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

By email transport@accc.gov.au

Dear Mr Schroder

HVEC submission on ARTC Draft 2016 HVAU

1 Overview

Hunter Valley Energy Coal Pty Ltd (**HVEC**) welcomes the opportunity to provide the following submission on the 23 December 2015 draft access undertaking (**Draft 2016 HVAU**) submitted to the Australian Competition and Consumer Commission (**ACCC**) by Australian Rail Track Corporation (**ARTC**), for assessment under Part IIIA of the *Competition and Consumer Act 2010* (Cth). HVEC has participated in and supports the Hunter Rail Access Task Force (**HRATF**) submission on the Draft 2016 HVAU, except to the extent supplemented by this submission.

Capitalised terms used in this submission have the meaning given in the Draft 2016 HVAU unless indicated otherwise or the context requires.

2 Potential privatisation of ARTC

The Department of Finance is currently managing a scoping study process into the future of the ARTC rail network, which includes consideration of options for the future management, operation and ownership of ARTC. Given the terms of reference of the scoping study, there is a real possibility that ARTC may be privatised during the term of the 2016 HVAU.

If a form of privatisation were implemented, control of the Hunter Valley below rail network may pass to the private sector. The potential privatisation of ARTC gives rise to considerable regulatory uncertainty for stakeholders in the Hunter Valley coal industry and HVEC submits that it is crucial for this uncertainty and the associated privatisation risks to be appropriately addressed in the 2016 HVAU.

2.1 Draft 2016 HVAU – current approach to privatisation protections

Clause 2.2(c) of the Draft 2016 HVAU sets out provisions relevant to the potential privatisation of ARTC. These provisions provide that if the lease for the Network is transferred or granted to an entity other than ARTC during the Term:

- ARTC may withdraw the Undertaking by written notice to the ACCC; and

- if the above notice is given, ARTC must at the same time use best endeavours to procure that the lessee of the Network gives an undertaking to the ACCC on the same terms as the Undertaking.

Clause 2.2(c) also provides that the ACCC will approve a withdrawal of the Undertaking and submission of a new undertaking that complies with the above.

HVEC considers that clause 2.2(c) does not sufficiently address the risks and implications of a potential privatisation of ARTC for Hunter Valley coal industry stakeholders.

2.2 Minimum protections proposed by HVEC

HVEC proposes the following minimum protections in order to sufficiently address the risks associated with a potential privatisation of ARTC:

1. a prohibition against vertical integration (including any change in ownership or business operations that would result in a synthetic vertical integration) of the Network by a future owner, either by incorporating relevant provisions in enabling sale legislation and agreements, or by reflecting this in amendments to the Network lease;
2. a prohibition on a future owner charging higher than the regulatory rate of return for Network expansions, either by incorporating relevant provisions in enabling sale legislation and agreements, or by reflecting this in amendments to the Network lease;
3. at an Undertaking level, incorporating a mandatory, rather than reasonable endeavours obligation for ARTC to procure that any future lessee of the Network gives an access undertaking to the ACCC on substantially the same terms as the Undertaking (with appropriate mechanics for WACC adjustments), as a condition to the implementation of any change of control in the entity holding the Network lease or the transfer of the Network lease;
4. at a Network lease level, incorporation of an amendment to require the holder of the Network lease to maintain an access undertaking in place at all times on terms substantially the same and no less favourable to industry than in the Undertaking (with appropriate mechanics for WACC adjustments);
5. at a Network lease level, incorporation of an amendment to preserve the participation by the holder of the Network lease in the Hunter Valley Coal Chain Coordinator or any replacement group (**HVCCC**);
6. at a Network lease level, incorporation of an amendment to oblige the holder of the Network lease to operate and maintain the Network in accordance with good operating practices;
7. at an Undertaking level, incorporation of an amendment to require greater transparency in respect of the scope and cost of operating and maintenance activities.

HVEC notes that in relation to 4 above, similar measures were successfully implemented in the privatisations of Aurizon Network[1] and the Dalrymple Bay Coal Terminal. HVEC's view is that the above protections would provide effective regulatory oversight and certainty for industry, and would go some way towards alleviating the risks associated with control of the Hunter Valley below rail network passing to the private sector.

[1] Although, in respect of Aurizon Network it should be noted that there is no prohibition on vertical integration. It should also be noted that the ring-fencing provisions in the Aurizon Network access undertaking are wholly inadequate to protect against the competitive advantage that Aurizon Network enjoys from vertical integration.

3 Term of the Undertaking

3.1 Term

Provided that the risks associated with a potential privatisation are appropriately addressed, HVEC supports the proposed 10.5 year Undertaking term. HVEC's view is that:

- a 5 year period would be too short in light of lengthier industry approaches to contracting and the uncertainty around the future ownership of ARTC;
- a 10.5 year term provides the certainty required to underpin long term investment decisions by proponents in the Hunter Valley; and
- it is beneficial to align the term of the Undertaking with calendar years, which is consistent with the operation of Access Agreements.

3.2 Periodic review

HVEC commends the inclusion by ARTC of a periodic review mechanism. However, HVEC considers that the current proposed review mechanism should be further developed in order to achieve a more commercially balanced position between ARTC and industry stakeholders.

As drafted, under clause 2.3 ARTC must publish an issues paper on certain minimum economic matters and other matters that ARTC considers should be the subject of review. ARTC must invite submissions from stakeholders on the issues paper and other matters stakeholders consider relevant. However, clause 2.3(c) only obliges ARTC to consider in good faith submissions received on the issues paper, as opposed to the issues paper *and* all other matter raised by stakeholders. HVEC submits that ARTC should be required to:

- consider in good faith both submissions on the issues paper *and* all other matters stakeholders have raised as relevant to a review; and
- to the extent that stakeholder views raised as part of the above are not reflected in any application to the ACCC to amend the Undertaking following the periodic review, ARTC should be obliged to provide reasons for the omissions to the ACCC and stakeholders.

HVEC also suggests that where (as part of the periodic review) ARTC considers that no change to the Undertaking is required it should be obliged to give reasons for that review. The ACCC's consideration must not be limited to the changes which are proposed by ARTC.

To ensure appropriate checks and balances are in place, HVEC also considers that stakeholders should have the opportunity to make submissions to the ACCC on any application by ARTC to amend the Undertaking following a periodic review process *prior* to the ACCC making a determination in respect of ARTC's amendment application.

3.3 Further Term mechanism

HVEC supports the principle of an extension mechanism in appropriate circumstances, however does not support the rolling mechanism currently reflected in the Draft 2016 HVAU. As drafted, the mechanism provides for rolling extensions of the Undertaking for further periods of 5 years at the election of ARTC, so long as the extension is accepted by the ACCC. HVEC suggests that it is commercially inappropriate for:

- ARTC to have unilateral discretion to determine whether to seek an extension following consideration of submissions from stakeholders; and
- users to potentially be locked into an open ended regulatory mechanism which may not take appropriate account of changing market conditions over time and therefore be of declining utility to industry.

HVEC proposes that a more balanced position would be for ARTC to have the ability to seek a single extension only if an agreed percentage of users (HVEC suggests 80% by number is appropriate) have notified ARTC and the ACCC by an agreed date of their support for an extension. HVEC also considers that any extension should be conditional on implementation of amendments identified via the periodic review process.

4 Loss capitalisation

HVEC submits that the ACCC's 30 October 2015 draft determination (**Draft Determination**) on ARTC's financial model compliance should stand in respect of loss capitalisation. HVEC's strong preference is for the loss capitalisation provisions in clause 4 to be removed from the Draft 2016 Undertaking and for any losses which remain outstanding at the conclusion of the 2011 HVAU to be dealt with via a transitional arrangement.

HVEC acknowledges the historical utility of the loss capitalisation mechanism in Pricing Zone 3 as a means of encouraging investment in new assets where there may have initially been limited demand. However, HVEC considers that losses currently capitalised into the RAB for Pricing Zone 3 should be recouped from Pricing Zone 3 users by the end of the 2011 HVAU.

ARTC has suggested that due to the ACCC's ongoing review of its approach to revenue allocation, there is a level of uncertainty as to whether capitalised losses will be entirely recovered by the end of the 2011 HVAU. HVEC disagrees and submits that:

- there is very limited uncertainty around Capacity extensions in Pricing Zone 3 as the major expansions are largely already in place for contracted volumes and no further significant Network investments are currently planned; and
- any such uncertainty could in any case be overcome by the implementation of an appropriate transitional framework.

ARTC has also proposed that retaining loss capitalisation for Pricing Zone 3 will give ARTC appropriate flexibility in relation to pricing and the rate of recovery of capitalised losses. HVEC suggests that these considerations ought to be balanced with the need to promote economically efficient investment in the Network as a whole and does not consider that this level of ongoing flexibility is necessary.

5 Maintenance scope

HVEC submits that considerable additional transparency is required in the Undertaking regarding the scope of ARTC's maintenance work, maintenance costs incurred and budgeting and maintenance reporting.

Although HVEC commends ARTC's inclusion of the clause 9.2 RCG maintenance reporting obligations, HVEC considers that these measures do not go far enough and are an inadequate substitute for a clear obligation on ARTC to act prudently at all times in respect of Network maintenance.

HVEC submits that ARTC's maintenance efficiency should be:

- measured against industry benchmarks; and
- assessed annually by an independent expert if a majority of the participants in the RCG deem it appropriate.

6 Rate of return (WACC)

ARTC has proposed a:

- real pre-tax Rate of Return of 6.74%; and
- nominal pre-tax Rate of Return of 8.5%.

HVEC supports the WACC position outlined by HRATF in the HRATF submission. The rate of return is a key element in determining the tariffs that will apply to the Network during the term of the Undertaking and HVEC considers that appropriate ongoing engagement between industry and ARTC on this issue is very important.

7 Temporary Trade Of Path Usages

ARTC has proposed amendments to the Access Holder Agreement (**AHA**) to contractually bind producers to a Train Path Schedule that is terminal specific. HVEC supports optimisation of the Hunter Valley Coal Chain through accurate forecasting and planning by the terminals and the HVCCC however, HVEC does not support these changes nor believe they are necessary. Forecasting and planning is already currently efficiently executed through:

- The ARTC Annual Terminal Specific Exit Point Nomination which obliges producers to specify volume nominations per terminal exit point per quarter. This arrangement is non-binding, does not form part of the AHA and is used by the HVCCC as a basis for determining the impact of trades on the supply chain.
- The Capacity Transfer Protocol which is administered by the HVCCC and describes the process and criteria for the assessment of contracted capacity trades requiring HVCCC's recommendation as well as terminal and ARTC approval.

HVEC does not support the proposed amendments by ARTC which will remove the necessary flexibility for producers to mitigate any unanticipated issues in the supply chain through the trading of paths. HVEC believes it is unnecessary to modify the AHA such that it requires Access Holders to be contractually bound to a terminal specific Train Path Schedule and does not support the proposed amendments in this regard.

8 Further engagement on HVEC submission

Thank you for your consideration of this HVEC submission. Please contact Adam Lancey on (02) 6544 5854 if you would like to discuss any aspect of this submission. HVEC confirms that this submission may be published publicly.

Yours sincerely

Adam Lancey
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