individual coal producers who publicly supported the NSWMC position above.

3 SIGNIFICANCE OF THE CURRENT HUNTER VALLEY EXPORT COAL INDUSTRY POSITION

Hunter Valley export coal producers constitute a substantial part of ARTC volume and revenue base on the 2011 HVAU Network. Based on 2011 financial modelling provided to the ACCC, export coal volumes on the 2011 HVAU Network (measured in terms of GTK) represent around [redacted]% of volumes affected by the higher Rate of Return (as described above – Affected Users) and 88% of all use of the 2011 HVAU Network in 2011. In revenue terms, export coal volumes represent around [redacted]% of revenue recovered from Affected Users and 94% of revenue recovered from all users.

Affected Users represent around 93% of all volume and 99% of all revenue recovered from the 2011 HVAU Network.

Due to the expected increase in export coal volumes over the term of the 2011 HVAU, ARTC would expect that the proportion of volumes and revenues of export coal producers, compared to Affected Users and all users of the 2011 HVAU Network would increase.

As such, the position taken by Hunter Valley export coal producers through the HRATF in relation to Rate of Return is compelling given that these users represent the vast majority of users of the 2011 HVAU Network that will be affected by a higher Rate of Return.

4 IMPACT OF A HIGHER RATE OF RETURN ON USERS OTHER THAN THE HUNTER VALLEY COAL EXPORT INDUSTRY

The Hunter Valley network is utilised by services transporting minerals (other than coal), grain and cereals products, rural commodities including flour and cotton, passengers and on occasion containerised intermodal and steel traffic. None of these traffics will have pricing adjusted a result of the proposed higher rate of return.

It is possible that there are parties that are not Hunter Valley export coal producers, and so not represented by the HRATF, but could be directly or indirectly impacted by a higher Rate of Return under the 2011 HVAU. In 2011, ARTC expects there to be only one such party that could be impacted in such a way. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

As such, the impact on parties, other than those represented by the HRATF, of a higher Rate of Return under the 2011 HVAU is very small when considered in the context of the 2011 HVAU Network as a whole.

5 ARTC'S RECOMMENDATION

In light of the strength of representation of parties likely to be affected by a higher Rate of Return during the Term of the 2011 HVAU that is captured by a submission made by the NSWMC (HRATF), ARTC considers that support for the higher (9.10%) Rate of Return currently proposed by ARTC by the HRATF should represent a compelling factor in the ACCC's consideration of a regulated Rate of Return to apply under the 2011 HVAU.