18 March 2019

Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Completion and Consumer Commission
Email: transport@accc.gov.au

By: Email

Dear Mr Schroder

Draft Determination – ARTC’s 2015 Annual Compliance Hunter Valley Coal Network Access Undertaking

Idemitsu Australia Resources Pty Ltd (Idemitsu) welcomes the opportunity to provide the following submission regarding the Draft Determination issued on 18th February 2019 by the Australian Competition and Consumer Commission (ACCC), in relation to the Australian Rail Track Corporation’s (ARTC) 2015 Annual Compliance with the financial model in the Hunter Valley Coal Network Access Undertaking (HVAU).

The ARTC is required to annually submit documentation to the ACCC for assessment, demonstrating its compliance with the financial model as set out in section 4 of the HVAU. The assessment by the ACCC considers whether:

(a) The ARTC has undertaken prudent capital expenditure in accordance with the requirements of the HVAU;

(b) The ARTC has incurred efficient operating expenditure in accordance with the requirements of the HVAU;

(c) The ARTC has rolled forward the regulatory value of assets in accordance with the HVAU;

(d) Pricing Zone 3 forms part of the Constrained Network or whether Loss Capitalisation continues to apply in accordance with the HVAU; and

(e) The ARTC has reconciled revenues with the applicable revenue floor and ceiling limits (Revenue Ceiling Test) and determined any ‘unders or overs’ amounts to Constrained Customers in accordance with the HVAU.

The 2013 Annual Compliance was a complex and extended process, the ACCC engaged an overseas expert who examined and introduced (through the ACCC) the Incremental Cost methodology. An outcome of this prolonged process has been the creation of a backlog of Annual Compliance assessments - in accordance with the provisions of the HVAU 2015, 2016 and 2017 assessments should all have been completed by now. These delays have had significant impacts on all Access Holders:

(a) Regulatory Uncertainty - through delays and retrospective unwinding of previously approved HVAU provisions which have formed the basis upon which Access Holders have contracted with the ARTC and made significant financial decisions.

(b) Financially ‘out of pocket’ – these delays have significant financial implications for Access Holders. For example, the 2015 Annual Compliance has identified an over recovery of
Idemitsu is supportive of the Annual Compliance and the role of the ACCC in this process, however Idemitsu would encourage all stakeholders to appropriately expedite the outstanding Annual Compliance assessments with a view to realigning with the HVAU schedule or risk carryover, confusion and regulatory uncertainty into any new HVAU. One of the challenges when considering providing views or comments on the Annual Compliance which should have been completed two and half years ago, is the passing of time and applying the provisions of the HVAU at that time versus changes to the HVAU resulting from separate regulatory processes and negotiations. Furthermore, 2015 was the year in which stakeholders began a long process of developing and negotiating a new HVAU with the ARTC. Which was ultimately unsuccessful and resulted in an extension to the current HVAU, a retrospective Annual Compliance review using concepts and methodologies accepted in a future and separate regulatory process is inappropriate.

Idemitsu disagreed with the interpretation of Incremental Cost methodology contained in the 2013 Final Determination, particularly the adoption of actual usage rather than contracted usage, as the allocator for Incremental Capital Cost. This approach has been appropriately implemented by the ARTC in 2015 (acknowledged by the ACCC) and will be maintained up to including 2018, however for the remainder of the current HVAU (expiry 2021) the Incremental Capital Cost allocator will revert to the more appropriate contract usage. This revision was a part of the comprehensive September 2018 HVAU variation process, which was supported by a significant majority of Hunter Valley coal producers (with only one exception).

The ACCC has asked for comments on Pricing Zones 3’s contribution to fixed costs associated with their use of Pricing Zone 1. The ACCC have acknowledged they raised this issue previously with the ARTC and members of the Hunter Valley Rail Access Task Force (HRATF) and the agreed industry feedback was this methodology was not an issue whilst Pricing Zone 3 remained unconstrained. Furthermore, stakeholders have acknowledged this would be a matter for discussion and review in the development of a replacement HVAU. Given these circumstances Idemitsu’s considers any consultation on the future approaches to fixed cost contribution in Pricing Zone 1 is not appropriate for the 2015 Annual Compliance or any other Annual Compliance assessment under the current HVAU.

Idemitsu acknowledges the ARTC undertook a restructure in 2015 and this is the first Annual Compliance post the restructure and the establishment of the Hunter Valley business unit. The new Hunter Valley business unit has embarked on a transformation of the ARTC to enhance customer satisfaction, seek operational and capital efficiencies and improve overall transparency. From a customer perspective at the end of 2015 these underlying objectives were evident and were starting to be developed, however they would take considerable time to develop and implement. The ARTC have made significant improvements in all areas, however this is an ongoing challenge for both the ARTC and Access Holders and requires annual assessment to determine value for money for customers.

The following submission provides Idemitsu’s views on selected issues in the ACCC’s Draft Determination for the 2015 Annual Compliance and includes responses to the questions posed by the ACCC. This submission does not comment on all the issues raised by the ACCC, particularly those seeking additional information from the ARTC. Idemitsu is willing to provide comments on these matters once the additional information is available.
Should you have any queries regarding this submission or would like to discuss this matter further please do not hesitate to contact me (Ph +61 7-3222 5623).

Yours sincerely

Craig Forster
Senior Manager Infrastructure and Risk
Idemitsu Australia Resources Pty Ltd
Idemitsu Submission
ARTC Hunter Valley Rail Access Undertaking – 2015 Annual Compliance Assessment

1. Overview

Idemitsu is an active coal producer with mines located in the Hunter Valley, Pricing Zone 1 (PZ1) and the Gunnedah Basin, Pricing Zone 3 (PZ3).

The ARTC is required to annually submit documentation to the ACCC for assessment, demonstrating its compliance with the financial model as set out in section 4 of the HVAU. This assessment by the ACCC considers whether:

(a) The ARTC has undertaken prudent capital expenditure in accordance with the requirements of the HVAU;
(b) The ARTC has incurred efficient operating expenditure in accordance with the requirements of the HVAU;
(c) The ARTC has rolled forward the regulatory value of assets in accordance with the HVAU;
(d) PZ3 forms part of the Constrained Network or whether Loss Capitalisation continues to apply in accordance with the HVAU; and
(e) The ARTC has reconciled revenues with the applicable Revenue Floor and Ceiling Limits (Revenue Ceiling Test) and determined any 'unders or overs' amounts to Constrained Customers in accordance with the HVAU.

Idemitsu acknowledges the ACCC have several minor outstanding information requests with the ARTC which will need to be fulfilled before finalising the 2015 Annual Compliance and there may be immaterial amendments to the final 2015 Compliance assessment.

Despite these outstanding information requests, the ACCC has provided a Draft Determination:

(a) The ARTC has undertaken prudent capital expenditure;
(b) The ARTC in some instances has not efficiently incurred efficient operating expenditure (discussed below);
(c) Subject to an adjustment in PZ3, the ARTC has rolled forward the regulatory value of assets appropriately (discussed below);
(d) In PZ3 the RAB Floor Limit is less than the RAB and therefore Loss Capitalisation continues with a closing balance of $86.2M and remains unconstrained;
(e) There has been an over recovery by the ARTC in the Constrained Network of $41.7M based upon the Ceiling Limit; and
(f) ACCC has accepted the auditor's (BDO) True Up Test findings, the ARTC not being liable for any rebates for 2015.

Idemitsu acknowledges the increased disclosures the ARTC is now providing in the Annual Compliance process and supports the role of the ACCC, however Idemitsu would encourage all stakeholders to improve the overall timeliness of the Annual Compliance process. Based upon the timetable set out in the current HVAU, the ARTC should be close to submitting the 2018 Annual Compliance, instead stakeholders are still finalising the 2015 Annual Compliance. This is creating significant regulatory uncertainty for Access Holders and exposing them to untimely and needless financial burdens. Idemitsu requests the ARTC and ACCC to work more cooperatively around the information requests to avoid further undue delays on future Compliance assessments.
2. **Error RAB Roll Forward**

Idemitsu would like to draw the ACCC's attention to a typographical error in Table 24\(^1\). The Opening RAB for PZ3 is stated as $745,320,126, this is incorrect and should be $748,320,125. The Closing RAB for PZ3 is stated as $785,856,022, this is correct.

3. **Incremental Cost**

The ARTC for the second consecutive year have applied the accepted Incremental Cost methodology outlined (by WIK\(^2\)) in the approved 2013 Annual Compliance with some minor amendments which were subsequently approved in the 2014 Annual Compliance. The Incremental Cost methodology calculates the incremental cost (capital and maintenance) of PZ3 Access Holders use of PZ1.

Idemitsu understands the significant 2015 over recovery ($41.7M) in the Constrained Network is principally attributed to the reclassification of a large portion of costs to Incremental Costs compared with the cost classification at the time of setting the 2015 prices and their respective TOP and Non- TOP components. Due to the timing of the ACCC's final decision on the 2013 Annual Compliance, a similarly large over recovery is expected in the 2016 Annual Compliance.

It is essential the delayed Annual Compliance assessments be appropriately expedited to enable these over recoveries to be returned to Access Holders. Access Holders have been out of pocket for up to two and half years with no compensation (interest on outstanding monies). Furthermore, as part of the extension process of the current HVAU, rebates due to Access Holders resulting from changes in the WACC are being held up due to the delays in the Annual Compliance process.

4. **Prudence of Capital**

The HVAU requires the ARTC to incur capital expenditure on a prudent basis (net capital expenditure). The ACCC considers prudent capital expenditure to be that which has been endorsed by the RCG and in accordance with the consultation provisions of the HVAU. In addition, the HVAU permits interest costs during construction, and the appropriate disposal of assets at the RAB written down value.

4.1. **Major Capital Expenditure**

Major Capital expenditure incurred by the ARTC for 2015 was the commissioning of the upgrade to the Gunnedah Yard ($18.2M) and the post commissioning costs ($15.0M) of several projects across all pricing zones. Idemitsu understands the ARTC has provided appropriate evidence (including RCG materials) to consider this Major Capital expenditure as prudent.

With respect to post commissioning costs, Idemitsu has concerns regarding the transparency of these costs and encourages the ARTC to provide regular updates and ongoing cost balances to the RCG for those Major Capital projects not yet closed. Furthermore, the ARTC should continue the timely distribution of project close out reports when a project is completed. The 2015 amount of $15M is a significant amount and contains projects which were commissioned as far back as 2012 (e.g. Minimbah Bank commissioned August 2012 and Nundah Bank commissioned November 2012). Idemitsu acknowledges the number of Major Capital projects has reduced significantly since 2015 and therefore there is likely to be lower post commissioning costs in future Compliance periods.

---

1. ACCC Draft Determination Australian Rail Track Corporation's compliance with the Hunter Valley Access undertaking financial model for the 2015 calendar year. 18th February 2019, p64.
4.2. Corridor Capital Expenditure

The ACCC has identified some minor discrepancies in the ARTC’s initial Compliance submission including lacking RCG endorsement of Minor Capital, RCG endorsed amounts not reconciling with submitted amounts and negative capital expenditures. Idemitsu understands these have now been addressed and the ACCC is satisfied the ARTC has incurred prudent expenditure for Minor Capital Projects.

Idemitsu encourages the ARTC to continue with the pre-approved Corridor Capital customer engagement and the regular Maintenance and Corridor Capital reconciliation reporting to the RCG throughout the year.

4.3. Interest During Construction (IDC)

The ACCC has identified an issue with interest during completion for the Gunnedah Yard Upgrade project in PZ3. This project was due for completion in November 2014 but was delayed until March 2015 as a result of the performance of the signal design consultant under the control of the ARTC.

Idemitsu acknowledges the updates provided by the ARTC to the RCG, however Idemitsu agrees with the ACCC:

"...as the responsible manager of the project and its associated risks, including selection of a contractor subsequently found to be unsatisfactory. Therefore, the ACCC considers that the cost of delayed completion should not be accepted as prudent expenditure during construction and Access Holders should not bear the cost of an additional year’s interest in 2015"  

The ARTC is most suitably placed to manage the performance of all its contractors and consultants which are integral to the critical path of its projects. Furthermore, allowing the ARTC to claim interest during construction on projects which have exceeded their scheduled commissioning date whilst under their control is an inappropriate return.

In this instance allowing the ARTC to claim half a year’s interest on 2015 expenditure by reducing the ARTC claim from $2.1M to $1.1M is appropriate.

4.4. Disposals

Idemitsu is satisfied with the ACCC’s assessment of the asset disposals after additional information was provided by the ARTC at the request of the ACCC. Idemitsu would welcome ARTC providing improved transparency and similar commentary (ACCC information request) regarding asset disposal as part of future initial Annual Compliance submissions.

Idemitsu understands the ARTC is still required to provide underlying calculations to the ACCC which determine the written down value of disposed assets.

5. Efficiency of Operating Expenditure

The ARTC’s operating expenditures are categorised into several main subgroups; maintenance, expensed projects, loss on disposal, business unit management, network control and corporate overheads. Idemitsu recognises a number of these categories are down compared to prior years due to the decrease in capital projects (e.g. expensed project costs and loss on disposals) and the organisational restructure.

---

3 ACCC Draft Determination Australian Rail Track Corporation’s compliance with the Hunter Valley Access undertaking financial model for the 2015 calendar year, 18th February 2019, p15.
Several cost categories for 2015 have been changed from prior years (e.g. business unit management costs versus shared maintenance costs) this makes 2015 costs comparisons against 2014 challenging and possibly misleading.

The Draft Determination sets out a significant number of information requests made by the ACCC to the ARTC as part the 2015 Annual Compliance assessment, much of this information has been provided directly to the ACCC and ldemitsu has not had the benefit of this additional information. Therefore, ldemitsu supports the ACCC conducting a rigorous review of the operating costs related information to test for efficiency on behalf of all Access Holders. ldemitsu acknowledges the ACCC’s re-engagement of WIK-Consult (and their engineering subcontractor TUV Rhineland) to provide independent expert advice with respect to the ARTC’s operating expenditure (and maintenance practices).

ldemitsu requests both the ACCC and the ARTC pursue opportunities which can streamline the Annual Compliance process to enable it to be a more timely and efficient process (but no less robust) as envisaged by the HVAU.

5.1. Maintenance

WIK-Consult has identified a major concern regarding the ARTC’s application of a 10% margin to Routine Corrective and Reactive Maintenance (RCRM) activities.\(^4\) The ARTC contends it has been a long standing regulatory precedent, outsourcing maintenance is consistent with a prudent service provider or an asset owner can create its own formal internal service division which formally contracts with its related party asset owner at a margin deemed efficient. The ARTC has implemented the later of these approaches by retaining a maintenance services division within its structure for RCRM activities. The ARTC considers the inclusion of the 10% margin reflects the efficient market price for these maintenance services based upon efficient price benchmarks through alliance contracts in the ARTC Interstate Network.

ldemitsu’s comments are as follows:

(a) ldemitsu is aware of similar regulatory precedence for maintenance activities whereby the asset owner establishes an internal service division which formally contracts with asset owner at an efficient market tested price and the arrangement are transparent to all stakeholders.

(b) ldemitsu was not aware of the application of the 10% margin on RCRM activities. The lack of transparency by the ARTC on this matter is disappointing.

(c) The ARTC have advised the 10% margin has been applied to RCRM activities since the commencement of the HVAU in 2011. This matter was not raised or disclosed as part of the discussions between the ARTC and the small group of Access Holders attempting to develop an Operating Cost Efficiency Mechanism as part of the new HVAU in early 2017.

(d) ldemitsu does not consider the alliance contracts in the ARTC Interstate Network as efficient pricing benchmark. In addition, it remains unclear how the benchmarking exercise has been able to consistently determine the 10% margin is appropriate. It would seem unrealistic the 10% margin has been maintained for the period 2011 to 2015, particularly with the decline rail work and subsequent softening of the contractor market in the Hunter Valley commencing in 2015.

(e) WIK-Consult identified approximately 40% of RCRM activities are attributable to purchased service and goods. ldemitsu agree with WIK-Consult it is inappropriate to add

\(^4\) WIK-Consult, Assessing the Efficiency of Australia Rail Track Corporation’s Operating Expenditure for the 2015 Calendar Year, 20 December 2018, p23.
a 10% margin has these purchased service and goods have already been charged in a workable competitive market and yields an unreasonable notional expenditure.5

(f) Given the lack of transparency, it is difficult for Idemitsu to comment on the arrangements between the ARTC’s internal maintenance service and network ownership, however Idemitsu is not aware of any formal agreements within ARTC and the is no separate legal entities within ARTC, as established in other regulated rail networks.

Idemitsu supports the removal of the 10% margin on RCRM activities which equates to $1.9M. Idemitsu notes WIK-Consult identified some consistency discrepancies between the ARTC general ledger and the ARTC Compliance submission, which have been explained by the ARTC or are considered to have no negligible effect on Access Holders. However, Idemitsu supports the ACCC’s request for further explanation from the ARTC regarding 15-line Segment discrepancy ($223,253) and the maintenance cost for ‘incidents’ ($53,648)

It should be recognised on several occasion WIK-Consult considered the ARTC’s approach to certain maintenance activities as sensible, extensive, efficient, cost effective and commonly applied in Europe (e.g. ballast cleaning, ballast undercutting, signalling, rail grinding).

5.2. Network Control

The ACCC has considered the increases in Network Control Costs (compared to 2014) and is satisfied these expenditures are efficient, however, WIK-Consult has identified a potential issue with the sequence of the allocation methodology applied (mainly between PZ1 and PZ2). The ACCC is seeking further clarification from the ARTC on this matter, once received Idemitsu request this additional information be distributed to Access Holders.

The other matter of concern, which Idemitsu has raised in previous Compliance assessments, is the treatment of the three unconstrained Segments in PZ1. Like the ACCC, Idemitsu is seeking clarity on how these Segments are treated in the financial model but also should these Segments receive an allocation from the other operating cost categories and has there been any capital expenditure incurred? Noting the ARTC allocates some corporate overhead costs attributed to these Segments to the Constrained Network. WIK-Consult has recommended these be allocated to the Unconstrained Networks, it is not clear to Idemitsu what allocating to the Unconstrained Networks means.

5.3. Corporate Overheads

WIK-Consult has conducted an assessment on the appropriateness of the casual links and cost allocators for corporate overheads used by the ARTC in the 2015 Annual Compliance. Idemitsu welcomes the proposed reduction of $1.3M in corporate overheads for the Hunter Valley Coal Network, subject to the ARTC’s response to the outstanding information request. WIK-Consult has articulated valid reasons for the changes to the cost allocators to four of the ‘delivery units’ (Operations Planning, Communications, Property and Plant Department), however Idemitsu would like to consider the ARTC’s response to the information request regarding these cost allocators before providing comment.

The ACCC has referenced changes to the future cost methodology from 1 July 2017, Idemitsu considers using future regulatory changes originating from a completely different regulatory processes and retrospectively applying this future methodology will create significant confusion and regulatory uncertainty for all stakeholders. Stakeholders are making

---

5 WIK-Consult, Assessing the Efficiency of Australia Rail Track Corporation’s Operating Expenditure for the 2015 Calendar Year, 20 December 2018, p24.
significant financial decisions based upon the provisions and sections of the HVAU current at that point in time, retrospective changes establishes an inappropriate precedence.

5.4. Business Unit Costs

Idemitsu recognises the ARTC undertook a restructure in 2015 and this is the first Annual Compliance post the restructure and the establishment of the Hunter Valley business unit. The new Hunter Valley business unit has embarked on a transformation of the ARTC to enhance customer satisfaction, seek operational and capital efficiencies and improve overall transparency. From a customer perspective at the end of 2015 these underlying ARTC objectives were evident and starting to be developed acknowledging they would take considerable time to implement. The common measure of success of this restructure will be value for money which will be different from customer to customer. Idemitsu considers the restructure was needed and some immediate benefits have been achieved such as; improved transparency, enhanced access to key personnel, improved understanding of the ARTC’s role and obligations in the Hunter Valley coal chain and customer engagement.

Idemitsu supports the ACCC seeking clarification regarding a difference between the ARTC Compliance Submission and the general ledger of $441,872 for ‘Management and Support’.

5.5. Other Matters

5.5.1. Procurement

The ACCC appropriately undertook a review of the ARTC’s procurement policies and application based upon investigative works by the Australian National Audit Office (ANAO) into the pre-construction phase of the Inland Rail programme6.

The review was conducted by WIK-Consult on behalf of the ACCC and concluded during 2015 the ARTC appears to have a reasonable and appropriate approach to procurement which has led to efficient expenditure for the Hunter Valley Rail Network.7

Idemitsu acknowledges the ARTC does provide high level procurement updates on contractor and materials supply markets which effect the Hunter Valley Coal Chain from time to time.

Idemitsu would encourage the ACCC to conduct similar procurement reviews for future Annual Compliances as this significantly contributes to Access Holder understanding and confidence of efficient expenditures.

5.5.2. Capitalisation policy

The ACCC (via WIK-Consult) undertook a review of the ARTC Capitalisation Policy, setting out whether a cost is defined as capital or operating expenditure. Idemitsu is a member of the HRATF and supported the concerns raised regarding ‘capitalisation rules’ in a separate HVAU process.

This review has determined for 2015 the ARTC’s capitalisation policy is appropriated and been applied to ensure efficient operating expenditure.8

---

6 ACCC Draft Determination Australian Rail Track Corporation’s compliance with the Hunter Valley Access undertaking financial model for the 2015 calendar year, 18th February 2019, p53.
7 ACCC Draft Determination Australian Rail Track Corporation’s compliance with the Hunter Valley Access undertaking financial model for the 2015 calendar year, 18th February 2019, p54.
8 ACCC Draft Determination Australian Rail Track Corporation’s compliance with the Hunter Valley Access undertaking financial model for the 2015 calendar year, 18th February 2019, p55.
Idemitsu consider it appropriate for the ACCC to test the application of the ARTC's capitalisation policy and its application (and any amendments) from time to time. Furthermore, Idemitsu would welcome the ARTC publishing and explaining this policy (or extracts of the policy) annually when the Minor Capital is presented to the RCG for approval to ensure Access Holders have a clear understanding.

6. System True Up Test

Idemitsu acknowledges the ACCC's view on the 2015 True Up Test audit provided by BDO and the response by the ARTC in relation to the Kankool (15 February 2015) and Pages River (28 August 2015) derailments. Idemitsu understands these losses where appropriately recorded via the Hunter Valley Coal Chain Coordinator (HVCCC) cancellation process and these were subsequently included in the respective Monthly True Up Tests. Idemitsu's only concern is whether the safety regulator has completed its investigation determining cause by the time the Annual Compliance process has been completed. Until the determination of the incident has been determined the HVCCC leave these losses as unallocated.