Idemitsu Australia Resources Pty Ltd
ABN 45 010 236 272
Level 28, 10 Eagle Street
Brisbane, QLD 4000 Australia
GPO Box 1127, Brisbane QLD 4001 Australia
TEL +61-7-3222-5600 FAX +61-7-3222 5665

30 January 2015

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

Position Paper – ARTC's compliance with the financial model in the Hunter Valley Coal Network Access Undertaking for January – December 2013

Idemitsu Australia Resources Pty Ltd (**Idemitsu**) welcomes the opportunity to provide the following submission in regards to the Position Paper issued (26 November 2014) by the Australian Competition and Consumer Commission (**ACCC**) in relation to Australian Rail Track Corporation's (**ARTC**) compliance with the financial model in the Hunter Valley Coal Network Access Undertaking (**HVAU**) for January – December 2013.

Idemitsu acknowledges the ACCC is yet to make its final determination regarding the 2013 Annual Compliance Assessment but has expressed its preliminary views and identified other considerations in the position Paper. ARTC is required to annually submit documentation to the ACCC demonstrating its compliance with the financial model as set out in section 4 of the HVAU. This assessment by the ACCC considers whether:

(a) ARTC has undertaken prudent capital expenditure in accordance with the requirements of the HVAU;

(b) ARTC has incurred efficient operating expenditure in accordance with the requirements of the HVAU;

(c) ARTC has rolled forward the regulatory value of assets in accordance with the HVAU:

(d) PZ3 forms part of the Constrained Network or whether Loss Capitalisation continues to apply in accordance with the HVAU; and

(e) ARTC has reconciled revenues with the applicable revenue floor and ceiling limits (Revenue **Ceiling Test**) and determined any 'unders or overs' amounts to Constrained Customers in accordance with the HVAU.

In addition, the Position Paper makes reference to ARTC's current approach to Revenue Allocation and the potential impact this may have on the Revenue Ceiling Test. Idemitsu expressed its views on the Revenue Allocation during the ACCC consultation process (Discussion Paper 29 May 2014). Our views remain as follows:

(a) The current approach is consistent with the approved HVAU.

(b) It is inappropriate to (as some stakeholders propose) seek to force ARTC to amend the undertaking during its approved term or to direct ARTC to apply the undertaking in a different way, given that the current approach is consistent with the undertaking, particularly given that the current approach:

- is aligned with the objects of Part IIIA of the Competition and Consumer Act 2010 (Cth) (the **Act**), as it promotes the economically efficient use of and investment in infrastructure and promotes competition in coal markets; and
- is appropriate taking into account the legitimate business interests of ARTC, ARTC's investment in the facility (specifically the PZ3 infrastructure), and the public interest, including the public interest in having competition in markets.

(c) The current approach has promoted, and is continuing to promote, investment in mines and rail infrastructure in PZ3, which is in the public interest and is ultimately in the interests of other users of the network. The current approach is achieving desirable outcomes, just as it did when applied to Pricing Zone 2 (**PZ2**).

The nature and complexity of the Revenue Allocation approach has given rise to a robust debate amongst stakeholders with vested interests. The ACCC has provided its preliminary view regarding ARTC's current approach to Revenue Allocation and its potential impact on the Annual Compliance Assessment through the Revenue Ceiling Test.

The ACCC in its Position Paper has emphasised the notion of Standalone and Incremental Costs when calculating the Revenue Ceiling Test, however the proposed approach is inconsistent with historical methods applied to PZ2 and with the method previously approved by the ACCC in the past two Annual Compliance Assessments under the current HVAU. Idemitsu considers the approach proposed by ARTC is consistent with the undertaking and that there is no basis under the undertaking on which the ACCC should reject ARTC's proposal.

This submission provides responses to the questions posed by the ACCC in its Position Paper accompanied by additional comments by Idemitsu.

Should you have any queries regarding this submission or would like to discuss this matter further please do not hesitate to contact Mr Craig Forster (Ph +61 7-3222 5623)

Yours sincerely

Chris Walsh
General Manager Commercial and Legal
Idemitsu Australia Resources Pty Ltd

Idemitsu Submission
ARTC Hunter Valley Rail Access Undertaking – 2013 Annual Compliance Assessment

1. Introduction

Idemitsu is an active coal producer with mines located in the Hunter Valley, Pricing Zone 1 (**PZ1**) and the Gunnedah Basin, Pricing Zone 3 (**PZ3**). Idemitsu is uniquely positioned to comment on this matter as it is the only producer in the Hunter Valley Coal Chain which currently has operating mines in both PZ1 and PZ3.

ARTC is required to annually submit documentation to the ACCC demonstrating its compliance with the financial model as set out in section 4 of the HVAU. This assessment by the ACCC considers whether:

(a) ARTC has undertaken prudent capital expenditure in accordance with the requirements of the HVAU;

(b) ARTC has incurred efficient operating expenditure in accordance with the requirements of the HVAU;

(c) ARTC has rolled forward the regulatory value of assets in accordance with the HVAU:

(d) PZ3 forms part of the Constrained Network or whether Loss Capitalisation continues to apply in accordance with the HVAU; and

(e) ARTC has reconciled revenues with the applicable revenue floor and ceiling limits (**Revenue Ceiling Test**) and determined any *'unders or overs'* amounts to Constrained Customers in accordance with the HVAU.

ARTC have submitted its Economic Costs for the Constrained Network was $297.5M and it had collected Constrained Network revenue of $277.9M, indicating there is a $19.6M it would seek from Constrained Access Holders. Furthermore, based on ARTC conducting the applicable RAB and RAB Limit assessment in PZ3, Loss Capitalisation would continue to apply in this pricing zone only.

In relation to the Revenue Ceiling Test, the ACCC undertook a consultation with stakeholders regarding ARTC's approach to Revenue Allocation in which the revenue associated with Fixed or Common Costs (Take or Pay Charges) from PZ3 Access Holders traversing through PZ1 are collected and reallocated back to PZ3, prior to the Revenue Ceiling Test being conducted. This consultation provided a robust debate on a complex issue with numerous stakeholders expressing their expected views relative to their pricing zone. PZ1 and PZ2 Access Holders expressing concerns of cross subsidisation and PZ3 Access Holders promoting the benefits of investment, competition, historical practice and the growth of the NSW coal market.

The final component of the 2013 Annual Compliance Assessment is the audit of the Annual True Up Test, which provides for the payment of rebates to Access Holders by ARTC for its failure to deliver contracted path usages on the Hunter Valley Rail Network with due consideration given to certain factors (system availability shortfall). ARTC have submitted the True Up Test was conducted for each quarter and each month during 2013. ARTC have engaged BDO (SA Pty Ltd) Pty Ltd (**BDO**) as auditor for the 2013 Annual Compliance period with the approval of the ACCC. BDO have conducted the audit and identified ARTC is not liable for any rebates for 2013. Idemitsu has no objections to the findings of the Annual True Up Test.

2. Prudency of Capital

The HVAU requires ARTC to incur capital expenditure on a prudent basis. The ACCC considers prudent capital expenditure to be that which has been endorsed by the Rail Capacity Group and in accordance with the consultation provisions of the HVAU. Furthermore the HVAU permits interest costs incurred during construction up until 1 July in the calendar year that the asset was commissioned, the application of a regulated rate of return and prudent disposal of assets.

2.1. Major Capital Expenditure

Idemitsu supports the ACCC's request for further supporting information regarding the Aerosol (Murumbo) Valley Loop $37,750 of post commissioning costs.

Furthermore, it is Idemitsu's view more detail is required on post commissioning costs with the current total for the period $49M. Idemitsu acknowledges ARTC has provided post commissioning costs by project in the Capital Consultation document, however this should be extended to disclosing major cost categories enabling stakeholders to better understand this component of capital expenditure.

Idemitsu would welcome a clearer reconciliation between RCG endorsed projects and those included in the Annual Compliance Assessment.

2.2. Minor Capital Expenditure

Idemitsu support the ACCC's request for additional information to enable reconciliation of the amounts and scope of minor capital expenditure for 2013 prior to any roll forward into the regulatory asset base.

Idemitsu acknowledges and appreciates the Corridor Capital Reconciliation (minor capital expenditure) reporting that was implemented by ARTC in 2014. Two reports were produced:

- Corridor Capital Reconciliation Jan 2013 to Jun 2014 – current as at 31 Jan 2014 (issued Apr 2014)
- Corridor Capital Reconciliation Jan 2013 to Jun 2014 – current as at 30 Jun 2014 (issued Nov 2014)

It is Idemitsu's expectation a timely report will be issued shortly by ARTC reflecting updated expenditure for 31 December 2014.

In regards to the minor capital endorsement process at the Rail Capacity Group and the recently introduced reconciliation and reporting, these currently align with ARTC's financial year (July to June). Idemitsu considers it more appropriate these should be aligned and issued in accordance with the calendar year to more appropriately reflect the HVAU contract year and Annual Compliance period, which will allow Access Holders increased transparency and understanding.

2.3. Interest During Construction

Idemitsu has no comment with respect to interest during construction.

2.4. Disposals

Idemitsu supports the ACCC seeking further clarification from ARTC on the treatment of sale proceeds from the sale of assets and the transfers to inventory with respect to ARTC's confidential financial model to ensure their appropriate removal from the regulated assets.

3. Efficiency of Operating Expenditure

ARTC operating expenditures are classified into maintenance, expensed projects, network control and corporate overheads. It is Idemitsu's view a more consistent reporting methodology by ARTC will assist Access Holders in transparency and understanding of the costs incurred by ARTC under the HVAU. For example, the forecast operating expenditure for 2013 contained in the 2013 Annual Pricing correspondence issued to Access Holders in November 2012 was extremely inadequate and provides limited opportunity for Access Holders to make any meaningful comparisons against the information provided by ARTC in the 2013 Annual Compliance information.

Example of inconsistent reporting for the Constrained Network – different categorisation:

2013 Pricing Information ($M)	
Variable Maintenance Costs	$44.4
Fixed Maintenance Costs	$32.8
Non Segment Specific Costs	$40.3
Total Operating Expenditure	**$117.5**

2013 Annual Compliance Assessment ($M)	
Variable Maintenance Costs	$28.8
Fixed Maintenance Costs	$29.1
Shared Maintenance Costs	$15.9
Expensed Project Costs	$9.0
Network Control Costs	$9.3
Corporate Overheads	$10.7
Total Operating Expenditure	**$102.8**

It is Idemitsu's view ARTC should provide Access Holders with a budget or forecast of the coming year's operating expenditures (basis for establishing pricing for the coming year) prior to the commencement of that Contract Year at an appropriate level. At the very least a level commensurate with that provided in the Annual Compliance Assessment but ideally the next level down, major cost categories. Subject to realistic budgets being established by ARTC such comparative reporting (budget v actuals) in addition to comparisons to prior years' costs will greatly assist in ensuring efficient operating expenditure.

Furthermore, Idemitsu notes the ACCC's comment regarding limited operating expenditure details for PZ3, with all commentary focussed on the expenditure for the Constrained Network and would welcome PZ3 operating expenditure explanations by ARTC, particularly as total operating expense for PZ3 has increased by 39% compared 2012.

3.1. Maintenance

Idemitsu supports the ACCC's request for ARTC to provide additional detailed information in relation to the 2013 maintenance costs. It is Idemitsu's view ARTC needs to improve maintenance reporting to stakeholders, including scope, budget and actual costs.

3.2. Expensed Projects

Idemitsu has no comment with respect the expensed projects included by ARTC but does acknowledge they were presented to the Rail Capacity Group.

3.3. Network Control

Idemitsu has no comment with respect to Network Control.

3.4. Corporate Overheads

Idemitsu has no comment with respect to Corporate Overheads.

4. Revenue Reconciliation – Ceiling Limits

Idemitsu understands, ARTC collects revenue from Access Holders by applying various Access Charges as they traverse each Segment of the Network that forms part of their journey. In particular, for each pricing zone, ARTC levies Access Charges that include a Variable Charge (Non-TOP charge) and a Fixed Charge (TOP charge). The Non-TOP charges are set to cover Direct Costs (i.e. efficient variable maintenance expenditure) while the TOP charge is set to recover remaining operating and capital costs.

As a result, each Access Holder initially contributes an amount to cover both variable and fixed operating and capital costs as they traverse each part of the network.

Revenue is received and allocated to Segments in PZ1 from Access Holders that commenced their journey in PZ3, ARTC subsequently reallocates the revenue received from their TOP Charges for PZ1 from the amount allocated to the Segments in PZ1 and applies it to Segments in PZ3. Thus, Access Holders commencing in their journey in Pricing Zone 3 contribute only to the Direct Costs as they traverse the network in PZ1.

It is after this allocation that ARTC then reconciles its revenues received with the applicable floor and ceiling limits to determine whether there is any revenue shortfall or surplus in the Constrained Network. In addition, ARTC reconciles the RAB and the RAB Floor Limit for PZ3 to determine if PZ3 forms part of the Constrained Network or whether Loss Capitalisation continues to apply in accordance with the HVAU.

The Revenue Allocation approach by ARTC was the basis for the ACCC's consultation on Revenue Allocation in May 2014,.

Idemitsu's main issues contained in the submission[1]:

(a) The current approach is consistent with the approved HVAU.

(b) It is inappropriate to (as some stakeholders propose) seek to force ARTC to amend the undertaking during its approved term, and worst still to suggest implementing changes with retrospective effect.

(c) Most importantly, the current approach is aligned with the objects of Part IIIA of the Competition and Consumer Act 2010 (Cth) (the **Act**) as it promotes the economically efficient use of and investment in infrastructure and promotes competition in coal markets. The approach is also appropriate taking into account the legitimate business interests of ARTC, ARTC's investment in the facility (specifically the PZ3 infrastructure), and the public interest, including the public interest in having competition in markets.

(d) The current approach has promoted, and is continuing to promote, investment in mines and rail infrastructure in PZ3, which is in the public interest and is ultimately in the interests of other users of the network. The current approach is achieving desirable outcomes, just as it did when applied to Pricing Zone 2 (PZ2).

The Revenue Allocation approach by ARTC is a complex issue, however based on some submissions received by the ACCC from stakeholders there appears to be a misconception regarding the payment of Access Charges. Idemitsu would like to clarify, PZ3 Access Holders are paying all charges levied by ARTC in accordance with HVAU, the Revenue Allocation is an allocation methodology utilised by ARTC, not a payment issue.

4.1. Transparency

Idemitsu is a firm supporter of equal transparency for all stakeholders in regards to the operation and functioning of the HVAU, but still prescribes to its initial view that some stakeholders should

[1] Idemitsu Submission – ARTC HAVAU – Revenue Allocation Review 1 September 2014.

have been aware of the Revenue Allocation approach by ARTC given it had been applied previously in PZ2 with the underlying premise of enabling growth and competition for the NSW coal industry.

4.2. Investment Decision

It is Idemitsu's view the current Revenue Allocation approach by ARTC encourages the entry of new coal producers promoting competition and ensures the development and growth of the NSW coal market which is in the broader public interest. This has been exemplified in PZ2 with the development of multiple coal mines on the Ulan line and the recent development in PZ3, which has seen the expansion of the Boggabri Coal mine, commencement of the new Maules Creek mine and the recently State approved Watermark project.

Furthermore, Idemitsu's submission articulated a longer term view to Revenue Allocation is more appropriate, similar to the development of PZ2. Revenue Allocation applied in PZ2 has enabled PZ2 to transition from Unconstrained to Constrained in 2007-08. Prior to 2007-08, PZ2 volumes were insufficient to recover the full Economic Cost and they made no contribution to PZ1 Fixed Costs. ARTC has advised during the period 2007-08 to 2013 the most significant Network growth has occurred in PZ2, which has triggered investments in both PZ1 and PZ2 to accommodate the PZ2 growth[2].

In the ARTC response to Revenue Allocation, forecast estimates in which the growth in PZ3 volumes are expected to be sufficient to recover PZ3 Fixed Costs in 2015 as well as recovering Loss Capitalisation up to 2014. Based upon the continued growth profile of PZ3 volumes, from 2016 PZ3 Access Holders will begin making a contribution to PZ1 Fixed Costs. Initially this is expected to be approximately 5% of total PZ1 Fixed Costs, increasing to 15-20% by 2020, which aligns with PZ3 Access Holder's use of PZ1[3]. Based upon these forecast it would suggest the Revenue Allocation approach will no longer be required from 2016[4].

4.3. Investment Certainty

It is Idemitsu's continued view changing ARTC's current Revenue Allocation will undermine investor confidence and increase the risks to investments in the Gunnedah Basin by both ARTC and coal producers. The current revenue allocation has been successful in promoting investment in the Gunnedah Basin and a change in approach at this late stage in the HVAU would put further investment by ARTC and the Gunnedah Basin coal producers at risk.

Idemitsu considers it appropriate to review the Revenue Allocation approach by ARTC in the next undertaking.

4.4. RCG Process

Idemitsu is concerned by comments made by some stakeholders in their submissions' with respect to the Revenue Allocation transparency and their approach to endorsing projects in the RCG. Idemitsu appreciates the need for transparency, however this should not be traded off against endorsing justified future rail infrastructure projects, which will provide wider coal chain benefits to stakeholders.

4.5. Standalone and Incremental Costs

The ACCC in its Position Paper has emphased the notion of Standalone and Incremental Costs and proposed an approach which is inconsistent with historical methods applied to PZ2 and has not been the method previously approved by the ACCC in the past two Annual Compliance Assessments under the current HVAU. Any change to the current methodology mid-way through the current HVAU is

---

[2] ARTC Submission – ARTC HAVAU – Revenue Allocation Review 21 August 2014, p14.

[3] ARTC Submission – ARTC HAVAU – Revenue Allocation Review 21 August 2014, p14.

[4] ARTC Submission – ARTC HAVAU – Revenue Allocation Review 21 August 2014, p15.

inappropriate and erodes regulatory stability and commercial confidence. The need for regulatory stability is essential for the development, competitiveness and sustainability of the NSW coal market.

In the event the ACCC's preliminary view on Standalone and Incremental Costs is determined as appropriate and applied, it is Idemitsu's understanding the revised Revenue Ceiling Test would be recalculated for the 2013 Annual Compliance period to include Incremental Costs relevant to PZ3 Access Holders utilising PZ1 capital infrastructure. These Incremental Costs would include the Variable Cost associated with the actual usage of the Network in PZ1 by PZ3 Access Holders plus the Fixed Costs that could have been avoided if the PZ3 Access Holders did not use PZ1. The Incremental Costs associated with PZ3 Access Holders' use of PZ1 will include Direct Costs plus any capital expenditure projects that were commissioned to increase capacity of PZ1 ***solely*** to accommodate the increase in volumes from PZ3.

The fundamental challenges with the proposed approach by the ACCC is the objective identification, assessment and quantification of the capital projects commissioned in PZ1 to increase capacity to solely accommodate the increase in volumes from PZ3. The ACCC acknowledges it does not currently have information to[5]:

(a) perform an itemisation of the capital expenditure of projects that have occurred in PZ1 solely for the purpose of PZ3 Access Holders' use; and

(b) quantify the value of these capital expenditure projects.

Hence the ACCC is seeking stakeholder input and support to achieve a resolution.

Firstly, (in the event that ACCC confirms its draft decision and that ARTC accepts that decision), Idemitsu is willing to actively participate in any related discussions or engagements within the industry, amongst stakeholders and with the ACCC in regards to consideration of the above matter.

Secondly, it is Idemitsu's view ARTC is the most appropriately placed entity (with potential modelling support of the Hunter Valley Coal Chain Coordinator) to conduct the necessary objective identification, assessment and quantification of the capital projects commissioned in PZ1.

Finally, Idemitsu has a number of general considerations regarding any proposed methodology used for the identification, assessment and quantification of the capital projects commissioned in PZ1:

(a) It is important an objective approach is undertaken when assessing capacity projects and whichever approach is implemented it is transparent and stakeholders are given the opportunity to provide input and comments.

(b) Consideration needs to be given to a realistic timeframe to appropriately complete the capacity project assessment for PZ1 and a consultation period with stakeholders on the findings.

(c) ARTC and the HVCCC on a number of occasions have identified the majority of capacity projects are interrelated, one project is dependent upon on one or many, hence multiple projects will need to be considered.

(d) At fundamental level, it is misleading to simply deduct the capacity requirements of PZ1 and PZ2 Access Holders from the total PZ1 capacity and assign the residual to PZ3 Access Holders utilising PZ1 as potential excess capacity will overstate the requirements of PZ3 Access Holder. This excess capacity will need to be considered and addressed.

(e) Consideration will need to be given to PZ3 Access Holder who have invested substantially in rollingstock payloads and infrastructure development in PZ3 which has liberated capacity to

[5] ACCC Position Paper – ARTC compliance with the financial model in the Hunter Valley Coal Network Access Undertaking for January – December 2013, 26 November 2015, p28

the benefit of all Access Holders using PZ1 (noting PZ1 and PZ2 Access Holder make no contribution to PZ3 investment or costs).

(f) Idemitsu supports Whitehaven's view[6] PZ3 Access Holders are currently limited to shorter trains (approx 1330m) due to rail infrastructure limitations in the Gunnedah Basin, however rail infrastructure in PZ1 is constructed for longer trains (approx 1550m), effectively over specified and over designed for PZ3 Access Holder needs to be considered in any incremental cost assessment. In addition, PZ3 Access Holders are substantially impacted via differentiated pricing as a result of these smaller trains.

(g) In addressing the 2013 Annual Compliance period, Idemitsu note ARTC will be required to begin preparations for the 2014 Annual Compliance period and therefore an appropriate and timely resolution is essential.

(h) Any potential use of Incremental Costs and resulting changes to the Revenue Ceiling Test shall not be applied retrospectively beyond the 2013 Annual Compliance period.

In Idemitsu's view:

- it is inappropriate to change the approach midway through the undertaking period.
- the complexity of applying the ACCC's proposed approach suggests that this exercise ought to be deferred and (if still relevant at the time) reflected in the next undertaking.

[6] Whitehaven Submission – ARTC HAVAU – ARTC compliance with the financial model in the Hunter Valley Coal Network Access Undertaking for January – December 2013, 19 January 2015, p4.