

Submission to the  
Australian Competition and Consumer Commission

**Extension of 2011 Hunter Valley Coal Network Access Undertaking**

**Anglo American Metallurgical Coal Pty Ltd**

20 June 2017

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## 1 Executive Summary

Anglo American Metallurgical Coal Pty Ltd (**Anglo American**) welcomes the opportunity to provide submissions to the Australian Competition and Consumer Commission (**ACCC**) in response to the submission on 5 June 2017 by Australian Rail Track Corporation Ltd (**ARTC**) of amendments to the 2011 Hunter Valley Coal Network Access Undertaking (**2011 HVAU**).

The submission of those amendments (the **Extension Application**) comes at the end of a long process in respect of ARTC's 2017 Hunter Valley Draft Access Undertaking (the **2017 DAU**), including:

- (a) numerous submissions by stakeholders, including Anglo American;
- (b) the ACCC's Draft Decision of 20 April 2017 (the **Draft Decision**); and
- (c) ARTC's withdrawal of the 2017 DAU on 9 June 2017.

Anglo American is a member of the Hunter Rail Access Task Force (**HRATF**) and shares the concerns about the process expressed in the HRATF submission, and the disappointment of the HRATF that a reasonable outcome on economic parameters as proposed in the Draft Decision will now not be given effect to.

However, this submission focuses on Anglo American's views of the proposed amendments to the 2011 HVAU.

In particular, while Anglo American is willing to support the proposed extension of the 2011 HVAU on the basis of the economic parameters proposed, it has reservations about the requirements ARTC proposes to be imposed on the subsequent variation regarding:

- (a) incremental capital costs being allocated on the basis of contracted capacity; and
- (b) take or pay charges including incremental capital based on contracted capacity.

Those approaches are inconsistent with the ACCC's 2013 Annual Compliance Review, were not supported by the Draft Decision, and have been opposed throughout the 2017 DAU process by Anglo American.

A thorough merits review of these issues cannot be conducted given:

- (a) the ACCC is being provided with severely limited time to consider the Extension Application; and
- (b) despite the ACCC's request for further information in the Draft Decision, ARTC has not yet provided further modelling or information on the outcomes of such changes.

In that context, Anglo American considers that, at a minimum, the ACCC's Final Decision must make it absolutely clear that any approval of an amendment inserting that variation mechanism is not based on any determination that such an amendment is appropriate, and is simply a recognition of ARTC's ability to submit an amendment (which is always subject to the ACCC's approval).

Anglo American considers that cannot be controversial, as to do otherwise would be prejudging the issue without any real details about the content and outcomes of ARTC's proposals on those issues.

## 2 Statutory Criteria

The ACCC may approve a variation of an undertaking if it considers it appropriate having regard to the matters in section 44ZZA(3) *Competition and Consumer Act 2010* (Cth) (**CCA**): s 44ZZA(7) CCA.

Relevantly those matters include the objects of Part IIIA, the pricing principles from s44ZZCA, the legitimate business interests of the provider, the public interest, the interests of access seekers, and other matters the ACCC considers relevant: s 44ZZA(3) CCA.

ARTC has not sought to substantiate how the outcomes it is proposing subsequent amendments for in relation to incremental capital costs allocation and take or pay methodologies are consistent with those criteria.

However, Anglo American considers that such amendments will be:

- (a) inconsistent with part of the object of Part IIIA by blunting incentives for efficient use (including through capacity trading arrangements), by making more of the costs fixed irrespective of the volume used;
- (b) inconsistent with the public interest in providing regulatory certainty – given they are not only overturning the ACCC's June 2016 decision in the 2013 Annual Compliance Review (described by the ACCC in that decision as providing a 'fair and reasonable outcome', at page 59), but replacing it with a proposed variation of which the details are so scant that the outcomes for users of the network are virtually unknown;
- (c) not demonstrably in ARTC's interests – as the change does not impact on ARTC's revenue certainty (given the revenue cap and unders and overs elements of the regulatory framework to which it is subject); and
- (d) not demonstrably in the interests of access seekers as a whole, given that users hold divergent views and (as noted in the Draft Decision) there are limited differences between contracted and actual usage.

### **3 Subsequent Variation Requirements**

#### **3.1 ARTC's proposal in relation to requirements for a subsequent variation**

The Extension Application contains a specific provision in relation to submission of future amendments in the proposed section 2.3(d) of the 2011 HVAU, namely:

- (d) *ARTC will engage in good faith negotiations with Access Holders and, by no later than 31 December 2017 or such later date as agreed with the ACCC in writing, lodge a variation application with the ACCC under section 44ZZA(7) of the CCA to vary this Undertaking to:*
  - (i) *incorporate path based pricing; and*
  - (ii) *apply an incremental costs methodology such that:*
    - (A) *Pricing Zone 3 Access Holders contribute incremental costs for Pricing Zone 1 for the remaining term of the Undertaking;*
    - (B) *incremental maintenance costs are allocated on the basis of actual usage and incremental capital costs are allocated on the basis of contracted capacity;*
    - (C) *take or pay charges include incremental capital based on contracted capacity; and*
    - (D) *a dual ceiling limit applies.*

Anglo American has reservations about including a requirement in the undertaking to submit a variation to which it is strongly opposed.

#### **3.2 Draft Decision**

The Draft Decision noted the divergent views expressed by stakeholders on the issue of the allocation of incremental capital costs and indicated (at page vi and 55) that the ACCC:

- (a) has not yet formed a final view on the appropriate basis for allocating Incremental Capital Costs;
- (b) is seeking further information from ARTC and stakeholders in order to form a final decision on ARTC's proposed approach;
- (c) set out in the Draft Decision its understanding of the effect of the 2013 Annual Compliance Final Determination; and
- (d) is seeking submissions from ARTC and stakeholders on the ACCC's understanding of:
  - (i) the relationship between setting TOP Charges and the reconciliation with ceiling revenue tests; and
  - (ii) the likelihood of Access Holders over-contracting capacity as a result of allocating Incremental Capital Costs on the basis of actual usage, in the context of the operation of the DAU and indicative Access Holder Agreement (**AHA**).

### 3.3 Previous submissions on these issues

Anglo American's opposition to ARTC's proposed requirements for the subsequent variation in relation to allocation of incremental capital costs and take or pay charges is consistent with every submission that Anglo American has made in the 2017 DAU process.

In that regard Anglo American refers to its previous submissions of 8 February 2017, 27 February 2017 and 12 May 2017.

Without restating those submissions in full, in summary:

- (a) **The current methodology for allocating incremental capital costs is the result of the ACCC's recent (June 2016) considered assessment in the 2013 Annual Compliance Review**, including the advice of the ACCC's independent consultant, Wik Consult. There has been no evidence provided of adverse outcomes having arisen from ARTC implementing that approach;
- (b) **Allocating incremental capital costs based on contracted capacity appears likely to have adverse outcomes** including giving rise to windfall gains and losses for stakeholders who have made decisions based on the 2013 Annual Compliance Review and potentially giving rise to cross-subsidisation and inefficient investment decisions;
- (c) **Users (and the ACCC) do not have sufficient information to understand the outcomes of ARTC's proposed approach** – the HRAFT submission accurately describes the 2011 HVAU annual compliance review as a 'black box' and worked examples of the type the Draft Decision suggested would be useful are not available. The 10 November 2016 ARTC presentation provided in the last HRATF submission contains examples but they are abstract and unrealistic (including issues such as only using depreciation and arbitrary values and allocations);
- (d) **The assertion that a high proportion of take or pay charges is required to provide revenue certainty to ARTC has been disproved** – given the limited differences between contracted and actual volumes (Draft Decision at 59), the forecast usage used for the purposes of allocation should not vary greatly from actual usage (given the extent of information available to ARTC through the HVCCC), and that variability for individual users does not equate to variability for ARTC (giving differences between forecast and actual usage for individual users are likely to 'balance out' to a large degree);
- (e) **The assertion that allocating incremental capital based on usage rather than contracted capacity will provide an incentive to over-contract has been shown to be simplistic and incorrect** – no evidence has been presented to suggest there is any

existing or likely future over-contracting, there are other mechanisms in the regulatory framework to prevent over-contracting as mentioned in the ACCC's Draft Decision, only incremental capital is being allocated by reference to usage, and the costs of matching above rail and port capacity ensures that such over-contracting would not be economic in any case; and

- (f) **The assertion that allocating incremental capital based on usage rather than contracted capacity will cause inefficient investment is unsubstantiated** – it is simplistic to state that investment is only made based on contracted position when it is clear from ARTC's own planning documents that it takes into account future forecast but uncontracted usage and the RCG considers annual investment with the input of HVCCC forecasts of actual usage.

### **3.4 Inappropriateness of pre-judging merits of subsequent variations**

In addition to Anglo American firmly believing the variations proposed in clause 2.3(d)(ii)(B) and 2.3(d)(ii)(C) are inappropriate based solely on the merits, it is beyond any doubt that giving them any form of blessing or approval now without thorough consideration is inappropriate.

As the ACCC knows, this issue is not one on which there is unanimous agreement.

The Extension Application contains no further details on how the proposed incremental costs methodology will operate beyond that set out in the new section 2.3(d). In that regard, it clearly fails to respond to or rectify the information deficiencies raised by the ACCC in the Draft Decision.

While Anglo American would prefer that those parts of clause 2.3(d) are deleted, it considers that at the bare minimum the ACCC's Final Decision must make it absolutely clear that any approval of an amendment inserting that variation mechanism is not based on any determination that such an amendment is appropriate, and is simply a recognition of ARTC's ability to submit an amendment (which is always subject to the ACCC's approval). It is critical that the ACCC makes clear that a decision on the variation will be made on the merits at the time of its submission, and the ACCC's concerns as noted in the Draft Decision have not been overcome.

Anglo American considers that cannot be controversial, as to do otherwise would be prejudging the issue (which constitutes a departure from the existing ACCC determined appropriate position), in an extremely short time period, without any real details about the content and outcomes of ARTC's proposals on those issues.

Even then, Anglo American has reservations about how this variation mechanism effectively dictates what the outcome of good faith negotiations must be, thereby (on its face) precluding other outcomes. In that regard it would be useful for ACCC's Final Decision to also confirm that:

- (a) ARTC is permitted and encouraged to consult on the appropriate approach to the issues in clause 2.3(d) (i.e. not being restricted to the outcomes currently described in clause 2.3(d); and
- (b) if the result of that consultation is a different proposal that is considered appropriate, the ACCC would welcome the submission of a subsequent variation of a different character.

## **4 Conclusion**

No convincing rationale has been provided for departing from the ACCC's conclusions of June 2016, reached after a thorough consideration of this issue in the 2013 compliance assessment.

The uncertainties raised in the Draft Decision have also not been resolved, and stakeholders continue to hold divergent views on at least the issues referred to in clause 2.3(d)(ii)(B) and 2.3(d)(ii)(C) of the drafting provided for the Extension Application.

In that context, if the ACCC determines to approve the Extension Application, which Anglo American can understand in order to provide certainty of continued regulation of the Hunter Valley rail coal network, it is critical that the ACCC does not, and is not seen to have, prejudged how incremental capital costs should be allocated and how take or pay charges should be calculated.