

Pacific National Submission to the ACCC on the ARTC Proposed 2017 Hunter Valley Access Undertaking

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1. Introduction

Pacific National welcomes the opportunity to respond to the Australian Competition and Consumer Commission (ACCC) on the Australian Rail Track Corporation (ARTC) proposed 2017 Hunter Valley Access Undertaking (proposed 2017 HVAU).

Pacific National is a major operator of coal trains in the Hunter Valley coal rail network. Pacific National does not currently hold rail access rights¹ or pay access charges in the Hunter Valley coal rail network, however Pacific National recognises that rail access regulation and rail access pricing provide strong incentives to access holders (and hence to operators) as to how train operations should be managed on the Hunter Valley coal rail network. Thus Pacific National has a strong interest in ensuring that efficient and effective access regulation and pricing is in place which provides strong incentives for efficient and effective train operations in the Hunter Valley coal rail network. In particular Pacific National strongly supports access regulation and pricing which encourages more efficient consumption of capacity in the Hunter Valley coal rail network. Efficient consumption of capacity allows more coal to be moved through the network.

Previously Pacific National was part of the broader Asciano group but following the sale of Asciano in August 2016 Pacific National has become a stand-alone company with new owners. Thus future submissions relating to the ARTC Hunter Valley Access Undertaking regulatory processes will be made by Pacific National rather than Asciano. Submissions made by Asciano before this ownership change should be treated as being from Pacific National.

Pacific National notes that the December 2016 ACCC Consultation Paper on the proposed 2017 HVAU contains numerous questions on the proposed 2017 HVAU rate of return, remaining mine life and floor and ceiling revenue limits. Given Pacific National does not hold access agreements Pacific National has not addressed these questions in this submission².

This submission is public.

¹ Pacific National holds access rights through the Hunter Valley rail system for non-coal trains and access rights for ancillary train services (for example wagon movements) which serve the coal industry but which do not haul coal.

² Pacific National notes that Question 9 of the December 2016 ACCC Consultation Paper which relates to allocation unit for incremental cost was addressed in the Asciano March 2016 submission page 15.

2. Pacific National's General Comment on the Proposed 2017 HVAU

Pacific National believes that the broad matters outlined below need to be addressed by the ACCC when considering the proposed 2017 HVAU

Previous Submission to be taken into Account - Asciano previously made a submission to the ACCC in relation to the ARTC proposed 2016 HVAU in March 2016³. To the extent that the issues raised by Asciano in this March 2016 submission have not been addressed in the subsequent ARTC proposed 2017 HVAU then Pacific National is seeking that ACCC take into account the positions put forward in the Asciano March 2016 submission in the current 2017 HVAU regulatory process. Issues of particular importance in the March 2016 submission which have not been addressed in the proposed 2017 HVAU include:

- the current ARTC access contracting approach in the Hunter Valley coal network which effectively precludes train operators from holding access;
- the scope of the mid term review;
- concerns with the service envelope characteristics;
- extension of RCG voting membership to include train operators and a requirement to include train operators in consultations regarding maintenance and operating costs;
- concerns with the scope and application of the Innovation Incentive mechanism; and
- concerns with changes to the Access Holder Agreements in relation to improved operational efficiency impacting on take or pay, limited agency clauses, uplift of the access undertaking into Access Holder Agreements and the need for spot agreements.

Need for Efficient Use of Capacity in the Hunter Valley Network - Pacific National has a strong interest in ensuring that efficient and effective access regulation and access pricing are in place in the Hunter Valley network as this will help ensure efficient and effective train operations in the Hunter Valley network. In particular Pacific National strongly supports access regulation and pricing which encourages more efficient use of capacity in the Hunter Valley coal rail network as this allows more coal to be moved through the network.

Under the proposed 2017 HVAU ARTC is moving from an indicative service pricing model towards a path based pricing model. The previous indicative service model was subject to extensive

³ The submission can be found at <https://www.accc.gov.au/system/files/Asciano%20submission%20-%202016%20HVAU%20consultation%20paper.pdf>

consultation and throughout this consultation Pacific National consistently put forward the position that larger and higher payload trains configured with sufficient power to operate within system assumptions are the most efficient trains for the Hunter Valley coal supply chain⁴. Pacific National continues to hold this view and believes that the Hunter Valley coal supply chain is best served by providing access pricing incentives for larger and higher payload trains.

The proposed path based pricing model includes the take or pay charge being charged as dollars per kilometre. This approach could act to incentivise larger trains as the dollar per kilometre pricing unit is essentially fixed and so if this fixed charge can be spread over a larger tonnage of coal then the access holder has a financial incentive to move to a higher payload train. Pacific National supports this access pricing approach.

Operating Cost Efficiency Regime - The proposed 2017 HVAU includes a new operating and maintenance cost efficiency regime. Pacific National has strong concerns regarding this proposed regime. In particular Pacific National is concerned that:

- in developing the regime ARTC is not consulting with train operators (even though train operators are directly impacted by changes in operating and maintenance costs); and
- the regime provides incentives for ARTC to under spend on operating and maintenance costs to the potential detriment of asset quality and train operations.

Pacific National's detailed concerns are outlined in section 3 of this submission.

Access Contracting Approach – The manner in which the 2011 HVAU was applied by ARTC did not allow above rail operators, such as Pacific National, to hold coal access rights. Under the approach used by ARTC access rights were to be held by coal miners or end users (for example,

⁴ Asciano submissions on the matter of the indicative service included:

- Asciano, November 2011, Submission to the ARTC: 2011 Hunter Valley Access Undertaking – Response to the Initial Indicative Service Proposal
- Asciano, January 2012, Submission to the ACCC in relation to the ACCC Consultation Paper on the ARTC Hunter Valley Access Undertaking Variation
- Asciano, May 2012, Submission to the ACCC in relation to the ACCC Position Paper on the ARTC Hunter Valley Access Undertaking Variation
- Asciano, August 2012, Asciano Submission to ACCC Further Consultation on the ARTC Proposal to Defer Implementation of Initial Indicative Access Charges
- Asciano, September 2012, Asciano Submission to ACCC Consultation on the ARTC Revised Application to vary the Hunter Valley Access Undertaking
- Asciano, March 2014, Submission to the ACCC: Response to ACCC Consultation Paper Regarding the Proposed Final Indicative Service Variation to the ARTC Hunter Valley Access Undertaking
- Asciano, September 2014, Submission to the ACCC: Response to the ACCC Position Paper Regarding the Final Indicative Service Variation to the ARTC Hunter Valley Access Undertaking

power generators). The access rights contracting approach in the proposed 2017 HVAU does not appear to have changed from the approach used for the 2011 HVAU.

The ARTC's approach to access rights contracting in the Hunter Valley coal rail network constrains the contracting options available to users of the network. Pacific National believes that train operators should be permitted to hold access rights on behalf of end users and miners if these parties do not wish to hold access rights. End users and smaller mine operators often view rail access as a function requiring specialised management which these parties do not have. The contracting approach used by ARTC should be altered to allow above rail operators to hold access for miners and end users who do not wish to hold access in their own right.

Regulatory Process – ARTC has indicated that the proposed operating expenditure efficiency mechanism will impact a number of provisions in the access undertaking. Where the new proposed operating expenditure efficiency mechanism is likely to impact the 2017 HVAU, ARTC has indicated that it has preserved the drafting in the proposed 2016 HVAU and included a placeholder indicating that the provision will be re-examined and potentially redrafted in the final access undertaking documentation proposed to be lodged in 2017.

Pacific National believes that any new drafting resulting from the proposed ARTC operating expenditure efficiency mechanism should be released for stakeholder comment prior to any final ARTC approval of the proposed 2017 HVAU.

3. Pacific National's Specific Comment on the on the Revised Drafting of the Proposed 2017 HVAU

This section addresses the drafting of the proposed 2017 HVAU undertaking document. This section focuses on the sections of this document which have been revised from the proposed 2016 HVAU undertaking document.

Grant and Duration of The Undertaking 2.2 c) – The section relating to the treatment of the access undertaking if the lease for the Hunter Valley network is transferred has been deleted. Given the nine year term of the proposed 2017 HVAU Pacific National believes that retaining this wording (or similar wording) is useful as it provides an increased level of regulatory certainty.

In addition Pacific National notes that section 2.2 b) ii) cross references 2.2 c). Pacific National is seeking that ARTC confirm that this cross-reference remains correct if 2.2 c) is deleted.

Mandatory Review of the Undertaking 2.3⁵ – Pacific National supports the mid-term review as proposed in section 2.3 of the proposed 2017 HVAU but believes that further items should be added to the scope of the mid-term review. These items relate to areas where changes are proposed to be made between the 2011 HVAU and 2017 HVAU. The new concepts added to the 2017 HVAU should be subject to the periodic review to ensure that the concepts are functioning as intended. The new concepts to be reviewed should include (but not necessarily be limited to):

- the Service Envelope characteristics and pricing structure as outlined in the proposed 2016 HVAU section 4.15;
- the new Opex Efficiency Regime as outlined in the proposed 2017 HVAU section 9.3;
- the Innovation Incentive Mechanism as outlined in the proposed 2017 HVAU section 14; and
- Schedule D: Network Key Result Areas.

In addition, major quantitative inputs into the regulatory and access pricing processes (such as volume forecasts) not currently addressed in the proposed 2017 HVAU section 2.3 should be included in the review. Any material change in these quantitative inputs in the period between the commencement date and the review date should be taken into account in access pricing beyond the review date.

Variation of the Undertaking 2.4 – Pacific National supports the changes made to the proposed 2017 HVAU in section 2.4. These changes broadly reflect the position previously put forward in the Asciano submission of March 2016⁶.

New Opex Efficiency Regime 9.3 – The 2017 proposed HVAU puts forward a new opex efficiency mechanism including

- establishing an ex-ante operating cost allowance through a forecast and benchmarking process;
- establishing an initial forecast period with a reset of the opex allowance after the initial period; and
- allowing ARTC retain the benefit of any under spending of opex relative to the allowance and requiring ARTC to bear the cost of any over spending of opex relative to the allowance.

⁵ Note that the Asciano submission of March 2016 put forward a similar position on pages 7 to 9

⁶ Asciano submission of March 2016 pages 9 -11

The ACCC Consultation Paper (page 16) seeks responses to several questions regarding the proposed Opex Efficiency Regime. Pacific National responses to these questions are contained in Attachment 1.

Pacific National has strong concerns regarding the New Opex Efficiency Regime contained in section 9.3 of the proposed 2017 HVAU. These concerns relate to the consultation regarding this regime, the incentives that will arise under the regime itself and the review of the regime.

*Consultation Regarding the Regime*⁷ - Pacific National is concerned that ARTC will finalise its proposed operating expenditure efficiency regime with extensive input and consultation from access holders but without any input from train operators and port terminal operators.

Pacific National notes that the efficiency incentive proposal included in the proposed 2016 HVAU section 9.3 b) required that other stakeholders (including train operators) be consulted; however the proposed 2017 HVAU sections 9.3 d) and 9.3 e) now only requires regular ARTC consultation with access holders regarding the development of the opex efficiency regime. Thus, unlike the proposed 2016 HVAU, the proposed 2017 HVAU has no requirement to consider the views of other parties even if these parties are directly impacted by ARTC's proposal.

Pacific National has previously submitted⁸ that train operators should be directly involved in consultations on maintenance and operating costs as they are directly impacted by changes in operations and maintenance arising from changes in these costs.

The direct operational impact of any changes to operating and maintenance expenditure arising from the regime will fall primarily on train operators rather than access holders, yet ARTC is not consulting with train operators regarding the proposed operating expenditure efficiency regime. Pacific National believes that as a minimum the proposed 2017 HVAU must require consultation with train operators as these operators will be directly impacted by expenditure on operations and maintenance.

Incentives Arising from the Regime – Pacific National has strong concerns that the new opex efficiency regime provides strong incentives for ARTC to potentially under spend on operating and maintenance functions which will act to the potential detriment of train operations and train operators. In particular underspending on operations and maintenance will directly impact train operators rolling stock and staff and raises concerns regarding future track quality over the period of the nine and a half year undertaking.

⁷ The ACCC Consultation Paper (page 14) recognises Pacific National's previous concerns with proposed 2016 HVAU approaches to consultation regarding operating and maintenance costs.

⁸ Asciano March 2016 submission pages 17 and 18

As previously submitted to the ACCC⁹ Pacific National has a concern that in recent years ARTC maintenance costs have been lower than forecast due to the deferral or reduction of maintenance activities. Pacific National's concern is that a certain level of maintenance is required for efficient train operations and a reduction in maintenance expenditure is likely to impact on train operators.

While Pacific National recognises the access price benefits of reduced expenditure, Pacific National is concerned that continued under spending on operations and maintenance has the potential to reduce track quality resulting in unplanned delays and increasing costs to both operators and access holders.

Pacific National believes that if an opex efficiency regime is to be introduced any under spending on operations and maintenance relative to a previous time period should be justified by ARTC. In particular in the event of any operations and maintenance under spending relative to a previous time period the HVAU should require that track quality and service quality performance indicators be tested and the reduction in spending should only be kept by ARTC if these track infrastructure performance indicators have not been adversely affected.

Need for Review of Regime – Pacific National has concerns about the absence of a review mechanism for the new opex efficiency regime. Pacific National believes that if the proposed opex efficiency regime is implemented then the operation of the regime should be reviewed as part of the review of the undertaking as outlined in section 2.3 of the proposed 2017 HVAU.

Pacific National notes that the proposed 2017 HVAU 9.3 b) ii) states that the allowance will be reset "following the initial period"; although the term initial period is not defined. Given this wording Pacific National believes that there is an intention to review some aspects of the regime; however Pacific National believes that such a review should be formalised by including it in section 2.3 and extending the scope of such a review to include all aspects of the regime including its impact on operating and maintenance activities and service standards and track quality.

In considering the comments regarding the opex efficiency regime above it should be recognised that Pacific National does not oppose a well designed and effective performance incentive scheme however Pacific National does oppose the opex efficiency regime included in the proposed 2017 HVAU.

⁹ Asciano March 2016 submission page 18

4. Pacific National's Specific Comment on the on the Drafting of the IAHA

Pacific National's main concerns with the access holder agreements (as briefly outlined in section 2 above) are:

- the deletion of section 11.5 d) from the previous 2011 access holder agreement. Section 11.5 d) allowed for a change in train services even if take or pay was reduced if the change in train services resulted in a more efficient use of coal chain capacity. Pacific National is concerned as this deletion appears to act against network efficiency and operators using trains with a larger coal carrying capacity;
- Clause 4.6 c) of the IAHA continues to include "Limited Agency" which states that the access holder does not incur liability for incidents caused by acts or omissions of the train operator as a result of the operation of the AHA. Pacific National continues to believe that this wording is inappropriate in an agreement to which the train operator is not a party.
- Clause 19.1 of the IAHA continues to require that changes to certain provisions in a new or amended access undertaking will be uplifted to the AHA. Pacific National is concerned that clauses which may impact train operators are being uplifted into the AHA. Pacific National seeks that where changes are to be made to an AHA, which may be expected to impact on train operators, the train operators are consulted prior to the changes being made and that the relevant train operator is notified of all changes to the AHA so that the train operator is aware of its obligations.

In addition Pacific National seeks that ARTC to develop a simple spot access agreement which allows for the purchase of paths on a spot basis if capacity is available.

5. Conclusion

Pacific National previously made a submission on the proposed 2016 HVAU. To the extent that the issues raised in this previous submission have not been addressed in the proposed 2017 HVAU Pacific National is seeking that the ACCC take into account the positions in the previous submission.

Pacific National has several concerns with the proposed 2017 HVAU. In particular Pacific National has strong concerns with the new operating and maintenance cost efficiency regime in the proposed 2017 HVAU. These concerns include that:

- in the developing the regime ARTC is not consulting with train operators (even though train operators are directly impacted by changes in operating and maintenance costs); and
- the regime provides incentives for ARTC to potentially under spend on operating and maintenance costs to the potential detriment of asset quality and train operations.

If an opex efficiency regime is to be introduced then any under spend on operations and maintenance should be tested by assessing track quality and service quality performance indicators. The reduction in spending should only be kept by ARTC if these performance indicators have not been adversely affected.

Other areas of concern for Pacific National include:

- the proposed 2017 HVAU should allow train operators to hold access in their own right; and
- the limited scope of the mid term review in the proposed 2017 HVAU section 2.3. Pacific National believes the scope of the review should be expanded and should include a review of the new opex efficiency regime.

Attachment 1 - Pacific National Responses to ACCC Consultation Paper Questions on the Opex Efficiency Regime

Below are Pacific National responses to questions on the ARTC's proposed opex efficiency regime which are raised by the ACCC's Consultation paper (page 16).

14. Are the proposed principles governing the opex efficiency regime appropriate?

Pacific National believes that the broad principles governing the opex efficiency regime should include additional principles to ensure that operating and maintenance service quality and track quality are maintained, and ideally enhanced. If these factors are not taken into account then the principles governing the opex efficiency regime are fundamentally flawed.

As outlined in the body of the submission, Pacific National believes that any under spend on operations and maintenance should be tested by assessing track quality and service quality performance indicators. The reduction in spending should only be kept by ARTC if these performance indicators have not been adversely affected.

In addition the governance principles applied to the development and implementation of the opex efficiency regime must be changed so that they require consultation with other parties which are impacted by the regime, notably consultation with train operators.

15. Are the requirements on ARTC to consult with Access Holders in the development and implementation of the opex efficiency regime adequate?

As outlined in the body of the Pacific National submission above the current consultation requirements on ARTC are completely inadequate. Pacific National believes that as a minimum the proposed 2017 HVAU must require consultation with train operators as these operators will be directly impacted by expenditure on operations and maintenance.

16. Are the milestones appropriate?

Pacific National's main concern is the lack on consultation on the milestones in Annexure B of the proposed 2017 HVAU.

Pacific National believes that milestones relating to the maintenance and operating cost methodology and benchmarks must include milestones for methodologies and benchmarks for assessing operating and maintenance standards and track quality as well as costs.

In addition Pacific National believes a further milestone should be included to allow assessment of the proposed opex efficiency regime after it is implemented.

17. Are there any issues with the coexistence of the opex efficiency regime and the Innovation Incentive Mechanism (section 14 of the 2017 HVAU)?

Pacific National does not believe that there is a fundamental issue with the coexistence of the opex efficiency regime and the Innovation Incentive Mechanism. However there may be potential for “double dipping” if ARTC reduces operating costs under the opex efficiency regime and then seeks to replace the functions where costs were reduced under an innovation proposal under the Innovation Incentive Mechanism. Given the RCG are required to endorse ARTC innovation proposals Pacific National believes that opportunities for such “double dipping” are minimised.

More broadly Pacific National continues to have concerns with the Innovation Incentive Mechanism (as outlined in its previous submission¹⁰). In particular Pacific National is concerned that parties not involved in developing and endorsing an innovation incentive proposal (such as train operators), may still be impacted by such a proposal. Pacific National believes that train operators should be consulted and involved in any process where the innovation proposal will result in the train operators having to make material capital investments or incur material operating costs.

¹⁰ Asciano March 2016 submission pages 21- 22