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3 February 2017

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

Consultation Paper – ARTC's 2017 Hunter Valley Access Undertaking

Idemitsu Australia Resources Pty Ltd (**Idemitsu**) welcomes the opportunity to provide the following responses in regards to the Consultation Paper issued (15 December 2016) by the Australian Competition and Consumer Commission (**ACCC**) in relation to Australian Rail Track Corporation's (**ARTC**) submission of the 2017 Hunter Valley Access Undertaking (**2017 HVAU**), for assessment under Part IIIA of the Competition and Consumer Act 2010 (Cth).

Idemitsu understands the ARTC intends to submit the 2017 HVAU in two parts to the ACCC for assessment. The first includes all matters excluding the operating expenditure efficiency regime (**OPEX Scheme**), which is currently being developed in consultation with stakeholders. The ARTC proposes to submit the second stage of the 2017 HVAU (inclusive of the OPEX Scheme) to the ACCC in April/May 2017

Idemitsu is a coal producer with mines located in the Hunter Valley and Gunnedah Basin, which makes Idemitsu uniquely placed as the only coal producer with mines in Pricing Zone 1 and Pricing 2 as defined by the 2011 HVAU (and 2017 HVAU). Idemitsu requires access to the Hunter Valley Coal Network (**HVCN**) to transport coal from its mines to the port of Newcastle.

Idemitsu is an active participant of the Hunter Valley Rail Access Taskforce (**HRATF**), a collective group of nine coal producers and Access Holders utilising the HVCN. The HRATF will be providing a more fulsome submission to the ACCC on a variety of common issue regarding the 2017 HVAU. Idemitsu supports HRATF submission and uses this submission to further highlight specific issues.

It is Idemitsu's view, based upon this submission, the substantive submissions provided by the HRATF (March 2016 and February 2017) and the letter setting out the preliminary views of the ACCC relating the to the 2016 HVAU; the ACCC must reject the 2017 HVAU.

Should you have any queries regarding this submission or would like to discuss this matter further please do not hesitate to contact me.

Yours sincerely

Craig Forster
Senior Manager Infrastructure
Idemitsu Australia Resources Pty Ltd

Idemitsu Submission
Consultation Paper – ARTC's 2017 Hunter Valley Access Undertaking

1. Introduction

Idemitsu is a coal producer with mines located in the Hunter Valley and Gunnedah Basin, which makes Idemitsu uniquely placed as the only coal producer with mines in Pricing Zone 1 and Pricing 2 as defined by the 2011 HVAU (and 2017 HVAU). Idemitsu requires access to the Hunter Valley Coal Network (**HVCN**) to transport coal from its mines to the port of Newcastle.

Idemitsu is an active participant of the Hunter Valley Rail Access Taskforce (**HRATF**), a collective group of nine coal producers and Access Holders utilising the HVCN. Initially, the HRATF was formed to consider and assess the 2011 HVAU; subsequently the group was reformed as a result of the ARTC application of the 2016 HVAU. The HRATF has continued to consider, assess and comment on the 2017 HVAU.

Idemitsu understands the ACCC's current consultation of the 2017 HVAU is focussed upon departures or differences to the 2016 HVAU lodged in December 2015 by the ARTC. During the 2016 HVAU consultation, Idemitsu and the HRATF provided submissions prior to the ACCC's Final Determination of the 2013 Annual Compliance Assessment (**2013 Compliance**), which was a long and complex process. In the main, many of the issues and concerns set out in these submissions remain and are addressed within these submissions. However, with 2013 Compliance Final Determination greater certainty has been provided and a number of new issues have a risen. In addition, some of the existing issues now have a new frame of reference to be considered.

Furthermore, the ACCC provided a letter to stakeholders in July 2016 (post the 2013 Compliance Final Determination), which set out the ACCC's preliminary views on a number of key issues regarding the 2016 HVAU. In the context it was intended, this letter provided stakeholders with improved clarity on a number significant policy issues. Should the ACCC depart from these preliminary views, Idemitsu requests the opportunity to review, and subsequently discuss these departures with the ACCC.

2. 2013 Compliance

(a) 2013 Compliance Principles

The 2013 Compliance was a complex process which involved the ACCC engaging the assistance of an independent external consultant, WIK-Consult (**WIK**). WIK provided a report to the ACCC articulating a number of principles associated with revenue allocation and incremental costs. The ACCC considered these principles and applied them in the 2013 Compliance Final Determination, which has enhanced stakeholder understanding and acceptance. Furthermore, ARTC have applied these same principles in the 2014 Compliance Assessment.

The ARTC have rightly developed the 2017 HVAU based upon these principles, which have already been applied by the ACCC and the ARTC.

The ARTC has made one departure from the 2013 Compliance principles, implementing contracted volumes rather than actual volumes as an allocator for Incremental Capital. Idemitsu supports this approach as it realigns with the established commercial framework for the Hunter Valley Coal Chain and reduces the uncertainty for Access Holders by restabilising the underpinning Take or Pay commitments with respect to capital investments and endorsements by the Rail Capacity Group. Idemitsu supports this approach by the ARTC.

The complex economic nature of the 2013 Compliance was always going to be challenging with respect to economic concepts translated into regulatory drafting (2017 HVAU), to ensure appropriateness and clarity for stakeholders. The HRATF have provided comments on the drafting to assist with clarifying the principles of Incremental Costs, Ceiling Limits, Unders and Overs etc.

Idemitsu considers it absolutely essential and to the benefit all stakeholders the principles applied by the ACCC in the 2013 Compliance Final Determination continue to be adopted and implemented in the 2017 HVAU to ensure consistency, transparency and certainty.

(b) Incremental Costs

Subject to minor drafting changes proposed in the HRATF submission and some further clarifications, Idemitsu accepts ARTC's application of Incremental Cost.
In addition, the HRATF submission identifies the inconsistency between Incremental Capital Cost and Incremental Maintenance Cost, relative to the definition of incremental costs being those costs that are avoidable in the long run.

The approach in determining long run costs must be aligned with the development of the new OPEX Scheme (below), the ARTC annual budget and forecast process and the Annual Compliance Assessment.

3. Rate of Return

Idemitsu acknowledges during the negotiation of the 2011 HVAU parties agreed a rate of return percentage (as part of a package) rather than a defined process or methodology resulting in a calculated rate of return. However for the 2017 HVAU Access Holders are seeking regulatory certainty and transparency with respect to the rate of return.

Idemitsu supports the orthodox methodology set out in the HRATF submission, which is characterised by transparent cost of capital input parameters and a methodology which can be consistently repeated, reducing subjectivity and avoiding unnecessary protracted arguments and disputes during the proposed Mandatory Review.

The application of the HRATF methodology (including the averaging period prior to 30 June 2016) calculates a rate of return of 4.9% pre-tax real (and 7.5% post-tax nominal).

4. Remaining Mine Life (RML)

The ARTC have proposed a departure from the RML methodology under the 2011 HVAU. The ARTC's new approach to calculating the RML appears to be founded upon concerns regarding asset stranding risk and hence the ARTC have developed a 16.5 years RML from 1 July 2016.

The following principles have been used by the ARTC to manufacture the desired RML:

(a) Removal of mines on care and maintenance (noting there would be no Take or Pay relief for these mines;

(b) Arbitrary 10% discount of reserves to reflect life of mine impacts;

(c) Mining licence renewal as a proxy for determining mine life; and

(d) Access Holders' contracted position with the ARTC as an estimate of production

Each of the above principles have been individually addressed and refuted in significant detail in the HRATF submission. The HRATF submission also addresses the nature and inclusion of Prospective Mines.

Idemitsu supports the HRATF approach of maintaining the 2011 HVAU methodology with the addition a more diligent and rigorous approach to independent mining data (i.e. JORC code) and similar to the approach to the rate or return, a transparent process which can be repeated during the Mandatory Review. Idemitsu notes the HRATF RML calculation of 30 years is based upon a HVCN wide approach (there will obviously be different RML's for individual Pricing Zones that when aggregated provide the 30 year RML).

5. OPEX Scheme

Idemitsu is actively collaborating and working with the ARTC in developing an Opex Scheme for inclusion in the 2017 HVAU with a commencement from 1 July 2017. All stakeholders acknowledge this is a challenging and time sensitive task given there was no such scheme in the 2011 HVAU and these schemes are traditionally evolutionary.

Although committed to the development and implementation process, Idemitsu is concerned throughout the 2017 HVAU the ARTC has made reference to a number of sections being linked to the outcome of the OPEX Scheme; hence subsequent amendments may be required. The ARTC has not provided an explanation of these possible amendments.

This has a twofold impact; firstly, potentially slow the development of the OPEX Scheme, as the individual impacts of the OPEX Scheme need to be assessed by the ARTC against the draft 2017 HVAU (and the impact to Access Holders). Secondly, it has the potential for the ARTC wanting to reopen sections of the 2017 HVAU which may have already been agreed. A by-product of these trade-offs is a delayed and ineffective OPEX Scheme.

6. Other Matters

(a) Path Based Pricing

The ARTC have proposed a significant change to the pricing methodology under the 2017 HVAU, moving from Gross Tonne Kilometre to Train Kilometre (distance based) with respect to the Take or Pay portion of the Access Charge and remaining with Gross Tonne Kilometre basis of the Non Take or Pay component. However in both instances there will be no differential factors applied due to the move to a Service Envelope rather than the Indicative Service (envisaged in the 2011 HVAU).

The ARTC have indicated the reasons for the change to path based pricing:

- difficulty in determining the characteristics of the indicative service (under the 2011 HVAU);
- encourage the efficient utilisation of available capacity (tonnes) per path; and
- simplicity for Access Holders.

Similar to the Indicative Service approach, Path Based Pricing provides no consideration or incentive to Access Holders who are already using the most efficient service the rail infrastructure will allow (i.e. Pricing Zone 3 Access Holders will pay significantly higher rate in Pricing Zone 1 compared to other Access Holders).

Furthermore, it is disappointing the ARTC has not provided a Path Based Pricing update (pricing/tariff estimate) to individual Access Holder since October 2015, so that Access Holders have a more complete understanding of the impacts of Path Based Pricing.

(b) Role of the RCG

Idemitsu has concerns regarding the role of the RCG in the application of section 9.2(a)(ii). Based upon the voting process it would seem highly unlikely there will be endorsement by the RCG of capital costs being treated as Fixed Costs rather than Incremental Capital Costs.

To ensure an equitable outcome it may be appropriate for the ACCC to adjudicate on such a situation.

7. Conclusion

The HRATF and the ARTC in good faith have expended considerable effort and resources with the intention of achieving a negotiated outcome with respect to the 2017 HVAU and this should be recognised. Unfortunately, in this instance, a negotiated outcome has not been forthcoming. It should be noted when compared to the negotiation of the 2011 HVAU, it was a different economic climate and the Hunter Valley coal chain was at a different stage of evolution. These factors provide context for the positions expressed by both Idemitsu and the HRATF.

It is Idemitsu's view, based upon this submission, the substantive submissions provided by the HRATF (March 2016 and February 2017) and the letter setting out the preliminary views of the ACCC relating the to the 2016 HVAU; the ACCC must reject the 2017 HVAU.