VALE

21 January 2015

Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
ACCC
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

I refer to the ACCC's invitation to provide submissions regarding the position paper on Australian Rail Track Corporation's (**ARTC**) compliance with the financial model in the Hunter Valley Rail Network Access Undertaking (**HVAU**) dated 26 November 2014 (**Paper**). Vale appreciates the opportunity to provide this submission as part of the additional consultation process on the 2013 Compliance review.

Does Industry have comments on any aspect of ARTC's capital expenditure additions, interest during construction or disposals amounts for the 2013 Compliance Period?

Vale notes that ARTC has identified in the compliance report that it has now commenced the publication of a detailed minor capital report to the Rail Capacity Group (**RCG**). The first report was tabled in April 2014 and the second report was presented in November 2014. Vale supports the additional transparency that has been achieved with the release of the bi annual report on minor capital expenditure. The report provides details of each of the minor projects that are to be completed under the minor capital expenditure budget approved by the RCG. Vale supports this transparency but is concerned about the internal ARTC governance structure in place to monitor and manage the expenditure of the individual minor capital projects. Although not part of the 2013 compliance review, the minor capital expenditure report received in late 2014 indicates that many minor capital projects had exceeded their original budget cost allocation. Vale notes that there appears to be some references within the report to funds being transferred between projects to cover cost overruns, but this does not appear to be consistently applied or at least consistently noted in the report. Of concern to Vale is the latest minor capital report included some capital items that had total expenditure of 100% above the budget allocation and there was no indication that any formal internal ARTC process had been completed to transfer funds from another minor project to cover this cost overrun. Vale appreciates that minor capital project priorities will be subject to change, however, Vale believes it is good practice to have a clear governance structure that allows for funds to be transferred between minor projects and does not allow over budget expenditure on minor projects. Vale believes this process will ensure that the combined total of the individual minor projects will not exceed the minor capital allowance approved by the RCG.

Does industry have any comments on any aspect of ARTC's operating expenditure, including maintenance costs, expensed projects, network control and corporate overheads for the 2013 Compliance Period?

ARTC has indicated that maintenance costs were in line with previous years but suggest it would have been 24% higher except there was a reduction in the scope of maintenance completed. ARTC indicated that the scope was reduced because of a lack of availability of track possessions and track resources. It is unclear to Vale as to whether this means the network has deteriorated due to this reduced scope or this scope was not required. Vale is also concerned that ARTC was unable to complete the maintenance scope even though the RCG monthly report indicates that ARTC has only managed to complete the planned possessions within the planned hours for 3 months during 2013. It is not clear to Vale whether the inability to achieve maintenance scope is a result of over contracting network capacity and therefore insufficient allocation of capacity for maintenance, inefficient maintenance planning, or the maintenance scope is not actually required. Vale believes that a more efficient maintenance planning process needs to be established to ensure that the appropriate level of maintenance scope is achieved to ensure the rail network is maintained to a standard that supports the contractual tonnes committed to by ARTC.

The Paper notes that ARTC's network control costs remained largely unchanged from 2012 and the corporate overhead costs were lower than 2012 due to an increased share in interstate non-coal train kilometres compared to the Constrained Coal train kilometres, resulting in less corporate overheads being allocated to the Constrained Network. Vale would like to see ARTC focus on productivity improvements during the coming years to assist the productivity drive being undertaken by coal producers to remain competitive in the global coal market.

Does industry have any comments about the ACCC's application of the standalone cost test contained in subsection 4.3(a) of the HVAU that requires the incremental costs (as opposed to Direct Costs) of the use of Pricing Zone 1 by Pricing Zone 3 Access Holders to be taken into account in determining the ceiling revenue limits?

Vale supports the application of the standalone cost approach which includes at least the direct costs and plus any capital expenditure projects that were commissioned to increase capacity in Pricing Zone 1 for Pricing Zone 3 Access Holders. Vale believes this would lead to a cost reflective approach to pricing that would assist in matching the revenue received with the costs incurred to and avoid any cross subsidies between Pricing Zone 1 and Pricing Zone 3 Access Holders.

Does industry have any comments on how the capital investments in Pricing Zone1 should be itemised to determine the incremental cost of Pricing Zone 3 Access Holders? If yes, please explain the approach and rationale.

Vale believes there is always going to be some subjectivity in identifying any piece of rail infrastructure on a multi user section of a rail network as all trains on the network will utilise the asset once constructed. Vale supports the concept of determining a stand alone cost approach to determine the allocation of the capital costs to Pricing Zone 3. Vale's approach would be to establish a standalone network baseline including items such as the asset value, rail network infrastructure, and contracted train paths, for Pricing Zone 1, before the commencement of any railings from Pricing Zone 3. Vale would argue that at this point the standalone network baseline represents that costs and infrastructure that are required to operate Pricing Zone 1 on a standalone basis. Therefore, any capital investment constructed within Pricing Zone 1 after this period should be allocated between the pricing zones based on the additional asset value and contracted train paths added above the standalone network baseline. Vale believes that allocating capital costs across pricing zones based on contracted train paths is a fair and reasonable approach as it represents the mechanism used by ARTC to determine when an expansion of the rail network is required. Vale believes this approach is appropriate as Pricing Zone 3 producers gain the benefit of any latent capacity that existed in Pricing Zone 1 prior to the commencement of railings from pricing zone 3

Does industry have any further comments on revenue allocation and reconciliation?

Vale supports the view of the ACCC that the current revenue allocation methodology is not efficient and involves a cross subsidy between producers. Vale believes this inefficiency will lead to a long term pricing advantage to Pricing Zone 3 producers and provides a reduction in revenue risk for ARTC which is likely to have not been considered in the ACCC's determination of ARTC's WACC.

Vale supports the ACCC's views that further transparency would be gained by the introduction of examples to demonstrate the likely outcomes of any proposed changes, to allow stakeholders to make a better informed decision. Vale believes that examples would assist understanding and reduce asymmetric nature of information and knowledge between ARTC and coal producers.

Vale appreciates the opportunity to provide its views on this topic and would be happy to discuss this further if you need any clarification.

Yours sincerely,

Anneliese Mattos
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Vale Australia Pty Ltd