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Submissions to the Australian Competition and Consumer Commission Hunter Valley Coal Network Access Undertaking submitted by Australian Rail Track Corporation ("ARTC")

1. General

Glencore is a major coal producer operating several mines which utilise ARTC's Hunter Valley Coal Network.

Glencore is a member of the Hunter Valley Rail Access Task Force ("HRATF") and supports the submissions that have been made by the HRATF.

2. Loss capitalisation in Pricing Zone 3

We do not believe that the retention of loss capitalisation in Pricing Zone 3 is appropriate, except if a differential Weighted Average Cost of Capital ("WACC") is also adopted in Pricing Zones 1 and 2 reflecting the lower risks within these Pricing Zones compared to Pricing Zone 3.

Loss capitalisation, and ARTC's approach to revenue reallocation (which Glencore rejects), permit Pricing Zone 3 users to use ARTC's infrastructure without paying the Economic Cost of that infrastructure as Access Charges (as Pricing Zone 1 and 2 customers must do). We, like the ACCC, had previously understood that loss capitalisation was likely to come to an end during 2016. Given that this is not now the case, and ARTC wishes to retain loss capitalisation as a longer term feature of the Access Undertaking, we believe that this issue should be addressed seriously by the ACCC.

ARTC has provided little explanation of the basis on which it has decided to extend loss capitalisation, other than the strong preference of Pricing Zone 3 customers. It has presumably decided to do so on the basis of a commercial calculation that the risk is justified, perhaps on the basis that the Pricing Zone 3 customers would currently have difficulty in paying the full Economic Cost of their infrastructure.

However, this decision by ARTC brings about a situation where the risks inherent in different parts of the ARTC business are different, with the risks in Pricing Zone 3 being higher. In Pricing Zone 3, ARTC is deliberately running the risk of deferring the recovery of Economic Cost into the future. Of course, currently ARTC uses a single WACC which applies equally within all Pricing Zones, despite the difference in risk which exists between the constrained and unconstrained zones. Presumably the current WACC reflects a blend of the different risks inherent in the different Pricing Zones. We propose that if loss capitalisation is allowed to continue that the Pricing Zones 1 and 2 WACC rate should be set lower than the Pricing Zone 3 rate, to reflect that there is no risk relating to deferral of revenue recovery in those Pricing Zones.

GLENCORE

3. Changes to section 4.4 of the HVAU - Revenue reallocation to Pricing Zone 3

We do not regard section 4.4 of the HVAU as being appropriate.

Glencore has made several previous submissions in relation to the approach to revenue reallocation from Pricing Zones 1 and 2 and Pricing Zone 3. We have been clear that we do not approve of a methodology which effectively results in the cross subsidy of users in Pricing Zone 3 by users in other Pricing Zones. This is particularly the case given that Pricing Zone 3 is only “unconstrained” by virtue of the fact that ARTC has made a commercial decision to allow loss capitalisation within that Pricing Zone rather than to recover its full Economic Cost. This has the effect not only of sparing users in Pricing Zone 3 from paying current Access Charges reflecting the Economic Cost of Pricing Zone 3 infrastructure (which will be recovered by ARTC in future Access Charges), but spares them from paying the Economic Cost of Pricing Zone 1 and 2 infrastructure (which is borne by the Pricing Zone 1 and 2 users resulting in cross subsidy). We will not repeat the arguments in full in this submission, but we strongly maintain that view.

4. Pricing Zone 3 and Weighted Average Mine Life

To the extent that Pricing Zone 3 customers continue to access Pricing Zone 1 and 2 on the basis of paying only incremental cost, Pricing Zone 3 customers are effectively being cross subsidised by the existing users. If that continues to be the case, we would strongly submit that, assuming that the mines in the unconstrained network have a longer average mine life, the depreciation profile of all existing infrastructure should reflect a weighted average mine life across the Network, rather than ever being calculated on a Pricing Zone by Pricing Zone basis. The Pricing Zone 3 customers are already gaining the benefit of accessing the existing network on the basis of incremental cost. It would be even more egregiously unfair to permit ARTC to fully depreciate the infrastructure in Pricing Zones 1 and 2 during the weighted average life of the mines only within those Pricing Zones, when the same infrastructure may continue to be used by Pricing Zone 3 mines with a longer weighted average mine life once it has already been fully depreciated. The current drafting of the HVAU contemplates the concept of separate weighted average mine life per Pricing Zone. We believe this language should be limited to a case where the weighted average mine life within the constrained network exceeds the weighted average mine life for the Network as a whole.

5. Path based pricing

We are supportive of ARTC’s proposed change to path based pricing. We believe that this will help incentivise the efficient utilisation of the available capacity on the Network, by providing an incentive to Access Holders to operate trains which move the maximum amount of coal which is possible within the constraints of the train path as defined by ARTC in order to maximise the efficiency of their usage of their contracted train paths. Given that the “product” that Access Holders contract for under their Access Holder Agreements is the use of train paths, we believe that it makes sense for the charges also to apply on a per train path basis.

We were previously supportive of the determination of an efficient train size as the “Final Indicative Service” as the means to incentivise efficient utilisation of the Network. However, it has proved impossible to determine an efficient train size and we do not believe that it would be able to be achieved during the term of the next Access Undertaking.

GLENCORE

We do not believe there will be any material adverse impact on existing Access Holders as a result of path based pricing. It is our understanding that the way in which the paths will be defined will ensure that all existing trains and operators within the Hunter Valley will be able to utilise the paths that ARTC defines. Access Holders which do not operate trains which maximise the efficiency of their utilisation of train paths may be relatively disadvantaged, but this is due to their less efficient utilisation of the Network. Glencore currently operates a train which is not of the optimal size and we are willing to accept that so far as this train is concerned, we may face a slight per tonne increase in the Access Charges relevant to that train.

6. Asset Beta

We support the submissions that have been made by the HRATF on this subject. ARTC is operating a business whose cash flows are underwritten for the next 10 years by a group of leading coal producers, including several with investment grade rated ultimate holding companies. This period of forward commitment will remain relatively constant given the nature of the evergreen Access Holder Agreements which require a ten year commitment to be maintained in order to preserve renewal rights.

Beyond the defined period of forward commitment, ARTC's cash flows are underwritten by the fact that it owns a monopoly rail network which must be used by the coal which will be produced by the existing mines in the world's premier coal exporting region.

On the basis of the current ARTC approach to the calculation of weighted average mine life (which we reject as inappropriate), the return of all capital invested by ARTC in the Network will occur during the mine life of mines which have already been built and are in operation. It is not difficult to identify the very limited material risks ARTC is actually exposed to in its business. These risks are easily defined, unlikely to occur, and at least in case of ARTC's costs and financing arrangements, should be within the capability of ARTC to manage. These highly limited risks bear no relationship to the level of risk which is faced by a normal operating business.

In the following table we identify some risks that might be faced by a typical business, and to what extent they relate to ARTC.

Risk	Summary	Application to ARTC	ARTC exposure
1. Demand risk	<ul style="list-style-type: none"> Risk of demand for company's products 	<ul style="list-style-type: none"> Hunter Valley is a monopoly asset required for all coal exports from the Hunter Valley. All users are contracted for 10 years of future demand. Shortfall in demand results in higher prices for existing users rather than reduced revenue for ARTC, due to the revenue cap model. 	Very low.

GLENCORE

Risk	Summary	Application to ARTC	ARTC exposure	
2.	Competition	<ul style="list-style-type: none"> A competitor enters the company's market. 	<ul style="list-style-type: none"> Hunter Valley is a monopoly asset required for all coal exports from the Hunter Valley. No competition is possible given that it is practically impossible to build a new railway to the Port of Newcastle. 	None.
3.	Increase in costs	<ul style="list-style-type: none"> The company's cost of producing its products increase. 	<ul style="list-style-type: none"> Hunter Valley is a monopoly asset required for all coal exports from the Hunter Valley. ARTC is able to pass through all prudent costs to users, which are guaranteed to be recovered within the revenue cap. 	Low, within the control of ARTC
4.	Poor service delivery	<ul style="list-style-type: none"> The company's service delivery is poor. 	<ul style="list-style-type: none"> If ARTC is consistently unable to deliver the required number of Train Paths due to its own default then the True Up Test may result in the return of some Access Charges. The TUT has never been triggered during the period of the 2011 HVAU. 	Low, within the control of ARTC
5.	FX changes	<ul style="list-style-type: none"> FX rates increase the company's costs. 	<ul style="list-style-type: none"> As per item 2 	Very low
6.	Cost of finance	<ul style="list-style-type: none"> Cost of finance 	<ul style="list-style-type: none"> ARTC runs the risk (or takes the benefit) of deviations between ACCC approved WACC and its actual cost of finance. However, ARTC does benefit from very stable cash flows given the revenue cap model, 10 year rolling take or pay agreements and the low risk nature of its business. This means that it is likely to be able to source very competitive finance. Further, the ACCC decision is designed to reflect the cost of capital to ARTC and is to be 	Low

GLENCORE

Risk	Summary	Application to ARTC	ARTC exposure
		revisited at least every 5 years.	
7. Major disaster – track	<ul style="list-style-type: none"> Some sort of major disaster destroys ARTC assets e.g. flooding 	<ul style="list-style-type: none"> ARTC assets are widely dispersed meaning that a single event is likely to impact only a small proportion of its assets. ARTC will be able to call force majeure, meaning that Access Holders will still be liable to pay Access Charges. Insurance likely to respond to the cost of repair. 	Low
8. Major disaster – port	<ul style="list-style-type: none"> Some sort of major disaster affects the port, e.g. vessel blocks channel, terminal damaged 	<ul style="list-style-type: none"> Access Holders must continue to pay Access Charges regardless. 	None
9. Major disaster – mine	<ul style="list-style-type: none"> Some sort of major disaster affects a mine, e.g. collapse or fire 	<ul style="list-style-type: none"> Access Holders must continue to pay Access Charges regardless. ARTC services a portfolio of mines. 	None
10. Single commodity exposure	<ul style="list-style-type: none"> Hunter Valley is exposed to a single commodity (i.e. coal) 	<ul style="list-style-type: none"> The ARTC network will remain the only way to deliver coal to Newcastle. ARTC is not exposed to the price of coal, only to the usage of its network. Volume of production is not positively correlated to price – as we have seen over the past few years. 	Very low

We have referred to the Incenta Report to the Queensland Competition Authority in relation to Asset and Equity Beta for Aurizon Network, dated 9 December 2013, and in particular to their findings of asset beta in the regulated energy sector. In our view, ARTC faces a very similar profile of risks to a regulated energy business – both businesses operate a monopolistic network with the ability to recover their approved costs from their users. ARTC's network also carries energy in the form of coal.

It might be argued that ARTC should be distinguished from other regulated energy networks on the basis of its single commodity exposure. We do not accept that ARTC's single commodity exposure

GLENCORE

should result in a higher asset beta than any other regulated energy network. We believe that the demand for coal will remain robust – in much the same way as the demand for electricity or gas will remain robust. There is no substitute for coal in the process of steel making. There are (less economic) substitutes for coal in power generation, but we believe demand for thermal coal will remain strong. There has been, and continues to be, very substantial investment in long life coal fired power generation assets that will require coal during and beyond the depreciation period of the ARTC Hunter Valley network. Given the long life and large capital value of generation assets, past and current investment decisions will have effects long into the future.

Furthermore, in the highly unlikely event that the outlook for coal was to significantly change by the time of the next review of ARTC's pricing parameters, then the ACCC could change its stance on the pricing parameters as appropriate, for example by allowing an increased WACC or through permitting an accelerated depreciation profile. If there were to be any more sudden change, then it would also be open to ARTC to seek an out of cycle price review by the ACCC. The residual risk exposure of ARTC to a situation in which ACCC action could not provide complete mitigation is virtually nil.

We note that the Incenta Report gives the average beta for energy firms in Australia, NZ and UK under a revenue cap pricing model was a mean of 0.32 and a median of 0.27.¹ We also note that the conventional asset beta derived by its analysis of energy firms was a mean of 0.36 and median of 0.34.

We therefore believe that an Asset Beta of 0.27 - 0.36 would be appropriate for the Hunter Valley network.

7. Rail Capacity Group – Participation and voting

We are not supportive of the change which has been proposed by ARTC to allow participation of all Access Holders in the Rail Capacity Group. We believe that the current system of allowing the direct participation only of significant Access Holders ensures a more effective decision making body.

We are not supportive of the change to voting based on train km which has been proposed by ARTC. We believe that the current weighting of voting based on gross tonne kilometres is more reflective of the basis on which costs are recovered from Access Holders. A change to train km would increase the voting power of users which happen to utilise smaller trains at the expense of those using larger, more efficient trains.

8. Flexibility between unloading points

ARTC has introduced amendments which require unloading points to be nominated for Train Paths and which restrict the ability which currently exists to freely transfer train paths between NCIG and the PWCS terminals through the "Safe Harbour" provisions. We are supportive of these amendments.

Our understanding is that the network has not been physically designed to be able to accommodate transfers between NCIG and PWCS without having an adverse impact on the capacity of the Network

¹ Incenta Report, Table 1.6, page 18

GLENCORE

to accommodate its normal contracted throughput capacity. Such transfers may therefore have an adverse impact on other users. We believe that this issue has become more acute over the period of the current Access Undertaking, with the 30 mtpa Stage 1 of the NCIG terminal having achieved full throughput capacity in early 2012, Stage 2 achieving mechanical completion in mid-2012 taking the terminal capacity to 53 mtpa and Stage 3 taking the capacity of the terminal up to 66 mtpa. We would not support the construction of additional capacity to enable such flexibility to occur.

Furthermore, we do not understand how ARTC can coherently plan its network if the contracts held by Access Holders do not specify the end point of their Train Paths. ARTC needs to know whether Train Paths will actually end at PWCS or NCIG in order to ensure the appropriate Capacity is available. That being the case, we support the requirement to nominate the unloading point for each Train Path and do not believe that it is appropriate for such transfers to fall within the "Safe Harbour" provisions of the Access Holder Agreement. We believe that, as ARTC has proposed, it is appropriate for such transfers to be considered under clause 16.4(d) and only approved if they do not have an impact on Coal Chain Capacity and the Capacity entitlements of other users.

Other users may assert that because ARTC failed to require users to nominate paths by terminal in the original form of the Indicative Access Holder Agreement put in place in 2011, ARTC should be prevented from now requiring Train Paths to specify a destination or including a requirement that transfers between terminals should be subject to the normal review procedures which apply outside "Safe Harbour" transfers. We would not support that view, which would produce a gain for a limited subset of producers whose operations exploit the existing flexibility, at the expense of the system as a whole. If such a view was followed by the ACCC, then this would lead either to an ongoing adverse impact on the capacity of the system as a whole, or necessitate additional capital works (if physically possible) to continue to provide this flexibility to a small number of producers.