# Consultation Paper

## Australian Rail Track Corporation's 2016 Hunter Valley Access Undertaking

8 January 2016

# Contents

# 1. Introduction

The Australian Rail Track Corporation Limited (**ARTC**) has submitted an access undertaking to the Australian Competition and Consumer Commission (**ACCC**) for assessment under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**the Act**). The undertaking is in relation to the provision of access to the Hunter Valley rail network operated by ARTC in New South Wales (**the 2016 HVAU**).

The ACCC previously accepted an access undertaking in accordance with Part IIIA of the Act on 29 June 2011 in relation to the Hunter Valley rail network (**the 2011 HVAU**). The 2011 HVAU expires on 1 July 2016.

The intention is that the 2016 HVAU will come into operation at the same time the 2011 HVAU expires so there is no regulatory 'gap' under Part IIIA. While the ACCC intends to meet its statutory timeframes, whether the 2016 HVAU is accepted prior to the expiry of the 2011 HVAU depends on the complexity of any unresolved issues that remain at the time of the 2016 HVAU's formal submission to the ACCC for assessment.

## 1.1. ARTC's 2016 HVAU

ARTC provided the 2016 HVAU to the ACCC on 23 December 2015. The ACCC published the 2016 HVAU on its website on 24 December 2015 and circulated a copy of all relevant documents to industry noting that a formal consultation paper inviting submissions on the proposal would follow in early 2016. The 2016 HVAU and associated documents, including the Indicative Access Holder Agreement and submissions from ARTC, are available on the ACCC's website at:

http://www.accc.gov.au/regulated-infrastructure/rail/hunter-valley-access-undertaking-2016/undertaking-application

Alternatively, go to the ACCC's homepage at www.accc.gov.au and follow the links to 'For regulated industries' and 'Rail' and 'Hunter Valley access undertaking 2016'.

## 1.2. Request for submissions

The ACCC, by publication of this Consultation Paper, is inviting submissions on the 2016 HVAU.

Section 2 of this paper outlines a range of matters to which the ACCC wishes to draw your attention. The structure of this paper generally follows the chapters of the 2016 HVAU.

The matters in section 2 do not represent a comprehensive summary of all aspects of the 2016 HVAU, nor do you need to comment on each of those matters. The ACCC has been advised by ARTC that it has engaged in its own consultation process throughout 2015 in its development of the 2016 HVAU. As such, stakeholders are welcome to provide submissions on any relevant aspect of the 2016 HVAU including on any issues you consider outstanding (if any).

In making your submission, please include detailed reasons to support your views. If you consider that an aspect of the 2016 HVAU is *not* appropriate, please provide suggestions of changes that could be made to address the relevant concerns, including to the level of drafting amendments where possible.

### 1.2.1. Invitation to make a submission

Submissions should be addressed to:

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

Email: transport@accc.gov.au

### 1.2.2. Due date for submissions

**Submissions to this Consultation Paper are due by 22 February 2016**. It is in your interest that the submission be lodged by this date, as section 44ZZBD of the Act allows the ACCC to disregard any submission made after this date.

### 1.2.3. Confidentiality

The ACCC strongly encourages public submissions. Unless a submission, or part of a submission, is marked confidential, it will be published on the ACCC's website and may be made available to any person or organisation upon request. If you are providing a confidential submission the ACCC asks that you provide a full copy of the document, and a public version with the information to be excluded from the ACCC website omitted.

Sections of submissions that are claimed to be confidential should be clearly identified. 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 submission in whole or in part.

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.

## 1.3. ACCC assessment

The test the ACCC applies in deciding whether to accept an access undertaking is set out in subsection 44ZZA(3) of the Act. Essentially, the ACCC may accept the undertaking if it thinks it appropriate to do so, having regard to various matters. The full test is set out in section 3 of this paper.

The ACCC has not yet formed a view on the appropriateness or otherwise of the 2016 HVAU, and statements in this Consultation Paper should not be taken as indicative of the ACCC's view of the appropriateness of the 2016 HVAU under the Act, nor the likelihood of its acceptance.

## 1.4. Indicative timeline for assessment

Under subsection 44ZZBC(1) of the Act, the ACCC must make a decision in relation to the application within the period of 180 days starting at the start of the day the application was received (referred to as 'the expected period').

The Act also provides for 'clock-stoppers', meaning that some days will not count towards the 180 days of the expected period in certain circumstances. In particular, the clock is stopped where the ACCC publishes a notice inviting public submissions in relation to an undertaking application, or where the ACCC gives a notice requesting information in relation to an application.[1]

The ACCC will consider submissions and if necessary engage in further consultation with stakeholders and ARTC in January and February 2016 in order to clarify and obtain further details on any issues raised.

| Date | |
|---|---|
| **23 December 2015** | Lodgement of 2016 HVAU |
| **8 January 2016** | Consultation process begins |
| **22 February 2016** | Closing date for submissions to Consultation Paper |
| **March/April 2016** | Draft decision |
| **April 2016** | Consultation on draft decision |
| **June 2016** | Final decision |

This timetable is indicative only and may be subject to change during the assessment process.

## 1.5. Further information

The 2016 HVAU and other relevant material, including supporting submissions from ARTC, are available on the ACCC's website at the following link:

http://www.accc.gov.au/regulated-infrastructure/rail/hunter-valley-access-undertaking-2016

Public submissions made during the current process will also be posted at this location.

The current 2011 HVAU is available on the ACCC's website at the following link.

http://registers.accc.gov.au/content/index.phtml/itemId/1179990

If you have any queries about any matters raised in this document, please contact:

Sarah Sheppard
Director
Infrastructure & Transport – Access & Pricing Branch
Phone: +61 3 9290 1992
Email: sarah.sheppard@accc.gov.au

[1] See section 3 of this paper for further information on these provisions of the Act.

# 2. Key issues

The ACCC has outlined in this section various matters upon which it seeks comments. The issues raised and questions posed in this paper are not, however, designed to limit stakeholder's submissions. As noted above, the ACCC has not formed any final views on any of the matters set out in this paper and stakeholders are welcome to make comments on any aspect of the 2016 HVAU.

## 2.1. Term

The term of the undertaking is set out in sections 2.2 and 2.3 of the 2016 HVAU.

ARTC has proposed a term of 10.5 years, with a reoccurring option to extend for an additional five years. The additional half year allows the HVAU to be aligned with calendar years, consistent with the operation of the undertaking and Access Agreements.

The 2016 HVAU also sets out a process for a periodic review of certain elements of the undertaking. ARTC is required to commence a periodic review process six years before the then expiry date. The following elements of the 2016 HVAU will be considered at the time of the periodic review:

- the calculation for Depreciation (which includes both the remaining mine life and the depreciation mechanism as defined in section 4.7 of the 2016 HVAU)
- the rate of return
- loss capitalisation for Pricing Zone 3
- whether to extend the 2016 HVAU for a further five year term.

ARTC will also have the discretion to undertake a review of other matters relevant at the time of the periodic review.

ARTC are to submit an application to vary the undertaking six months after commencement of its periodic review process to the ACCC for approval, and the outcomes of the periodic review are intended to be implemented for the final five years of the 2016 HVAU term. Consequently, ARTC proposes that any variation application and amended 2016 HVAU terms resulting from the periodic review will apply on and from 1 January five years prior to the expiry of the undertaking regardless of the ACCC decision date.

The 2016 HVAU provides a reoccurring option to extend the 2016 HVAU term for an additional five years, which will be considered at the time of the periodic review. The option for ARTC to extend the 2016 HVAU with the consent of the ACCC is required to be made at the same time ARTC submits changes to the 2016 HVAU arising out of the periodic review.

The 2016 HVAU also includes a clause which defines a process for ARTC to follow in respect of the continuation of the 2016 HVAU in the event of a transfer or grant of the lease for the Hunter Valley rail network to an entity other than ARTC.

Questions for stakeholders

1. Is the initial 10.5 year undertaking term an appropriate duration?
2. Is the alignment of the 2016 HVAU to calendar years appropriate?
3. Is a periodic review of elements of the undertaking six years prior to the termination of the HVAU appropriate? Are there concerns with the proposed process for ARTC's

completion of the periodic review? Is the process sufficiently robust to take into account and if required implement any stakeholder concerns?

4. Is the reoccurring option to extend the 2016 HVAU for an additional five year term appropriate?

## 2.2. Minor variation process

In the 2016 HVAU, ARTC has proposed a new section to allow variations to the undertaking without seeking ACCC approval. Subsection 2.4(b) of the 2016 HVAU contains a mechanism that will allow for ARTC to vary certain provisions of the undertaking with endorsement from the Rail Capacity Group (**RCG**). The minor variation process will apply to the following provisions of the 2016 HVAU:

- the costing manual
- section 2.16 (insurance)
- subsection 2.7(a) (contact details)
- subsection 4.15(c) (the assumptions and characteristics of the Services Envelope)
- section 13.1 and Schedule D (Network Performance Indicators)
- Schedule B and Schedule E (Network and Segments)

In order for a variation under section 2.4(b) of the 2016 HVAU to come into effect, the RCG must endorse the change with Access Holders controlling at least 70 per cent of the contracted Train Km plus any prospective coal Train Km included at ARTC's discretion under section 9.2(g) of the 2016 HVAU.

Questions for stakeholders

5. Is a mechanism which allows for RCG endorsement of minor variations of certain provisions of the 2016 HVAU appropriate?
6. Do stakeholders have any concerns about the scope of the matters that may be varied under this process without ACCC consent?
7. Do stakeholders have any concerns with the RCG endorsement threshold for minor variations?

## 2.3. Access Pricing Principles

Section 4 of the 2016 HVAU sets out ARTC's access pricing principles and financial model. Charges to Access Holders include prices negotiated in accordance with the principles in the undertaking.

### 2.3.1. Loss capitalisation

Section 4.9 of the 2016 HVAU outlines the unders and overs accounting framework that results from the annual reconciliation of access revenue received with applicable Ceiling Limits. ARTC has also proposed to retain the use of 'loss capitalisation' for Pricing Zone 3.

The 2011 HVAU incorporated 'loss capitalisation' to enable ARTC to recover revenue shortfalls it had sustained in Pricing Zone 3 during earlier periods at a later period in time from Pricing Zone 3 Access Holders. The ACCC considered that the application of loss capitalisation in this instance was appropriate to facilitate necessary investment in Pricing Zone 3 ahead of demand while ensuring that ARTC had a reasonable expectation of recovering its losses once demand reached an appropriate level.

During the development of the 2011 HVAU, ARTC had anticipated that capitalised losses would have been recouped by the end of 2016. However, noting the ACCC's ongoing review of ARTC's approach to revenue allocation under the 2011 HVAU, ARTC has submitted that there is uncertainty as to whether capitalised losses will be fully recovered by the end of the 2011 HVAU.

ARTC submits that Pricing Zone 3 Access Holders have indicated a strong preference for the retention of this mechanism. As a result, ARTC has proposed to retain loss capitalisation for Pricing Zone 3 to provide it with flexibility in relation to pricing and the rate of recovery of capitalised losses. ARTC states that it would review loss capitalisation as part of the mandatory review of the 2016 HVAU.

### 2.3.2. Regulatory Asset Base

Section 4.4 of the 2016 HVAU describes ARTC's Regulatory Asset Base (**RAB**). The major changes from the previous undertaking are the provisions in subsections 4.4(a)-(c) of the 2016 HVAU that provide the initial values for the RAB and RAB Floor Limit. Subsections 4.4(a)-(c) of the 2016 HVAU propose initial RAB and RAB Floor Limit values that roll over from the June 2016 closing values. Subsection 4.4(b)(ii) of the 2016 HVAU clarifies that any additional segments incorporated into the Hunter Valley Rail Network after 1 July 2016 would be valued using the Depreciated Optimised Replacement Cost (**DORC**) method.

### 2.3.3. Average remaining mine life

Section 4.7 of the 2011 HVAU stated that the calculation of depreciation must have regard to, among other factors, 'the average remaining mine life of coal mines utilising the Pricing Zone of which that Segment or group of Segments forms part'. ARTC proposed that all assets (including new assets) would be depreciated using a straight line methodology over 22 years from 1 July 2010. The ACCC considered this average remaining mine life to be appropriate for the purposes of the 2011 HVAU.

ARTC has not proposed to alter the average remaining mine life in the 2016 HVAU, with asset lives to remain as 22 years from 1 July 2010. As such, new assets would have an average expected life of 16 years from the commencement of the 2016 HVAU at 1 July 2016. However, ARTC does state in section 2.3 of the 2016 HVAU that depreciation would be subject to review as part of the mandatory review of the 2016 HVAU, which would take place at least six years prior to the expiry of the undertaking. Appendix B of ARTC's Explanatory Guide further describes ARTC's decision to retain the current estimate of average remaining mine life in the 2016 HVAU. In particular, ARTC developed a methodology to act as a proxy for an economic test on the reserves per mine and delivers a remaining mine life consistent with the original 2009 assessment and reflecting ARTC's position to retain the 16 year estimate from 1 July 2016.

### 2.3.4. Costing manual

Section 4.5 of the 2011 HVAU outlined the Economic Cost of a Segment, while section 4.6 described how Non-Segment Specific Costs would be allocated to Segments. ARTC stated that the allocation mechanisms (GTK and Train Km) for indirect costs were very broadly defined in the 2011 HVAU and poorly recognised the costs associated with the network.

To address this issue, ARTC has proposed to replace these allocators with a more detailed set of allocation mechanisms and included these in a 'Costing Manual' for the 2016 HVAU.

ARTC considers that the Costing Manual will provide stakeholders with greater visibility of ARTC's processes and how indirect costs are allocated. For the 2016 HVAU, ARTC has proposed to delete the provisions in sections 4.5 and 4.6 that relate to the allocation of Non-Segment Specific Costs and have replaced these with a reference to the Costing Manual.

ARTC states that the Costing Manual would also provide greater support for the method that is being applied to calculate allocated costs. In particular, ARTC suggests that apportioned and indirect costs are currently understated and that application of allocation mechanisms in the Costing Manual would result in cost allocations that more appropriately reflect the consumption of resources by each user. Appendix D of ARTC's Explanatory Guide provides further description of how Non-Segment Specific Costs are allocated under the 2016 HVAU. In particular, ARTC provides a comparison of Non-Segment Specific Costs between the proposed new method and the method under the 2011 HVAU. The application of the proposed new method would result in an additional $5.5 million being allocated to the Hunter Valley rail network in 2017 than would have been allocated under the 2011 HVAU. ARTC contends that this demonstrates the level of under-recovery that has occurred under the broader approach in the 2011 HVAU.

ARTC also suggests that the introduction of a Costing Manual would assist in addressing the ACCC's concerns raised through its revenue allocation review. In particular, the Costing Manual describes ARTC's methodology in calculating the Floor and Ceiling Limits under the 2016 HVAU. The Costing Manual also provides a description of how RAB and RAB Floor Limit values are 'rolled-forward' for the purposes of pricing and annual compliance.

ARTC proposes to be able to review and amend its Costing Manual in accordance with the process set out in section 2.4 of the 2016 HVAU, which provides for the RCG to be consulted and endorse any amendments with which it agrees. In this scenario, the ACCC is no longer able to approve or reject amendments to methodologies.

Questions for stakeholders

8. Is the retention of loss capitalisation for Pricing Zone 3 in the 2016 HVAU appropriate?
9. Are the changes to section 4.4 of the 2016 HVAU (Regulatory Asset Base) appropriate?
10. Is it appropriate to roll over the existing mine lives from the 2011 HVAU, meaning an average remaining mine life of 16 years from 1 July 2016?
11. Is ARTC's proposed Costing Manual an appropriate replacement for existing provisions under the 2011 HVAU?
12. Are the cost allocation provisions included in the Costing Manual an appropriate replacement for existing provisions on the allocation of Non-Segment Specific Costs?
13. Is it appropriate that the RCG be tasked with approving ARTC's changes to the Costing Manual rather than the ACCC?
14. Does ARTC's proposed Costing Manual address transparency concerns?
15. Are there any other comments on ARTC's proposed changes to the Access Pricing Principles?

## 2.4. Rate of return (WACC)

A firm's weighted average cost of capital (**WACC**) is the value weighted risk adjusted rate of return required by the debt and equity capital providers to the firm. It reflects the opportunity cost of capital; that is, the return investors would expect to earn by investing in the next best investment of equivalent risk. Section 4.8 of the 2016 HVAU outlines ARTC's rate of return over the term of the undertaking.

### *2011 HVAU rate of return*

For the 2011 HVAU, the ACCC considered it appropriate to accept a 9.10 per cent real pre-tax rate of return and an 11.83 per cent nominal pre-tax rate of return.

Prior to accepting this figure, the ACCC had assessed ARTC's proposed rate of return according to financial analysis that is common to regulatory decision making. The ACCC had considered that a real pre-tax WACC of 8.57 per cent was more likely to reflect a rate of return consistent with the then market conditions and commensurate with the commercial and regulatory risks borne by ARTC.

However, ARTC reached an agreement with the majority of access seekers to not oppose the WACC sought by ARTC, conditional on ARTC incorporating certain revisions into the 2011 HVAU. The ACCC also noted that the 'premium' proposed above the ACCC's view on WACC did not of itself appear unreasonable or excessive, as it reflected that ARTC had in turn agreed to assume additional obligations.

The ACCC also emphasised that as the 2011 HVAU included a specified rate of return, the ACCC had not been required to finalise its views on the individual WACC parameters.

### *2016 HVAU rate of return*

For the 2016 HVAU, ARTC has proposed a 6.74 per cent real pre-tax rate of return and an 8.50 per cent nominal pre-tax rate of return.

ARTC engaged Synergies Economic Consulting (**Synergies**) to provide a review of the applicable WACC. Synergies concluded that the most appropriate methodology to adopt in calculating WACC, and particularly the market sensitive parameters, is the NSW Independent Pricing and Regulatory Tribunal's methodology. Synergies presumed there to be no change in the systemic risk profile faced by ARTC and concluded that an appropriate rate of return would be 8.11 per cent real pre-tax.

Following consultation with industry, ARTC re-evaluated its rate of return calculation and has shifted some of its assumptions. The key changes were:

- ARTC accepted that its risk was no greater than the market as a whole
- ARTC valued all market based parameters at a rate consistent with current market outcomes, rather than long term historical averages
- ARTC included an inflation rate that reflects the September 2015 Sydney (All Groups) CPI, excluding the Sydney Housing component. This results in a lower inflation rate than the initial long term forecast from Synergies.

Following this approach, ARTC calculated a 6.83 per cent real pre-tax rate of return and an 8.43 per cent nominal pre-tax rate of return. ARTC stated that it 'has further discounted this calculation to 6.74% (pre-tax real) to demonstrate its commitment to a workable solution with Industry'. ARTC advised that by making a CPI adjustment to further discount the real pre-tax rate of return, it also led to an increase in the nominal pre-tax rate of return. As such, ARTC stated that the 8.50 per cent nominal pre-tax rate of return in the 2016 HVAU reflects the status of negotiations with industry.

> Questions for stakeholders
>
> 16. Are the key assumptions underpinning the WACC parameter values appropriate?
>
> 17. Is ARTC's proposed rate of return appropriate?

## 2.5. Access Pricing Structure

### 2.5.1. Path based pricing

ARTC has proposed using path based pricing in the 2016 HVAU, moving away from the concept of 'indicative services', the basis for access pricing used in the 2011 HVAU.

ARTC submits that path based pricing would make pricing largely independent of the characteristics of the train, provided that the train specification fits within the 'Services Envelope' characteristics outlined in subsection 4.15(c) of the 2016 HVAU. ARTC has stated that all coal train configurations currently contracted within the Hunter Valley Rail Network fall within the Services Envelope. Pricing Zones continue to be in place, and the Segments within each of the three Pricing Zones are specified in Schedule E of the 2016 HVAU.

As outlined in sections 4.12 and 4.15 of the 2016 HVAU, the take or pay (**TOP**) component of access prices is specified on a Train Km basis for each Pricing Zone, rather than GTK as used in the 2011 HVAU. In line with the 2011 HVAU, the non-TOP component of access prices will remain on a GTK basis. However, the 2016 HVAU proposes a single GTK price for each Pricing Zone (for trains within the Services Envelope), rather than differentiating on the characteristics of each train.

### 2.5.2. Pricing notification process

The 2016 HVAU incorporates several changes to the annual pricing process, relating to relinquishing capacity, notification of prices and forward price estimates. These are outlined below.

#### *Facilitating relinquishment of capacity*

Sections 4.18 and 4.20 of the 2016 HVAU enable ARTC to facilitate the assignment of contracted capacity from one Access Holder to another. Section 4.20 outlines that if an Access Holder is unable to assign or trade its relinquished capacity to a third party, that Access Holder remains liable to ARTC for the TOP charges on that capacity.

#### *Earlier notification of prices*

Subsection 4.18(d) of the 2016 HVAU commits ARTC to providing prices for the following calendar year by 30 September of each year. The current requirement in the 2011 HVAU (subsection 4.20(d)) is for ARTC to provide prices by 1 November of each year.

### *Forward price estimates*

Subsection 4.19(a)(iii)(B) of the 2016 HVAU commits ARTC to providing range estimates for two calendar years of Standard Access Charges by 30 September of each year. Subsection 4.19(b)(ii) notes that these forecasts are not binding on ARTC.

| Questions for stakeholders |
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| 18. Is the move to path based pricing in the 2016 HVAU appropriate? How will this change affect users? |
| 19. Are the train specifications in ARTC's 'Services Envelope' characteristics appropriate? |
| 20. Are ARTC's proposed changes to the annual pricing process appropriate? |

## 2.6. Capacity Management

The 2016 HVAU includes a number of mechanisms that are designed to facilitate coordination and cooperation between various parties in the Hunter Valley coal chain, to ensure that contracted volumes on the Hunter Valley rail network align with the overall supply chain capacity. These mechanisms include the contracting structure, system assumptions, consultation with the Hunter Valley Coal Chain Coordinator (HVCCC), network exit capability, consistent protocols for the management of capacity and the investment framework. ARTC submits that the capacity management provisions in the 2016 HVAU remain largely unchanged from the 2011 HVAU.

### 2.6.1. Consultation with the HVCCC

One of the key changes to capacity management provisions in the 2016 HVAU is the inclusion of the principles from the Hunter Valley Supply Chain Alignment Protocol at Schedule G. The Hunter Valley Supply Chain Alignment Protocol, developed by ARTC in 2013, sets out the process of engagement and consultation between ARTC and the HVCCC on capacity management. The objective of the protocol is to ensure that ARTC and the HVCCC establish, develop, implement and monitor suitable mechanisms that assist them to carry out their respective roles under the HVAU in an effective, timely and consistent manner that meets the requirements of the HVAU.

### 2.6.2. Capacity losses

The 2016 HVAU removes the provision relating to the assignment of capacity losses. ARTC submits that it has adopted a more positive approach to achieving efficiency through other mechanisms such as the inclusion of an innovation incentive and the operating cost incentive process. The incentives are discussed further at section 2.9.

| Questions for stakeholders |
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| 21. Are the additional obligations regarding consultation with the HVCCC appropriate? |
| 22. Is the removal of the capacity losses provision appropriate? |

## 2.7. Capacity Investment Framework and RCG

The Capacity Investment Framework comprises three main steps:

- Project initiation; new projects to provide additional capacity are identified and ARTC is required to prepare a Concept Assessment Report for endorsement by the RCG.
- Industry consultation; staged process for development and implementation of a project in consultation with industry (represented by the RCG).
- User funding option; if ARTC elects not to fund all or part of a Project (irrespective of endorsement from RCG or ACCC), users have the option to fund it themselves and ARTC will become obliged to undertake the project pursuant to the user funding agreement.

### 2.7.1. The RCG

ARTC submits that the key change to the capacity investment framework is an expanded role for the RCG to include a greater level of consultation and decision-making.

In the 2016 HVAU, ARTC proposes to extend membership of the RCG to all Access Holders with coal access rights. ARTC also proposes to adjust the weighting for voting from GTK to contracted Train Km in keeping with the move to path based pricing.

In addition to providing for consultation and endorsement of capital expenditure on the network, section 9.2 of the 2016 HVAU now also provides for the RCG to take a more active role in consultation with regard to ARTC's maintenance plans, forecast operating costs, and for reporting of actual costs and operational outcomes. The RCG will also be consulted in respect of any minor variation.

ARTC proposes to amend the requirement for regular monthly meetings. RCG meetings will be held monthly, unless ARTC reasonably considers that a meeting for that month is not required.

The 2016 HVAU also includes a process to agree on an operating cost incentive scheme with the RCG. This is discussed further at section 2.9.

Questions for stakeholders

23. Is the extension of RCG membership to all Access Holders with coal access rights appropriate?
24. Will the consultation on maintenance plans, forecast operating costs and reporting of actual costs and operational outcomes through the RCG provide sufficient transparency and understanding of ARTC's costs and performance? If not, are there any actions ARTC could take, or further information that could be provided by ARTC, that may provide sufficient transparency and understanding?
25. What would be the effect of adjusting weighting for voting at the RCG from GTK to contracted Train Km?

## 2.8. User Funding Option

Section 10 of the 2016 HVAU provides a 'user-funding' option for investment. The objective is to provide a flexible mechanism whereby industry can fund projects where ARTC elects not to do so. If ARTC ceases or refuses development of a project, a user-funding agreement may be negotiated between ARTC and a 'Contributor'. The dispute resolution mechanism set out in section 3.15 of the 2016 HVAU provides a path through to ACCC arbitration.

For the 2016 HVAU, ARTC does not propose any substantive changes to the user funding provisions from the 2011 HVAU.

Questions for stakeholders

26. Are there any concerns with the 2016 HVAU user-funding provisions?

27. Do the user-funding provisions continue to meet their objectives? If not, please describe how this may be achieved and/or any amendments that may be required.

## 2.9. Performance Measurement and Incentives

### 2.9.1. Key performance indicators

Section 13.1 of the 2011 HVAU requires ARTC to report on its performance against Network Key Performance Indicators (**KPIs**). KPIs are set out in Schedule D of the 2011 HVAU.

In section 13 of the 2016 HVAU, ARTC proposes to allow KPIs (referred to as Network Key Result Areas in the 2016 HVAU) to be removed, changed or added to during the term of the undertaking in consultation with the RCG. This process proposes to use the minor variations process outlined in subsections 2.4(b) and (c) of the 2016 HVAU.

### 2.9.2. Performance incentives

Section 13.3 of the 2011 HVAU required ARTC to develop both True-Up Test (**TUT**) performance incentives and a non-TUT performance incentive scheme (the TUT provisions are explained further below). The objective of non-TUT performance incentive scheme is to encourage ARTC, through financial reward, to improve operating, maintenance and capital expenditure efficiency, and achieve desirable safety performance.

The ACCC considered that it was appropriate to accept the 2011 HVAU without an incentive scheme, provided that a suitable proposal would be developed in consultation with stakeholders and proposed for inclusion in the HVAU within an appropriate timeframe.

In August 2012, ARTC submitted a proposed variation to the ACCC for assessment which was subsequently withdrawn in December 2012 after a stakeholder consultation process. Stakeholders generally supported the principle of having a non-TUT performance incentive mechanism to drive improved efficiency and increase capacity, but did not consider that applying resources to the development of such mechanisms appropriate at that time.

Under section 9.3 of the 2016 HVAU, ARTC is required, within 18 months of the commencement of the undertaking, to prepare and publish a proposed incentive mechanism to reduce operating expenditure (**Efficiency Incentive Proposal**). Subsection 9.3(a) sets out elements of the Efficiency Incentive Proposal that must be included (unless otherwise agreed between ARTC and RCG). In particular, subsection 9.3(a)(iv) states that if an Opex Component Allowance is agreed with the RCG, ARTC will be able to recover up to 70 per cent of savings below this allowance from Access Holders. It is proposed that an Efficiency Incentive Proposal will be considered endorsed when Access Holders with 70 per cent of contracted Train Km endorse the proposal (subsection 9.3(e)). As part of the Efficiency Incentive Proposal, ARTC will engage an independent review of 'ARTC's cost efficient operation of the Network' (**Efficiency Study**), within six months of each review date.

Section 14 of the 2016 HVAU outlines a proposed Innovation Incentive Mechanism, designed to provide an incentive to ARTC to identify, promote and implement projects, change practices or technologies that are innovative and not in the ordinary course of ARTC's business. It is proposed that projects under this mechanism will require RCG endorsement. In particular, for a project that is expected to benefit all Access Holders, it is considered to be endorsed when Access Holders with 70 per cent of contracted Train Km vote in favour of the project (see subsection 14.6(c)). In addition, under section 14.5, ARTC may seek RCG endorsement to charge some or all Access Holders as the incentive for a project. These payments would be outside of the Ceiling Limit.

Questions for stakeholders

28. Are the proposed set of Network Key Result Areas appropriate?
29. Is it appropriate to remove, add or modify KPIs throughout the life of the undertaking?
30. Is the minor variation process the appropriate mechanism to make changes to the KPIs?
31. Is the proposed structure for developing the Efficiency Incentive Proposal appropriate?
32. Is the proposed frequency for Efficiency Studies in section 9.3(vii) appropriate?
33. Is the proposed structure for the Innovation Incentive Mechanism appropriate?
34. Is the proposed exclusion of incentive payments from the Ceiling Revenue Limit in section 4.3 appropriate? Are there alternative mechanisms that could achieve the outcomes sought by ARTC through this exclusion?

## 2.10. True Up Test / Liability Regime

ARTC has proposed to retain the existing system-wide TUT, as set out in Schedule 2 of the Indicative Access Holder Agreement (**IAHA**). The TUT determines whether there was sufficient capacity available on ARTC's rail network in a given period to meet all contracted entitlements, taking into account reductions in capacity caused by maintenance, usage by non-coal trains and other factors. If the TUT finds that ARTC has provided insufficient capacity in a period, then ARTC is required to provide a rebate of TOP charges to affected users.

ARTC has also proposed to retain the annual TUT audit. As outlined in section 4.11 of the 2016 HVAU, ARTC is required, through an independent auditor, to complete an annual TUT audit. Under subsection 4.11(k), the ACCC will review the Final Audit Report, and will determine and notify ARTC of any amounts of over- or under-payment.

Under the 2011 HVAU, the ACCC considered ARTC's TUT results during its annual compliance assessments for the 2011, 2012 and 2013 calendar years. On the basis of auditor reports provided for these years, the ACCC determined that ARTC has not been liable for any rebates in any of these calendar years.

In its final decision on the 2011 HVAU, the ACCC considered that the TUT was an innovative but complex and untested feature of the HVAU. On this basis, the ACCC also considered that the inclusion of a review mechanism was appropriate. This provision was included in section 13.4 of the 2011 HVAU, with ARTC completing the review in September 2014. ARTC proposes to not include this review provision in the 2016 HVAU.

As the 2011 HVAU is due to expire part way through the annual TUT audit period, the 2016 HVAU also contains provisions for the TUT audit during January – June 2016 (the

**Transitional Period**). In particular, section 15.2 of the 2016 HVAU contains provisions for the TUT audit for the Transitional Period and section 2.4 of Schedule 2 of the IAHA sets out the proposed process for calculating Access Holders' average Train Path TOP Charge for the 2011 HVAU and 2016 HVAU.

| Questions for stakeholders |
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| 35. Has the TUT process proven effective as a liability regime? Why / why not? |
| 36. Is the structure of the auditing mechanism appropriate? |
| 37. Is a TUT review mechanism required? |
| 38. Are the transitional arrangements, as they apply to the TUT, appropriate? |
| 39. Is the relationship between the TUT and the financial model transparent? |

## 2.11. Indicative Access Holder Agreement / Operator Sub-Agreement

The IAHA 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 Indicative Operator Sub Agreement (**OSA**) refers to an agreement between ARTC and an accredited operator. An Access Holder may only access the network through an accredited operator. The operator must have an operator sub-agreement with ARTC which must be endorsed by the Access Holder. This is proposed to be a condition precedent under the 2016 HVAU (IAHA clause 2.2).

ARTC submits that there are no substantive changes to the IAHA. ARTC submits that among other things there are some minor changes necessary to the IAHA for the transition to path based pricing, and the incorporation of payments associated with an Innovation Project as part of the performance incentives mechanism. Further, the IAHA is proposed to be amended to require Access Holders to nominate a port terminal exit point (NCIG or PWCS) for their coal export volumes.

ARTC submits that there are no changes of substance proposed to the OSA.

| Questions for stakeholders |
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| 40. Are the amendments to the Access Holder agreement appropriate? Are any further amendments to the IAHA necessary? |
| 41. Are any amendments to the OSA necessary? |

## 2.12. Other matters

### 2.12.1. Potential privatisation of ARTC

The Department of Finance is currently managing, on behalf of the Australian Government, a wide ranging 'Scoping Study into the future of the ARTC rail network which includes consideration of [its] future management, operations and ownership options'.[2]

In considering the future ownership of ARTC, which may include 'retention of its assets in part or in full, a trade sale or an Initial Public Offering', the Scoping Study will set out (among other things) 'an assessment of the readiness for partial or full sale of ARTC'.[3]

Given these terms of reference, there is a possibility that ARTC will be privatised during the life of the 2016 HVAU in some form. As a result, control of the below rail network in the Hunter Valley could move from a Government Business Enterprise into private hands.

Subsection 2.2(c) of the 2016 HVAU sets out provisions relevant to ARTC's potential privatisation.

Questions for stakeholders

42. Under the current terms of the 2016 HVAU, in what circumstances would a change in ARTC's ownership cause concerns? What are the specific issues that are likely to arise?
43. Should the 2016 HVAU be amended to deal with these matters? What could these provisions look like?
44. Are there other legislative or regulatory mechanisms that would alleviate these concerns (for example, section 50 of the Act)? Please give reasons why or why not.

### 2.12.2. Expiry of the 2011 HVAU prior to acceptance of the 2016 HVAU

The 2011 HVAU expires on 1 July 2016. ARTC submitted its 2016 HVAU for assessment by the ACCC on 23 December 2015.

The ACCC must make a decision in relation to the application within the period of 180 days starting at the start of the day the application was received. While the ACCC will meet its statutory timeframes and intends to finalise its assessment process prior to the expiry of the current HVAU, the Act provides for 'clock-stoppers', meaning that some days will not count towards the 180 days in certain circumstances.

Depending on these clock stoppers, the complexity of any unresolved issues that remain at the time of the formal submission of the 2016 HVAU to the ACCC, and the timeliness and completeness of responses to requests for information, there is a possibility that the assessment process could go beyond 1 July 2016.

[2] Department of Finance, *Australian Rail Track Corporation Ltd Scoping Study: Terms of Reference*, p. 1 <http://www.finance.gov.au/sites/default/files/artc-scoping-study-terms-of-reference.pdf>

[3] Ibid, p. 2.

While subsection 2.2(a) of the 2016 HVAU provides a mechanism for retrospective operation of the undertaking from 1 July 2016 regardless of the date of acceptance by the ACCC, it is not clear what would happen during the period between expiry of the 2011 HVAU and acceptance of the 2016 HVAU by the ACCC. This could cause significant uncertainty for ARTC and access seekers alike as there would appear to be a 'regulatory gap' under Part IIIA during this period.

Questions for stakeholders

45. Should the term of the 2011 HVAU be extended until the 2016 HVAU is accepted by the ACCC? Are there alternative approaches that would provide sufficient certainty for industry?

46. If the 2011 HVAU is extended, should the current rate of return continue to apply? Alternatively, should an alternative rate of return apply, and a reconciliation process conducted once a final figure is settled on in the 2016 HVAU? What mechanism could be used to conduct this reconciliation?

### 2.12.3. Final 2011 HVAU compliance assessment

Section 15.1 of the 2016 HVAU outlines the provisions for the final annual compliance assessment under the 2011 HVAU. As annual compliance is conducted on a calendar year basis, the 2016 HVAU proposes that the ACCC conduct a compliance assessment for the Transitional Period.

Under section 15.1(a) ARTC will submit documentation to the ACCC for the purposes of the annual compliance assessment, taking into account:

- revenue received in the Transitional Period
- capital expenditure during the Transitional Period
- a pro-rata adjustment to CPI and depreciation.

Taking the Transitional Period into consideration, section 15.1(b) proposes that the ACCC will determine whether ARTC has complied with the 2011 HVAU in relation to:

- the provisions in section 4.4 (the RAB)
- the applicable Ceiling Limit, including the calculation of the total unders and overs amount
- incurring efficient costs and operating expenditure.

Questions for stakeholders

47. Is the proposed approach to the final annual compliance assessment under the 2011 HVAU appropriate?

# 3. Legal test for accepting an access undertaking

In assessing an  access undertaking under Part IIIA of the Act, the ACCC must apply the test set out in subsection 44ZZA(3), which provides that the ACCC may accept the undertaking if it thinks it appropriate to do so, having regard to the following matters:

- the objects of Part IIIA of the Act, which are to:
  - 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
  - provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry;
- the pricing principles specified in section 44ZZCA of the Act (see further below);
- the legitimate business interests of the provider of the service;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of persons who might want access to the service;
- whether the undertaking is in accordance with an access code that applies to the service; and
- any other matters that the ACCC thinks are relevant.

In relation to the pricing principles, section 44ZZCA of the Act provides that:

- regulated access prices should:
  - be set so as to generate expected revenue for a regulated service that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
  - include a return on investment commensurate with the regulatory and commercial risks involved; and
- access price structures should:
  - allow multi-part pricing and price discrimination when it aids efficiency; and
  - 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
- access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

## 3.1. Timeframes for ACCC decisions and clock-stoppers

Subsection 44ZZBC(1) of the Act provides that the ACCC must make a decision on an access undertaking application within the period of 180 days starting at the start of the day the application is received (referred to as ‘the expected period’).

If the ACCC does not publish a decision on an access undertaking application under section 44ZZBE of the Act within the expected period, it is taken, immediately after the end of the expected period, to have:

- made a decision to not accept the application; and

- published its decision under section 44ZZBE and its reasons for that decision: see subsection 44ZZBC(6).

The Act contains 'clock-stoppers' that mean certain time periods are not taken into account when determining the expected period (see subsection 44ZZBC(2)). In particular, the clock may be stopped:

- by written agreement between the ACCC and the access provider (in this case, ARTC), and such agreement must be published: subsections 44ZZBC(4) and (5);
- if the ACCC gives a notice under subsection 44ZZBCA(1) requesting information in relation to the application;
- if a notice is published under subsection 44ZZBD(1) inviting public submissions in relation to the application;
- if a decision is published under subsection 44ZZCB(4) deferring consideration of whether to accept the access undertaking, in whole or in part, while the ACCC arbitrates an access dispute.

### 3.1.1. Information requests

Subsection 44ZZBCA(1) provides that the ACCC may give a person a written notice requesting the person give to the ACCC, within a specified period, information of a kind specified in the notice that the ACCC considers may be relevant to making a decision on an access undertaking application.

As noted above, the period within which the ACCC requests information constitutes a clock-stopper.