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Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Competition and Consumer Commission
GPO Box 520
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(By email: transport@accc.gov.au)

Dear Mr Schroder

Consultation Paper – Australian Rail Track Corporation's 2016 Hunter Valley Access Undertaking

Idemitsu Australia Resources Pty Ltd (**Idemitsu**) welcomes the opportunity to provide the following submission in regards to the Consultation Paper issued on 8 January 2016 by the Australian Competition and Consumer Commission (**ACCC**) in relation to Australian Rail Track Corporation's (**ARTC**) 2016 Hunter Valley Access Undertaking (**2016 HVAU**).

1. Background

Idemitsu is a coal producer with mines located in the Hunter Valley and Gunnedah Basin, for simplicity Pricing Zone 1 (**PZ1**) and Pricing Zone 3 (**PZ3**) as defined by the current 2011 Hunter Valley Access Undertaking (**2011 HVAU**). Idemitsu requires access to the Hunter Valley Coal Network (**HVCN**) to transport it coal from its mines to the Port of Newcastle.

The 2011 HVAU was voluntarily submitted by ARTC in accordance with Part IIIA of the Competition and Consumer Act 2010 (Cth) and accepted by the ACCC on 29 June 2011 and is due to expire on 1 July 2016. ARTC in accordance with Part IIIA has submitted a new undertaking (23 December 2015), **2016 HVAU** for consideration and assessment by the ACCC. The 2016 HVAU is proposed to commence 1 July 2016 to ensure Access Holders continuity and certainty with respect to access to the HVCN.

The Hunter Valley coal industry has reformed the Hunter Rail Access Task Force (HRATF), a group comprising nine[1] Hunter Valley coal producers who access HVCN. The HRATF was the body representing coal producers during the negotiation process for 2011 HVAU. The HRATF has been involved in ongoing discussions and negotiations with ARTC since late March 2015 regarding the 2016 HVAU. Although progress has been made no final negotiated outcome has been achieved with respect a number of the commercial and operational features of the new undertaking.

With the assistance of its nominated advisers, the HRATF has prepared a submission for this consultation process which addresses the issues raised in the ACCC Consultation Paper, however due to the differing commercial and financial interests between HRATF members some issues have been identified as unaligned and therefore individual coal producers would make individual submissions on these matters.

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[1] Representatives from the following Access Holders: Anglo American; Bloomfield Group; Coal & Allied (Rio Tinto Coal Australia); Glencore Coal; Idemitsu Australia Resources; NSW Energy Coal (BHP Billiton); Peabody Energy; Whitehaven Coal; and Yancoal Australia.

Idemitsu is a member of the HRATF and supportive of its submission with the exception of those matters outlined in this submission.

Idemitsu would like to take this opportunity to thank ARTC for the professional and open discussions which have occurred to date. Idemitsu is committed to continue working with ARTC and other stakeholders on the development of the 2016 HVAU.

2. Revenue Allocation

The Explanatory Guide[2] accompanying ARTC's 2016 HVAU application makes reference to the current review being conducted by the ACCC with respect to the methodology applied by ARTC for the allocation of revenue. The review is part of the ACCC's assessment of ARTC's 2013 Annual Compliance Assessment.

In preparing the application ARTC have noted the outcome of the review has the potential to impact unders and overs accounts, capitalised losses in PZ3 and the roll forward of the RAB and RAB Floor Limit for the subsequent years 2014, 2015 and 2016. As a result of this regulatory uncertainty, ARTC has applied forecasts based upon the current methodology and practices with the exception of indicative pricing for PZ3, extended recovery of Loss Capitalisation beyond 2017 and 2018[3]. It was originally envisaged Capitalised Losses would be recovered by the end of 2016.

Idemitsu has participated in numerous consultations regarding revenue allocation and provided a compressive submission (dated 29 January 2016) in response to the recent ACCC draft decision.

Some of the highlights included:

(a) it is a highly complex issue;

(b) disproportionate impact of PZ3 coal producers of a change during the term of the 2011 HVAU means regulatory uncertainty;

(c) below rail costs represent a much higher proportion of overall production costs for PZ3 coal producers than PZ1 coal producers;

(d) RAB value per kilometre in PZ3 is significantly higher than PZ1 and PZ2;

(e) has been successfully applied to PZ2 and PZ3 to promote growth;

(f) incorrect perceptions of inequity for PZ3 coal producers; and

(g) ARTC's approach to revenue allocation is consistent with the 2011 HVAU interpretation and was the basis upon which relevant provisions of the 2011 HVAU were approved and subsequently applied to the Annual Compliance Assessments for 2011 and 2012.

It should be noted the ACCC has indicated in its Draft Decision revenue allocation is an acceptable revenue methodology for ARTC. The use of revenue allocation is a mechanism used by ARTC to ensure coal producers in PZ3 pay their incremental costs in PZ1. This approach to recovering incremental costs has been accepted and considered appropriate in other regulatory environments such as Western Australian Rail (Access Code) regulated by the Economic Regulatory Authority Western Australia and the Queensland Competition Authority's recent draft decision with respect to UT4.

It is reasonable to expect the ACCC's final decision with respect to revenue allocation for the 2011 HVAU (2013 Annual Compliance Assessment) will establish a precedent for the 2016 HVAU. However, Idemitsu consider it an absolutely essential for the inclusion of a revenue allocation methodology similar to that currently used by ARTC and supported by the ACCC in the 2016 HVAU.

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[2] 2016 Hunter Valley Network Access Undertaking Explanatory Guide December 2015, ARTC, Page 7.

[3] 2016 Hunter Valley Network Access Undertaking Explanatory Guide December 2015, ARTC, Page 8.

Idemitsu reserves its rights to make a further submissions with respect to the 2016 HVAU subsequent to the ACCC's final decision on revenue allocation, as these impacts could be serve and significant to the economic viability of Idemitsu's mines.

3. Loss Capitalisation

Loss Capitalisation is a mechanism included in the 2011 HVAU for application in PZ3 only, to encourage and enable continued investment by ARTC in rail infrastructure for the timely delivery of capacity to meet growing coal volumes. Loss Capitalisation permits the capitalisation of economic losses/shortfalls in PZ3 into the Regulated Asset Base (**RAB**) by ARTC (due to Access Charges not recovering the total Economic Cost in PZ3). This enables the long term economic cost recovery in a future period once volumes have sufficiently increased and allows ARTC to escalate the RAB (in accordance with the consumer price index) and generate a regulated rate of return inclusive of Loss Capitalisation.

Idemitsu is supportive of ARTC continuing Loss Capitalisation from the 2011 HVAU into the 2016 HVAU on the same terms as noted in their application[4].

ARTC have proposed the RAB and the RAB Floor Limit will be rolled forward into the 2016 HVAU in accordance with the 2011 HVAU to establish an opening RAB and RAB Floor Limit – this will enable the outstanding capitalised loss balance to also be brought forward[5]. However, the Loss Capitalisation balance at the Commencement Date of the 2016 HVAU will be significantly influenced by the ACCC's Final Determination with respect to revenue allocation.

If the ACCC confirms the Draft Determination it will be critical the ACCC seeks ARTC's commitment to recover the resulting capitalised loss over an extended timeframe in order to prevent an immediate and substantial impact on the viability of the existing mines in PZ3. Idemitsu would suggest that a timeframe aligned with the life applied to ARTC's PZ3 fixed assets (which should be aligned to the PZ3 mine lives) is appropriate.

Idemitsu notes in accordance with Cl 2.3(a)(iii) of the 2016 HVAU Draft the Mandatory Review will consider the ongoing requirement for a separate RAB methodology for PZ3. This should not influence the recovery period of the capitalised losses but only consider whether the Loss Capitalisation mechanism is required in the future.

4. Remaining Mine Life – Pricing Zone 3

ARTC have concluded in their application for 2016 HVAU, the remaining mine life estimate (**RML**) remain unchanged based upon the 2011 HVAU methodology, 21 years from the commencement of the 2011 HVAU. This would mean at the commencement of the 2016 HVAU the RML would be 16 years.

In the context of a new undertaking and as part of good regulatory practice it is appropriate to review and update (reset where appropriate) the RML for operating and prospective mines accessing the HVCN. The RML with respect to Hunter Valley mines is used for the purposes of calculating depreciation (on Segment Specific Assets) and is included as part of the Economic Cost of a Segment.

The HRATF has conducted a review of the RML as outlined in its submission (basis independent and publicly available information) with a conservative approach to identifying prospective mines. The HRATF has concluded an RML of 22 years (based upon 2014 data 24 years)[6] applicable across the HVCN.

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[4] 2016 Hunter Valley Network Access Undertaking Explanatory Guide December 2015, ARTC, Page 13.

[5] Hunter Valley Coal Network Access Undertaking (Draft), 23 December 2015, Cl 4.4(c)(i), page 34.

[6] ARTC 2016 Hunter Valley Access Undertaking – Hunter Rail Access Task Force Submission to the ACCC, 9 March 2016, pages 22-25

Idemitsu is supportive of the methodology described by the HRATF in its submission with respect to the calculation of the RML; however both ARTC and the HRATF approaches promote a single RML applied to the entire HVCN. In the context of pricing zones this means a weighted average RML is universally applied across all pricing zones irrespective of the RML which may be applicable to individual pricing zone based upon the mines within. That is pricing zones with a high RML provide a benefit to the pricing zones with a lower RML. This then leads to artificially accelerated depreciation cost of rail infrastructure assets for those pricing zones which have a higher RML.

It is commonly accepted the growth in the NSW coal industry over the past number of years has occurred in the Gunnedah Basin and continues today. This has required significant capital investment in the hundreds of millions of dollars (by ARTC underwritten by coal producers via their access agreements); including new passing loops, loop upgrades, signalling upgrades and 30 tonne axle load upgrade (it alone approximately $150M).

Based upon the production and reserve data contained in Schedule 5 of the HRATF submission[7] it is evident the RML for PZ3 mines is significantly higher compared to the other pricing zones. Hence to apply a single RML across the entire HVCN severely disadvantages PZ3 coal producers by drastically underestimating the useful life of the rail assets and subsequently depreciates them at an accelerated rate, inflating the Economic Cost for PZ3.

PZ3 RML data:

Mine	2014 Reported Production	2014 Marketable Reserves	Remaining Mine Life
Boggabri	5.3	137	25.8
Maules Creek	13.0	350	26.9
Narrabri	5.7	208	36.7
Rocglen	1.3	4.4	3.3
Tarrawonga	2.2	41	18.6
Werris Creek	2.4	18	7.5
Coroona – Prospective		300	30
Vickery – Prospective		180	30
Watermark - Prospective		100	30

RML PZ3	**2014 Data**	**2016**
Prospective Mines Included	29 years	27 years
Prospective Mines excluded	28 years	26 years

Comparable RMLS at the Commencement Date of 2016 HVAU:

ARTC proposal – single RML across all pricing zones (Based upon carrying over current RML and 21 years in 2011)	16 years
HRATF submission – single RML across all pricing zones (Based upon 2014 data 24years)	22 years
Idemitsu's view – RML per pricing zone, for PZ3 only	27 years

[7] ARTC 2016 Hunter Valley Access Undertaking – Hunter Rail Access Task Force Submission to the ACCC, 9 March 2016, Schedule 5.

The pricing zone structure throughout the 2011 HVAU has created artificial geographic boundaries without clear explanation as to why these are required and are unique to the HVCN (not used in any other Australian rail networks). These pricing zones have been used to develop pricing, capture and determine costs, application of Loss Capitalisations etc. ARTC have continued the multiple pricing zone structure in the 2016 HVAU.

To avoid accelerated depreciation and inflated Economic Costs for PZ3 coal producers Idemitsu considers it essential the RML be applied per pricing zone in the 2016 HVAU and not a single RML across the entire HVCN. Therefore, at the Commencement Date of the 2016 HVAU an RML of 27 years should be used in PZ3 (and 22yrs in PZ1).

5. Path Based Pricing

Idemitsu acknowledges the challenges with regard to developing the Final Indicative Service as contemplated in the 2011 HVAU which has contributed to ARTC moving away from pricing based upon the characteristics of an indicative service. Instead ARTC has proposed a 'path based' approach to pricing[8]. ARTC have advised the path based price comprises:

(a) Take or Pay (TOP) component – fixed TOP component based on $/train kilometre.

(b) Non Take or Pay (Non TOP) component – variable access charge will continue to be charged on a gross tonne kilometre (GTK) for actual usage.

Price based pathing will remove the differentiation factors implemented in 2011 HVAU which provide positives and negatives for Access Holders dependent upon the train type used. This means any train within the specifications of the Service Envelope will be priced the same and adjusted for distance travelled.

Idemitsu disputes the use of the term 'Path Based Pricing' when it is quite obviously 'Distance Based Pricing'.

ARTC's view is this will simplify pricing for the 'majority' of Access Holders however it will significant impact on coal producers with distant mines, such as those in PZ2 and PZ3. Idemitsu appreciates the need for simplicity but not at the expense of a pricing scheme which is not cost reflective.

Furthermore, ARTC acknowledges one of the primary objectives of a pricing scheme is to send appropriate signals to Access Holders. The signals being sent by ARTC using the proposed path based pricing ($/train kilometre) is simply:

(a) rewarding the consumption of capacity by higher payload trains compared to lower payload trains (despite any infrastructure limitations); and

(b) distant mines will pay more than mines closer to the port, in the absence of any distance taper.

Idemitsu is concerned these are not the correct signals and could drive inappropriate behaviour such increasing train payloads could lead to inefficient capital expenditure in the current economic climate.

Although further refinement is required with respect to the Costing Manual proposed by ARTC, Idemitsu considers this a significant improvement with respect to transparency by ARTC. The Costing Manual identifies a number of cost categories (Segment and Non Segment) and cost allocators used by ARTC. Idemitsu considers good regulatory practice when the pricing mechanism is cost reflective – Idemitsu does not consider the $/train kilometre and GTK appropriately reflects the costs recovery (cost reflective) by ARTC. In particular, using $/kilometre indicates all costs are variable or linear with distance when this is clearly not the case given the cost categories provided by ARTC (e.g. Enterprise Services, Business unit costs etc.)

[8] 2016 Hunter Valley Network Access Undertaking Explanatory Guide December 2015, ARTC, Page 8.

Idemitsu considers a compromise on simplicity versus a cost reflective approach by using a layered access charge similar to that used by Aurizon in Queensland:

Category	Pricing Mechanism
AT1 – Incremental Maintenance	per thousand gtk
AT2 – Infrastructure Capacity Charge	per path each way
AT3 – Allocative NTK	per thousand ntk
AT4 – Allocative Payload	per tonne
AT5 – Electricity Overhead	per thousand gtk
EC – Electricity as a fuel	per thousand gtk
QCA Levy - Regulatory	per tonne

Further analysis is required to develop an appropriate structure.

6. Temporary Trade of Path Usage (IAHA)

ARTC has included in the Explanatory Guide[9] and accompanied by a drafting change to Cl 16.4(a)(iii) advice regarding a change to the contracting approach requiring the Access Holder to specify the use of Port Waratah or Newcastle Coal Infrastructure Group (individual coal terminals). Previously the coal terminals were considered a single location.

ARTC have stated they are concerned for coal chain capacity as this is currently an aggregation of train paths to a single Newcastle port. Furthermore, they have advised the change will maintain the principles of contractual alignment and assist the terminals and the HVCCC in planning. Idemitsu understands this change will only impact those coal producers which utilise both terminals.

Although Idemitsu welcomes any mechanism which safeguards and enhances coal chain capacity there are a number of concerns which require further clarification by ARTC:

(a) such a change places a more onerous condition on temporary trade of path usages under Cl 16.4;

(b) may limit path trades amongst Access Holders; and

(c) may limit path trades by an Access Holder who has multiple load points and multiple terminals.

Some coal producers have entered long term terminal contracts on the basis of flexibility; this change to the IAHA agreement could significantly restrict this flexibility and have significant commercial impacts.

This submission has identified four significant undertaking components (Revenue Allocation, Loss Capitalisation, increasing the RML and the concept of distance based pricing) critical to the ongoing viability of PZ3 coal producers which must be continued or amended in accordance with this this submission in the 2016 HVAU. In particular, revenue allocation and Loss Capitalisation are integral to the underlying structure of the 2011 HVAU to offset some of the disadvantages experienced by PZ coal producers.

Idemitsu would like to reiterate with respect to revenue allocation, some stakeholders have the misconception revenue allocation has provided PZ3 coal producers with some form of relative advantage when this is clearly not the case. Idemitsu has previously demonstrated directly to the ACCC the existing structure of the 2011 HVAU severely disadvantages PZ3 producers even before the application of revenue allocation.

[9] 2016 Hunter Valley Network Access Undertaking Explanatory Guide December 2015, ARTC, Page 22.

Idemitsu remains committed to working with all stakeholders to continuing to develop the 2016 HVAU and ensuring its timely implementation upon the cessation of the 2011 HVAU.

If you have any queries regarding this submission please do not hesitate to contact myself (Ph +61 7 3222 5631) or Craig Forster (Ph +61 7 3222 5623).

Yours sincerely

Chris Walsh
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