

Rio Tinto Coal Australia Pty Limited
GPO Box 391
Brisbane Queensland 4001
Australia
T +61 (0) 7 3625 3000
F +61 (0) 7 3625 3001

6 February 2015

Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne Vic 3001

via email: transport@acc.gov.au

Dear Matthew,

Australian Rail Track Corporation's compliance with the financial model in the Hunter Valley Coal Network Access Undertaking for January – December 2013

Rio Tinto Coal Australia (RTCA), as manager of Coal & Allied Industries Limited, appreciates the opportunity to provide comment on the above matter and submits the following in response to two key issues highlighted in the ACCC's November 2014 position paper regarding ARTC's 2013 compliance review:

1. *Efficiency of operating expenditure – expensing of costs associated with T4 rail projects*

RTCA has generally supported or endorsed ARTC submissions to the Rail Capacity Group (RCG) to expense certain project costs, such as concept assessments or stalled expansion projects. However, in light of what Access Holders now understand about ARTC's economic cost and revenue allocation processes, RTCA does not support the expensing of T4 rail projects in the manner proposed by ARTC and believes the approach employed by ARTC for expensing project costs must be reviewed.

Specifically, RTCA is concerned with the cost of concept studies for Pricing Zone 1 projects simply being incorporated into operating expenditure and recovered via 'unders and overs' from Access Holders *only* within the Constrained Network (i.e. Pricing Zones 1 and 2). As an Access Holder exclusively within Pricing Zone 1, RTCA considers ARTC's expensing mechanism to be fundamentally flawed as it disregards the very high likelihood that a given Pricing Zone 1 project, or group of projects, may have ultimately been for the benefit of *all users* of Pricing Zone 1, including customers outside the Constrained Network.

In the specific case of T4 projects, it is to be expected that T4 contract holders as well as existing users of the PWCS Kooragang/Carrington and NCIG terminals would have benefited to varying degrees from the additional rail infrastructure required to support the T4 expansion. At a

minimum, it was apparent at the time that additional rail infrastructure was likely to be required in the vicinity of the ports to ensure existing terminal customers would have been “no worse off” in terms of accessing rail capacity. RTCA accepted this position despite originally holding only a very small capacity allocation in the proposed T4 expansion.

In supporting the expensing of T4 project costs RTCA assumed that all Access Holders who utilise Pricing Zone 1 would be required to contribute. With a more complete understanding of ARTC’s revenue recovery model it is now clear that that is not the case. RTCA’s view is that a proportionate share of the \$8.97 million in T4 projects costs must be expensed across all Access Holders, not simply those within the Constrained Network. This is in lieu of expensing the cost across T4 contract holders only, which RTCA believes to be imprudent at this point. Critically, RTCA believes a more adequate expensing mechanism needs to be developed by ARTC, with appropriate amendments to the HVAU, to ensure that Constrained Network customers are not unfairly disadvantaged in this way in the future.

2. *Standalone cost test – ACCC position on the recovery of direct, incremental or full economic cost from Pricing Zone 3 Access Holders traversing Pricing Zone 1*

RTCA reiterates its position from past submissions that Access Holders should contribute to the full cost of the capacity they consume in a given Pricing Zone, as anything less amounts to an effective transportation subsidy. As it appears RTCA’s preferred position is unlikely to be adopted, RTCA offers its support for the ACCC position that access pricing must, at a minimum, reflect new Access Holders *paying the full incremental cost* of being provided capacity in a given Pricing Zone.

In determining the incremental cost of Pricing Zone 3 Access Holders utilising capacity in Pricing Zone 1, the ACCC has requested input on “*how the capital investments in Pricing Zone 1 should be itemised to determine the incremental cost of Pricing Zone 3 Access Holders*”. It is RTCA’s view that ARTC are clearly best placed to make the most accurate assessment given ARTC has complete information with regard to project costs and historical contracted coal volumes. Although not essential, the assessment may also benefit from the input of the Hunter Valley Coal Chain Coordinator (HVCCC) to confirm the stated capacity requirements and benefits of past track investment. RTCA is hopeful that ARTC will make a detailed submission, whether confidential or public, that supports the ACCC in this process.

Despite some limitations in available data, RTCA has attempted to analyse the investment that has occurred in Pricing Zone 1 in recent years to deliver the growth in coal volumes from Constrained Network and Pricing Zone 3 Access Holders. The following outlines an approach developed by RTCA to evaluate the impact on the Pricing Zone 1 RAB and ultimately requires a multipart pricing approach for track access in Pricing Zone 1:

(1) Define the time period	Define the period where it was clear that increasing coal traffic had originated in Pricing Zone 3 and, if possible, can be shown to have had an impact on the available Network Capacity of Pricing Zone 1 i.e. investment or operational changes were required in Pricing Zone 1 to support the increased Pricing Zone 3 volumes.
(2) Establish an “initial RAB value” to be recovered from Constrained Network customers	Determine the RAB value for Pricing Zone 1 prior to Pricing Zone 3 coal volume growth. This initial RAB value and corresponding asset base would be isolated to form the basis of pricing in Pricing Zone 1 for Constrained Network customers only. The contracted annual coal volumes from Constrained Network customers at the start of the time period could be used as the basis for pricing and recovery of the initial RAB by ARTC moving forward.
(3) Determine the value of the RAB during the PZ3 growth period	Deduct the initial Pricing Zone 1 RAB value from the most recent closing RAB value in order to determine the level of RAB growth and investment across the period in question.
(4) Establish access pricing that reflects the economic cost of the initial RAB and “expanded RAB”	Isolate the full incremental cost that can be attributed to Access Holders within each Pricing Zone by apportioning a share of the economic cost of additional Pricing Zone 1 RAB growth during the period in question. Under this approach, Pricing Zone 3 users will contribute to the common incremental cost of investment that was required in Pricing Zone 1 to support their volumes.

The approach outlined creates two standalone RAB’s ensuring that all users of Pricing Zone 1 contribute to what could be considered the *full incremental cost* of ARTC providing increased Network Capacity to all Access Holders during the higher growth period. RTCA has attempted to employ the above approach utilising available consultant data and public information provided by ARTC in past compliance reviews and annual Corridor Capacity Strategy documents. The summary results of RTCA’s analysis are shown in the slide pack attached to this submission, but it is important to note that the results are likely to be indicative only given the limitations on accurate Access Holder commercial information.

In completing the above analysis RTCA also sought to answer the ACCC’s specific question regarding itemised project-by-project assessment. Reviewing past compliance reviews and RCG submissions suggests that some branch-line specific investments could potentially be further isolated from the “expanded RAB”. However, RTCA’s view is that in general all Access Holders that utilise Pricing Zone 1 have benefited in recent years from the significant level of track investment that occurred along the main-line to the port terminals (e.g. Nundah bank, Minimbah bank, Maitland-to-Minimbah third track) and investment around the port terminals themselves (e.g. PWCS departure and arrival roads, Hexham relief roads etc). These investments constitute the bulk of growth in the Pricing Zone 1 RAB over the period in question when track investment ultimately sought to increase Network Capacity, minimise or reduce congestion and increase system reliability. Furthermore, it appears to RTCA that in most cases upgrades to branch-lines

and turnouts (e.g. Drayton Junction) have delivered direct benefits to regular users of the branch itself (e.g. faster turnout speeds), but also traffic that passes the turnout (e.g. reduced maintenance outages, improved timetabling/capacity in the vicinity of the turnout etc). Due to uncertainty around determining where the capacity benefit lies, RTCA has opted to include all projects of this nature in its assessment of the expanded RAB, but notes that input from ARTC or the HVCCC may assist in this area.

RTCA's analysis shows that coal volumes from Pricing Zone 3 began to grow substantially from around 2007 (+35% CAGR to 2014), with the most significant growth in recent years. In-line with this growth, the Pricing Zone 1 RAB increased by ~A\$794 million between FY2007-08 and CY2013 driven by the completion of track expansion works for the benefit of all users of Pricing Zone 1. RTCA analysis further suggests that over the past three years Pricing Zone 3 users have directly benefitted from at least A\$150 million in Pricing Zone 1 track investment that was necessary to support Pricing Zone 3 coal volumes. RTCA considers the stated figure to be indicative of the incremental capital cost of providing Network Capacity to Pricing Zone 3 Access Holders in Pricing Zone 1, but notes that the analysis could be improved with the use of confidential ARTC information. To that end, it is likely that the A\$150 million estimate is conservative as a GTK based analysis of coal movement and contracted volumes in Pricing Zone 1 would more accurately account for Pricing Zone 3 customers true usage of the network.

Without changes to ARTC's revenue allocation and recovery model, it is clear that Constrained Network customers will continue to be significantly disadvantaged in terms of access pricing. Meanwhile, the benefits received by Pricing Zone 3 customers are likely to increase in the future due to current expectations of increased Pricing Zone 3 coal volumes and further high value additions to the Pricing Zone 1 RAB. RTCA therefore re-emphasises the importance of urgently resolving the significant misalignment that exists between access pricing and key fundamental principles of the HVAU.

RTCA and Coal & Allied provide consent for this submission to be made available for publication in the usual way. As always, we would welcome the opportunity to discuss these matters directly with the ACCC and if you require any additional information, please call me on (07) 3625 5078.

Yours sincerely,



Adam Viertel

Manager – Infrastructure

ARTC Hunter Valley Rail Network Access Undertaking

ACCC 2013 Compliance Review

Coal & Allied indicative analysis of Pricing Zone 3 incremental costs in Pricing Zone 1

January 2014

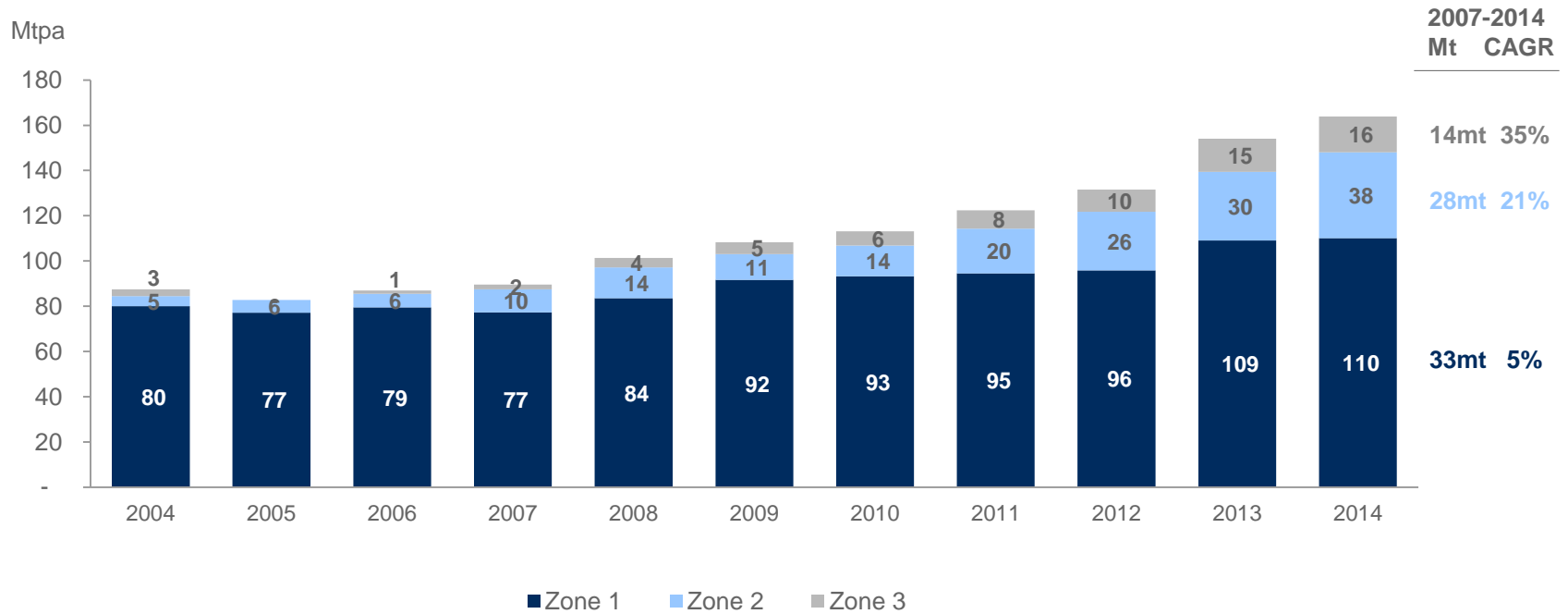
Summary

- Coal volumes from PZ3 began to grow substantially from 2007 (+35% CAGR to 2014), with the most significant growth in recent years.
- The PZ1 RAB increased by ~A\$794m between FY2007-08 and CY2013 driven by the completion of around ~A\$823m⁽¹⁾ in track expansion works for the benefit of all users of PZ1
- By isolating the PZ1 RAB at the FY2007-08 closing value, RTCA analysis suggests that over the past three years PZ3 users have been directly benefitting from around A\$150m in PZ1 track investment that was necessary to support PZ3 coal volumes.
- RTCA considers the stated figure to be indicative of the *incremental capital cost* of providing Network Capacity to PZ3 Access Holders in PZ1, but notes that the analysis could be improved with the use of confidential ARTC information.
- Without changes to ARTC's revenue recovery model, this benefit to PZ3 producers is set to increase in the future given current expectations of increased PZ3 coal volumes in the near-term and further additions to the PZ1 RAB

(1) Note: differences in RAB roll-forward timing, project inclusion and depreciation are likely to explain the A\$30m difference in RAB growth vs investment

Coal volume from PZ3 producers started to materially increase around CY2007, consistent with the timing of increasing growth from PZ1 and PZ2 producers

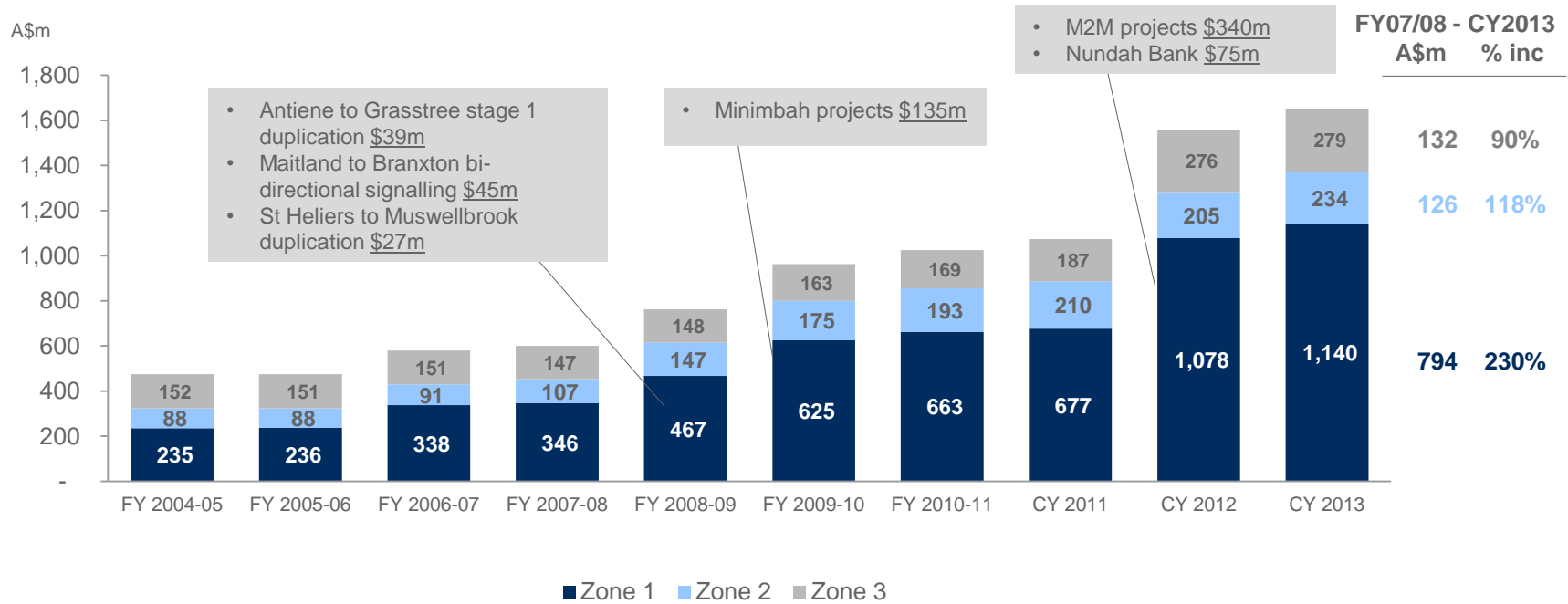
Hunter Valley Coal Production 2004-2014 (export & domestic) (Mtpa)



Source: RTCA Analysis, HVCCC , Wood Mackenzie, Draft Strategy Consultation Documents since 2004.

The PZ1 RAB began to grow substantially from FY2008-09 with the completion/inclusion of several key expansion projects south of Muswellbrook and locations along the mainline to the port terminals

ARTC Regulated Asset Base (A\$m)

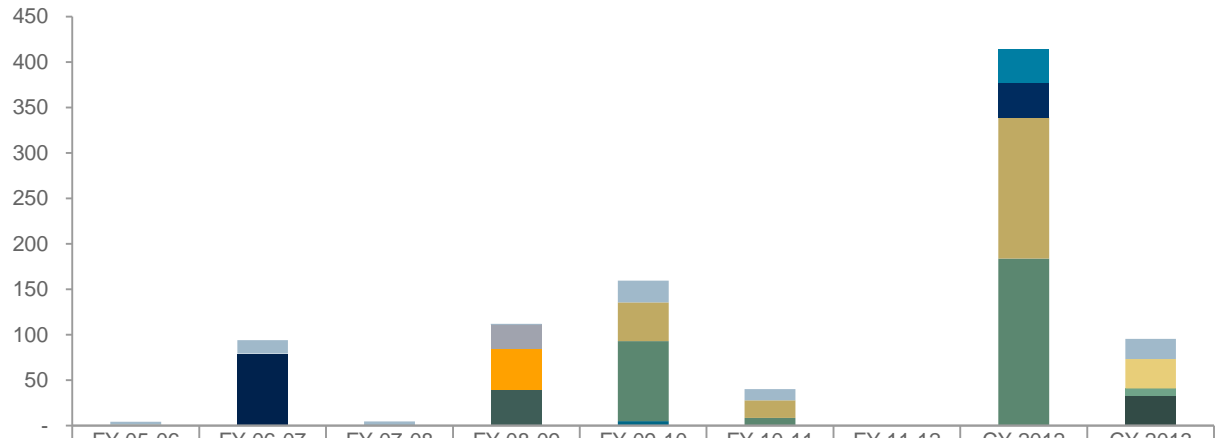


Source: IPART closing RAB value, ARTC compliance review closing RAB value

A project-by-project review highlights that ARTC invested around A\$823m in largely mainline track projects since 2008-09 to support increased coal growth

ARTC Pricing Zone 1 RAB (Actual by segment, ex depreciation) (A\$m)

PZ1 RAB growth due to track investment
 FY2008-09 to CY2013
 = A\$823M

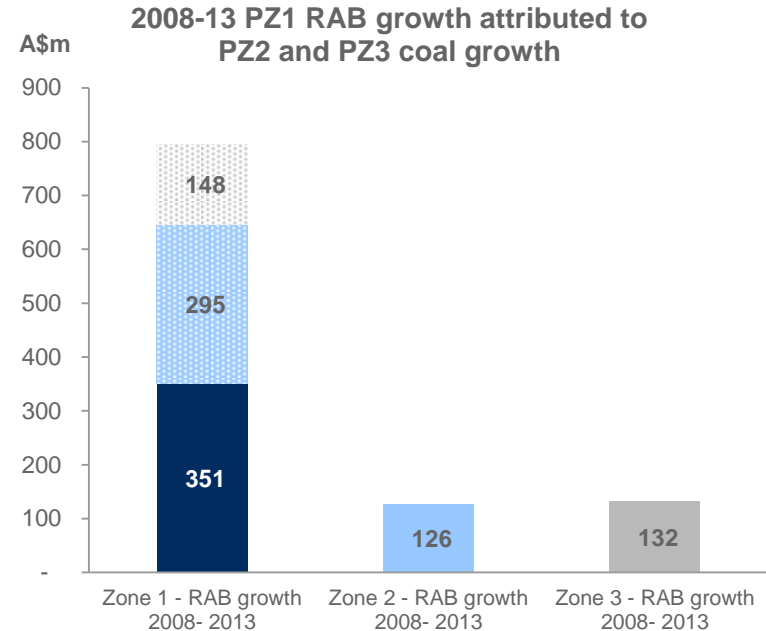
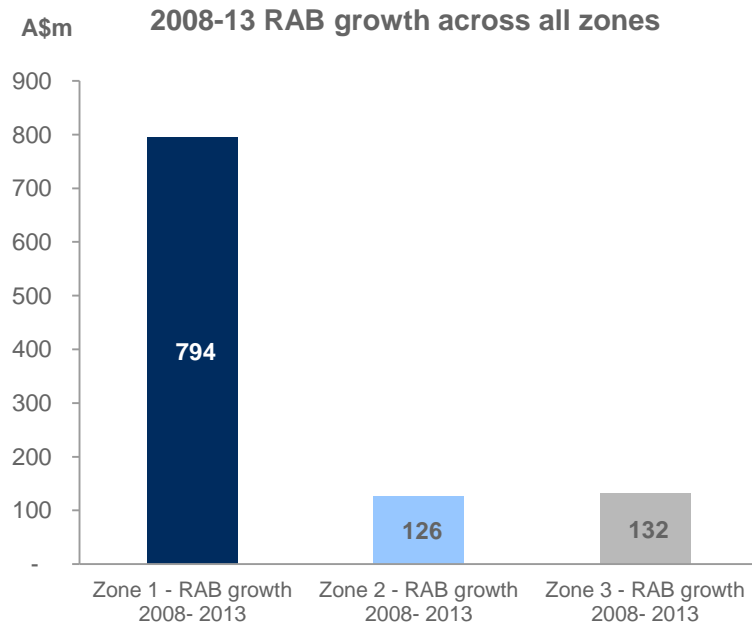


	FY 05-06	FY 06-07	FY 07-08	FY 08-09	FY 09-10	FY 10-11	FY 11-12	CY 2012	CY 2013
Other project (< A\$20m)	3.22	14.8	4.1	1.1	24.0	12.4	0.4	-	22.3
St Heliers to Muswellbrook duplication Segment 961				26.7					
Bi Direction Signalling Maitland to Braxton Segment 946/947				44.9					
Antiene to Grastree stage 1 duplication Segment 961				39.0					
Sandgate Grade Separation Segment 931		79.0							
Hexham Dep/Arr roads Segment 930	1.05								32.3
Nundah Segment other		-	-	-	-	-	-	-	7.8
Nundah Segment 956		-	-	-	-	-	-	37.4	-
Nundah Segment 955		-	-	-	-	-	-	38.0	-
Nundah Segment 418/956				0.3					
Mininbah Segment other									33.3
Mininbah Segment 428/948		0.3	0.6	0.2	42.6	19.0	-	155.1	
Mininbah Segment 416/947					87.9	8.3	-	184.0	
Mininbah Segment 415/946					5.2	0.5	-		

Source: IPART, ARTC compliance reviews

Based on RTCA estimates of 2014 coal production, approximately \$148m of incremental growth in the PZ1 RAB between 2008 and 2013 can be attributed to the provision of track capacity for PZ3 coal volumes

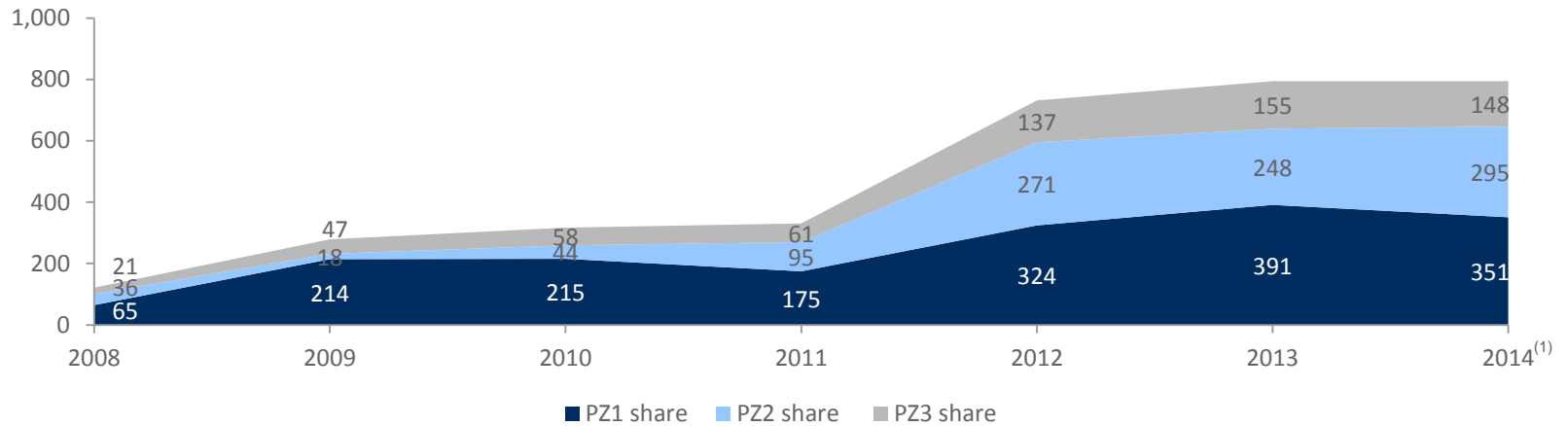
ARTC Regulated Asset Base (A\$m)



Source: RTCA analysis

It insufficient to only consider the 2013 RAB value though, as the PZ3 proportionate share of PZ1 RAB growth has been material since 2008 and increasingly so in recent years

Proportionate distribution of Pricing Zone 1 RAB growth based on coal volume (A\$m)



Production (Mtpa)		Cumulative Annual Production Increase Since 2007						
	2007	2008	2009	2010	2011	2012	2013	2014
PZ1	77	6	14	16	17	19	32	33
PZ2	10	3	1	3	9	16	20	28
PZ3	2	2	3	4	6	8	13	14
Total	90	12	19	24	33	42	64	74
2007 RAB		PZ1 Annual RAB growth since 2007 & Proportionate share of PZ1 RAB						
PZ1 RAB A\$m	346	121	279	317	331	731	794	794
PZ1 share		65	214	215	175	324	391	351
PZ2 share		36	18	44	95	271	248	295
PZ3 share		21	47	58	61	137	155	148

(1) RAB value as at 2013 using coal volume estimate for 2014

Key findings

- It is clear that large scale investment has been required in PZ1, particularly in recent years, to support material coal volumes originating in PZ3
- The incremental capital cost to support PZ3 coal volume growth, estimated by RTCA to be in the vicinity of A\$150m, is currently being recovered by ARTC from customers within the Constrained Network only.
- The material and substantial cost impost imposed on Constrained Network customers is distortionary and must be urgently remedied by ARTC via a change to their revenue allocation approach
- RTCA notes that there are opportunities to improve the accuracy of the analysis, including:
 - Utilising ARTC's GTK pricing unit rather than coal production in tonnes in order to estimate the proportionate impact of PZ3 coal volumes
 - Improving the modelling of domestic coal production that is railed to customers in or via PZ1
 - Utilising contracted capacity rather than actual railings, which would provide a far better indicator of the basis for committed track investment at a given time.