AngloAmerican

Supplementary Submission to the Australian Competition and Consumer Commission

Hunter Valley 2017 Draft Access Undertaking

Anglo American Metallurgical Coal Pty Ltd

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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 ARTC's 2017 Hunter Valley Draft Access Undertaking (the ***DAU***) and the ACCC's related Consultation Paper.

This is a supplementary submission (to the initial submission made by Anglo American on 8 February 2017 (the ***Initial Anglo Submission***)) which responds to:

(a) the ACCC's queries to the Hunter Rail Access Task Force (the ***HRATF***) of 15 February 2017 in relation to the methodology for allocation of incremental capital costs; and

(b) the HRATF supplementary submission of 20 February 2017 (the ***HRATF Supplementary Submission***).

While Anglo American is a member of the HRATF, as noted in the Initial Anglo Submission, it does not support the HRATF's position, nor ARTC's, on the allocation of incremental capital costs.

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

2 Rationale for Support of Usage Based Allocation Methodology

Without repeating the Initial Anglo Submission in full, Anglo American supports the ACCC's existing methodology for allocation of incremental capital costs by reference to actual usage due to:

(a) **consistency with the ACCC's existing extensively debated and fair and reasonable approach**: Anglo American is supporting a position consistent with the ACCC's Final Determination in the 2013 Annual Compliance Review (of 6 June 2016) where a usage based methodology was found to be *'a fair and reasonable outcome for Access Holders across all pricing zones'* after more than 2 years of consultation, with the ACCC having considered expert reports and submissions by stakeholders on this specific issue. No convincing rationale has been provided for damaging regulatory certainty in the way being proposed;

(b) **contracted capacity based allocation methodology results in cross-subsidisation and inefficient investment decisions**: allocation based on contracted capacity gives rise to cross-subsidisation (with users which have contracted capacity but are not using the network to contracted levels and therefore not triggering incremental capital effectively paying for those users who are). That, in turn, has the potential to lead to inefficient investment in new mines (and resulting inefficient contracting of coal chain capacity) by subsidising new mines or expansions to which the incremental capital is truly attributable; and

(c) **the HRATF's asserted issues regarding the usage methodology do not exist:** due to the stability of actual usage volumes and form of pricing regulation which is reflected in the Hunter Valley access undertaking, the usage based methodology does not result in material exposures of users to the individual volumes of other users, or any increase in ARTC's risk profile as the HRATF appears to be asserting.

3 Responses to HRATF Supplementary Submission

(a) Efficient allocation of risks between ARTC and users does not require all capital to be recovered through fixed charges

The HRATF Supplementary Submission asserts that the efficient allocation of risks between users and ARTC requires that the recovery of capital costs is contracted through capacity (take or pay) charges. It is not clear to Anglo American why that is necessarily the case.

As between ARTC and users, the question is how to ensure that ARTC receives an appropriate and efficient return on and of capital.

Zone 1 and 2 are considered by ARTC to be ‘constrained’, such that in the foreseeable future ARTC would be anticipated to continue to collect revenue reflecting the revenue ceiling limit from those pricing zones. There is no suggestion that there is a likely significant ongoing difference between actual usage and contracted volumes in respect of Zone 3 users.

Consequently, the methodology for allocation of incremental capital does not appear to adversely impact on whether ARTC recovers the same overall revenue (i.e. it does not impact on the efficiency of ARTC's return profile), rather it changes the outcomes for individual users of how that revenue is recovered.

(b) The assertion of incentives to over-contract

The HRATF Supplementary Submission asserts that a usage based allocation would provide incentives for users to over-contract (i.e. contract excess capacity above their likely usage). The grounds for that assertion appear to be that the user 'will only have to pay for what they use'.

That is an overly simplistic assessment, because:

(i) the methodology issue being considered only relates to allocation of *incremental* capital costs – there is no suggestion that other capital costs are going to be allocated based on usage. In that regard, Anglo American understands that:

(A) the ACCC's consultant, Wik Consult; and

(B) ARTC's consultant Bull Head Services Pty Limited,

have both recognised multiple major projects as not being incremental in nature, or only being partially incremental in nature; and

(ii) users would be anticipated to contract aligned volumes of capacity in the other elements of the supply chain (port and above rail) as well. Consequently an over-contracting strategy would not be pursued as it would expose such users to additional costs and liabilities beyond those relating to rail access (often with corresponding security requirements).

The HRATF also raises the potential for Zone 3 customers to have an incentive to contract for excess capacity in Zone 1. To Anglo American's knowledge, Zone 3 users must contract the same pathing for a Zone 3 load point through Zone 1. Further, such a strategy would expose Zone 3 producers to higher take or pay in Zone 1 relative to the additional corresponding fixed charges in Zone 3.

(c) The assertions about inefficient ARTC overinvestment

The HRATF Supplementary Submission asserts that ARTC develops capacity to reflect contracted requirements, such that recovery of incremental capital by reference to actual usage will result in inefficient investment by ARTC.

While that sounds correct at first blush, it does not reflect the reality of the framework for incremental investment in the Hunter Valley rail network according to ARTC’s own published strategy.

Firstly, the HRATF position assumes that the assertion about over-contracting is true (which Anglo American doubts as noted above).

Secondly, as the ARTC 2016-2025 Hunter Valley Corridor Capacity Strategy makes clear:

(a) ARTC makes investment decisions based on prospective (not just contracted) volumes; and

(b) under the ARTC Hunter Valley Access Undertaking it is a matter for the Rail Capacity Group (***RCG***) to determine the prospective volumes that are to be used for the purposes of such investment (which, given the benefit of reliable information from the HVCCC as an independent body tasked with providing such analysis eg – System Assumptions, etc, would surely be anticipated to not result in investment to reflect a contracted capacity profile if it was materially higher than actual usage).

Consequently, it is difficult to see how a usage based allocation for incremental capital results in over-investment in the network.

(d) The assertions about certainty and predictability of cost

The HRATF Supplementary Submission asserts that recovery of all capital costs (fixed and incremental) through take or pay charges would provide 'a higher degree of certainty and predictability for users'.

First, as Anglo American understands the application of the ACCC's 2013 compliance assessment, the element of variability is caused by the differences between forecast and actual usage (which are then reconciled as part of the subsequent annual 'unders and overs' calculations). Anglo American submits that any potential variance would not be anticipated to be significant because:

(i) the forecast usage ARTC assumes for the purpose of allocation during the year is presumably based heavily on the work of the HVCCC, who have visibility of all elements of the coal supply chain and have a track record of providing accurate forecasts as well as ARTC’s own information and modelling; and

(ii) for there to be aggregate variability in pricing there would need to be aggregate variability in actual usage. Whereas, what would be anticipated is that variability in usage by individual users will not all occur in the same direction (i.e. if one user under produces while another is overproducing, that will 'balance out' in terms of the aggregate differences between forecast and actual usage).

In any case, certainty and predictability of an inappropriate price is not a desirable outcome.

(e) The assertions about contractual alignment

The HRATF Supplementary Submission asserts that charges being 100% take or pay basis was the 'foundation of the capacity framework for the entire Hunter Valley Coal Chain'. Anglo American does not agree that there is any evidence of any such foundation or agreement between coal chain participants that that should be the case.

The Hunter Valley Capacity Framework Arrangements (as authorised by the ACCC in 2009) and implemented in 2009-10, were premised on seeking alignment of contractual arrangements across the coal supply chain (i.e. for below rail, above rail and port). However, the alignment desired was in respect of the long term contracting of capacity entitlements, not pricing methodology. That is, the 'foundation' was seeking to implement a system which provided greater assurance that the same level of port and below rail capacity was contracted by users and that each element of the system could deliver the level of capacity contracted (rather than there being bottlenecks in one element of the coal chain) in particular to reduce the vessel queue.

There was no agreement between coal chain participants that charges should be wholly take or pay based. In any case, the ACCC is required to determine whether the draft access undertaking is appropriate, and cannot be ‘shackled’ in that regard by what is now asserted to have been some implicit understanding of coal chain participants 7 to 8 years ago.

4 Conclusion

Anglo American considers that the case for departing from the ACCC's conclusions of June 2016, reached after a thorough consideration of this issue in the 2013 compliance assessment, has not been convincingly made. The contracted capacity based methodology being advocated for by other, seems to have flaws in any case.

Consequently, for the reasons set out in this submission and the Anglo Initial Submission, Anglo American considers it remains appropriate for incremental costs to continue to be allocated to users based on actual usage, not contracted capacity.