



Australian
Competition &
Consumer
Commission

Australian Rail Track Corporation

Access Undertaking – Hunter Valley Rail Network

Issues Paper

May 2009



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Glossary of Terms

ACCC	Australian Competition and Consumer Commission
Access provider	The owner or operator of the facility that is used (or will be used) to provide the service (also referred to as a service provider)
Access seeker	A person who wants access to a service or wants a change to some aspect of a person's existing access to the service (also referred to as a third party)
Act	<i>Trade Practices Act 1974</i>
ARTC	Australian Rail Track Corporation
CAPM	Capital Asset Pricing Model
DORC	Depreciated Optimised Replacement Cost
gtkm	Gross Mass Tonnes Per Kilometre
Interstate Undertaking	ARTC Interstate Rail Network Access Undertaking (2008) currently in operation
IPART	NSW Independent Pricing and Regulatory Tribunal
NCC	National Competition Council
NCIG	Newcastle Coal Infrastructure Group
Network	Unless otherwise indicated, the below rail network in the Hunter Valley leased by ARTC
NSW Undertaking	New South Wales Rail Access Undertaking currently administered by IPART
Operator	A party that provides above rail services
Producer	A party that produces coal in the Hunter Valley region
PWCS	Port Waratah Coal Services
RAB	Regulatory Asset Base
ERAB	Existing Regulatory Asset Base
IRAB	Investment Regulatory Asset Base
Undertaking	Hunter Valley Rail Access Undertaking submitted to the ACCC on 23 April 2009
WACC	Weighted Average Cost of Capital

1. Introduction

Under Part IIIA of the *Trade Practices Act 1974* (the Act) the Australian Competition and Consumer Commission (ACCC) must, among other tasks, assess access undertakings and make a decision on whether or not to accept them.

On 23 April 2009, the Australian Rail Track Corporation (ARTC) lodged an application for the ACCC to assess its proposed access undertaking for the Hunter Valley rail network (the Undertaking). The Undertaking has been submitted by ARTC in accordance with its lease agreement between the Commonwealth and New South Wales (NSW) governments in regard to certain rail infrastructure and assets in NSW.¹

In September 2004, ARTC commenced a 60 year lease of certain parts of the NSW rail network, including the interstate rail network outside of the Sydney metropolitan commuter network from Macarthur to Newcastle, the Hunter Valley rail network, and some parts of the regional rail network. Under the terms of ARTC's NSW lease, ARTC is required to submit an access undertaking or undertakings to the ACCC for approval in relation to the NSW leased network. ARTC has chosen to submit:

- one access undertaking for the Interstate rail network (incorporating the NSW interstate network) (accepted by the ACCC on 30 July 2008); and
- a separate access undertaking covering the ARTC leased Hunter Valley rail network.

The Undertaking sets out the price and non-price terms and conditions of access to the Hunter Valley rail network.

¹ ARTC (2004) *Memorandum between the Commonwealth of Australia and the State of New South Wales and Australian Rail Track Corporation Ltd in relation to the lease of the NSW Interstate and Hunter Valley Rail Assets to Australian Rail Track Corporation Ltd and associated arrangements*, 4 June, p. 8.

2. Issues Paper

Section 44ZZBD of the Act provides that the ACCC may undertake a public consultation process to assist it to assess an access undertaking if it considers it appropriate and practical to do so. Through this Issues Paper, the ACCC invites submissions from interested parties on the Undertaking.

The purpose of this Issues Paper is to provide information about the Undertaking to assist interested parties to prepare submissions and to identify potential issues likely to be relevant to the ACCC's decision to accept or not accept the Undertaking. Further, it contains information about the ACCC's assessment process.

The paper provides a summary and introduction to the main Undertaking provisions. It is not intended as a detailed description of the terms and conditions of access to the Hunter Valley rail network. Interested parties should refer to the Undertaking itself for the detailed terms and conditions. The views expressed are ACCC understanding of the operation of the Undertaking. ARTC has provided an Explanatory Guide to the Undertaking which is available on the ACCC website.

Following the receipt and consideration of submissions to this Issues Paper, the ACCC may release a draft decision that provides the ACCC's preliminary assessment of the Undertaking. The ACCC may then seek submissions on the conclusions reached in the draft decision before making its final decision on the Undertaking.

Submissions to this Issues Paper

In assessing the Undertaking, the ACCC will have regard to any submissions provided within the relevant consultation period.

The issues raised in the Issues Paper are provided for guidance only. Interested parties making submissions to the ACCC need not limit their comments to the matters raised in the Issues Paper and are welcome to discuss any other matter relevant to the Undertaking but not specifically raised in the Issues Paper.

Interested parties are encouraged to provide as much information and evidence as possible in support of their views. To assist the ACCC in its assessment of an undertaking, submissions from interested parties should, as far as practicable, refer to the legislative criteria.

Submissions received will be made available to any person or organisation on the ACCC's webpage (www.accc.gov.au) unless confidentiality is claimed in respect of all or part of a submission and such claim of confidentiality is accepted by the ACCC. Those parts of submissions for which confidentiality is claimed should be clearly identified and reasons provided for the claim of confidentiality.

The process for the making of submissions is outlined in section 3 of this Issues Paper.

Timing for Decision

Under s.44ZZBC of the Act, the ACCC is required to use its best endeavours to make a final decision on the Undertaking within six months of receiving an undertaking application, that is, by 23 October 2009. An expeditious process will depend on parties providing complete information in a timely way.

The ACCC may extend its assessment period beyond the six month timeframe if it requires further time to make its decision. The ACCC will provide written public notice of any extension to the decision-making timeframe.

Structure of the Issues Paper

The remainder of the Issues Paper is structured as follows.

Section 3 provides contact details for the making of submissions.

Section 4 sets out the regulatory background to the Undertaking.

Section 5 provides background to Part IIIA and in particular access undertakings, and gives an overview of the matters that the ACCC must have regard to in assessing an undertaking.

Section 6 outlines the assessment process the ACCC will apply to the Undertaking.

Section 7 describes the key features of ARTC's Undertaking and identifies issues that may assist interested parties in presenting their views about the Undertaking.

3. Submissions

Submissions should be forwarded by 5:00pm on **26 June 2009** to:

Anthony Wing
General Manager
Transport and General Prices Oversight Branch
ACCC
GPO Box 520
MELBOURNE VIC 3001

(03) 9290 1804

Submissions are to be sent by email, in Microsoft Word or other text readable document form.

Electronic versions should be emailed to: transport@accc.gov.au

Confidentiality and information sharing

All submissions will be made available to any person or organisation on request including on the ACCC's website unless the submission or parts thereof are claimed as confidential and the ACCC accepts such claim of confidentiality. The sections of submissions that are considered confidential should be clearly identified and reasons given supporting the claim.

The ACCC will consider each claim of confidentiality on a case by case basis. If the ACCC refuses a request for confidentiality, the submitting party will be given the opportunity to withdraw the information. The ACCC will then assess the Undertaking in the absence of that information.

Information sharing provisions in the Act allow the ACCC in certain circumstances to disclose protected information it receives to other government agencies.²

For further information about the collection, use and disclosure of information provided to the ACCC, please refer to the ACCC publication "*Australian Competition and Consumer Commission / Australian Energy Regulator Information Policy – the collection, use and disclosure of information*," available on the ACCC website.

Further inquiries:

Michael Gauci
Director, Transport Access Section
Transport and General Prices Oversight Branch
Ph: (03) 9290 6963
Email: michael.gauci@accc.gov.au
Fax: (03) 9663 3699

2 Section 155AAA.

4. Regulatory Background

As noted above, ARTC has chosen to submit:

- one access undertaking for the Interstate rail network (incorporating the NSW interstate network). (This was accepted by the ACCC on 30 July 2008.)
- a separate access undertaking covering the ARTC leased Hunter Valley rail network. (This is the current Undertaking.)

ARTC Interstate Rail Network

On 30 July 2008, the ACCC accepted ARTC's Interstate Rail Network Undertaking setting out the terms and conditions upon which ARTC would provide access to interstate rail tracks in South Australia, Victoria, NSW other than the Hunter Valley, and Western Australia (the Interstate Undertaking). The Interstate Undertaking came into operation on 20 August 2008 and will remain operative until 2018 (unless withdrawn earlier).

The Interstate Undertaking does not cover any aspect of the Hunter Valley rail network.

ARTC Hunter Valley Rail Network

The Hunter Valley rail network is presently subject to the 2004 NSW Rail Access Undertaking (the NSW Undertaking) which is administered by the NSW economic regulator, the Independent Pricing and Regulatory Tribunal (IPART).³

The 2004 NSW Undertaking does not have a specified duration and is intended to provide a 'high level' regulatory framework until a Part IIIA Hunter Valley rail network undertaking comes into operation. The NSW framework is essentially based on a negotiate/arbitrate model where access prices are negotiated between the access provider (ARTC) and operators. Where operators and ARTC fail to reach an access agreement, IPART will determine the dispute.

The NSW Undertaking contains some important and detailed principles in relation to the regulated asset base, treatment of new investment, and revenue received by ARTC from access seekers using the Hunter Valley network. Some of these principles have been adopted by ARTC in the proposed Undertaking.

³ IPART (2004) *NSW Rail Access Undertaking Pursuant to Schedule 6AA of the Transport Administration Act 1988 (NSW) - Rail Infrastructure Corporation and Rail Corporation New South Wales*, p. 1.

Port Waratah Coal Services Authorisations

The principle purpose of the Hunter Valley rail network is to provide infrastructure for the transportation of coal from mines to coal loading terminals at the Port of Newcastle. While the management, activities, and regulation of the port terminals do not strictly concern the rail network, the integrated nature of the coal supply chain means that port throughput will have direct and indirect affects on the (efficient) utilisation of, and investment in, the rail network.

In recent years, Port Waratah Coal Services (PWCS) has operated its terminals at the Port of Newcastle in accordance with various ‘capacity balancing systems’ that have been authorised by the ACCC. Under s.88 of the Act, the ACCC may ‘authorise’ businesses to engage in anti-competitive arrangements or conduct when it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.

These capacity balancing systems essentially involve coal producers receiving a pro-rata allocation of the available capacity of the Hunter Valley coal chain. The aim of these systems is to manage the large queue of vessels that formed offshore in response to a global surge in the demand for coal, and therefore, minimise demurrage costs incurred by coal producers.

While the capacity balancing systems do not address the terms of access to the Hunter Valley rail network, they nevertheless have implications for the rail network. The operation of port-based capacity balancing systems has had implications for throughput on the rail network, as well as potentially affecting commercial incentives for investment in rail infrastructure.

An authorised capacity balancing system has essentially been in operation at the Port of Newcastle since interim authorisation was first granted by the ACCC in March 2004. The ACCC has always considered that capacity balancing systems are in the public interest as transitional measures only. The ACCC became increasingly concerned that the underlying issues contributing to the capacity imbalance in the Hunter Valley coal chain were not being addressed by the industry.

In April 2008, the ACCC granted authorisation to extend the operation of a capacity balancing system at the Port of Newcastle until 31 December 2008, to provide a transition period that would allow the industry to develop a long term solution to address the ongoing capacity constraints within the Hunter Valley coal chain.

On 19 November 2008, the ACCC received a new application for authorisation from PWCS and the Newcastle Coal Infrastructure Group (NCIG) effectively seeking a further extension of the operation of a capacity balancing system (called the ‘PWCS Tonnage Allocation Stage 1’) while the industry developed a long term solution to coal chain capacity issues. Urgent interim authorisation was also requested by the applicants.

On 17 December 2008, the ACCC decided to grant interim authorisation to the PWCS Tonnage Allocation Stage 1 until 31 March 2009, conditional upon the ACCC being satisfied that work to finalise the long term solution continued. In making this decision,

the ACCC noted the progress that was now being made by the industry and NSW Government towards developing a long term solution – particularly through the NSW Government’s announcement on 12 December 2008 of a terminal access framework that was supported by all Hunter Valley coal producers.

The ACCC also expressed its view that to be effective, any long term solution must extend beyond terminal capacity allocation to ensure that all coal chain contracts, including above and below rail, are properly aligned and reflect whole of coal chain system capacity. To this end, the ACCC encouraged:

... all the relevant parties including producers, rolling stock and track providers, terminal operators and government to continue to work together to finalise the details of a long term solution as soon as possible.⁴

On 26 February 2009, the ACCC issued a draft decision proposing to grant authorisation to the arrangements until 30 June 2009. The ACCC noted that:

The industry and NSW Government appears to now be making significant progress towards finalising a long term solution in the Hunter Valley.⁵

In particular, the ACCC highlighted that:

Significantly, the Newcastle Port Corporation is drafting a detailed Implementation Memorandum which will be finalised by mid-late March. Another Group is developing a mechanism to align contracted capacity along the Hunter Valley coal chain.⁶

The proposed authorisation was conditional upon the parties finalising an Implementation Memorandum which sets out an agreed framework and details how the long term solution will be implemented on a timely basis, and a copy provided to the ACCC by 31 March 2009. The ACCC noted that it would consider whether interim authorisation of the PWCS Tonnage Allocation Stage 1 should continue in light of the content of the Implementation Memorandum.

In early April 2009, the ACCC received a signed Implementation Memorandum from the Newcastle Port Corporation, PWCS and NCIG which sets out the key agreed principles for, and a framework for the implementation of, a long term solution for access to and expansion of export capacity at the Port of Newcastle (Capacity Framework). The ACCC subsequently indicated that the Implementation Memorandum appears to set out a framework and processes that are sufficient for the development of a long term solution. It decided that interim authorisation would remain in place until the date the ACCC’s final decision comes into effect, unless otherwise revoked. On 13 May 2009, the ACCC issued a final decision granting authorisation to PWCS and NCIG for a transitional capacity balancing system until 30 June 2009.

⁴ ACCC news release ‘ACCC Grants Interim Authorisation to PWCS and NCIG,’ (NR 359/08), 17 December 2008.

⁵ ACCC news release ‘ACCC Proposes to Approve Coal Scheme At Port of Newcastle,’ (NR 040/09), 26 February 2009.

⁶ *ibid.*

The Implementation Memorandum contains a summary of documents which the parties consider necessary to be amended or developed for the effective implementation of the Capacity Framework. Notably amongst them is the need for '*Coal Chain Access Protocols*' in which the parties will address the contractual alignment between terminal access, track access and above rail which must be consistent with the contractual alignment principles set out in the Implementation Memorandum.

In this regard, the Undertaking and the long term solution for the port terminals are related and both are fundamental to the achievement of an overall supply chain solution.

5. Part IIIA of the Trade Practices Act and Access Undertakings

Overview

Part IIIA was inserted into the Act in 1995 by the *Competition Policy Reform Act 1995*. It establishes a regime to assist third parties to obtain access to services provided through facilities with natural monopoly characteristics to promote competition in upstream or downstream markets.

Part IIIA focuses on third party access to services that have the following features:

- natural monopoly (where due to economies of scale or scope, a single facility can satisfy all the demand for its services in a market at lower cost than two or more facilities);
- strategic position in an industry (so that access to the facility's service is a prerequisite for businesses to be able to compete effectively in markets upstream or downstream of the facility (often referred to as a 'bottleneck' facility); and
- national significance (given its size and/or importance to the national economy or interstate or international trade).

How Does Part IIIA Work?

Part IIIA provides three main mechanisms by which access can be obtained to infrastructure:

- declaration of a service (under s.44H) and arbitration (under s.44V);
- access undertakings and access codes (under ss.44ZZA and 44ZZAA respectively); and
- decision that a state or territory access regime is effective (under s.44N).

Declaration

Any person may apply to the National Competition Council (NCC) for a recommendation that a service provided by means of a facility be declared. After considering the NCC's recommendation, the relevant minister can declare the service provided that certain criteria are satisfied (including that: access would promote a material increase in competition in another market; it would be uneconomical to develop another facility to provide the service; and the facility is of national significance).

Declaration does not prevent the provider of the declared service and a party who requests access to that service from negotiating the terms and conditions of access to the service. However, if the parties are unable to agree, the ACCC may, upon notification of a dispute by either party, conduct an arbitration and make a determination that binds the parties.

Access Undertakings and Codes

A provider of a service (or a person who expects to be the provider of a service) may give an undertaking to the ACCC in connection with the provision of access to the service. An undertaking may specify the terms and conditions on which access will be made available to third parties. The ACCC may accept the undertaking after considering the matters set out in s.44ZZA(3).

If the ACCC accepts the undertaking, the provider is required to provide a third party with access in accordance with the undertaking. An access undertaking is binding on the access provider and is able to be enforced in the Federal Court upon application by the ACCC.

A service that is the subject of an access undertaking in operation cannot be declared. This provides greater regulatory certainty for the access provider and investors.

However, where a service has been declared, a service provider may still give an undertaking. Any future arbitration determination in respect of that service may only cover matters that are not dealt with in the undertaking (s.44ZZCB).

An undertaking may be withdrawn or varied at any time, but only with the ACCC's consent.

In addition to access undertakings, an industry body is able to give a code to the ACCC setting out rules for access to a service. The ACCC may accept the code considering the matters set out in s.44ZZAA(3) of the Act. If the ACCC accepts the code, this facilitates the process for assessing an undertaking submitted in accordance with the code.

This mechanism reflects the fact that, in some cases, industry codes are more appropriate than individual undertakings. The function of a code is to streamline the approval process for undertakings where it is advantageous for a number of access providers to provide access in a substantially similar way.

Effective state or territory access regime

A state or territory minister may apply to the NCC for a recommendation to the commonwealth minister that a state or territory regime is an effective access regime. If the commonwealth minister decides that the regime is an effective access regime (also described as 'certification'), a service that is the subject of the regime cannot be declared (subject to certain conditions) and the ACCC cannot accept an access undertaking or code in respect of that service.

There is no relevant certified state or territory access regime.

Assessment of Access Undertakings

If the ACCC accepts an undertaking from ARTC then the terms and conditions in the undertaking form the basis on which access rights holders can access ARTC's Hunter Valley rail network.

The ACCC may accept an undertaking if it thinks it appropriate to do so having regard to the following matters (s.44ZZA):

- the objects of Part IIIA (box 1);
- the pricing principles specified in s.44ZZCA (box 1);
- the legitimate business interests of the service provider;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of the persons who might want access to the service;
- whether the undertaking accords with an access code applying to the service; and
- any other matters that the ACCC thinks relevant.

The ACCC cannot accept an undertaking if the Commonwealth Minister has decided under s.44N that access to the service is already the subject of an effective regime.

To assist the ACCC in its assessment of an undertaking, submissions from interested parties should, as far as practicable, refer to the legislative criteria.

Box 1 Objects and Pricing Principles

Section 44AA - Objects of Part IIIA

The objects of this Part are to:

- (a) promote the economically efficient operation of use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
- (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

Section 44ZZCA - Pricing principles for access disputes and access undertakings or codes

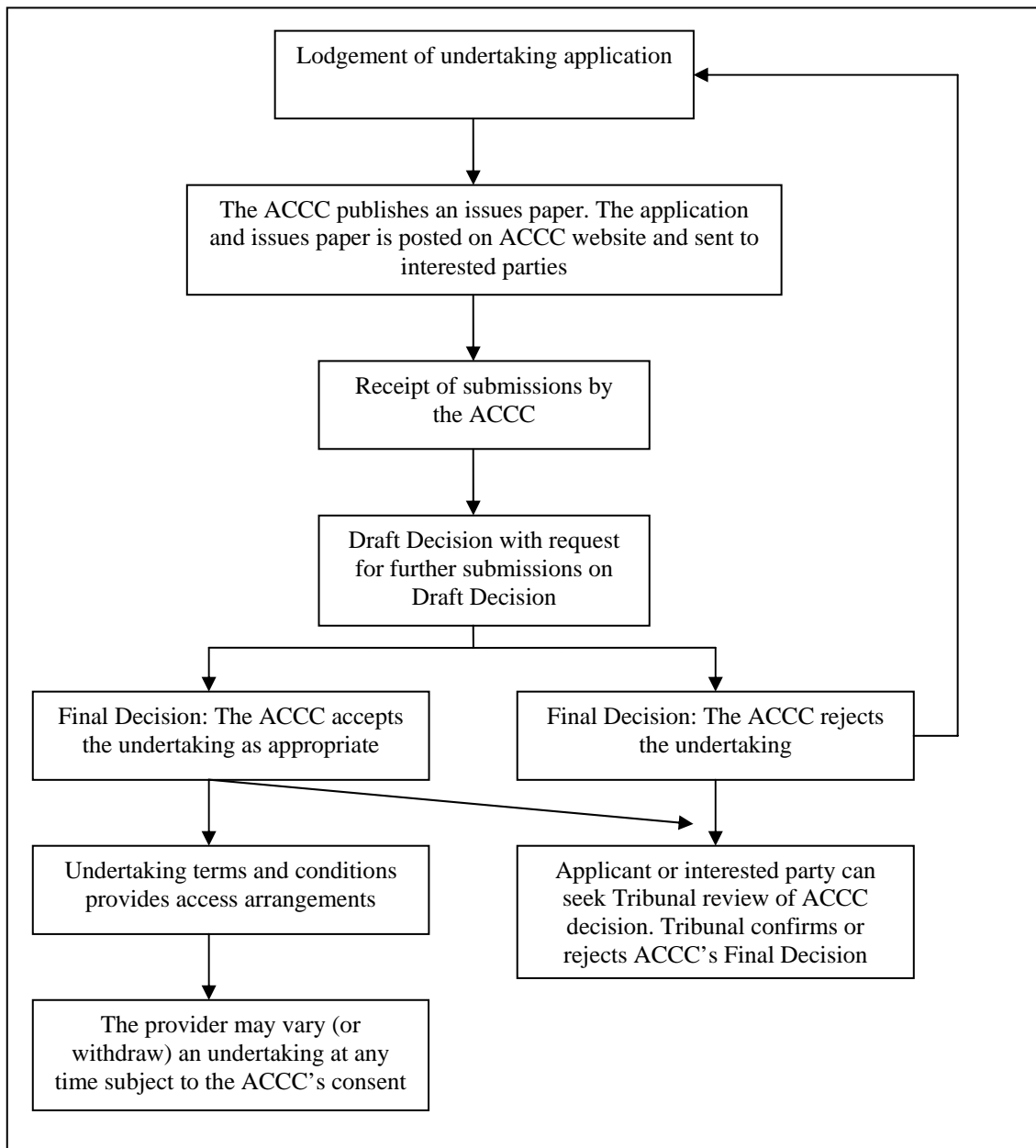
The pricing principles relating to the price of access to a service are:

- (a) that regulated access prices should:
 - (i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
 - (ii) include a return on investment commensurate with the regulatory and commercial risks involved; and
- (b) that the access price structures should:
 - (i) allow multi-part pricing and price discrimination when it aids efficiency; and
 - (ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and
- (c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

6. Assessment Process for ARTC's Hunter Valley Rail Access Undertaking

The following figure summarises the procedures for the ACCC's assessment of the ARTC Undertaking.

The process, which is indicative only, is designed to be transparent and public, relying on input from interested parties as well as the access provider making the application.



ACCC Time Lines

The legislative regime provides for the ACCC to use its best endeavours to make a decision an undertaking within six months of receiving an application. The ACCC received the ARTC Undertaking on 23 April 2009. The ACCC may extend the time for making a decision if it is unable to make a decision within the six month period. The ACCC will give written notice of any extension.

For the purposes of the Undertaking assessment, the ACCC has developed the following indicative timetable:

- publication of the Issues Paper on 29 May 2009;
- receipt of submissions by 26 June 2009;
- ACCC draft decision by August 2009; and
- ACCC final decision by 23 October 2009.

Interested Parties

A copy this Issues Paper has been sent to known stakeholders to assist them to prepare submissions. Any member of the public is, however, able to make a submission on the undertaking during the consultation period. The Issues Paper, the Undertaking, and other material relevant to the Undertaking are available on the ACCC's web site at **www.accc.gov.au**. The ACCC can provide hard copies of these documents on request.

Copies of submissions will be posted on the ACCC's website, unless the submission contains confidential information (see section three). ARTC may be asked to comment on submissions where this would assist the ACCC's assessment of the Undertaking.

In addition to submissions, the ACCC may seek information through meetings with interested parties and others who may be able to provide information to assist its assessment of the Undertaking.

7. Issues

Introduction

This section of the paper describes the key features of ARTC's proposed Undertaking and identifies issues that may assist interested parties in making submissions on the Undertaking.

The aim is to provide a brief explanation of the Undertaking and to highlight for comment issues that the ACCC has identified as being potentially important. It is not, however, intended to limit discussion of the Undertaking and parties are welcome to comment on any aspect of the Undertaking.

The ACCC will assess whether it is appropriate to accept the Undertaking having regard to the matters in s.44ZZA(3). The Undertaking is composed of a number of parts that deal with different aspects of the terms and conditions for negotiating and providing access. The ACCC will assess each provision individually and in the context of the Undertaking as a whole and consider whether, overall, the proposed terms and conditions of access are appropriate having regard to the matters in s.44ZZA(3).

ARTC Undertaking

The ARTC Undertaking consists of the main body of terms and conditions of access together with six Schedules and an Annexure as follows:

- Schedule A – Essential Elements of an Access Agreement
- Schedule B – Network
- Schedule C – Network Management Principles
- Schedule D – Performance Indicators
- Schedule E – Segments
- Schedule F – Parent Guarantee and Indemnity
- Annexure A – Indicative Access Holder Agreement

These are discussed in detail below.

Clause 1 – Preamble, Objectives and Contract Structure

Clause 1 of the Undertaking contains the preamble, objectives and describes the contract structure established by the Undertaking.

The preamble provides background information on ARTC, its establishment, structure and responsibilities as network manager.

Principles enunciated in the preamble are:

- recognition of the need to improve the operation and investment of the network and to improve its utilisation and performance so as to optimise coal export throughput;
- recognition of the role of the Hunter Valley Coal Chain Coordinator and ARTC's desire to support its role in identifying and facilitating expansion of the coal chain capacity;
- recognition that coal producers are seeking to align capacity contracted across all aspects of the coal supply chain, including above and below rail and port terminal capacity;
- access pricing for non-coal hauling traffic on the network is such that it only meets the direct cost of access to the constrained network;⁷
- ARTC adopts the concepts of equity and transparency and will not discriminate price on the basis of the identity of the access seeker;
- maintenance and investment in the network is a large component of ARTC's current cost structure and a key objective in maintenance planning is to maximise coal chain throughput and reliability; and
- the Undertaking will be applied consistently to access applications.

ARTC describes the objectives of the Undertaking as being to:

- provide a framework to manage negotiations with access seekers for access;
- establish a workable, open and non-discriminatory efficient and inclusive process for access applications;
- use transparent and detailed methodologies, principles and processes for determining access revenue limits and terms and conditions;
- reach an appropriate balance between the legitimate business interests of ARTC, the interests of the public and the interests of access seekers;

⁷ The constrained network is that part of the network that is at the revenue ceiling and thus recovers full economic costs.

- provide an efficient and effective dispute resolution process; and
- operate consistently with the objectives and principles of Part IIIA of the Act and the Competition Principles Agreement.

ARTC propose a separate contract structure for coal and non-coal traffic. For coal traffic, ARTC propose a contract structure in which either the coal owner (usually the coal producer) or accredited operator may directly contract with ARTC for coal access rights. Coal producers who directly contract with ARTC for rail access rights must nominate an accredited train operator who is required to have an operator sub-agreement with ARTC which is endorsed by the producer.

Operators may also enter into an access holder agreement direct with ARTC for coal access rights and this will require an operator sub-agreement with ARTC.

For non-coal traffic, ARTC will enter a single access agreement with an accredited operator or with an applicant, who is not an accredited operator, but who then must procure the services of an accredited train operator. Such an agreement will provide an entitlement to train paths and a right to operate non-coal trains on the paths.

Issues for Comment

- *Are the principles enunciated in the preamble appropriate and complete? If not what should be changed?*
- *Are the objectives appropriate and sufficiently balance the interests of ARTC, access seekers, and the public? If not what should be changed?*
- *Is the contract structure appropriate and sufficiently balances the needs and interests of ARTC, operators, and producers and contributed to efficiency in the coal supply chain? If not, how should it be structured?*

Clause 2 - Scope and Administration of the Undertaking

Clause 2 sets out the scope and term of the Undertaking and mechanisms for the review of its operation. It notes the insurance held by ARTC and the various information that ARTC will publish regarding ARTC and the Undertaking.

The Undertaking provides for the negotiation of access rights to the network with details of the services to be defined during negotiations. Apart from the track itself, access will be granted to associated facilities required for network access, which includes structure supports, tunnels, bridges signalling systems and other plant, machinery and equipment, but does not include sidings and yards or extensions that may connect to the network.

ARTC undertakes to the ACCC to comply with the terms and conditions of the Undertaking. The proposed term of the Undertaking is ten years. There is provision for ARTC to seek extension of the Undertaking by seeking approval from the ACCC prior to its expiry, as well as provision for ARTC to submit another undertaking at any time during the term of the Undertaking.

ARTC may seek to vary the Undertaking during its term by seeking ACCC approval if the Undertaking becomes no longer commercially viable or inconsistent with its objectives. Before seeking the variation, ARTC will consult with access holders and operators. The Undertaking may only be varied with the approval of the ACCC.

After five years, ARTC will undertake a review of the Undertaking in consultation with stakeholders.

The Undertaking will only apply to new access agreements and negotiation of access rights in addition to those already subject to an access agreement. The Undertaking cannot require a party to vary the terms of an existing access agreement.

ARTC will reserve, at no charge, existing access rights for non-coal traffic under existing agreements and will make them available to non-coal rights applicants within 30 business days of the Undertaking commencing.

ARTC will maintain liability insurance policy of not less than \$250,000,000 for any one occurrence to cover indemnity obligations.

ARTC will publish a range of information on its website regarding ARTC and the Undertaking including, *inter alia*:

- maps containing a geographical description of the network (Schedule B);
- indicative access charges for Indicative Services;
- prices for which access has been granted to other services together with a description of those services;
- network management principles (Schedule C);
- performance indicators;
- the regulatory asset base for each network segment; and
- a Hunter Valley corridor capacity strategy.

Issues for Comment

- *Is the scope of the Undertaking, including the defined network in Schedule B, clear and appropriate?*
- *Does the Undertaking cover all facilities necessary for effective access?*

- *Is the ten year undertaking term an appropriate duration?*
- *Are the review provisions appropriate (i.e. are they sufficiently transparent, inclusive and effective)?*
- *Is ARTC's proposed insurance liability sufficient in terms of monetary limit and coverage?*
- *Is the information proposed to be published sufficient (i.e. extent of the information, relevance, timeliness)? Should other information be available?*

Clause 3 – Negotiating for Access

Clause 3 outlines the process to be followed to enable an access seeker to gain access. Basically, the framework provides for:

- preliminary meetings and exchange of information;
- submission of an access application;
- preparation of an indicative access proposal;
- negotiations to develop an access agreement; and
- dispute resolution procedures.

Introduction and Framework

These sections set out the framework within which ARTC intends to negotiate with operators wishing to access the services provided by its network. It covers the initial negotiation processes and procedures, provision of information, confidentiality, determination of capacity availability, negotiations following the lodgement of an application, the finalisation of an access agreement, and dispute resolution.

ARTC intends to negotiate in good faith and to provide a flexible consultation process for negotiating access to the network.

ARTC recognises the important role of the Hunter Valley Coal Chain Coordinator in managing coal chain capacity and the importance of ARTC and applicants consulting with the Hunter Valley Coal Chain Coordinator and the coal chain service providers in determining the impact on coal chain capacity of the rail capacity sought by applicants.

Issues for Comment

- *Is the negotiation framework appropriate for facilitating access to the network? If not, what should be added or changed?*

- *Is ARTC's proposed consultation with the Hunter Valley Coal Chain Coordinator an appropriate component of the negotiation process?*

Provision of Information

Upon the request of an access seeker, ARTC will provide a range of information to assist access negotiations, including: path length availability, axle load limitations, section run times, and other relevant information. Additionally, ARTC will provide the incremental and economic cost for the pricing zones for which access is sought and any other information relating to capacity and train operations reasonably required by the access seeker. Provision of this information is subject to ARTC not disclosing confidential information and the access seeker agreeing to pay the reasonable cost of obtaining information not ordinarily available to ARTC.

Issues for Comment

- *Is the scope of information sufficient to enable meaningful and effective access negotiations? If not, what should be changed?*
 - *Are the other aspects of the information provision clause appropriate?*

Parties to Negotiation

ARTC will negotiate with access seekers that:

- agree to comply with the requirements and processes of the Undertaking;
- are accredited operators or can procure the services of an accredited operator;
- meet certain prudential requirements including solvency, no material default of an access agreement in the last two years, and demonstrate an acceptable credit rating or credit security;
- can demonstrate a legal ownership structure, assets and value sufficient to meet liabilities under an access agreement.

For coal access rights, ARTC will negotiate with an applicant who is not an accredited operator on the basis that the applicant will nominate an accredited operator prior to utilising the coal access rights, that the operator will enter into an operator sub-agreement with ARTC, and that the applicant will endorse the operator sub-agreement. ARTC will negotiate the terms of an operator sub-agreement with the access seeker or operator when it has been appointed.

For non-coal access rights, ARTC will negotiate an access agreement provided that the applicant will procure the services of an accredited operator and all the terms of the access agreement are met by the applicant.

ARTC may at any time before or during the negotiation process, require an applicant seeking coal access rights to demonstrate that it has sufficient network exit capability. This means that the applicant has sufficient capacity allocated to it at the Port of Newcastle for the export of coal to be transported on the rail network either for the contracted train path period or ten years from the time coal access rights are available for use.

ARTC will provide written reasons for refusing to negotiate. If the applicant feels that ARTC unreasonably refuses to negotiate, the applicant may refer the matter to arbitration in accordance with the Undertaking.

If ARTC considers an access request to be frivolous, it may refer the request to arbitration.

Issues for Comment

- *Are the bases for negotiating with an access seeker appropriate? If not, why not?*
- *Is the concept of 'network exit capability,' and the potential requirement for applicants to demonstrate sufficient port capacity allocation during rail access negotiation, appropriate? If not, why not?*
- *Are the prudential requirements appropriate? If not, why not?*
- *Are the bases and process for refusing to negotiate reasonable? If not, why not?*

Confidentiality

This clause concerns acknowledgment by the parties that information concerning markets and business strategies as exchanged between the negotiating parties are confidential and will be treated that way. It then sets out what information is not to be regarded as confidential.

The Undertaking then describes the circumstances in which confidential information may be disclosed. This includes information:

- necessary for a range of professional advice;
- to a related party;
- to the Hunter Valley Coal Chain Coordinator and the Rail Capacity Group for the purpose of assisting the coordinator to determine the impact of access rights

on coal chain capacity and the operating requirements necessary for delivery of that capacity and scheduling and planning, and to the Rail Capacity Group for consultation purposes (subject to appropriate confidentiality arrangements); or

- to an operator necessary for the purposes of complying with contractual obligations.

Issues for Comment

- *Are the confidentiality provisions sufficient to protect such information and do they facilitate the negotiation process? If not, what should be changed?*
- *Is the provision of confidential information to the Hunter Valley Coal Chain Coordinator and Rail Capacity Group appropriate and likely to facilitate negotiations? If not, what should be changed?*

Initial review where Coal Access Rights are sought

Where an applicant seeks coal access rights and the applicant has requested ARTC to take part in a review, ARTC will participate in an initial review of capacity requirements. The purpose of the review is to assist the applicant to provide the Hunter Valley Coal Chain Coordinator with sufficient information to allow the Hunter Valley Coal Chain Coordinator to determine the impact of the applicant's sought rail capacity on coal chain capacity and to provide the applicant with advice as to the operating requirements needed to deliver coal chain capacity, and determine how many train paths may be required.

ARTC will participate in the review to the extent that the other coal chain participants reasonably and effectively participate in the review.

Issues for Comment

- *Is the initial review of capacity requirements useful and reasonable in terms of promoting access negotiations and facilitating efficient utilisation of the network? If not, what should be changed?*

Application and Acknowledgement

Clauses 3.7 and 3.8 deal with the making and acknowledgement of an access application.

An application must be made in writing and provide the following information: applicant details, capacity requirements, any need for additional capacity, above rail requirements, duration of access, type of service required and details of rolling stock, and details of operators for each train path sought.

Further, confirmation of sufficient network exit capability is required including a copy of the applicant's contract with the port company showing the ability of the applicant to offload coal at the port. In addition, ARTC requires any advice obtained from the Hunter Valley Coal Chain Coordinator as to the impact on coal chain capacity of the access rights sought.

ARTC may accept an access application from an applicant seeking coal access rights, but who does not yet possess sufficient network exit capability, if that applicant can establish that it is negotiating sufficient network exit capability with the relevant port operator to offload the anticipated coal volumes.

An applicant may seek initial meetings with ARTC to discuss and clarify the access application prior to submitting it.

ARTC will acknowledge receipt of an application in writing. However, it may also seek additional information it reasonably needs for preparing an indicative access proposal or clarification of information before doing so.

Issues for Comment

- *Are the information and acknowledgement requirements reasonable? If not, what should be changed?*
- *Is the requirement for applicants to demonstrate sufficient network exit capability reasonable?*

Determination of Capacity and Indicative Access Proposal

ARTC will use reasonable efforts to provide the applicant with an indicative access proposal within 60 business days. ARTC will advise the applicant if there is to be a delay in the provision of the proposal and will estimate a time for its delivery. If the applicant feels that the delivery time is excessive, it may refer the matter to arbitration.

ARTC will have regard to any Hunter Valley Coal Chain Coordinator advice provided on the impact of the access rights on coal chain capacity and on operating requirements needed to deliver that capacity.

ARTC will determine whether there is sufficient available capacity to accommodate the access rights sought by conducting a capacity analysis (see below). ARTC may require the applicant to seek a further review by Hunter Valley Coal Chain Coordinator of the impact of the access rights on coal chain capacity and ARTC will have regard to this further review. However, ARTC will solely determine whether there is sufficient available network capacity to grant the access rights.

If ARTC considers there is not sufficient available capacity, the applicant may request additional capacity (see clause 6 below).

Issues for Comment

- *Is the process and timeframes for determining capacity reasonable? If not, what should be changed?*

Indicative Access Proposal

Clause 3.10 deals with the provision to the applicant of an indicative access proposal. This proposal will set out information about:

- the results of capacity analysis (determining whether there is sufficient available capacity to accommodate the requested access rights);
- if additional capacity is required, an outline of the work and estimate of cost of such work;
- the existence of other applicants which, if granted, would limit the ability of ARTC to provide the access rights sought;
- refer the applicant to the Hunter Valley Coal Chain Coordinator for any additional information about coal chain capacity
- currently available market terms and conditions;
- an initial estimate of access charges; and
- details of any additional information for ARTC to progress the proposal.

The indicative access proposal is indicative only and places no binding obligations on ARTC. The applicant may seek arbitration if it believes reasonable progress has not been made with the proposal.

If ARTC cannot meet the needs of the applicant, it will, if possible, offer an alternative proposal, which ARTC reasonably believes may meet the applicant's requirements.

Issues for Comment

- *Is the process and timeframes for developing and providing an indicative access proposal reasonable?*
- *Is the information provided to the applicant sufficient?*

Negotiation

The applicant must advise of its intent to progress the application on the basis of the indicative access proposal within 30 business days. If notice is given after this period, ARTC may prepare a revised proposal.

If the applicant has concerns about the indicative access proposal, it must advise ARTC within 30 business days, in which case ARTC will take reasonable steps to address the concerns within 30 business days of receipt of the applicant's concerns. If ARTC is unable to address the concerns within this time, it will advise on an intended course of action of how the concerns are to be addressed, including any revision to the proposal. If the applicant is satisfied of this, it must notify ARTC of its intention to proceed with negotiations within 30 business days of receiving ARTC's response. If the applicant is not satisfied with ARTC response, it may invoke the Undertaking dispute resolution process.

Both parties will then enter into a negotiation period upon notification by the applicant of its intention to proceed toward an access agreement. Negotiations will cease upon:

- execution of an agreement;
- the applicant indicating that it no longer wishes to proceed;
- expiry of three months from commencement of negotiations;
- ARTC believes negotiations are not progressing in good faith within a reasonable period and ARTC has informed the applicant of this and its intention to end the negotiation period;
- an arbitrator has determined that negotiations are not progressing in good faith within a reasonable period;
- ARTC receives evidence that the applicant no longer satisfies the network exit capability requirement and has issued a notice of intention to end negotiations and provided reasons to the applicant for its decision to end negotiations; and
- ARTC receives evidence that the applicant no longer meets the prudential requirements and the applicant is not willing to provide a security or parent guarantee.

Issues for Comment

- *Is the negotiation process reasonable and reflects an appropriate balance between the interests of ARTC and access seekers?*
- *Are the timeframes reasonable?*
- *Are the bases on which ARTC may cease negotiations reasonable?*

Application for Mutually Exclusive Access Rights

Where two or more applications for mutually exclusive access rights are received, ARTC will advise all applicants of the applications as soon as practicable.

ARTC will grant access to the applicant who will accept the access agreement with ARTC which, in its opinion, is most favourable to it (which will ordinarily be based on the access agreement that represents the highest present value of future returns to ARTC after considering all risks associated with the access agreement).

An applicant will not be granted access rights unless it can satisfy the network exit capability requirement.

If at any time during the negotiation period a dispute arises, then either party may seek dispute resolution in accordance with the Undertaking.

Issues for Comment

- *Is this a reasonable process for choosing between mutually exclusive access applications? If not, how should it operate?*

Access Agreement

Access rights are finalised in the form of an access agreement between the applicant and ARTC. ARTC may offer the following as an access agreement:

- an indicative access holder agreement (subject to satisfaction of network exit capability and prudential requirements) (coal access rights);
- the current available market terms and conditions in the form of an access holder agreement (coal access rights);
- the current available market terms and conditions in some other form (for non-coal access rights); and
- an updated access holder agreement to reflect agreed amendments to the indicative access holder agreement (for coal and non-coal access), which must at least address the essential elements set out in Schedule A.

ARTC must offer the indicative holder agreement for coal access rights if the applicant:

- seeks access for the operation of indicative services;
- meets the network exit capability and prudential requirements; and either
- the network has sufficient capacity to its needs or ARTC consents to provide additional capacity.

Once the applicant has notified ARTC that it is satisfied with the terms and conditions of the access holder agreement, ARTC will as soon as reasonably practicable provide a final access agreement for execution.

Issues for Comment

- *Are the different forms of and bases on which the access agreements will be offered appropriate?*

Dispute Resolution and Arbitration

The Undertaking provides for a three stage approach to dispute resolution – negotiation, mediation and arbitration.

If any dispute arises under the Undertaking or in relation to the negotiation of access rights between an applicant and ARTC, then the dispute will be resolved in accordance with the Undertaking (unless expressly agreed otherwise by the parties). Parties are to use reasonable endeavours acting in good faith to settle a dispute.

Disputes in relation to an access agreement (as distinct from arising under the Undertaking) are resolved according to that agreement.

Negotiation

The first stage involves senior representatives of the parties meeting and using reasonable endeavours by joint discussion to resolve the dispute. This must occur within five business days of a party notifying a dispute. If a dispute is not resolved, then within ten business days, the dispute is referred to mediation (if agreed) or arbitration.

Mediation

If mediation is agreed, the chief executive officers of the parties will attempt to resolve the dispute including by informal mediation. If the dispute is not resolved within ten business days, the matter is referred to formal mediation in NSW by a single mediator appointed by agreement or failing agreement, by the President of the NSW Law Society.

Unless otherwise agreed, the mediation will be conducted according to the NSW Law Society guidelines. Parties may appoint lawyers, each party will bear their own costs and the costs of the mediator will be shared.

Arbitration

If the dispute is not resolved by negotiation or mediation, either party may terminate the mediation and notify the arbitrator of the dispute. In notifying the arbitrator of a dispute, the applicant must also agree to pay for any charges of conducting the

arbitration and indemnify the arbitrator for any claims made against it arising in connection with the arbitration.

The ACCC will be the arbitrator and will be constituted by two or more members of the ACCC nominated in writing by the Chairperson of the ACCC.

With some exceptions, ARTC and the applicant agree to adopt the arbitration procedures in Division 3, Subdivision D of Part IIIA of the Act.

The ACCC will, *inter alia*, make a final determination in writing including reasons for its decision. The ACCC may at any time terminate an arbitration if it thinks that the dispute is vexatious, trivial, or negotiations were not in good faith.

The ACCC will, in deciding a dispute, take into account, amongst other things, the principles, methodologies and provisions of the Undertaking and the objectives and principles of Part IIIA, the legitimate business interests of ARTC, the interests of persons who have a right to use the network, and the economically efficient operation of the network.

In making a determination, the ACCC is required to act within the scope of its powers as set out in Part IIIA in terms of what it may deal with and the effects of its determination.

The ACCC may publish its determination at its discretion subject to concerns of the parties about sensitivity of information. The ACCC may join separate arbitrations which raise common issues and join additional persons as a party to an arbitration.

The ACCC determination is final and binding and it may charge for its costs of conducting the arbitration.

An applicant must comply with a determination or direction of the ACCC otherwise ARTC will no longer be obliged to continue access negotiations. Similarly, ARTC will comply with directions or the determinations of the ACCC and indemnify it in respect of claims made in the performance of its duties excluding circumstances where the arbitrator is negligent, dishonest or engaged in unlawful conduct.

Issues for Comment

- *Is the proposed dispute resolution process appropriate having regard to such matters as the timeframes for escalation, the sequence of escalation stages, the matters the ACCC must take into account in making a determination, the procedural powers of the ACCC and the responsibilities of the various parties involved in the process?*
- *Is the ACCC an appropriate arbitrator for disputes arising under the Undertaking?*

Clause 4 - Pricing Principles

Clause 4 sets out proposed pricing principles. A charge to an access holder will include a price negotiated in accordance with the principles in the Undertaking.

Access charges for coal services are based on a single charge, which is a function of distance and gross mass tonnes per kilometre (gtkm) for a pricing zone. Access charges may be based on a take or pay basis and/or actual usage. Access charges for non-coal services are structured as a multi-part tariff comprising fixed and variable components.

All elements of the access fee are subject to negotiation between ARTC and access seekers.

The pricing regime introduces a methodology for establishing revenue ceilings that differs from the 'Building Block' approach. The key feature of which is a 'Loss Capitalisation' approach for rolling over the Regulatory Asset Base (RAB). The regime also separates Existing Regulatory Asset Base (ERAB) from Investment Regulatory Asset Base (IRAB), and introduces different rates of return for the ERAB and IRAB.

Floor and Ceiling Price and Revenue Limits

Clause 4.2 sets out floor and ceiling price and revenue limits. Access revenue from each customer must at least meet the direct costs of access imposed by that access holder.

For each segment or group of segments of the network, revenue from access holders should, as an objective, meet the incremental cost of those segments. This is the floor limit.

For any access holder, access revenue must not exceed the economic cost of the segments utilised by the holder. This is the ceiling limit.

Issues for Comment

- *Are the definition and application of floor and ceiling prices appropriate?*

The Loss Capitalisation Model

The access pricing principles in the Undertaking constrains ARTC's ability to earn revenue above that necessary to generate a normal rate of return over the life of its assets. This is achieved through the use of a model that capitalises economic losses into the RAB. ARTC recognises that this approach is different from the conventional approach used to regulate infrastructure (see Box 2).

Box 2 – Regulatory Models

Conventional approach to defining a revenue limit - ‘Building Block Model’

Sets the revenue limit equal to the sum of the ‘return on capital’ (WACC times RAB) plus depreciation ‘return of capital’ plus operating expenditure.

The RAB is rolled forward as the sum of the previous RAB, less depreciation plus net capital expenditure.

Proposed ARTC approach - ‘RAB Capitalisation Model’

The access provider is allowed to ‘capitalise’ economic losses incurred over time, provided its RAB is above a specified lower limit, so the access provider is allowed to earn a regulated return on these losses in the future.

Under the proposed approach, if the access provider is earning insufficient revenue to cover operating expenditure and capital costs, the RAB will increase over time, reflecting the need to recover larger amounts of revenue in the future in order to achieve normal returns over the life of assets.

The Undertaking proposes a regulatory roll forward model that allows ARTC, over time, to capitalise a segment’s economic losses into the RAB. That is, the size of the RAB would be adjusted each year to reflect whether the infrastructure is operating at an economic profit or an economic loss.

The RAB capitalisation model allows a long run view of profitability so that expenditure that is not recovered in the early years of an investment would be built into the RAB and may be recovered in the future.

The RAB capitalisation model divides assets into two ‘classes:’

- assets that exist at the commencement date (the ‘existing RAB’ or ‘ERAB’). The ERAB will be initially valued in accordance with the valuation used by IPART under the NSW Rail Access Undertaking and in force at the time immediately preceding the commencement of the Undertaking. The choice of asset valuation methodology can affect the value assigned to the initial RAB. ARTC has established the initial RAB valuation for the ARTC network using a Depreciated Optimised Replacement Cost (DORC) methodology; and
- assets that are commissioned during the term of the Undertaking (‘investment RAB’ or ‘IRAB’).

The RAB for all assets in a segment or group of segments at the start of any year will be the sum of ERAB and IRAB. The RAB floor limit for a segment or group of segments is then ‘rolled forward’ on an annual basis.

Issues for Comment

- *Is the RAB capitalisation approach an appropriate basis for regulating prices in the ARTC Hunter Valley rail network?*
- *Is the RAB capitalisation approach clear, transparent, and appropriate to promote efficient use of, and investment in, the network?*
- *Do the methodology and formulas reflect the intentions of the RAB capitalisation approach?*
- *Is the treatment of government capital contributions, including infrastructure assets and financial capital, in the ERAB and IRAB appropriate?*

Regulatory Asset Base

The Undertaking differentiates between an existing or initial RAB (‘ERAB’) and an asset base that includes assets commissioned during the term of the Undertaking (‘IRAB’).

ERAB

To determine the RAB at the commencement of the Undertaking, the segments, network and associated facilities will be:

- in relation to segments that have been ascribed a regulatory asset value in accordance with the NSW Undertaking, will be set at the value determined under the NSW Undertaking; and
- in relation to other segments not ascribed a regulatory asset value under the NSW Undertaking, they will be valued using a DORC methodology.

The Undertaking then specifies a methodology for calculating the annual roll forward of the ERAB.

IRAB

For assets commissioned during the term of the Undertaking, the segments, network and associated facilities will be initially valued at zero. The Undertaking contains a methodology for calculating the annual roll forward of the IRAB.

Issues for Comment

- *Is the separation of the RAB into an ERAB and IRAB appropriate?*
- *Is the adoption of IPART's valuation of assets of \$521 million⁸ for the ERAB appropriate, having regard to IPART's valuation methodology and resulting DORC estimation?*
- *Are the assets to be included in the ERAB clear and appropriate?*
- *Are the segments not ascribed a regulatory asset value under the NSW Undertaking sufficiently clear and appropriate to include in the ERAB?*

Economic Cost

Clause 4.4 deals with what is meant by the term 'Economic Cost' of a segment. This includes, *inter alia*, segment specific costs, depreciation, allocation of non-segment specific costs, and interest reasonably incurred during the construction of additional capacity. All costs are to be assessed on a stand alone basis.

Issues for Comment

- *Is the definition of economic costs appropriate?*
- *Is the definition of economic costs consistent with the intention and methodology of the loss capitalisation model?*

Cost Allocation

Clause 4.5 deals with non segment specific costs and non segment specific assets and how, for the purposes of determining their economic cost, they will be allocated.

ARTC proposes that, where possible, costs will be directly attributable to a segment. Where possible, non-segment specific costs (and non-segment specific assets) will be allocated, in the first instance, to an ARTC corridor or allocated as system-wide and secondly, to individual segments within those corridors. The basis of the allocation of non-segment specific costs and assets is:

- gross tonne kilometres with respect to non-segment specific costs as well as depreciation of, and return on non-segment specific assets associated with train maintenance; and

8 ARTC (2009) 2007-08 *Submission to The Independent Pricing and Regulatory Tribunal in respect of Hunter Valley Regulatory Network: Roll Forward Asset Base, Ceiling Test, Unders and Overs Account*, p. 9, www.ipart.nsw.gov.au, accessed on 28 April 2009.

- train kilometres with respect to non-segment specific costs as well as depreciation of, and return on non-segment specific assets not associated with track maintenance.

All costs will comprise ARTC's reasonably anticipated costs over a reasonable future timeframe.

Issues for Comment

- *Is the proposed cost allocation of segment and non specific segment costs and assets appropriate?*
- *Is there sufficient detail in the Undertaking about ARTC's approach to operating and maintenance expenditures?*
- *Does the Undertaking contain sufficient incentives to encourage ARTC to undertake efficient operating, maintenance and capital expenditures and to pursue efficiency gains?*

Depreciation

Clause 4.6 sets out the method of calculating the depreciation allowance in any year. Depreciation is to be calculated at the beginning of each calendar year using a straight line depreciation methodology having regard to an estimate of the remaining useful life of assets.

The useful life of segments is to be determined having regard to the average remaining mine life, average mine production levels, and marketable coal reserves. ARTC has used Booz and Co. to estimate the remaining mine life relevant to the Hunter Valley rail network. The mine life proposed by ARTC in the Hunter Valley for the period 2009-2014 is differentiated by regions (analogous to network pricing zones) as follows:

- 24.1 years for mines located on track sectors south of Muswellbrook;
- 21.8 years for mines located on track sectors west of Muswellbrook; and
- 20.2 years for mines located on track sectors north of Muswellbrook.⁹

The average remaining mine life may vary between pricing zones as approved by the ACCC.

The estimate of remaining mine life will be reviewed by ARTC five years from the commencement of the Undertaking and any revised estimates will be submitted to the ACCC for approval.

⁹ Booz and Co. (2009) *Mine Life Assessment – Hunter Valley Region – Australian Rail Track Corporation*, February, pp. 2 and 3.

Depreciation is to be charged each year on the opening balance of the RAB and on 100 per cent of the prudent capital expenditure of assets commissioned for a period of half the year.

Issues for Comment

- *Is the information that ARTC has regard to in determining the useful remaining life of assets sufficient?*
- *Are the mine life estimates conducted by Booz and Co. appropriate, having regard to the assumptions, methodology, variables, and options adopted by Booz and Co.?*
- *Is the method and rate of depreciation appropriate?*
- *Should remaining mine lives vary between pricing zones and regions?*

Rate of Return

Clause 4.7 deals with the rate of return. The rate of return will be equivalent to ARTC's weighted average cost of capital (WACC) as accepted by the ACCC after consideration of the risks in which ARTC operates on the network. The clause then specifies the elements as follows:

- capital asset pricing model (CAPM) for determining the cost of equity;
- debt to equity ratio considered prudent for ARTC's business; and
- appropriate adjustment (beta) to the equity risk margin appropriate for investment in rail infrastructure forming part of the network.

Returns on assets are calculated by applying ARTC's WACC to the value of the assets employed, based on a DORC valuation.

The rate of return may vary between assets existing as at the commencement date of the Undertaking and assets provided by capital expenditure during the term of the Undertaking to reflect differences arising from the risks with the commercial environment in which ARTC operates in relation to those respective assets.

ARTC has used Synergies Economic Consulting to estimate its WACC for the Hunter Valley rail network. The WACC parameters used by Synergies Economic Consulting for the Hunter Valley rail network are as follows:¹⁰

¹⁰ Synergies Economic Consulting (2009) *ARTC's Hunter Valley Coal Network – Weighted Average Cost of capital Review*, April, p. 8.

	Lower Bound	Upper Bound
Risk-free rate	4.95%	4.95%
Debt to total value	50%	55%
Equity to total value	50%	45%
Debt margin	3.36%	3.36%
Debt raising costs	0.125%	0.125%
Market risk premium	6%	7%
Gamma	0	0
Tax rate	30%	30%
Asset beta	0.5	0.6
Debt beta	0	0
Equity beta	0.99	1.32
Cost of equity	10.88%	14.16%
Cost of Debt	8.44%	8.44%
WACC nominal post tax	9.66%	11.01%

ARTC's WACC is estimated using the CAPM. The nominal post-tax WACC is given by the following formula:

$$WACC = \frac{D}{V} R_d + \frac{E}{V} R_e$$

where: R_d is the cost of debt capital and D/V is the share of debt in the total value of the firm; R_e is cost of equity capital and E/V is the share of equity in the total value of the firm.

The rate of return is to be reviewed by ARTC five years from the commencement of the Undertaking and if necessary a revised rate of return will be submitted to the ACCC for approval.

ARTC will revise the rate of return on 1 January each year to take account changes in the risk free rate and the debt margin. The revised rate of return will be approved by the ACCC.

ARTC has proposed a WACC for the ERAB of 10.47 per cent and 10.67 per cent for the IRAB.¹¹

Issues for Comment

- *Are the parameters and assumptions used to derive the components of the WACC appropriate, having particular regard to the assumptions, methodology, variables, and comparative firms adopted by Synergies Economic Consulting?*
- *Is the proposed ERAB WACC of 10.47 per cent and the IRAB WACC of 10.67*

¹¹ ARTC (2009) *Explanatory Guide – Hunter Valley Access Undertaking 2009*, May, p. 110.

per cent appropriate, having particular regard to ARTC's commercial risks?

- *Should there be different WACCs applied to the ERAB and IRAB?*
- *Is the rate of return review period reasonable?*
- *Is the proposed annual revision to the WACCs appropriate?*
- *Are other proposed financing cost (i.e. equity raising costs and interest during construction) to be included in cash flows appropriate?*

Unders and Overs Accounting

Clause 4.8 explains that the unders and overs accounting is the outcome of the reconciliation of access revenue with applicable ceiling limits undertaken by ARTC as part of the annual ACCC compliance assessment.

'Overs' is the amount of over recovery of revenue compared to full economic costs for the constrained group of mines. 'Unders' is the amount of under recovery of revenue compared to full economic costs for the constrained group of mines.

In order to account for potential discrepancy between estimated and actual volume throughput, ARTC will adopt an 'unders and overs' account. The overs and unders account calculation is based on a final reconciliation of the forecast revenue ceiling with actual end of year tonnages, revenues, and direct costs to be recovered.

Basically, for each constrained coal customer, ARTC will:

- establish an account;
- determine an annual allocation of total unders and overs amount in accordance with a specified methodology;
- add or subtract the annual allocation for the calendar year from the opening balance in each account; and
- reconcile the accounts and advise the customer of the details.

The amounts will be submitted to the ACCC and may need to be adjusted in accordance with a determination of the ACCC as part of its annual compliance assessment.

Issues for Comment

- *Is the methodology for the allocation of unders and overs appropriate?*
- *Is the methodology for reconciling each coal customer's account appropriate?*

Annual ACCC Compliance Assessment

The unders and overs accounting refers to an annual ACCC compliance assessment. Clause 4.9 provides that ARTC will submit by 30 April each year in respect of the previous calendar year, documentation detailing roll-forward of the RAB and RAB floor limit; and where the documentation demonstrates that RAB is at or below the floor limit, documentation detailing calculations relevant to reconciliation of access revenue with the applicable ceiling limit and any calculation of allocation of the total unders and overs amount.

The ACCC will, *inter alia*, determine whether ARTC has undertaken roll-forward of the RAB in accordance with the Undertaking and where it is not, determine what closing RAB or RAB Floor Limit is in accordance with the Undertaking. In determining whether ARTC has complied with the roll forward of IRAB, ERAB, RAB or RAB floor limit, the ACCC may have regard to submissions of relevant industry parties in relation to any capital expenditure not endorsed by the Rail Capacity Group.

The ACCC is to publish its findings on its website and ARTC will revise the closing RAB and manage customer accounts in accordance with any ACCC determination.

The ACCC may have regard to submissions of relevant stakeholders in making its findings on ARTC's annual compliance.

Issues for Comment

- *Are the annual RAB roll-forward compliance measures appropriate (i.e. extent of the information, processes, relevance, consultation and timeliness)?*

Structure of charges

Clauses 4.10 and 4.11 describe how access charges are distinguished between coal and non-coal services and how they are comprised.

Coal Access Rights

For coal train services, access charges may be on the basis of a combination of:

- actual usage, which is a function of distance and gross mass (i.e. \$/gtkm) for a pricing zone; and
- a take or pay component for the contracted access rights regardless of whether the access holder uses all or any of the rights.

Non-Coal Access Rights

For non-coal train services, access charges will comprise:

- a variable component which is a function of distance and gross mass (\$/gtkm).

- a flag-fall charge which is fixed and specific to each train service type and segment (\$/km); and
- an excess network occupancy component which is a function of time on a (\$/hour or part thereof) sought by the applicant for a train path on the network which is in excess of:
 - a reasonable allowance for section run times as determined by ARTC;
 - dwells for crossing and passing other trains as determined by ARTC; and
 - an allowance for reasonable requirements for operational activities while the train occupies the network.*

for a pricing zone.

It is proposed that the flag-fall and excess component are levied from the date ARTC grants access to the train path to the access holder until the expiry of the train path irrespective of usage.

The Undertaking provides that all elements of the charges are open to negotiation.

****Note:** The Undertaking does not include figures for the allowance for reasonable requirements for operational activities of non-coal traffic in each pricing zone. This information is to be provided by ARTC and the ACCC will seek submissions on these.*

Issues for Comment

- *Does the Undertaking provide sufficient information about the structure of access charges for access seekers to meaningfully negotiate access holder agreements with ARTC?*
- *Is the proposed composition and method of application of the access charges to be applied clear and reasonable?*
- *Is the distinction in price structure between coal and non-coal traffic appropriate?*
- *Is the adoption of 'take or pay' price structures for coal traffic reasonable?*
- *Should the fixed components of the non-coal charges be payable irrespective of whether a train path is utilised?*
- *Are the proposed prices for each pricing zone reasonable in regard to non-coal traffic?*
- *Is the application of an excess network occupancy charge reasonable?*

- *Are the provisions relating to charges specified at Schedule 3 of the access holder agreement appropriate, particularly in terms of methodology and structure of charges?*
- *Are the provisions relating to charges specified at Schedule 3 of the access holder agreement sufficient to balance the legitimate interests of ARTC, operators, producers, and the public?*

Pricing Objectives

Clause 4.12 deals with the pricing objectives. In determining access charges, ARTC will have regard to separate cost elements as follows:

- variable component of costs being direct costs;
- fixed component of costs being fixed operating costs and depreciation of, and return on existing assets at the commencement of the Undertaking; and
- new capital component of costs being depreciation of, and return on new assets commissioned during the Undertaking.

In determining access charges, ARTC will have regard to objectives as follows:

- achieving full cost recovery of direct costs from all customers for actual usage;
- achieving maximum recovery of fixed component costs and new capital component costs from all users;
- provide certainty to ARTC through the application of take or pay component to fully recover new capital contributions over the economic life of new investments and recover some or all of fixed component costs from coal users on the basis of forecast network usage or otherwise on actual usage;
- the recovery of fixed component costs through a take or pay component that is consistently applied to all coal train users within a pricing zone; and
- an open and equitable mechanism for the application of take or pay charges.

Issues for Comment

- *Are the pricing objectives reasonable (i.e. do they appropriately balance the interests of ARTC, access seekers, and the public)?*
- *Will the pricing objectives promote efficient use of, and investment in, the network?*
- *Will the pricing objectives promote throughput and efficiencies in the Hunter*

Indicative Access Charge

Clause 4.13 provides that ARTC will each year determine an indicative access charge for coal access. Coal access rights with certain characteristics (indicative services) will be established in consultation with Hunter Valley Coal Chain Coordinator having regard to delivery of optimal coal chain capacity given certain coal chain assumptions agreed with the coordinator. The coal chain assumptions will include:

- maximum axle load;
- maximum speed;
- train length; and
- section run times.

ARTC may prescribe more than one indicative service and indicative charge within a pricing zone. Indicative service assumptions and indicative access charges apply to all segments within a zone and both may vary between pricing zones. Once the charges for indicative services are finalised, ARTC will publish the indicative access charges on its website.**

The indicative access charges will be offered to applicants seeking coal access rights.

****Note:** *ARTC has not provided the ACCC with any indicative access charges in the Undertaking. The ACCC understands that these charges are to be finalised at a later date following commencement of the Undertaking.*

Issues for Comment

- *Does the Undertaking provide sufficient information about the indicative access charge for access seekers to meaningfully negotiate access holder agreements with ARTC?*
- *Is the distinction between take or pay and non take or pay charge appropriate?*
- *Is the potential adoption of multiple indicative access services and charges, either within a single pricing zone or across the entire network, appropriate?*

Charge Differentiation and Limits on Charge Differentiation

Clause 4.14 provides that ARTC may differentiate access charges, having regard to a number of factors which impact on its business and coal chain capacity including:

- the particular characteristics of the relevant service intended to utilise the access rights sought (such as axle load, speed, wheel diameter and train length);
- the indicative charges and services applicable to coal access rights;
- the commercial impact on ARTC's business including:
 - term of access agreement;
 - potential growth of business;
 - credit risk of the business;
 - opportunity costs to ARTC;
 - market value of train path sought;
 - consumption of ARTC resources;
- logistical impacts on ARTC's business;
- for coal access rights, the consumption of coal chain capacity;
- capital or other contributions by the Applicant to ARTC's costs; and
- the cost of any additional capacity.

ARTC will have regard to the optimal usage of the network for indicative services with the objective of maximising coal chain capacity.

If an access holder disagrees with a charge other than an indicative charge, then the access holder may refer the matter to arbitration.

Clause 4.15 provides that ARTC will not have regard to the identity of an applicant or whether the applicant is a government authority in the determination of access charges. Subject to some conditions, ARTC will also not differentiate between applicants where the characteristics of the access rights sought are alike and the applicants are operating within the same end market.

ARTC will determine whether the characteristics are alike having regard to such matters as axle load, speed, wheel diameter and train length.

Issues for Comment

- *Are the bases for charge differentiation appropriate?*

- *Are the limitations on charge differentiation sufficient and appropriate? If not, what conditions or limitations should be added or modified?*

Interim Indicative Access Charges

ARTC recognises that at the commencement date it may be unable to determine the indicative services and indicative access charges associated with coal right due to institutional arrangements, available modelling, and timing constraints. As an interim measure, ARTC proposes to determine interim indicative access charges that will apply from the commencement of the Undertaking until ARTC is able to determine indicative services and charges.

In determining interim indicative access charges, ARTC will have regard to:

- the institutional arrangements in place for the management of coal chain capacity;
- the availability of appropriate modelling tools for determining coal chain capacity and its optimum utilisation; and
- the availability, cost and quality of information required for ARTC to determine such interim charges.

Interim indicative access charges will be determined each calendar year during the interim period. The Undertaking proposed interim indicative access charges to apply from 1 July 2009.***

***** Note:** ARTC had not included the interim indicative access charges in the Undertaking. This information is to be provided by ARTC and the ACCC will seek submissions on these.

Issues for Comment

- *Is the use of an interim indicative access charge appropriate?*
- *Is the basis or constraints on formulating an indicative access charge appropriate and likely to promote efficient use of, and investment in, the network and broader coal supply chain?*
- *Is the implementation timing of the charge and annual renewal of the charge appropriate?*
- *Is the distinction between take or pay and non take or pay charge appropriate?*

Process for Finalising Indicative Access Charges

Clause 4.17 describes how ARTC will finalise the indicative access charges. Before the start of each calendar year, ARTC will seek forecast coal volumes and likely distribution of volumes across its operators from each access rights holder and will use this information to forecast actual gross tonnes for coal trains for the next calendar year for each pricing zone.

ARTC will determine annual forecasts of network costs in each pricing zone to be recovered by ARTC in the next calendar year.

The indicative access charge will be determined on these forecasts.

ARTC will notify these forecasts and indicative access charges to access holders at least 20 business days before the charges are due to take effect. If more than two thirds of access holders (based on contracted gross tonne kilometres) dispute the indicative access charges, then the dispute will be resolved by arbitration. If less than two thirds of access holders dispute the indicative access charges, then the charges are final.

ARTC will publish the final indicative access charges on its website.

Issues for Comment

- *Is the process, timing, and methodology for determining final indicative access charges appropriate?*
- *Is the mechanism as to indicative access charges disputes appropriate?*

Clause 5 - Capacity Management

Capacity Analysis

Clause 5.1 provides that ARTC will undertake a capacity analysis as part of preparing the indicative access proposal. This will identify whether there is sufficient available capacity to meet the applicant's requirements and, if not, to what extent additional capacity is needed.

Where ARTC believes that there are major impediments to providing additional capacity, and this would have significant bearing on the economics of the operation, ARTC may have to prepare a more detailed capacity analysis which may take a longer time to prepare and for which ARTC may charge the applicant a fee based on reasonable cost and agreed with the applicant.

The capacity analysis will enable the finalisation of the applicant's capacity entitlement, train paths, charges and terms of access agreement. In preparing the analysis, ARTC will consult with and take into account the comments of Hunter Valley Coal Chain Coordinator on the availability of coal chain capacity.

Issues for Comment

- *Is the capacity analysis appropriate?*
- *Is the basis and process for conducting a more detailed analysis appropriate?*
- *Is consultation with the Hunter Valley Coal Chain Coordinator appropriate and likely to promote efficient utilisation of the network?*

Capacity Reservation

Where an applicant seeks to execute an access agreement more than 6 months prior to utilising those access rights (e.g. extent of potential revenue lost), and there is sufficient available capacity to accommodate those rights, such that ARTC are reserving the capacity, ARTC, at its discretion, will execute the agreement (or amendment thereto) subject to the applicant agreeing to pay a reservation fee for the period between the execution of the agreement and the utilisation of the access rights.

In determining the fee, ARTC will have regard to the opportunity cost foregone in relation to the reserved access rights. The fee will be no greater than 75 per cent of the indicative access charge for the applicable pricing zone. The fee will be reduced to the extent of any utilisation of the access rights during the period of reservation.

Issues for Comment

- *Is the basis for the capacity reservation fee appropriate?*
- *Is the possible imposition of the fee appropriate?*
- *Is methodology and amount of the capacity reservation fee appropriate?*

Shortfall in Existing Capacity

Clause 5.3 sets out a system to enable ARTC to manage shortfalls in existing capacity entitlements. ARTC will manage shortfalls in existing capacity according to the duration of such shortfalls. Where ARTC expects the shortfall to be seven days or less, ARTC will allocate capacity first to passenger services pursuant to statutory obligation. It will then, at ARTC's discretion, allocate remaining capacity to access holders taking into account ARTC's contractual obligations under access agreements and any impact on the efficient utilisation of the coal chain capacity.

Where the shortfall is expected to be greater than seven days, capacity will be allocated first to passenger services and then to access holders on an equitable prorata basis according to each access holder's unused capacity entitlement.

Shortfall in creation of additional capacity

Where there is a delay in the completion of a project creating additional capacity and only some becomes available, then capacity is allocated among the access holders on an equitable prorata basis.

Issues for Comment

- *Does the treatment of capacity shortfalls by ARTC appropriately balance the interests of ARTC, operators, and access holders?*
- *Is the management of capacity shortfalls of seven days or less appropriate (i.e. is the intention of the provision and the shortfall management methodology appropriate)?*
- *Is the management of capacity shortfalls of more than seven days appropriate (i.e. is the intention of the provision and the shortfall management methodology appropriate)?*
- *Is the management of additional capacity shortfalls appropriate?*
- *Are the provisions concerning 'system monthly true-up' specified at Schedule 2 of the access holder agreement appropriate, particularly in light of the operational requirements of producers, operators, and the coal chain as a whole?*
- *Is the methodology and timeliness of the 'system monthly true-up' specified at Schedule 2 of the access holder agreement appropriate and likely to balance the legitimate interests of ARTC, producers, operators, and the public?*

Capacity Resumption, Relinquishment and Transfer

The access agreement will provide that ARTC may reduce capacity entitlement of an access holder where the holder has under-utilised its entitlement. A decision of this nature is subject to the dispute resolution procedure in the agreement.

An access holder may reduce its entitlement in accordance with the access agreement.

A capacity entitlement may be assigned or traded by an access holder to a third party with ARTC approval in accordance with the access agreement.

Issues for Comment

- *Are the capacity resumption, relinquishment, and transfer provisions appropriate?*
- *Are the capacity entitlement provisions reasonable, particularly in regard to*

reduction of entitlement through under utilisation?

- *Are the capacity transfer provisions appropriate, particularly in regard to the daily and long term operational requirements of producers, operators and the coal chain as a whole?*
- *Are the monthly tolerance thresholds specified in the access holder agreement appropriate, particularly in regard to the determination of the tolerance and the extent of tolerance provided to access holders?*
- *Are the provisions governing permanent train path variations specified in the access holder agreement appropriate, particularly in light of the operational requirements of producers, operators, and the coal chain as a whole?*
- *Are the provisions governing temporary train path usages specified in the access holder agreement appropriate, particularly in regard to the notification requirements, limitations on load point transfers, and the operational requirements of producers, operators, and the coal chain as a whole?*

Clause 6 - Network Connections and Additions

Clause 6 deals with situations where other owners of track wish to connect to the network and where additional network capacity is required.

Network Connections

The owners of tracks not part of the network can connect to ARTC's network with the ARTC's consent provided:

- all relevant government authority approvals are obtained;
- the configuration of the connecting track will not reduce coal chain capacity (ARTC will consult with Hunter Valley Coal Chain Coordinator and take their comments into account in this regard);
- interface arrangements are in accordance with ARTC requirements;
- users of the connecting track agree to comply with ARTC network controller directions;
- the connection meets ARTC engineering and operational standards; and
- the owner of the connecting track meets the costs of constructing and maintaining the connection.

If requested, ARTC will give written reasons to the applicant if consent is refused including reasons as to why in its view or that of Hunter Valley Coal Chain Coordinator, coal chain capacity will be reduced.

Issues for Comment

- *Are the network connection provisions appropriate?*
- *Do the network connection provisions appropriately balance the interests of current and future producers and operators against the interests of ARTC?*
- *Are the network connection provisions likely to promote new investment in coal mining infrastructure?*

Additional Capacity Sought by Applicants

ARTC will consider as part of the negotiation process, requests for the provision of additional capacity and will consent to the additional capacity if:

- such provision is commercially viable to ARTC;
- the applicant agrees to meet the cost of the additional capacity;
- the additional capacity of the network is, *inter alia*:
 - technically and economically feasible;
 - consistent with safe and reliable operation of the network; and
 - does not reduce capacity or coal chain capacity (ARTC will consult with Hunter Valley Coal Chain Coordinator).

The cost of providing the additional capacity may be met by a range of means (e.g.: reimbursing ARTC's costs).

Any additional capacity created will be owned and managed by ARTC.

If the additional capacity is used by another access holder, ongoing maintenance and capital costs will be shared on the basis of the relative beneficial use of the additional capacity where total access revenue exceeds the ceiling limit for the relevant pricing zone.

Additional capacity may be governed by a separate agreement outside of the indicative access agreement forming part of the Undertaking.

Issues for Comment

- *Are the conditions for the provision of additional capacity reasonable?*
- *Are the means of paying for the additional capacity appropriate?*
- *Is the ownership and management of the additional capacity an issue?*
- *Is the basis on the charging for shared use of the additional capacity reasonable?*

Additional Capacity Endorsed by the Hunter Valley Coal Chain Coordinator

ARTC will cooperate with the Hunter Valley Coal Chain Coordinator in planning expansions of capacity and coal chain capacity. Where the Hunter Valley Coal Chain Coordinator recommends an investment to provide additional capacity, ARTC will consent if:

- such provision is commercially viable to ARTC
- the additional capacity is, *inter alia*:
 - technically and economically feasible;
 - consistent with safe and reliable operation of the network; and
 - does not reduce capacity or coal chain capacity.

Issues for Comment

- *Is this an appropriate process for the provision of additional capacity?*

Industry Consultation

In relation to additional capacity sought by an applicant, or identified by ARTC, ARTC will undertake a consultation process as set out in the Undertaking. The objectives of the consultation process are to inform Hunter Valley coal chain participants of additional capacity requirements and investment strategies, to provide a means for industry input, and to provide a process for industry to endorse capital incurred by ARTC in providing additional capacity as prudent.

The depth of analysis will depend on the cost, benefits and risks of the project. Where ARTC considers that the consultation process will unjustifiably compromise the timely delivery of a project, ARTC will propose a modified consultation process and advise the Rail Capacity Group accordingly. Otherwise, ARTC will reasonably endeavour to

undertake the stages of consultation set out in the Undertaking having regard to the objective of delivering capacity in line with forecast demand.

Any endorsed costs incurred in comply with the consultation provisions will be included in the RAB.

ARTC will convene and conduct a monthly meeting with Rail Capacity Group to obtain endorsement of additional capacity.

Access holders and some operators (who are not access holders) will be represented on the Rail Capacity Group, with voting entitlements granted in accordance with contracted goal gross tonne kilometres. The membership (as selected by industry) may change and members may or may not be participants in the Hunter Valley Coal Chain Coordinator.

The Rail Capacity Group will be involved at each stage of project development and will have the opportunity, but not the requirement, to endorse each stage. ARTC may elect to move to the next stage of development without the Rail Capacity Group endorsement.

Investment consultation includes the following cascading steps:

Development of Hunter Valley Corridor Strategy

- ARTC will develop a *Hunter Valley Corridor Capacity Strategy* annually and in doing so will base the strategy on the rolling annual capacity forecasts developed by Rail Capacity Group. These forecasts will in turn be based on demand forecasts for existing and prospective coal producers and will be aligned with Newcastle port terminal capacity forecasts and will identify maximum future capacity requirement. The strategy will include capacity expansion options which:
 - seek to meet producers' combined demand forecasts;
 - take into consideration preferred outcomes of the Coal Chain Master Plan existing capability and future investment commitments;
 - include a preliminary high level assessment of objectives and indicative cost estimate; and
 - recommendation of preferred options.
- ARTC may seek formal endorsement from Rail Capacity Group of identified preferred options in the *Hunter Valley Corridor Capacity Strategy* to proceed to concept assessment;

Concept Assessment

- ARTC will prepare a concept assessment report for each option and each project creating additional capacity accepted by ARTC and will provide such report to the Rail Capacity Group. The objective of the report is make a preliminary

assessment of the potential costs, benefits, and risks of the investment option. ARTC may seek Rail Capacity Group endorsement to proceed to project feasibility. Endorsement to proceed to project feasibility would mean endorsement of ARTC's actual cost incurred in undertaking concept assessment and estimated cost of project feasibility to be included in the RAB or expensed in the year incurred.

Project feasibility

- For each option endorsed at the concept assessment stage, ARTC will provide a project feasibility report to the Rail Capacity Group. The report may include:
 - confirmation of objectives and a preliminary functional specification;
 - scope, potential benefits and risk assessment;
 - estimated cost (+/- 20 per cent); and
 - project management plan.

ARTC may seek Rail Capacity Group endorsement to proceed to project assessment. Endorsement of the project feasibility report by the Rail Capacity Group would mean endorsement of ARTC actual costs incurred in undertaking project feasibility and estimated costs to undertake project assessment to be included in the RAB or expensed in the year incurred.

Project Assessment

- for each option endorsed at the project feasibility stage, ARTC will provide a the project assessment report for endorsement by Rail Capacity Group which will include:
 - objectives report, including functional specifications;
 - scope of work including assessment of technical and operating requirements, concept design, independent design verification;
 - project budget (+/- 10 per cent);
 - financial evaluation, included estimated impact on access pricing; and
 - project management plan and project risk assessment.

ARTC may seek formal endorsement from the Rail Capacity Group. to proceed to project implementation. Endorsement to proceed to project implementation would include endorsement of ARTC's actual costs of the project assessment and estimated costs of complying with project implementation to be included in the RAB or expensed in the year incurred.

Project Implementation

- ARTC may, at its own discretion, commence project procurement in parallel with project assessment, prior to endorsement to proceed to project implementation;
- for projects endorsed through the project assessment stage, ARTC will undertake a tender process, internal evaluation, and confirmation of project scope and cost;
- where the cost is outside the range endorsed, ARTC will seek the endorsement of a variation to that cost;
- where Rail Capacity Group endorses less than the confirmed cost, ARTC may refer the matter to an agreed independent expert for determination as to whether the variation is prudent; and
- ARTC will proceed with project implementation upon the expert deciding on prudent cost.

Project Initiation

- ARTC will finalise the project management plan including a contract management plan and operational readiness plan

Project Delivery

- ARTC will implement the project management plan and provide progress reports to Rail Capacity Group. A progress report may include status of work commenced, resource availability, identification of risks, deviations to planned cost and timing tolerance margins; and
- where a variation to an endorsed project budget arises, ARTC may cease construction to submit a revised costing to the Railway Capacity Group for endorsement as to prudence. Where Rail Capacity Group endorses less than the full variation, ARTC may refer the matter to an independent expert to determine prudence. Upon the expert deciding on the extent of the variation to be prudent, ARTC will proceed to project implementation.

Independent Expert Review

- where ARTC refers a matter to an agreed independent expert, the expert will, *inter alia*,
 - act as an expert and not an arbitrator, proceed as quickly as possible to a decision and have regard to the principles, methodologies and provisions of the Undertaking.

Commissioning

- ARTC will commission the project into operation upon completion of project delivery. ARTC may propose a staged delivery where the project is large or extended.

Project Close-Out

- upon the completion of project implementation, ARTC will provide a 'close-out' report for the Rail Capacity Group which may include formal acceptance of works, cost report and verification of benefits delivered;
- any capital expenditure incurred by ARTC in providing additional capacity that is within the cost range, or endorsed by the Rail Capacity Group, or determined by the expert at the project implementation stage, will be taken as prudent;
- where additional capacity is provided in relation to a particular pricing zone, endorsement of coal producers that hold over 50 per cent of contracted coal gtkm in that pricing zone, will be endorsement by the Rail Capacity Group; and
- where additional capacity is provided in a particular pricing zone (whether by way of single or series of projects), and that additional capacity results in an increase in the indicative access charge for that zone by more than 10 per cent, the endorsement of coal producers that hold over 70 per cent of contracted coal gtkm in that zone, will be endorsement of the Rail Capacity Group.

Issues for Comment

- *Are the consultation provisions concerning the provision of additional capacity sufficient and appropriate?*
- *Is the definition and treatment of 'prudent' capital expenditure in the Undertaking appropriate?*
- *Is the 'Rail Capacity Group' appropriate in terms of membership, its role in terms of endorsement of projects, procedural functions, and voting entitlements?*
- *Is the development of a 'Hunter Valley Corridor Capacity Strategy' appropriate and sound?*
- *Are the actual or potential processes used by the 'Rail Capacity Group' to endorse capital expenditure as prudent and appropriate?*
- *Are the provisions regarding industry endorsement of capital expenditure, particularly in regard to the prudence of such investment, appropriate?*
- *Is the role of the independent expert appropriate?*

- *Are the additional capacity provisions likely to promote investment in the network that will meet demand requirements for producers, whether in terms of the rail network or the coal supply chain as a whole?*
- *Are the cost estimate ranges proposed in the project feasibility and project assessment stages appropriate?*
- *Are the provisions concerning industry endorsement of capital expenditure appropriate with respect to the inclusion of such capital expenditure into the investment regulatory asset base ('IRAB')?*
- *Is the means by which additional capacity in a particular pricing zone and the way projects are deemed endorsed by Rail Capacity Group reasonable?*

Clause 7 - Network Transit Management

Clause 7 provides for the short and medium term capacity management planning of the network.

ARTC will undertake medium term capacity planning and will develop a Master Train Plan having regard to:

- capacity entitlements under existing and other access agreements; and
- the *Hunter Valley Corridor Capacity Strategy*.

The Master Train Plan will be provided to Hunter Valley Coal Chain Coordinator to assist it with the day-to-day scheduling of trains.

In terms of short term capacity management, ARTC will undertake short term capacity planning including the development of the Daily Train Plan having regard to:

- the Master Train Plan;
- any relevant input from Hunter Valley Coal Chain Coordinator; and
- the Network Management Principles (Schedule C)

ARTC will manage transit on the network in accordance with the Network Management Principles.

Issues for Comment

- *Is this a sufficient and reasonable approach to the planning of network transit*

management? Should other network management planning be included?

- *Are the Network Management Principles at Schedule C appropriate and likely to promote efficient utilisation of the network?*

Clause 8 - Performance Indicators

ARTC will develop and report on its website performance indicators for the network including indicators developed by ARTC customers and operators through the Hunter Valley Coal Chain Coordinator that are specific to the operation of coal trains and focus on the management of the Hunter Valley coal chain.

It is noted that the indicative access holder agreement (Annexure A) at clause 3.12 refers to key performance indicators.

Issues for Comment

- *Is this a sufficient commitment in relation to performance indicators?*
- *Are the performance indicators outlined in the access holder agreement appropriate and likely to promote efficient use of, and investment in, the network?*

Clause 9 - Definitions

Clause 9 is the definitions section which provides specific meaning to terms used throughout the Undertaking. There are a number of critical terms used in the Undertaking including, *inter alia*:

- ‘Constrained Network’
- ‘Indicative Access Charges’
- ‘Network Exit Capability’
- ‘Pricing Zones’
- ‘Prudent’
- ‘Train Path’

Issues for Comment

- *Are the ascribed meanings of the terms in clause 9 reasonable and provide sufficient clarity and certainty to the operation of the Undertaking?*

Schedules

A number of schedules form part of the Undertaking. These are:

Schedule A – Essential Elements of an Access Agreement

Schedule A is a detailed listing of the matters that are to be reflected in the coal and non coal access holder agreements to be offered by ARTC. These include such things as:

- provisions for the grant of coal train paths for the transport of coal;
- provisions for ARTC to allocate existing and additional network capacity;
- access holders paying an access charge based on actual usage and on a take or pay basis (coal);
- ARTC having the ability to vary, remove or review contracted capacity entitlements;
- ARTC to maintain network control and maintain and operate the network in a non-discriminatory manner; and
- operators using the network in a manner that minimises obstruction of the network.

Issues for Comment

- *Are the essential elements to be included in access agreements appropriate? What should be included, changed or removed from the Schedule?*

Schedule B – Network

Schedule B is a description and map depiction of the Hunter Valley rail network as defined and referred to in clause 9 which provides:

‘Network’ means the network of railway lines delineated or defined in Schedule B, excluding the annexure to Schedule B.

Issues for Comment

- *Is this an appropriate meaning and depiction of network? Should it include or exclude any other part of the rail system, and if so why?*
- *Is the definition of the network sufficient to promote access and efficient utilisation of the network by both current and potential users?*

Schedule C – Network Management Principles

Clause 7 provides that ARTC will manage transit on the network in accordance with the Network Management Principles. Schedule C is the proposed network Management Principles.

Issues for Comment

- *Are the principles appropriate and do they represent a reasonable approach to managing network traffic? If not, what principles should apply?*
- *Are the network management principles appropriate for promoting the efficient utilisation of the network and of the Hunter Valley coal chain?*

Schedule D – Performance Indicators (see clause 8)

Schedule D relates to clause 8 and contains no specific information other than that the performance indicators are to be determined in accordance with section 8.

Schedule E – Segments

Schedule E is a table of rail network segments as defined and referred to in clause 9.

‘Segment’ means a component of the Network as defined in Schedule E and is the smallest component for which the Ceiling Limit and Floor Limit applies.

Each Segment(s) is given a pricing zone. The pricing zone is relevant to the structure of access charges (clause 4.10) and calculating the depreciation allowance of a segment (clause 4.6). Please also refer to the ‘Segment’ associated definitions in clause 9.

Issues for Comment

- *Please provide any comments on segments and pricing zones as illustrated in Schedule E.*

Schedule F – Parent Guarantee

Schedule F is referred to in clause 3.4(e)(iii) and provides a *pro forma* for parent guarantee and indemnity.

Issues for Comment

- *Are the proposed terms of the parent guarantee and indemnity appropriate? If not, why not and why changes are necessary?*

Annexure A – Indicative Access Holder Agreement

- Access Holder Agreement for Indicative Services in the Hunter Valley
- Operator Sub-Agreement for Indicative Services in the Hunter Valley

The access holder agreement for indicative services in the Hunter Valley (indicative access holder agreement) is referred to in clause 3.14 of the Undertaking and arises in the context of the formal grant of access through an access agreement. An offer of access in relation to coal access rights will be in the form of an indicative access holder agreement which ARTC will offer to an access seeker if, *inter alia*, the access seeker meets certain specified requirements and the network has sufficient available capacity to meet the access seeker's needs.

The indicative access holder agreement is an access agreement between ARTC and the access holder. It sets out the terms and conditions upon which ARTC agrees to grant the access holder rights of access to the network for the purposes of coal transport.

The agreement contains a number of operational and legal concepts that will govern the contractual relationship between ARTC and the access rights holder. Possible points of discussion include:

- charges and payments (clause 5), which includes provision for a take or pay rebate based on a 'true-up' test. The 'true-up test' is the means by which ARTC assesses whether it made available the train path usages it contracted to provide in a month and is the mechanism for determining an access holder's entitlement to a rebate of take or pay charges paid (please also refer to discussion of Clause 5 – Capacity Management above);
- assignment, trading and novation (clause 16), which makes provision for the permanent or temporary assignment of path usages for a train path and the conditions under which this may occur (please also refer to discussion of Clause 5 – Capacity Management); and
- monthly tolerance (clause 3.3), which provides a mechanism for flexibility in contracting for path usages each month.

The access holder may only access the network through a nominated operator (see clause 1.3 in relation to contract structure). The operator must have an operator sub-agreement with ARTC which must be endorsed by the access holder (see recital D to the indicative access holder agreement). One aspect of the operator sub-agreement is:

- Indemnities and liabilities (clause 15), which excludes all third party claims from the contractual liability regime as was proposed, ‘in principle’, in ARTC’s application to the ACCC to vary the Interstate Undertaking in October 2008.

Issues for Comment

- *Are the proposed terms of the indicative access holder Agreement appropriate? If not, why not and what changes do you think are necessary?*
- *Are the proposed terms of the operator sub-agreement appropriate? If not, why not and what changes do you think are necessary?*
- *Are there any conceptual or operational problems or limitations that arise from the need for both an access holder agreement and an operator sub-agreement?*