Submission to the

Australian Competition and Consumer Commission

Hunter Valley 2017 Draft Access Undertaking

Anglo American Metallurgical Coal Pty Ltd

8 February 2017

Contents

1 Executive Summary

Anglo American Metallurgical Coal Pty Ltd (***Anglo American***) welcomes the opportunity to provide this submission to the Australian Competition and Consumer Commission (***ACCC***) in response to ARTC's 2017 Hunter Valley Draft Access Undertaking (the ***DAU***) and the ACCC's related Consultation Paper.

Anglo American is a member of the Hunter Rail Access Task Force (the ***HRAFT***) and supports each of the positions set out in the submission of the HRAFT except in relation to the methodology for allocation of incremental capital costs.

In that regard Anglo American, considers that it is appropriate for allocation of such incremental capital to continue to occur by reference to actual usage, not contracted capacity, consistent with the ACCC's recent final determination in relation to the 2013 Annual Compliance Review.

2 The issue

As noted in the ACCC's Consultation Paper (at page 13):

> *ARTC proposes to alter the method of allocating Incremental Capital Costs to be based on contractual commitments rather than actual usage, which was determined in the 2013 Annual Compliance process.*

The ACCC's Consultation Paper (at page 13, question 8) has specifically sought comments on that proposed change as follows:

> *8. Is the use of contracted commitments rather than actual commitments appropriate as the method of allocation incremental cost?*

This is not a matter that was originally dealt with in the now withdrawn 2016 Hunter Valley Draft Access Undertaking. Rather, it is a recent change introduced by ARTC with submission of the latest version of the DAU in December 2016.

While it might seem like a minor matter, the approach to this issue impacts directly on the assessment of the floor and ceiling pricing limits under the annual revenue compliance assessment process, particularly as it relates to Pricing Zone 1 revenue allocation. As a result it has a material impact on both the extent of charges paid by some access holders and the proportion of charges faced by users of the network which are fixed and variable in nature in addition to creating potential for onerous contracts given the prevalent long term contracting regime.

3 ACCC's previous consideration

This matter was the subject of detailed and very recent consideration by the ACCC in the ACCC's Final Determination in the 2013 Annual Compliance Review (of 6 June 2016).

In that review the ACCC concluded (at page 59) that:

> *it is appropriate to take into account the available information on the actual usage of the network by Access Holders and to allocate costs between users based on what they actually used rather than what users were contracted to use.*
>
> *Accordingly, the ACCC considers that a usage based allocation (such as that adopted in the WIK model) represents a fair and reasonable outcome for Access Holders across all pricing zones.*
>
> *…*
>
> *the use of contracted volumes is not consistent with the calculation of incremental cost via the WIK methodology.*

There has been no change in circumstances since the time of that review other than ARTC resubmitting the latest DAU with the relevant changes to Section 4 seeking to effectively ‘reverse’ the outcome of the ACCC’s final determination in that regard. ARTC has not provided with the latest DAU any material new arguments which were not presented to the ACCC during that recent comprehensive review which would justify changing the ACCC's previously expressed view.

Changing this approach now would also be making a change to one element of the 'WIK methodology' in isolation (from the Wik-Consult Assessment of the Incremental Costs of Pricing Zone 3 Access Holders’ Use of Pricing Zone 1 and 2 of the Australian Rail Track Corporation’s Hunter Valley Rail Network, 30 September 2015) without making changes to other parts of the methodology. This was also specifically recognised by the ACCC in its 2013 Annual Compliance Review (at page 59) when it stated:

> *the ACCC considers that ARTC and the Pricing Zone 3 Access Holders' arguments for the use of contracted volumes as an allocation mechanism are inherently linked to their proposed alternative approaches to the WIK methodology. However, the ACCC does not accept these proposed alternative approaches and the use of contracted volumes is not consistent with the calculation of incremental cost via the WIK methodology.*

The outcomes of such a lengthy but thorough compliance process, only finishing some 2 and half years after the year being reviewed, should not be lightly discarded and, in particular, in circumstances where no substantive grounds have been put forward to support such a significant change.

Further, it is in the interests of all stakeholders (making long term investment decisions in respect of mines, rolling stock or below rail infrastructure) for the ACCC's determinations in respect of ARTC's services to provide regulatory certainty. Changes in methodology that are not in response to changes in circumstances or new information, not only undermine accepted principles of regulatory certainty, but also have the potential to simply create windfall gains and losses.

Anglo American notes that the concerns which were expressed by some users in submissions to the ACCC early in the 2013 Annual Compliance Review process (that Pricing Zone 3 actual volumes were still substantially different to the contracted volumes which triggered capital investments), is no longer relevant given that Pricing Zone 3 actual volumes have now 'ramped up' to be more reflective of long term contracted volumes.

It is also accepted practice in other jurisdictions, eg – Queensland Competition Authority’s regulation of Aurizon Network, that where there is an incremental capital requirement for below rail track expansions or enhancements that, under a socialised system, existing users should be ‘no worse off’ from a pricing (and capacity) perspective.

For these reasons, Anglo American considers that the ACCC should continue its approach of allocating incremental capital costs by actual usage, as determined to be appropriate by the ACCC and for the reasons outlined in the WIK report only 8 months ago in respect of the 2013 Compliance Assessment.

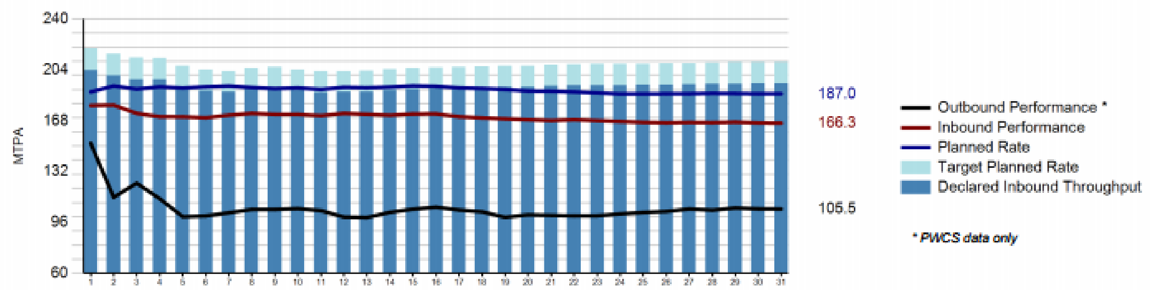
4 Response to ARTC's submissions

Anglo American is not convinced by the rationale for the change advocated by ARTC in its submissions in connection with the DAU.

In particular Anglo American notes:

(a) *exposure to other Access Holder's volumes*: given the significant tonnage, based on approximately 35 different mines, utilising the Hunter Valley network, the exposure to individual access holders for variations in another individual access holder's actual rail usage would be very limited, particularly in Zone 1 given it is used by all access holders, due to socialisation of any such impact across all users of the network. The below graph from the HVCCC Monthly Performance Report (31 January 2017) demonstrates the stability of actual usage volumes through the Hunter Valley coal chain:

Monthly Cumulative Performance Graph



In addition, in most cases the impact on an individual user's changes in actual usage would be expected to balance out over the contract year (given that, although there is an ability to access additional 'flex' paths, a user's contractual entitlement is limited to the annual entitlement). Railings will never be perfectly even given production variability and the cargo assembly nature of the terminals, but in some periods an access holder might use less than their contracted capacity, when in other periods they might use more than their contacted capacity.

(b) *cross subsidisation*: Anglo American considers that basing incremental cost allocation on contracted paths also involves cross-subsidisation. A mine that has contracted capacity which it is unable to use (such as a mine which has subsequently closed or been placed on care and maintenance) and is not responsible for triggering capital investments would effectively be required to continue to pay for capital investments triggered by others under ARTC's proposed changes.

(c) *impact on efficient investment*: Anglo American considers that basing incremental cost allocation on contracted paths will also impact on efficient investment. Because, as noted above, existing mines that are 'over-contracted' will effectively be cross-subsidising new mines which triggered the incremental capital, which will make it lower cost than would be efficient. Consequently there is a risk of coal miners making inefficient investment decisions in mines based on the lower pricing, which then become problematic when the over-contracted positions of existing mines cease. ARTC's latest 2016-2025 Hunter Valley Corridor Capacity Strategy acknowledges (at page 3) that its growth strategy, and the investment required, takes into account not only future uncontracted volumes but also the anticipated reduction from volumes which are contracted but unlikely to be renewed:

> *The fundamental approach of ARTC in developing this Strategy has been to provide sufficient capacity to meet contracted volumes based on the principles of the ARTC Hunter Valley Access Undertaking (HVAU). It also identifies those projects that would be required to accommodate prospective volumes that have not yet been the subject of a contractual commitment, though this is a hypothetical scenario only and does not imply that those volumes will be contracted. This Strategy identifies a preliminary scope of work to accommodate contracted plus prospective volumes of up to 254 mtpa. This is a reduction in the peak volume compared to recent previous years, reflecting current market conditions. Notwithstanding this, there remains a clear pathway to achieving the peak volumes in the 280—290 mtpa range identified in previous Strategies…. Currently contracted export coal volumes are 190.9 mtpa in 2016 [including 9.5Mtpa of domestic coal]. They are essentially stable at approximately this level until they start to decline in 2024, falling to 167.9 mtpa in 2025. ARTC contracts on a rolling*

10 year "evergreen" basis and producers are choosing to not roll-over some volume. This volume is not being replaced by new volume contracts.

(d) *ARTC revenue is not placed at greater risk or made more volatile:* Given the form of regulation (a revenue cap) with a floor and ceiling test that is applied by the ACCC to ARTC with related unders and overs mechanisms, the exact methodology for allocation of incremental capital costs does not change ARTC's risk profile and is therefore not really an issue for ARTC itself. This is particularly so in respect of Zone 1 being used by all access holders. The revenue cap and annual revenue reconciliation process also protects access holders from pricing volatility given the relevant pricing period is the same financial period with a reasonably near term and therefore reliable volume forecast able to be determined with the additional benefit of the annual HVCCC assessment as part of its system capability review for the coming year.

5 Conclusion

For the reasons set out in this submission, it is appropriate for the incremental costs to be allocated to users based on actual usage, not contracted capacity.

Any other results will:

(a) undermine the regulatory certainty provided by the ACCC's administration of ARTC's Hunter Valley access undertakings;

(b) create the potential for windfall gains and losses for producers or haulage operators that have made investment or contracting decisions on the basis of the ACCC's existing approach; and

(c) involve cross subsidisation that has the potential to distort related markets (and result in inefficient) future contracting decisions.

Consequently Anglo American considers that the DAU must be rejected in this regard, due to not being appropriate, having regard to the factors in section 44ZZA(3) *Competition and Consumer Act 2010* (Cth).