02 October 2012

Mr Matthew Schroder
General Manager
Fuel, Transport and Prices Oversight Branch
ACCC
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Melbourne VIC 3001

By Email: transport@accc.gov.au

Dear Mr Schroder,

Consultation Paper in relation to Australian Rail Track Corporation's application to vary the Hunter Valley Rail Access Undertaking non-TUT related performance incentive mechanism

I refer to the ACCC's invitation to provide submissions regarding the consultation paper in relation to Australian Rail Track Corporation's (**ARTC**) application to vary the Hunter Valley Access Undertaking (**HVAU**) non-TUT related performance incentive mechanism dated 4 September 2012 (**Report**). Vale appreciates the opportunity to provide this submission as part of the consultation process on future pricing and rail efficiency in the Hunter Valley Coal Chain (**HVCC**).

Integra Coal Operations Pty Ltd (**ICO**) (a related entity of Vale Australia Pty Ltd (**Vale**)), operates the Integra Coal Mine, as agent for and on behalf of the Integra Coal Joint Venture Participants. As a smaller producer in the HVCC, ICO has to be able to clearly understand the pricing mechanisms that exist in the logistics market so it can make informed decisions on future investment decisions, both at a mine level, and as part of the wider HVCC development.

The need for a performance incentive arises due to the application of a Revenue Cap form of regulation. Essentially, ARTC bares minimal revenue risk from the provision of access services over its regulated rail network and minimal performance risk if the regulated rail network fails to deliver contracted capacity. The lack of financial accountability on ARTC means it is neither strategically nor commercially aligned to the downstream market which relies on access to its services in order to compete in the global coal market.

In an attempt to improve the alignment between ARTC and Access Holders section 13.3 and 13.5 were inserted in the HVAU to allow for the establishment of performance incentives. The current application is related to section 13.3 and the development of non TUT related ARTC performance incentive. Based on section 13.3 ARTC provided a consultation document in December 2011 which outlined some concepts and sought stakeholder feedback to assist in the development of these incentives. Vale provided a submission to ARTC in response to this consultation.

Vale acknowledges that ARTC has completed the development of this application in line with the requirements set out in section 13.3 of the HVAU. However, Vale's views are the consultation process was very limited and the development of the performance incentives could have benefited from more robust consultation between ARTC and Access Holders.

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Vale is very supportive of developing an Incentive Mechanism which encourages productivity improvements in the coal supply chain. As the objective of the performance incentives is to "encourage ARTC, through financial reward," Vale believes the incentives developed must be aligned with cost or revenue improvements to Access Holders. Improvements in the coal chain must consider the contractual positions of the Access that currently exist as the development of the HVAU has been based on these contractual positions and therefore any incentive mechanism must already consider the revenue cap that ARTC is receiving for the operation of the rail network. Vale believes that additional revenue should only be achievable if contractual performance has been exceeded and it provides a real benefit to Access Holders.

Vale believes that incentive mechanisms must be specific, measurable, achievable, relevant, and time bound. It is important that these requirements are considered in developing any incentive mechanisms to ensure an efficient incentive is developed that is simple and clear for all to understand. It is important that these incentive mechanisms are transparent to all industry participants to allow them to be considered during future operational and investment decision processes. Less subjectivity within a metric assists to provide certainty to all stakeholders and reduces the potential for disputes around meeting or exceeding targets.

Outlined below are Vale's views and comments to the questions that have been raised in the ACCC's consultation paper.

Is the combination of an Additional Capacity Investment Innovation Incentive and the Positive Performance Incentive Metrics likely to provide incentives for ARTC to perform to deliver better outcomes for the coal chain, as envisaged by industry during the assessment of the HVAU?

Vale does not believe the proposed combination of an Additional Capacity Investment Innovation Incentive (ACIII) and the Positive Performance Incentive Metrics (PPIS) will deliver better outcomes as envisaged by industry during the assessment of the HVAU. Vale's believes the incentives were important to encourage ARTC to provide a rail network that outperformed their contractual obligations. In Vale's view the current proposed incentives do not appear to align with this goal.

Vale believes that an ACIII does not appear to take into account the current system environment where the HVCCC has identified that the Hunter Valley system capacity is below the contractual obligations. If ARTC have some innovative options to increase system capacity it should be identifying these now as the HVCCC has forecast the misalignment between system capacity and contractual capacity will remain for at least a further 2 years.

Vale is also concerned about the lack of transparency and clarity of the proposed metrics. The metrics proposed raise several issues around the calculation of the metric and the method of setting the target, which does not appear to pursue the goal of outperformance of contractual capacity.

What do you see as the benefits of the proposed Additional Capacity Investment Innovation Incentive and the Positive Performance Incentive Metrics that will flow through to the users of the Hunter Valley rail network?

Vale believes the key benefit of this process is to encourage ARTC to establish a rail network that links with other sections of the coal chain to outperform the existing contractual obligations. ARTC would then receive financial reward for this outperformance which should provide competitive benefits to Access Holders in the global coal market.

Vale does not see many benefits with the current proposal that will flow through to the Access Holders of the Hunter Valley rail network as the incentives do not appear to be linked to outperformance. As the current proposals do not appear to be linked to the existing contractual obligations, it could result in a situation where ARTC are provided greater returns when Access Holders are still unable to utilise their full contractual capacity.

Is the combination of an Additional Capacity Investment Innovation Incentive and the Positive Performance Incentive Metrics likely to encourage ARTC to take appropriate risks?
Vale does not see the current proposal necessarily changes the risk profile of ARTC as the current proposal does not require ARTC to achieve their contractual obligation before they can achieve an incentive. Vale is concerned that this could lead to a result that actually lowers the risk to ARTC whilst providing a higher return.

Are the oversight and auditing mechanisms relating to the development of, and measurement of, the relevant performance measure appropriate?
Vale finds quarterly reporting to be adequate, although would like to see this aligned to a majority of the Access Holders which are on a monthly capacity allocation. Vale believes the incentives would benefit from an independent review and verification of targets and measures for the incentives. Vale believes a provision should be inserted that at a minimum allows for an annual independent audit and for an Access Holder to request an audit at least once a year, prior to having to go directly to a dispute process.

Do you have any comments on ARTC's proposal not to include the positive performance incentive mechanisms that were put forward as potential options in its Consultation Document in the Proposed Variation?
Vale is concerned that potentially better incentive mechanisms were not considered due to the lack of consultation between ARTC and Access Holders. Vale is concerned that ARTC discounted productivity related incentives at this time as it interpreted the views of Stakeholders to value increased throughput as more important than cost of service. Vale believes the views of stakeholders should be considered within the context of the current operating environment in the Hunter Valley network where Access Holders are unable to utilise their full contractual capacity. Vale believes this is resulting in a greater focus on throughput but as this should not be increased at any cost an incentive based on cost of service should not necessarily be excluded without further investigation.

As outlined by Vale in its submission it does not agree that incentives based on cost reductions, such as maintenance, are necessarily appropriate as they can often lead to detrimental outcomes for the network. Generally reducing spending on an item like maintenance can have a short term gain in improvement in costs, but often lead to long term effects on the performance of the network. Therefore, Vale accepts that ARTC has not pursued incentives that involve cost reductions as the key objective of the incentive.

Vale does not necessarily view a specific safety incentive as being appropriate but does note some of the other stakeholder's views regarding a trigger or threshold relating to safety being employed and believes there is some merit in potentially pursuing further consultation on this option as any poor safety performance by ARTC in the Hunter Valley could have a detrimental effect on the Hunter Valley Coal Chain as a whole.

ARTC, via their interpretation of submissions, ultimately decided on the final metrics included in the application that has been presented to the ACCC. Vale believes there could be benefit in further discussions on all the potential options to assist in finding incentives acceptable to all stakeholders.

Is the Additional Investment Innovation Incentive mechanism proposed by ARTC appropriate?
Vale has concerns with the CIIII as it appears to be very subjective in nature and proposes to involve a legacy well beyond each applicable year through the inclusion of the Innovative Amount in the RAB. The current wording only requires the Innovation to intend to create capacity and for ARTC to demonstrate that it partially arose through their innovation. The incentive as currently proposed does not provide a robust incentive to encourage ARTC to deliver better outcomes for the coal chain and does not deal with the current lack of capacity that is currently being experienced in the Hunter Valley Coal Chain. Vale would find it unacceptable to provide any incentive to ARTC under this current state of operation as there does not appear to be sufficient ARTC capacity to match the existing contractual capacity.

The CIII is defined to allow an incentive for projects that are "intended to provide Additional Capacity on the Network". Vale believes that for this incentive to be rewarded there must be a greater accountability on ARTC than innovation that is "intended" to provide Additional Capacity. If the innovation does not actually provide capacity to the Network that can be utilised by Access Holders than it should not qualify for any incentive. A reduction in capital expenditure is only of value to Access Holders if real network capacity is made available to transport coal.

Vale is also concerned about the inclusion of this innovation amount in the Regulated Asset Base (RAB) even when this is offset by an increase in operating expenditure. The inclusion of an amount in the RAB assumes there would be a continuous advantage provided by the applicable innovation and this may not always be the case and could also leave Access Holders with increased operating costs. Whilst Vale is generally not against an incentive of an innovative nature, it believes that it should not be included in the RAB and no financial reward should be achieved for an innovation that is offset by increased operating expenditure. Vale believes this would create a situation where ARTC is incentivised to reduce their capital expenditure and identify another option that has potentially higher operating costs which results in a net increase in costs to Access Holders.

Is it clear from the proposed drafting what type of "innovation" will be captured under the Additional Capacity Investment Innovation Incentive?
The drafting on innovation is very broad and in effect could be related to anything that is proposed and Vale believes does not provide a strong obligation for the innovation to actually create capacity. Vale would prefer to see the words in brackets "(amongst other things)" removed as this is too broad and believes that the requirement to only "assist" in the creation is also not appropriate. Innovation should only be included when it results in the creation of Additional Capacity. Additional Capacity should be defined as that capacity above that already contracted to make it clear that innovation to meet existing contractual capacity is not included.

Is the role of the RCG/independent expert/ACCC in endorsing an Innovation Incentive Amount appropriate? Will this provide an effective check and balance?
The RCG process was implemented specifically to provide an efficient process to allow the development and expansion of the Hunter Valley rail network in a timely manner. Vale feels the CIII process now requests the RCG to be able to assess the differences between competing options and does not feel this is the correct process to be used to approve this process. As the Access Holders are generally not experts in rail development and the potential "trade offs" proposed by ARTC for the innovation, Vale feels it would be more appropriate that an independent expert was appointed to review this incentive with a report to the RCG or ACCC to allow Access Holders to provide submissions on the report.

Is it appropriate that the Innovation Incentive Amount be included in the RAB that will result in ARTC receiving an incentive payment "over the economic life of the Additional Capacity"? If this approach is not considered appropriate, what are alternative approaches?
Vale does not feel this is an appropriate outcome of an incentive mechanism that is generally related to an annual True Up Test process. As stated earlier ARTC should already have an incentive to be efficient with capital as any savings achieved by ARTC are able to be utilised for other future growth opportunities of their business. It also potentially leads to a outcome where Access Holders are paying for the innovation through a return on the amount in the RAB and also incurring increased operating expenditure. Vale does not consider this outcome will assist Access Holders to remain competitive in the global coal market.

Any alternative approach should only consider a financial reward in the year that the innovation was incurred. Vale believes that the result of this innovation would be the increase of Ad Hoc paths above contractual obligations. Vale would consider the access charges for these Ad Hoc paths that have been provided due to the innovation be excluded from the revenue cap calculations.

Are the circumstances in which ARTC is able to benefit from an Innovation Incentive Amount appropriate? For example, should ARTC be able to benefit from an Innovation Incentive Amount where it has not satisfied its contractual obligations regarding delivery of contracted paths?
Vale believes that no incentive amounts should be paid to ARTC for a year if it fails to make available the contracted paths. Vale believes that meeting the contracted paths is already compensated via the revenue cap and therefore ARTC should only gain an incentive if it exceeds this requirement. It is also important that the incentive provide an opportunity for Access Holders to benefit from the paths above ARTC's contractual obligations otherwise the incentive becomes an additional cost of the current contract rather than a true incentive subject to risk.

Vale also does not agree with ARTC receiving an incentive when the innovation requires an increase in operating expenditure. This could result in a situation where the costs incurred by Access Holders actually increase when Vale believes the intention of the incentive process is to result in a total reduction of costs, whether they are capital or operating, to increase productivity and the competitiveness of the Hunter Valley in the global coal market.

Is the formula for the calculation of the Innovation Incentive Amount appropriate?
As discussed above Vale does not agree with the inclusion of the Innovation Amount in the RAB. Vale would prefer to see an appropriate price per path developed that provided an incentive for ARTC to increase paths. This additional revenue would then be excluded from the revenue cap calculations at the end of the year.

Is the PPIS – Metrics mechanism proposed by ARTC appropriate?
Vale believes the quarterly averaging of the incentives appears to be out of step with the majority of Access Holders in the Hunter Valley that are subject to monthly allocation. Vale would also like to see an annual trigger or threshold to ensure a long term view is taken to infrastructure investments. If there is no annual measure requirement on ARTC it could lead to short term quarterly decisions that achieves the objective of the KPI, but potentially damages the long term operation of the network.

Vale believes that Quarterly Incentive Amount Cap (QIAC) should be clearly explained and identified as part of this process rather than subject to the "determination" by ARTC. Any QIAC must be developed with consideration of the potential financial reward it provides to Access Holders to ensure it is appropriate. Vale believes that the overriding principle with all of these metrics is that ARTC must be required to make the contractual capacity available for use by Access Holders. If ARTC are unable to provide the contracted capacity then they should not receive any financial reward for the PPIS.

Does the drafting of clause 1.3 of Schedule 5 of the IAHA make it clear how the Target Value and Upper Bound for each PPIS Metric will interact with the determination of the Quarterly Incentive Amount?
The drafting in clause 1.3 does appear to be clear and does not overlap. The only further comment Vale would make is that the drafting does not advise the level of rounding, if any, that is required in the calculation of the metrics.

Is the formula for the calculation of the Quarterly Incentive Amount where the PPIS Metric is less than the Target Value, or exceeds the Upper Bound, for each particular metric clear and appropriate?
The formula does appear to be clear with the exception of what rounding, if any, is required. Vale also notes that the formula includes a reference to the QIAC, which is not clear to Vale how this item is calculated.

Are the reporting requirements contained in clause 3 of Schedule 5 of the IAHA and reiterated in section 13.3 of the June 2011 HVAU appropriate?
Vale believes that not only should the report be provided on the website but it should also be sent to all Access Holders and be a requirement for ARTC to present the incentives to Access Holders to assist in the understanding of the metrics themselves and the likely trend. Vale is

also concerned with the length of time to provide the reporting. 40 business days is basically 2 calendar months and provides very little time to adjust operating practices for future periods. This length of time will also cause some reporting issues for Access Holders in trying to match revenues and expenses for their operations. This amount of time is not appropriate and Vale would suggest that ARTC should be required to complete the report in the calendar month following the period being reported to ensure timely information is provided to all Access Holders.

Is the interaction between the provisions set out in Schedule 5 (regarding the determination of the Quarterly Incentive Amount) and clause 5.4A of the IAHA (relating to the calculation of the performance incentive amount payable by the access holder) clear and appropriate?
Vale believes the interaction between the provisions appear to be reasonably clear although it would be appropriate for ARTC to advise the NPU for each quarter to allow Access Holders to understand their likely liability for incentive mechanisms. It would also be appropriate for the incentives to include a mechanism that does not allow ARTC to seek an incentive if it fails to meet the total contractual obligation for the Contract Year. It is important that incentives are not provided for short term gains in a quarter that result in longer term harm to the network.

Is the proposed dispute resolution provisions in clause 5.4A(f) appropriate?
Vale believes the dispute resolution provisions proposed in 5.4A(f) should refer to 10 Business Days rather than two weeks to provide consistency in the approach. Vale notes the 10 Business Days is on the basis that changes are made to reduce the timing of presentation of the reports by ARTC to 20 Business Days as proposed in this submission. If the proposed reporting period remains at 40 Business Days then the timing between ARTC's obligation and an Access Holders obligation appears to be inappropriate. Vale would suggest under this situation an Access Holder is provided 20 Business Days to provide a notice of dispute.

Given the different timings provided for between clause 5.4A(f) and clause 5.4A(e), Vale believes there should be an exclusion inserted in clause 5.4A(e) that allows for a non payment due to an item subject to dispute.

Is ARTC's proposed data set and method of measuring coal chain losses (ARTC cause) appropriate?
Vale does not agree with the use of historical data as the basis for setting the targets as it does not recognise the contractual obligations of ARTC. The determination of the targets should be based on what level of performance is required to meet ARTC's contractual obligations as achieving better performance than the previous years is important from a continuous improvement perspective but Vale believes this does not recognise the regulatory revenue cap that exists for the contractual performance. Vale is also concerned that ARTC are not indicating that any of the proposed metric values will or have been verified by independent sources, and the drafting specifically states that metrics will be determined by ARTC. Vale believes the proposal should clearly set out where ARTC will source the measures and if possible there should be a governance process relating to the verification of this data.

Vale also believes the definition of ARTC Cancelled Service is too broad and ineffective. ARTC are able to exclude any losses that are not "directly attributable to an act or omission by ARTC", and then provides further exclusions of cancelled services that are contributed in part by others. As the Hunter Valley Coal Chain involves significant interaction between many parties it is likely that most cancelled trains will be able to trace some part contributed by parties other than ARTC, even if this is only a minor interaction. Based on this definition Vale believes that this metric would not encourage ARTC to improve performance as it is unlikely to require any change of operational behaviour to meet the target. If the metric is to be maintained, then at the very least, the attribution of cancelled services should rest with an independent assessment such as the independent coal chain co-ordinator (HVCCC)/Live Run group.

Is the mechanism and formula by which PPIS Metric 1 is to be determined clear and appropriate?

Vale believes the formula itself is relatively simple but the definitions, and determination of the components, of the formula are not appropriate. Vale has highlighted in the previous question its concerns with the very broad exclusions that have been inserted in the definition of ARTC Cancelled Service, and the requirement that ARTC will determine the metric.

It is not clear to Vale how the QIAC will be determined each quarter and how the metric target values may be changed or adjusted, if required, to meet future needs. The drafting appears to suggest this will be determined by ARTC each quarter. Vale believes the proposal should also provide a clear understanding of the likely cost imposition of the incentive mechanisms. Vale believes further consultation would be appropriate to ensure that the QIAC is set at a level that does not create a position where ARTC gains a financial reward but industry does not gain any benefit for this activity.

Is the Target Value and Upper Bound for PPIS Metric 1 appropriate, given the objective of PPIS Metric 1?

Vale believes the Target Value and Upper Bound should be determined in relation to contractual obligation and not historical data as proposed by ARTC. As Vale has not received the complete set of data or the detailed methodology for the data set used to determine the values, it is unable to provide a clear response as to whether they are appropriate to the objective.

Vale notes that ARTC propose this metric to indirectly balance against the broader negative asymmetric nature of the TUT. Vale would propose that further analysis of the link between the two would be appropriate to move towards a symmetrical metric. The target could then be set to provide this symmetrical view.

Is the mechanism for determination of the Quarterly Incentive Amount Cap, and the cap itself, for PPIS Metric 1 appropriate?

It is not clear to Vale how the Quarterly Incentive Amount Cap (QIAC) will be determined to evaluate if it is appropriate. In Schedule 5 of the Indicative Access Holder Agreement (IAHA) the definition for QIAC states that this will be determined by ARTC each quarter. This provides very little guidance on how this value will be determined and does not provide any transparency to advise if this is appropriate or not.

How will PPIS Metric 1 benefit ARTC and industry?

Vale believes that a metric such as measuring cancelled trains can contribute to the stability of the daily operation of the coal chain. Stability in the day of operations environment should lead to greater throughput within the coal chain as it will require fewer changes to the daily plan and less disruption to the coal chain generally. Whether this metric will have a clear benefit to the current coal chain is unclear to Vale as it believes that the metric needs to be assessed against other possible metrics to determine the current cost impact an improvement in this metric will have on the coal chain.

Is ARTC's proposed data set and method of measuring the impact of temporary speed restrictions appropriate?

As per the discussion with Metric 1, Vale believes that the targets should be set based on the requirements that are needed to ensure availability of contractual capacity rather than historical data. Vale is also concerned that the data set proposed by ARTC only includes 14 observations which appears to be a very small sample size.

The method that ARTC has proposed to calculate the quarterly result is the average of Temporary Speed Restrictions on the last day of each month in the quarter. This results in only 3 data points being considered over approximately a 90 day period. Vale believes the use of this data set to determine the measure is not appropriate as it would not be a valid representative sample of the activities during the period.

Vale is also concerned about the exclusions to the definition of Temporary Speed Restriction (TSR) that ARTC are proposing. ARTC have limited the potential TSRs by only allowing its inclusion if it is "directly attributable to the state of repair of the Network, to minimise the risk of an incident or accident until the Network can be repaired". ARTC limits the definition with a further 4 exclusions. Based on this definition, Vale believes there will be very few instances of a TSR being captured by this metric and it will not encourage ARTC to improve the performance of the network. Vale believes that if this metric is to be retained the definition needs to be expanded to include all Temporary Speed Restrictions on the network.

Is the mechanism by which PPIS Metric 2 is to be determined clear and appropriate?
Vale does not believe the mechanism proposed to determine metric 2 is appropriate as it does not provide a clear encouragement to increase productivity of the network. Vale believes the sample data to be evaluated is too small (3 days out of 90), and the definition of a Temporary Speed Restriction is too narrow.

Is the Target Value and Upper Bound for PPIS Metric 2 appropriate, given the objective of PPIS Metric 2?
Vale believes the Target Value and Upper Bound should be determined in relation to contractual obligation and not historical data as proposed by ARTC. As Vale has not received the complete set of data or the detailed methodology for the data set used to determine the values, Vale is unable to provide a clear response as to whether they are appropriate to the objective.

Is the mechanism for determination of the Quarterly Incentive Amount Cap, and the cap itself, for PPIS Metric 2 appropriate?
It is not clear to Vale how the Quarterly Incentive Amount Cap (QIAC) will be determined to evaluate if it is appropriate. In Schedule 5 of the Indicative Access Holder Agreement (IAHA) the definition for QIAC states that this will be determined by ARTC each quarter. This provides very little guidance on how this value will be determined and does not provide any transparency to advise if this is appropriate or not.

How will PPIS Metric 2 benefit ARTC and industry?
This metric could potentially benefit industry as a reduction in Temporary Speed Restrictions will enable quicker movement of coal from mine to unloading point. This will assist the network to maintain on time arrivals and departures and general increase capacity on the network. Unfortunately due to the narrow view that ARTC has taken to defining this metric, Vale believes it is unlikely to see any significant benefits from the application of this metric.

Is ARTC's proposed data set and method of measuring track condition by the Track Quality Index (TQI) appropriate?
As per the discussion with Metric 1and 2, Vale believes that the targets should be set based on the requirements that are needed to ensure availability of contractual capacity rather than historical data. Vale has not been supplied with a detailed analysis of the underlying data to make a clear judgement of the data used to determine this metric. It is also not clear what this final measurement is actually going to be as ARTC have indicated that they expect to complete further adjustments to this metric in the future. Vale is not sure how this adjustment will be made and whether it will be subject to further consultation.

Vale is also concerned that the data set proposed by ARTC only includes 16 observations which appears to be a very small sample size. Vale assumes, by the size of the observations over the period, that the measurement of this metric will only occur once a quarter. It is not clear how a movement in the TQI metric will operationally affect the network to provide additional capacity or generally benefit an Access Holder above the current operating performance.

Is the mechanism by which PPIS Metric 3 is to be determined clear and appropriate?
Vale is concerned that the averaging nature of this metric it is not likely to provide the appropriate importance of an impact of an incident near the port compared to an incident near the end of the network. This form of averaging may not necessarily ensure the appropriate parts of the track are maintained to the desired level. As this metric will be determined by ARTC there does not appear to be any governance mechanism for verification of this data.

Is the Target Value and Upper Bound for PPIS Metric 3 appropriate, given the objective of PPIS Metric 3?

Vale believes the Target Value and Upper Bound should be determined in relation to contractual obligation and not historical data as proposed by ARTC. As Vale has not received the complete set of data or the detailed methodology for the data set used to determine the values, it is unable to provide a clear response as to whether they are appropriate to the objective. It is also unclear to Vale what benefits would be gained if the network moved above or below the target values.

Is the mechanism for determination of the Quarterly Incentive Amount Cap, and the cap itself, for PPIS Metric 3 appropriate?
It is not clear to Vale how the QIAC will be determined to evaluate if it is appropriate. In Schedule 5 of the IAHA the definition for QIAC states that this will be determined by ARTC each quarter. This provides very little guidance on how this value will be determined and does not provide any transparency to advise if this is appropriate or not.

How will PPIS Metric 3 benefit ARTC and industry?
It is unclear to Vale the benefits this metric will have for industry given ARTC already has an obligation to maintain the network to an appropriate level as part of the regulated environment. This metric may be an industry standard measurement but is going to be conducted by ARTC which seems to be an inappropriate situation as they are the recipients of any financial reward of achieving this target.

Is the proposed reporting mechanism, and the associated publication obligations, appropriate?
Vale believes the quarterly averaging of the incentives appears to be out of step with the majority of Access Holders in the Hunter Valley that are subject to monthly allocation. To match the timing of the capacity allocation to Access Holders, Vale feels that ARTC should be measured on a monthly basis.

Vale would propose that ARTC should have a greater obligation of reporting and publishing the incentive results then posting the report on its website. Vale proposes that ARTC should not only be required to send the report to Access Holders but also conduct industry presentations to promote an understanding of the results and the incentives in general. Providing a clear understanding of the incentives prior to the TUT process would be very informative to Access Holders when they consider the future TUT related performance incentive proposal.

Vale believes that allowing 40 business days to complete the reporting process appears to be excessive. Vale would propose that any reporting should be required within the calendar month following the period being reviewed to allow quicker reactions to any appropriate changes that may be required to the network and provide an earlier indication of additional costs to Access Holders.

Are the proposed amendments to section 13.5, now covering the review of the PPIS and the development of the TUT-related performance incentives appropriate?
Vale believes the review of the PPIS must be completed in parallel with the TUT review and section 13.5 should require a greater obligation for ARTC to consult with Access Holders. Vale would hope this extra level of consultation would provide a better outcome to understand the combination of these two sets of incentives. This consultation will allow greater discussion on all the options and the reasons why ARTC would, or would not, implement the metrics. It would also allow an opportunity to provide industry with a clear understanding on how the measures would be developed and calculated once in operation.

Are the other consequential amendments (as set out in ARTC's Proposed Variation and summarised in Appendix A of this Consultation Paper) appropriate?
The majority of the consequential amendments summarised in Appendix A of the ACCC consultation paper relate to the inclusion of a CIII in the HVAU. As Vale proposes that the current CIII should not be accepted into the HVAU we would not feel these amendments are appropriate. Vale specifically notes the Reasonable test that ARTC is proposing to use in the CIII amendments. Vale does not see why, if a CIII was approved, that the test for expenditure should be changed from Prudent to Reasonable. In Vale's view this seems to create a lower

standard of obligation to be met by the innovation incentive which Vale does not view as appropriate. The Prudency test is well founded in the regulatory environment and as the innovation incentive is proposed to replace Prudent capital expenditure it should also be subjected to the same Prudency test.

Conclusion

Vale believes the key benefit of this process is encouraging ARTC through financial reward to create additional capacity for use by Access Holders. Vale's view is that additional capacity should refer to paths above the contractual obligation that can be utilised in the Hunter Valley Coal Chain. Any incentive that is introduced must provide this opportunity for additional capacity to Access Holders, otherwise, the incentive is merely an increase in return for ARTC and does not provide for productivity gains in the network. Vale feels this objective is very important in the current environment where HVCCC has indicated that Access Holders are unable to fully utilise their existing contracted capacity as it is higher than the system capacity in the Hunter Valley Coal Chain.

It is in the public interest to establish an efficient operating coal chain as this promotes better utilisation of the assets and greater development of the State in general through greater royalties and the local community benefits that are derived from viable mining operations. Vale feels that a strong incentive mechanism is important to continually drive innovation and efficiency in operations across the logistics environment. Vale believes the only way to clearly establish if there are improvements in the logistics environment is to develop the incentive mechanism based on the contractual obligations rather than improvements on historical data which has historically not matched the contractual capacity.

Vale believes that any Incentive Mechanism must encourage commitment from service providers to achieve contractual performance and ultimately greater throughput capacity in the coal chain. When the system achieves greater productivity it will then assist the industry as a whole to become more robust and competitive in an ever increasingly competitive global coal market.

As per clause 13.3 ARTC are required to consult with Access Holders and stakeholders on these amendments. Vale believes the level of consultation for this very important topic could have been greater to assist in a better understanding for all stakeholders. Vale acknowledges that ARTC released a paper and then interpreted the stakeholder submissions to develop the application to the ACCC. Vale believes there needs to be a more robust process that seeks further consultation with stakeholders prior to a submission to the ACCC. Vale believes this would provide a more efficient process in the development of the incentive mechanisms in the HVAU.

Vale believes the key to any incentive mechanism will be the target that is set to measure performance. The target needs to be set to encourage the required outcome of the activity and Vale believes the required target for any incentive mechanism should be based on the necessary targets that need to be achieved to meet the contractual obligations. Historical data is not an appropriate measure as this fails to account for the revenue cap process that already provides revenue for ARTC to maintain their contractual obligation and the failure in the past of the network to meet contractual capacity.

At this stage Vale's view would be for the ACCC to not approve the ARTC application and require them to seek further consultation with industry to investigate if further agreements can be reached on some of the incentives that have currently been proposed or if new metrics should be proposed. Vale believes a further review of the methodology of setting the targets to align with contractual capacity would be more appropriate for the incentive mechanisms. It will also be important to establish clear information on how the incentive mechanism will be administered and how changes can be made and what approvals are required to allow these changes. A clear governance structure for the incentive mechanism will assist in the efficiency of this process.

Vale appreciates the opportunity to provide its views on this topic and would be happy to discuss this further if you need any clarification.

Yours sincerely,

Anneliese Mattos
Acting General Manager Logistics
Vale Australia Pty Ltd