

# GLENCORE

## Glencore Coal submissions in response to ACCC Discussion Paper on ARTC's Hunter Valley Rail Network Access Undertaking – Revenue Allocation Review, 29 May 2014

### Analysis of Access Undertaking

The Discussion Paper states that:

“The HVAU does not specify how revenue from the charges is to be allocated to particular Pricing Zones or Segments for the purposes of compliance with the combinatorial matrix in sections 4.2 and 4.3 of the HVAU.”

Section 4.2(b) of the Access Undertaking reads as follows:

“For each Segment or group of Segments, Access revenue from Access Holders should, as an objective, meet the Incremental Cost of those Segments (“Floor Limit”).”

Sections 4.3(a) and (b) of the Access Undertaking both use a similar construction. Section 4.3(a) states:

“In relation to Segments identified as forming part of Pricing Zone 1 and 2 in Schedule E, Access revenue from any Access Holder, or group of Access Holders must not exceed the Economic Cost of those Segments which are required on a stand alone basis for the Access Holder or group of Access Holders”

Whilst the Discussion Paper is correct that these sections of the Access Undertaking do not specify how revenue is to be allocated to Pricing Zones, Glencore would submit that this is because no allocation process should be carried out in relation to revenue. Access revenue always arises in a Pricing Zone and it is the actual incidence of Access revenue that is relevant for the purposes of the Access Undertaking. Furthermore, the reference in section 4.3(a) to the comparison between Access revenue and Economic Cost being carried out on a “stand alone basis” makes it even clearer that it is not intended that any revenue from Pricing Zones 1 and 2 should be reallocated to a different Pricing Zone.

The Coal Access Agreements make it clear what revenue is attributable to each Pricing Zone because the calculation of all charges under those Access Agreements is performed on the basis of Pricing Zone. Under Schedule 3 of the Indicative Access Agreement, each of the applicable charges is calculated based on aggregating the revenue which is applicable in relation to each Pricing Zone that a Train Path traverses. It is clear from the formulae what revenue has been derived from each Pricing Zone. TOP Rebates are also calculated on the basis of each Pricing Zone. No further allocation process is required to calculate the revenue for each Pricing Zone – all that is required is to sum the net revenue attributable to each Pricing Zone under each relevant Access Agreement. The provisions in relation to charges form part of the mandatory provisions in relation to Coal Access Agreements which are set out in Schedule A: 1 of the Access Undertaking. The Indicative Access Charges set under the Access Undertaking itself are also set based on Pricing Zones.

It is therefore unnecessary to carry out any allocation process in respect of revenue because all revenue arises in relation to a specific Pricing Zone. In fact, in our view it is artificial, wrong and improper to undertake “revenue allocation” in the way that ARTC has done. The pricing framework mandated by the Access Undertaking relies on the attribution of costs to Pricing Zones in order to compare against actual revenue from that Pricing Zone. Costs must be allocated to Pricing Zones particularly common costs such as corporate overheads and network control costs that are not closely related to the provision of services in respect of a particular Segment or Pricing Zone in accordance with the methodology prescribed in the Access Undertaking to arrive at the Economic Cost of a Segment. This is because the incidence of costs is not always so clearly attributable to a Pricing Zone. Reflecting this requirement, there is a cost allocation methodology for non-specific costs set out in section 4.6 of the Access Undertaking. It is not necessary to allocate revenue in the same way because as explained above all revenue arises in a specific Pricing Zone – and this is why the Access

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Undertaking does not contain a provision that would allow ARTC to allocate revenue or contain any methodology for doing so as it does for costs.

A manipulation of the revenue used in this calculation is fundamentally inconsistent with this framework and means that the Access Undertaking would not produce a true test of whether the allocated costs are being passed through appropriately to Access Holders within each Pricing Zone. To proceed as ARTC appears to have done turns the pricing framework under the Access Undertaking into an artificial exercise rather than one based on the real charges actually paid by Access Holders.

In characterising sections 4.2 and 4.3 of the Access Undertaking as a “combinatorial matrix”, we submit that the ACCC appears to misconstrue the purpose of these sections. The point of sections 4.2 and 4.3 is not to set the parameters within which ARTC is allowed to manipulate the revenue figures between Pricing Zones, but rather to set out the tests which must be applied to the actual revenue earned in each Pricing Zone. The objectives and limits which are set out in those sections are not allowed to be met by ARTC “goal-seeking” a reallocation of revenue which optimises its commercial position, but rather reflect parameters within which ARTC must operate in the actual conduct of its business. There is nothing in these sections which permits or implies that ARTC is allowed to reallocate revenue.

The “revenue allocation” process which ARTC has carried out has resulted in the imposition of higher charges on Pricing Zone 1 and 2 customers than would have otherwise been the case, and has benefitted the Pricing Zone 3 customers by limiting the losses to be capitalised within the cost base attributable to Pricing Zone 3. The effect of this is that Access Holders in Pricing Zones 1 and 2 are subsidising the future charges that will be paid by Access Holders in Pricing Zone 3.

## **Transparency**

Section 1.1(h) of the Access Undertaking states:

“ARTC has adopted the concepts of equity and transparency as key elements of its pricing policies.”

It appears to us that the conduct of ARTC in relation to the “revenue reallocation” processes that it has gone through has not given sufficient weight to the key element of transparency which it has adopted. The operation of this unexpected approach to revenue has been hard or perhaps impossible to detect from the publicly available material. While we appreciate the requirement to keep sensitive commercial information private, we are concerned that such an unusual practice has previously been allowed to occur with so little transparency. We certainly welcome the initiative that the ACCC has taken to shine a light on this practice. However, we would be concerned if any other practices are used by ARTC in administering the Access Undertaking which are not clearly documented in a transparent fashion.

Clearly, when we entered into our Access Agreement it was on the basis that the terms of the arrangements with ARTC would be as set out in the Access Agreement and the Access Undertaking. It now appears that this is not the case. This means that we have relied on incomplete information when undertaking our evaluation of the Access Agreement and when considering the terms of the Access Undertaking. It would have been highly material to our decisions in relation to the Access Agreement and our approach to the Access Undertaking if we had known that ARTC was proposing a system whereby Access Holders in Pricing Zones 1 and 2 would subsidise their competitors in Pricing Zone 3.

## **Historical Practice**

Glencore does not consider that historical practice under the New South Wales Rail Access Undertaking or previous decisions by IPART should be persuasive in determining the approach under the current Access Undertaking. It is not clear to Glencore whether any stakeholders had ever been informed of or consented to these past practices. It is also unclear whether these past practices were ever documented in the NSWRAU. However, it is certainly clear that they are not permitted by the current Access Undertaking, particularly given that ARTC will be able to recover its economic costs in

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Pricing Zone 3 in the future due to the application of loss capitalisation and therefore revenue reallocation is not necessary to preserve its commercial position.

### **ACCC's Previous Determinations**

Glencore notes that in the ACCC Determination dated 24 March 2014 in respect of ARTC's compliance with the financial model and pricing principles in the Hunter Valley Coal Network Access Undertaking for January – December 2012, the ACCC formed a view that a similar revenue allocation process was in compliance with the Access Undertaking. We note that the approach to revenue allocation was set out in confidential information and therefore was not commented on by stakeholders<sup>1</sup> and that the determination proceeded on the basis of confidential information before the ACCC and the past practice of IPART under the HVAU<sup>2</sup>. While this finding formed part of the final Determination, the matter was not ascertainable from the Submissions made by ARTC or mentioned in the Consultation Paper issued by the ACCC on 12 June 2013. Glencore notes that in the Determination dated 5 April 2013, this issue is not explicitly dealt with.

For the reasons outlined above, Glencore considers that the Determination dated 24 March 2014 has erred in the approach it has taken in respect of revenue allocation and that the ACCC should review and reissue this Determination to correct this approach. If a similar approach has been taken under any other Determination made in respect of the Access Undertaking, that other Determination should also be reviewed and if necessary reissued.

### **Answers to specific ACCC questions**

#### **1. What information has ARTC provided to stakeholders about its revenue allocation practices?**

Glencore Coal is not aware of ARTC having provided any information to stakeholders about its revenue allocation practices. If Glencore has been aware of this practice, we would have already taken appropriate action.

#### **2. To the extent that ARTC has provided information on revenue allocation, has it been sufficient to understand how ARTC allocates revenue across Segments of the network?**

No. We have previously had no understanding of the "revenue allocation" processes followed by ARTC.

#### **3. Do stakeholders consider they have sufficient information about ARTC's revenue allocation/ reconciliation processes to make informed business and investment decisions? If not, please provide reasons why.**

Glencore Coal has acted under the assumption that ARTC would give effect to the provisions of the Access Undertaking. We consider that by inventing a secret revenue allocation process with no basis under the Access Undertaking which distorts pricing outcomes, ARTC has misled stakeholders and undermined the ability of stakeholders to rely on the terms of the Access Undertaking when making business and investment decisions.

#### **4. Please identify and explain any other matters relevant to this revenue allocation review.**

Glencore Coal is of the view that the concept of "revenue allocation" is artificial, improper and has no basis under the Access Undertaking. As explained above, our view is that the determination of which Pricing Zone revenue is attributable to is to be based on the Pricing Zone in respect of which the revenue is earned. No further allocation process is required in relation to revenue between Pricing Zones.

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<sup>1</sup> 2012 Determination, paragraph 2.3.2

<sup>2</sup> 2012 Determination, paragraph 2.3.3

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We would submit that the outcomes in relation to previous years should be re-examined to determine the extent to which this improper practice has previously impacted upon Pricing Zone 1 and 2 customers and that ARTC be ordered to make good any losses that those customers have suffered. A new reconciliation of Access revenue with Ceiling Limits and unders and overs accounting process should immediately be undertaken for previous periods where the pricing outcomes for customers have been affected by the adoption of the "revenue allocation" process. Access Holders which have overpaid should have the overpayments refunded to them with interest.

We would also recommend that the ACCC undertake a broader review of the materials available to it to ensure that all other processes used by ARTC are transparently documented in the Access Undertaking. Although we welcome the initiative that the ACCC has now taken, we are concerned that a deviation from the terms of the Access Undertaking such as this one has occurred without the intervention of the ACCC before now.