



AUSTRALIAN RAIL TRACK CORPORATION LTD

Application by ARTC to vary the Hunter Valley Access Undertaking to provide for the Positive Performance Incentive Scheme

1 Application

1.1 Application

This is an application to the ACCC for consent to vary the Hunter Valley Coal Network Access Undertaking (**HVAU**) under section 44ZZA(7) of the *Competition and Consumer Act 2010* (Cth) (**CCA**), and as contemplated by section 13.3(b) of the HVAU. The HVAU was accepted by the ACCC on 29 June 2011 with a Commencement Date of 1 July 2011.

Sections 13.3 and 13.5 of the HVAU provide a two-stage process for the development, and incorporation into the HVAU, of a positive performance incentive scheme that is intended to offset certain negative asymmetries inherent in other parts of the HVAU.

The two stages of the process are:

- **Stage 1 - Non-TUT related performance incentive scheme**
The development by ARTC, with Access Holder and stakeholder consultation, of options for performance incentives which have the objective of encouraging ARTC, through financial reward, to improve operating, maintenance and capital expenditure efficiency, and achieve desirable safety performance (section 13.3).
- **Stage 2 - TUT related performance incentive scheme**
The development by ARTC, either in parallel with, or following completion of, a review of the system-wide true up test (**TUT**) to be undertaken following the completion of the first two calendar years after the Commencement Date, of options for performance incentives which have the objective of encouraging ARTC, through financial reward, to improve performance in relation to making Capacity available for use either on a contracted or ad hoc basis and balancing the negative consequences of failing the TUT (section 13.5).

In addition to consultation explicitly required under sections 13.3 and 13.5 of the HVAU, ARTC has had regard to the proposal put forward by QR National Network (**QRNN**) to the Queensland Competition Authority (**QCA**) in April 2012 in the paper titled 'Draft Incentive Mechanism'.

Sections 13.3 and 13.5 were included in the HVAU in response to concerns expressed by the ACCC and stakeholders prior to the acceptance of the HVAU



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that it contained only negative asymmetric incentives, which could potentially lead to ARTC adopting a ‘minimum risk’ performance approach. Coal stakeholders expressed support for a proposal to provide ARTC with positive performance incentives, where such incentives delivered better outcomes for the coal chain.

Sections 13.3 and 13.5 therefore provide only for the proposal of a *positive* performance incentive scheme, which is intended to offset the negative asymmetry of existing incentives in the HVAU and Access Holder Agreements, such as the TUT, which limit upside for over-performance and/or penalise under-performance.

The purpose of this Application is to vary the HVAU (and Indicative Access Holder Agreement (**IAHA**)) in accordance with section 13.3(b) to incorporate ARTC’s proposed non-TUT related positive performance incentive scheme (**PPIS**). The PPIS will counterbalance existing negative incentives in the HVAU, by positively motivating ARTC to efficiently invest in, and maximise utilisation of, the Hunter Valley Coal Network, as well as achieve positive workplace safety outcomes.

The proposed PPIS and amendments to the HVAU and IAHA are set out in the marked up versions of those documents included in **Attachment A**. ARTC intends that the variation approved pursuant to this application will take effect from the commencement of the next calendar year. This will give ARTC time to implement systems, and will ensure that the commencement of the PPIS coincides with the commencement of the next regulatory year.

The incentive scheme required under section 13.5 of the HVAU will be developed contemporaneously with, or following, ARTC’s future system-wide TUT review under section 13.4 of the HVAU.

1.2 Criteria for approving variation

Pursuant to sections 2.3 and 13.3 of the HVAU, and section 44ZZA(7) of Division 6 of Part IIIA of the CCA, variation of the HVAU by ARTC is subject to the ACCC’s consent.

The ACCC may only consent to a variation if it considers it appropriate to do so having regard to the matters set out in section 44ZZA(3) of the CCA. These matters include:

- a) the objects of Part IIIA of the CCA;
- b) the pricing principles specified in section 44ZZCA;
- c) the legitimate business interests of ARTC;
- d) the public interest, including the public interest in having competition in markets;



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- e) the interests of Access Holders and Operators; and
- f) any other matters that the ACCC thinks are relevant.

ARTC considers it appropriate for the ACCC to consent to ARTC's proposed variation for the reasons set out in section 2 below.

2 Proposed PPIS

2.1 *Proposed positive performance incentives*

Pursuant to section 13.3 of the HVAU, this section 2.1 sets out ARTC's proposed PPIS. ARTC considers that the PPIS satisfies the objectives of section 13.3 in encouraging ARTC to improve operating, maintenance and capital expenditure efficiency, and achieve desirable safety performance in relation to the Hunter Valley Coal Network. In relation to the use of a safety performance incentive, ARTC now agrees with the view held by some stakeholders that incentivising ARTC's safety performance through an economic model may not be appropriate for the reasons set out in **Attachment B (Report and Proposal)** and therefore has not included a specific incentive relating to safety.

In response to stakeholder submissions, ARTC has also incorporated into its PPIS on an interim basis ahead of the development contemplated at section 13.5 of the HVAU, incentives that focus on controllable behaviours related to capacity and throughput. ARTC recognises that section 13.3 does not explicitly require such incentives but does not exclude proposal of such incentives.

ARTC's proposed variation enables ARTC to re-visit these elements of the PPIS during the development of TUT-related performance incentives in order to ensure that the combined scheme, including non-TUT and TUT related performance incentives, remains appropriate and balanced in the context of the prescribed HVAU objectives.

Further detail as to each incentive is provided in the supporting document to this application set out in **Attachment B**.

a. Network KPIs focussed on controllable behaviours related to capacity and throughput

- i. Coal Chain Losses – ARTC cause
- ii. Transit Time – impact of temporary speed restrictions

b. Network KPIs focussed on other controllable behaviours

- i. Track condition measured by index



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c. Innovation related performance incentive

ARTC has also proposed a capacity investment positive performance incentive which focuses on encouraging the use of innovation (soft assets) to achieve outcomes that ARTC may otherwise deliver through the use of hard assets (infrastructure). This performance incentive is intended to address the fact that ARTC is not currently rewarded under the HVAU for solutions derived from innovation, where these solutions extract additional productivity from an existing asset base, and thus reduce Capital Expenditure (because the Ceiling Limit under the HVAU operates to return the additional revenue to Access Holders).

To incentivise ARTC to seek solutions based on innovation, as opposed to solutions based on the construction of 'hard' assets, ARTC proposes an incentive mechanism based on 'capitalising' into the asset base 50% of the value of the equivalent 'hard' asset that would have produced the same Additional Capacity as is achieved through the relevant innovation, subject to endorsement by the Rail Capacity Group.

2.2 Development of the PPIS

In developing the PPIS, ARTC has had regard to the following:

- its obligations under section 13.3 of the HVAU;
- feedback received from stakeholders;
- views expressed by the ACCC; and
- the Draft Incentive Mechanism proposed by QRNN to the QCA.

a. Consultation with industry

Section 13.3 of the HVAU requires the development of PPIS between ARTC and stakeholders. ARTC has undertaken a comprehensive stakeholder consultation process in satisfaction of clause 13.3.

On 30 December 2011, ARTC published the Consultation Document set out in **Attachment C** which sought stakeholder views to assist in the formulation of positive incentive mechanisms that would have broad stakeholder support. The Consultation Document addressed in detail a range of considerations that ARTC believed were relevant to the development of a PPIS to apply to ARTC in the Hunter Valley, and presented four potential non-TUT related incentive mechanisms. ARTC sought submissions and comment from stakeholders by 20 February 2012.



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ARTC received submissions from three stakeholders: Asciano, Coal & Allied, and Vale. To the extent that these stakeholders have confirmed that ARTC is able to provide these submissions to the ACCC, the submissions are included at **Attachment D**.

Overall, ARTC considers that the submissions received are supportive of ARTC's proposal to incorporate a positive performance incentive scheme into the HVAU. In reviewing these submissions, ARTC was able to identify and reflect on the common views held by stakeholders, including the importance placed on the development of TUT related positive performance incentives over non-TUT related positive performance incentives. These views as interpreted by ARTC, and ARTC's response, are set out in detail in the Report and Proposal in **Attachment B**.

ARTC has had regard to the views provided by stakeholders in their submissions and these views are reflected in the PPIS set out in this application and the proposed variation.

b. Review of QRNN Access Undertaking

In developing the PPIS, ARTC has also had regard to the incentive mechanism development process undertaken by QRNN.

In October 2010, QCA accepted the QRNN 2010 Access Undertaking (**2010 AU**) covering the central Queensland coal network. One of QRNN's obligations under the 2010 AU is to submit to the QCA draft amendments to the revenue cap adjustment provisions that give effect to an incentive framework within 12 months of approval of the 2010 AU. In doing so, QRNN must consult with industry. In April 2012, QRNN submitted to the QCA a paper titled 'Draft Incentive Mechanism' which proposes amendments to the 2010 AU intended to meet this obligation.

Whilst ARTC acknowledges that there are differences in the circumstances and objectives surrounding QRNN's development and the ARTC's developments under section 13.3 of the HVAU, there are aspects of the process undertaken by QRNN to date that are relevant to ARTC's considerations in preparing this application and the Report and Proposal set out in **Attachment B**. Accordingly, ARTC has considered QRNN's paper and built on relevant aspects in formulating the proposed PPIS. ARTC's consideration of QRNN's paper is set out in full in the Report and Proposal in **Attachment B**.



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Attachment A

ARTC has prepared a mark-up of the HVAU and IAHA to reflect the proposed amendments. The mark-ups are attached as **Attachment A1** and **Attachment A2** respectively.



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Attachment A1

Mark-up of the HVAU to reflect proposed variation amendments



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Attachment A2

Mark-up of the IAHA to reflect proposed variation amendments



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Attachment B

Report and Proposal



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Attachment C

Consultation Document circulated to stakeholders



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Attachment D

Submissions received from stakeholders