Hunter Valley Coal Chain Coordinator

Submission

Australian Rail Track Corporation's 2016 Hunter Valley Access Undertaking

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HVCCC Submission

1. Executive Summary

In our submission HVCCC have focussed on key changes that have the potential to impact the industry and its efficient running, and/or the enablement of capacity and the impacts of a potential change of ownership. HVCCC do not have visibility or involvement in the commercial aspects of the HVAU so commentary has not been provided on these aspects or from this point of reference.

HVCCC's focus and objects are to plan and co-ordinate the cooperative operation and alignment of the Coal Chain to maximise coal volumes at minimum logistics costs in accordance with the agreed collective needs and contractual obligations of Producers and Service Providers. HVCCC was incorporated in 2009 as an independent entity, funded by the industry to meet those objects.

HVCCC have played a key role, in conjunction with the 2011 HVAU and Port of Newcastle's long term Commercial Framework Agreement (2009 agreement with PWCS, NCIG and NPC), in enabling capacity and supporting growth of the industry, and more recently focussing on coal chain efficiency. These constructs have supported the long term solutions to systemic challenges experienced by the industry.

It is critical that the engagement, consultation and information exchange between ARTC and HVCCC continues to be enabled to ensure HVCCC's role as an independent entity providing services and benefits to the whole industry can be achieved.

Change of ownership (and associated potential withdrawal of the HVAU) raises significant concerns and risks relating to the ongoing operation and efficiency of the coal chain. The Hunter Valley Coal Chain construct has proven effectiveness in enabling capacity and efficiency. Any reduction, displacement or elimination of this construct, and the role of HVCCC in that, presents increasing risk to efficient operation across the various coal chain stakeholders. Given current economic conditions and commodity prices, any increased cost of operating or increased uncertainty could have a significant impact on the industry.

HVCCC's role in the 2016 HVAU is very similar to that of the 2011 HVAU. Additional steps on the HVCCC / ARTC consultation process relating to capacity management are welcomed. We recommend an additional RCG endorsement for determinations on the definition of HVCCC as that definition is set out in the 2016 HVAU.

2. Response to Key issues

2.1. Term

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?

In response to question 1: The logical assumption would be that the longer the HVAU can be in place the better (for HVCCC and stakeholders) as it provides greater certainty, but if the proposed 2.2(c) of the HVAU is accepted, the benefit of that length of term loses relevance as ARTC can effectively withdraw the HVAU, at its discretion, in the event of transfer of its lease of the Network. The benefits of the term duration can only be realised then if there is no sale or if the process and effect of a proposed sale, as outlined in clause 2.2(c), is revised per our submissions in response to questions 42, 43 and 44 below.

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)

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?

In response to questions 5 – 7: Enabling minor variations under the oversight of the RCG introduces flexibility on parameters that RCG members may want to change over time to better support coal chain efficiencies and attainment of increased capacity. Of particular note for the HVCCC are the operational parameters:

- 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)

The proposed approach seems like a reasonable and pragmatic approach to minor variations across these components and ensures key stakeholders have governance of this.

An additional item relating to the RCG is meeting frequency. In Section 9.2(a) of the HVAU ARTC propose that they have discretion (acting reasonably) to determine an RCG meeting is not required however establishing a minimum number of RCG meetings per year would guarantee a degree of meeting regularity but still enable timing/frequency flexibility if required.

2.3. Access Pricing Structure

2.3.1. 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.

2.3.2. Pricing notification process

Questions for stakeholders

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?

In response to question 18 – Noting that HVCCC are not able to comment on the commercial implications of pricing ARTCs proposed move to 'Path Based Pricing' and the removal of 'Indicative Services' is likely to be beneficial for overall coal chain efficiency and may better motivate the adoption of train configurations that result in a system-wide minimum mine-to-ship cost per tonne of coal exported, subject to meeting a total export tonnage target.

2.4. 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.

2.4.1. 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.

HVCCC and ARTC systems are interdependent and interfaced in a range of areas and at present HVCCC utilise an ARTC system for some core planning and scheduling tasks. The ability to maintain a collaborative approach and to ensure systems remain current with appropriate updates is critical. A requirement or commitment to do so via the 2016 HVAU would be valuable in ensuring HVCCC’s ability to meet its Objects and effectively plan for the whole of coal chain.

2.4.2. 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

21. Are the additional obligations regarding consultation with the HVCCC appropriate?

22. Is the removal of the capacity losses provision appropriate?

In response to questions 21 and 22: Schedule G covers the Principles to guide ARTC/HVCCC Consultation. This schedule outlines some additional steps in ARTC/HVCCC consultation in how differences in view are handled, and provides (within confidentiality requirements) increased transparency as to the reasons for a difference. HVCCC supports the improved process outlined, noting ARTC have no obligation to follow HVCCC’s recommendations (as per the current HVAU).

With respect to capacity losses HVCCC has the following related constitutional objects in:

Identifying and advising on capacity constraints (whether physical, operational or commercial) affecting the efficient operation of the Coal Chain and assisting the evaluation of proposals to overcome these constraints

Evaluating and advising on access impact, capacity assessment and system consideration including port, track and rail.

The ability for HVCCC to support capacity assessments on Coal Chain operations is a key role of HVCCC. ARTC's ongoing support and provision of information to enable such assessments is critical for HVCCC to perform these functions. As long as the deleted section 5.8 does not change the support for capacity assessments by HVCCC regardless of the issue or situation that may trigger such a request or need, the removal of 5.8 and relationship to capacity loss mechanism(s) can be supported by HVCCC where other schemes are included to support and motivate efficiency outcomes (in the current 2016 HVAU draft these are the Innovation Incentive Mechanism Section 14 and Operating Costs and Incentive Proposal Section 9.3).

We note that in support of HVCCC's ongoing role ARTC:

- continues to recognise HVCCC's role and theirs as a HVCCC participant in Section 1.1(e) and 1.1(h).
- continues to have a trigger for capacity analysis as part of the Indicative Access Proposal where ARTC will consult with HVCCC with respect to Access Rights. Section 3.7(ix)(B) covers HVCCC's role in capacity assessments for Access Rights (note clause 3.7 is subject to 3.7 (iii) *any requirements for Additional Capacity (subject to Section 5))*
- continues to have an option where HVCCC can recommend a project (under Section 8.3) and this provides for a mechanism to propose efficiency and capacity enabling projects from HVCCC.
- continues to have HVCCC as an RCG member (non-voting)
- has a further addition to the 2016 HVAU in Section 2.3(b)(ii) where HVCCC are invited to provide submissions in the proposed HVAU review process.
- Has changes as noted under Schedule G

2.5. Performance Measurement and Incentives

2.5.1. 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.

2.5.2. 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?

In response to question 28: The Network Key Result Areas are appropriate at a high level. The ability to change these via the RCG means they can be adjusted should emphasis or relevance change over time.

In response to questions 29 and 30: Removal or Modification of KPIs with RCG Governance of the minor variation process, having flexibility to adjust KPI/KRAs over the term seems appropriate especially given the term proposed (10.5 years with an option for a further 5 years).

2.6. Other matters

2.6.1. 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'.[1]

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'.[2]

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.

In response to question 42: If as a result of the transfer of the Network lease to a third party, ARTC exercises its right under subsection 2.2(c) of the 2016 HVAU to withdraw the 2016 HVAU, and, despite ARTC's "best endeavours", a new undertaking on the same terms as the 2016 HVAU is refused by the ACCC, the absence of an undertaking represents a significant risk to the efficiency of the coal chain, its ability to enable capacity, and creates significant commercial uncertainty. The lack of an undertaking has the potential to impact HVCCC in its ability to deliver it services and objects in facilitating and coordinating the coal chain. The services currently performed by HVCCC for ARTC and other members of the coal chain are at risk in this scenario.

There are ownership models that could eliminate or undermine the ability of HVCCC to plan and coordinate the co-operative operation and alignment of the Coal Chain to maximise the volume of coal transported through it, at minimum logistical cost in accordance with the collective needs and contractual obligations of Producers and Service Providers. The meeting of contractual obligations and whole of coal chain efficiency could be at risk in such a scenario.

In response to question 43: The proposed subsection 2.2(c) of the 2016 HVAU could be amended in a number of ways to either eliminate, or substantially lessen, the adverse impact

1 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>

2 Ibid, p. 2.

a transfer of the Network lease to a third party might have on stakeholders (including HVCCC and its Members).

The discretion as to whether the 2016 HVAU is withdrawn should not rest with ARTC, nor should ARTC have only a “best endeavours” obligation to “procure the new lessee of the Network” to “submit” an undertaking on the same terms.

The only means of eliminating the risk of adverse consequences for HVCCC and its Members would be for the 2016 HVAU to be amended to make it clear that in circumstances where ARTC seeks to transfer its lease of the Network to a third party, a condition of that transfer is that the purchaser retains the 2016 HVAU in its then current form. An alternative proposal would be for the purchaser (at its discretion not ARTC’s) to elect to retain the 2016 HVAU *or* propose a new undertaking (and for that new undertaking to be on no less favourable terms for the Network stakeholders than the 2016 HVAU).

A further option is the ACCC having the discretion to refuse a request by ARTC to withdraw the 2016 HVAU (it is currently deemed to approve the request once it is made) and to stipulate, as a condition of the sale, that the 2016 HVAU remain in place or that an alternative access undertaking, on terms approved by ACCC, be implemented.

In any event, the 2016 HVAU should remain in place at all times for the duration of its intended term unless, or until, the ACCC approves its withdrawal and/or approves a new access undertaking.

The 2016 (and 2011) HVAU defines HVCCC as follows:

> “HVCCC” means the Hunter Valley Coal Chain Coordinator, or where that body no longer exists, or has been reconstituted, renamed, replaced or whose functions have been removed or transferred to another body or agency, is a reference to the body which has the responsibility to most closely perform functions of the first mentioned body as reasonably determined by ARTC.

HVCCC recommends any determination relating to the definition of HVCCC be required to be endorsed by the RCG, in addition to ARTC’s determination, so as to ensure support for the Industry construct represented by HVCCC.

2.6.2. 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.

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?

In response to question 45: from HVCCC's perspective in the absence of any apparent alternative and given the voluntary nature of this undertaking, extending the 2011 HVAU would appear to be the most appropriate way to ensure Industry stability, efficiency and certainty whilst awaiting approval of the 2016 HVAU.