GLENCORE

17th September 2014

Mr Matthew Schroder
General Manager
Fuel, Transport and Prices Oversight Branch
Australian Competition and Prices Oversight Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001
Email: transport@accc.gov.au

Dear Mr Schroder

Re ARTC Submission to HVAU Revenue Allocation Review

Glencore wishes to submit the following comments in response to ARTC's submission (dated 'August 2014') to the above review.

ARTC's "Revenue Allocation" Methodology

Clauses 4.2 and 4.3 are included in the Undertaking under section 4 "Access Pricing Principles". There is no section describing the "Revenue Allocation Principles" and yet ARTC insists on the existence of a well understood and transparent Revenue Allocation methodology. Clauses 4.2 and 4.3 are the key descriptors of the price determination methodology and yet they contain less than 15 lines of text (excluding the subordinate clause 4.3(c)). From these brief words ARTC has fashioned a methodology using "combinatorial" and "traffic based" tests although to our knowledge neither of these terms are mentioned in the Undertaking. We concede that the methodology implemented by ARTC is a method of revenue reallocation however there no doubt are numerous other potential reallocation processes that could be utilized if so desired. However, it must be observed that the Undertaking makes no mention of a "Revenue Reallocation" process at all.

The notion of a "Journey" based charging framework is also introduced by ARTC. This concept is also new to us. Access Agreements show an Access Holder's pathing entitlement in each Zone and all invoices raised by ARTC show charges for paths for each Zone. There is no entitlement to make a "journey" merely an entitlement to paths within each Zone and a corresponding charge for each path used in each Zone. In fact it may eventuate that a Zone 2 Access Holder had more Zone 2 paths than Zone 1 and hence was incapable of completing a "journey". ARTC states that "Revenue is not received for a particular Pricing Zone or Segment..." and yet this is exactly how they collect their revenue. It would be reasonable to assume that if an Access Holder is invoiced for Zone 1 charges that this revenue would be applied to that Zone and not be diverted to subsidise other Access Holders.

It comes as a surprise to now find that ARTC asserts that the Zone by Service prices published and charged by ARTC are irrelevant when an Access Holder is attempting to determine his access cost. On the basis of the methodology asserted by ARTC, a major determinant in a Zone 1 and 2 Access Holder's cost is in fact the amount of coal being railed by a competitor in Zone 3. If that were the correct way of applying the HVAU, it would give no certainty in pricing to an Access Holder.

ARTC also contend that the ceiling test is a Network wide test despite clause 4.3 detailing the Segment based test regime. A Network wide test would really call into doubt the very need for Segments or Zones. If a Network wide test was the intent, why was clause 4.6 required in order to allocate costs to specific Segments. Oddly this clause was deemed necessary, and yet there is no description in the Undertaking of ARTC's Revenue Allocation procedure.

Information Provision

ARTC contends that they went to some efforts to explain the revenue allocation methodology they have incorporated into their processes. The fact that Glencore and numerous other Access Holders (according to their submissions) express surprise at the revelation that Zone 1 users are subsidizing Zone 3 users could be the result of poor communication, poor comprehension or even poor corporate memory (as ARTC contends). However, Glencore does not consider that it is appropriate to view these issues on the basis of what information might have been provided by ARTC outside of the terms of the HVAU. Fundamental processes which are relevant to the commercial functioning of the HVAU should form part of the access undertaking itself. The Competition and Consumer Act 2010 (*Cth*) does not contemplate that explanatory statements or information briefings should form the basis of the regulation of service providers – this function is fulfilled by access undertakings. Furthermore, in its 2011 Hunter Valley Coal Network Access Undertaking Application, ARTC itself states at paragraph 13 that "The full terms and conditions are contained in the attached document, entitled 'Hunter Valley Coal Network Access Undertaking.'" Therefore, it is inappropriate to rely on any other document to introduce additional terms and conditions such as the revenue allocation approach asserted by ARTC.

While an explanatory statement might be referred to where there is some lack of clarity as to how a particular provision of an access undertaking is to work in practice, an explanatory statement cannot be relied on by a service provider to substantially modify the effect of the access undertaking which has been approved by the ACCC or to introduce terms and conditions which are not contained within the undertaking. It is particularly egregious for ARTC to seek to rely on the terms of an explanatory statement which was not included by ARTC in its application for ACCC's approval of the current HVAU, which ARTC itself states in its covering letter dated 23 June 2011 was "comprehensively re-engineered" over its three years of development, in order to justify procedures with a high degree of commercial significance such as the revenue allocation procedures that ARTC wishes to adopt. Even if one were to have regard to the rather vague description that ARTC included within its various explanatory documents and has quoted in its submissions, the text does not in fact state that there will be any reallocation of revenue between different Pricing Zones.

If the revenue allocation methodology that ARTC alleges exists was prescribed and agreed to then why was it not documented in the approved access undertaking or included as part of ARTC's application for approval? If the brief 15 lines of text in clauses 4.2 and 4.3 had been expanded to include this revenue allocation methodology then we would not be writing this submission and Glencore would not have supported the HVAU. However there is no such description in the Undertaking and instead ARTC contends that it is reasonable to rely upon Explanatory Notes supplied to the ACCC in July 2008 in relation to a different access undertaking document as sufficient authority.

ARTC also contend that as the revenue allocation procedure was a practice under the NSWRAU that it was well understood and accepted. They also observed that it was important that continuity in access principles be maintained. Glencore in considering the HVAU did not reflect on past practice and instead considered the HVAU a 'brave new world' that would offer improvement in flexibility, security and transparency. Since Glencore was not a direct access holder under the NSWRAU, the arrangements were opaque to Glencore. Consistency with the NSWRAU was definitely not a prerequisite for Glencore to judge the acceptability of the HVAU, if anything it was the opposite. Glencore considered the merits of

the HVAU regime based primarily upon the Undertaking and the Access Agreement documents.

ARTC's assertion that the "...retention of stakeholder knowledge over time is best managed by the internal process of stakeholders ..." is reasonable and Glencore agrees it has a responsibility to manage this knowledge retention. However it is also reasonable for Glencore to assume that the Undertaking (together with its subsequent Access Agreement) can be used as the comprehensive authority on the regime and it should not need to retain ancillary documents that were authored prior to the Undertaking coming into effect. Our corporate memory does not extend to retaining every draft and explanatory document on the Undertaking and having them catalogued for handy future reference. **The Undertaking should and is assumed to provide, a comprehensive and full description of all processes and calculations performed**. Any reader of the document should be able to rely upon it as describing all processes and methodologies involved in administering track access in the Hunter Valley Network – as was in fact stated by ARTC in its application document. It should be equally safe to assume that no supplementary processes or manipulations are performed on the basis that it is assumed all stakeholders are aware and are accepting because it is consistent with past practice.

The case of a new entrant into the Hunter Valley coal industry should also be considered. If such a party had had no involvement with previous access regimes then surely they are entitled to rely upon the access undertaking as read rather than rely upon nonexistent corporate memory of past practice under a previous undertaking.

Compliance:

The ARTC considers it has met its compliance obligations. It also points out a lack of queries from stakeholders in response to its compliance submissions for the 2012 and 2013 years. ARTC is correct in that Glencore did not question the revenue allocation process as part of the compliance process in these years. However, in reading the copious amounts of detail and calculations in the compliance submissions supplied by ARTC, there appears to be no detail on the revenue reallocation process carried out by ARTC in these years. This may explain the lack of queries.

Glencore is also concerned that the ACCC did not question the compliance documentation in light of its ability to determine the extent of compliance under clause 4.10 of the Undertaking.

Efficiency of the Current Arrangements:

ARTC justifies the revenue reallocation by arguing for charges to reflect capacity to pay. It is ironic that capacity to pay is being used as a justification when the Hunter Valley coal industry is enduring some of its worst market conditions ever. Low prices and a high Australian dollar are placing significant pressures on coal producers. Most producers would currently question this 'capacity to pay'. The growth in Network volumes into the future will no doubt be sourced materially from Zone 3 mines as nearer mines are now at mature life stages. Zone 3 expansion tonnes will be high quality coal from large open cut low cost production bases. This additional production will compete in the market directly with existing producers in Zones 1 and 2 (being potentially higher cost production). The 'great leveler' in the market place amongst the various producers is the cost of freighting product to the customer. The new Zone 3 producers have a natural advantage of low cost resources whereas Zone 1 producers have a strategic advantage in proximity to the port. The revenue reallocation process which levies an additional cost on the Zone 1 producers impacts upon this comparative advantage. As far as Zone 2 producers are concerned, they do not have this port proximity advantage and therefore are penalized even more. How can the ARTC argue that their revenue reallocation approach "...does not distort competition in the end product market" when the product is a commodity being placed in the same market place and yet some producers are faced with an additional cost impost?

At any time it is unconscionable to levy an additional impost onto Zone 1 and 2 producers to accelerate the recovery of an investment in Zone 3. The loss capitalization regime exists to cope with the gradual development of Zone 3 production. However, ARTC has deemed this mechanism insufficient to cover the risk associated with Zone 3 investments and has levied an additional 'unders' amount on Zone 1 and 2 access holders. ARTC cite the loss capitalization mechanism as insufficient to mitigate stranding risk. Glencore would argue that there are other mechanisms in the undertaking available to ARTC to deal with "risky" access seekers rather than simply levy other access holders to mitigate their perceived risk. If ARTC considered an additional mechanism to be necessary, then approval for that mechanism should have been sought from the ACCC by including the mechanism in the access undertaking.

The discovery of the revenue reallocation process throws some doubt over the behavior of users when voting upon network investments. Certainly, past votes by users to support investment in Zone 1 capacity may not have been carried if users were aware that Zone 3 users would not be contributing to the recovery of investments for some years to come. Glencore suspects a rethink by many users before future votes are taken. This will result in some uncertainty going forward.

Equity:

ARTC argues that equity must be judged on a longer time frame. ARTC has certainly taken a long term view by arguing that ARTC should have the discretion to reallocate revenue such that ARTC's investments are recovered over a reduced time frame by simply placing an additional impost on any group of Access Seekers who are deemed to have an 'ability to pay'. This policy seems to ignore the reality that access holders will be different legal entities over this "long term" with different stakeholders. The costs of access for these stakeholders will be unknown and will be partially determined by ARTC's revenue allocation methodology and where they sit in the life cycle of the constrained/unconstrained zones.

ARTC points out the example of PZ3 users moving to longer 30 tonne axle load operations as an outcome of this equity. Glencore disagrees that this is necessarily a beneficial outcome for PZ1 and PZ2 users as this assumes that there was a shortage of capacity. We would also question whether the motivation was to free up capacity or was it simply an effort by PZ3 users to move to a cost effective rail model and save needed infrastructure upgrades in Zone 3. Glencore can also point out the poor utilisation of Zone 1 capacity by the smaller Zone 3 trains and the subsequent need to invest (by all users) to offset this lower productivity. In our opinion this is not a good example of equity.

Impacts and Risks of Change:

ARTC cites the risk of discouraging investment in Zone 3 by any change in approach. They cite the potential damage to the development in the Gunnedah Basin as a result of any change to the allocation of revenue by ARTC. Glencore is concerned that ARTC is advocating the necessity of a cross subsidization by existing Zone 1 and 2 users to enable future new entrants (competitors) into Zone 3. Glencore is very much in favour of the development of the Hunter Valley (NSW/Australia) resources for the benefit of all stakeholders however it seems inappropriate that ARTC establishes itself as an implementer of government policy on cross subsidization to encourage this development. It should be obvious to any observer that the Hunter Valley producers are currently enduring very difficult trading conditions which are directly impacting the sustainability of towns such as Singleton. By comparison areas in Zone 3 undergo significant investment 'up cycles' associated with new coal mines. It is an interesting concept to argue that ARTC commercial agreements should be administered such that mines in different zones should not compete on an equal footing and that it is appropriate to place additional levies on different producers purely based upon their location. The development of one region should not be at the cost of another. Surely it is the established public policy that the economics of coal mines be determined by the nature of their resource (including physical location) and the efficiency of their operation without

'interference'.

Glencore does not believe that the removal of the revenue reallocation process will have an immediate detrimental impact on the level of investment in Zone 3. It will simply remove the added cost penalty from the Zone 1 and Zone 2 users and slow the recovery of ARTC's investment in Zone 3 infrastructure back to a rate that, we would argue, was envisaged under the Undertaking.

Summary:

In summary, it is Glencore's view the revenue reallocation process is not in accordance with the Undertaking. We seek the ACCC's cooperation to ensure the 2012 and 2013 overs and unders calculations are reworked to remove the bias against Zone 1 and Zone 2 users.