Australian Competition & Consumer Commission

Determination

Australian Rail Track Corporation's compliance with the financial model and pricing principles in the Hunter Valley Coal Network Access Undertaking for January – December 2012

24 March 2014

Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

Contents

Glossary heading

Capitalised terms used in this paper and not listed in this glossary are terms as defined in section 14.1 of the accepted Hunter Valley Coal Network Access Undertaking, which is available on the ACCC's website.

2012 Compliance Period	Calendar year from 1 January 2012 to 31 December 2012
ACCC	Australian Competition and Consumer Commission
ARTC	Australian Rail Track Corporation
BTRE	Bureau of Transport and Regional Economics
CCA	Competition and Consumer Act 2010 (Cth)
HVCCC	Hunter Valley Coal Chain Coordinator
HVAU	Hunter Valley Coal Network Access Undertaking
Initial Compliance Submission	ARTC's compliance documentation dated 24 May 2013
IPART	Independent Pricing and Regulatory Tribunal
NSW	New South Wales
NSWRAU	New South Wales Rail Access Undertaking
QCA	Queensland Competition Authority
QR	Queensland Rail
RAB	Regulatory Asset Base
RCG	Rail Capacity Group
Revised Compliance Submission	ARTC's compliance documentation dated 26 February 2014

Summary

The Australian Competition and Consumer Commission (**ACCC**) has conducted an assessment of the Australian Rail Track Corporation's (**ARTC's**) compliance with the financial model and pricing principles specified in the Hunter Valley Coal Network Access Undertaking (the **HVAU**) for the period 1 January 2012 to 31 December 2012 (the **2012 Compliance Period**).

Based on revised compliance documentation submitted by ARTC on 26 February 2014, the ACCC has determined that ARTC's reconciliation of revenues received with the applicable floor and ceiling limits for the 2012 Compliance Period complies with the requirements of the HVAU. The outcome of this determination is that ARTC has capitalised cumulative losses of $10.44 million in Pricing Zone 3 and ARTC is entitled to recover an additional $4.82 million in revenue from Constrained Coal Customers.

Annual compliance assessment requirements

ARTC is required to annually submit documentation to the ACCC for the purpose of an assessment of its compliance with the financial model and pricing principles set out in section 4 of the HVAU. As part of this assessment, the HVAU provides for the ACCC to determine whether ARTC has incurred prudent and efficient expenditure, rolled forward the value of its assets and reconciled revenues received with the applicable floor and ceiling limits[1] for the 'constrained'[2] part of the Hunter Valley Coal Network in accordance with the HVAU. This reconciliation process ultimately determines whether 'loss capitalisation'[3] applies in Pricing Zone 3 and whether ARTC is required to refund or recover any over- or under-recovery of revenue in the 'constrained' part of the network from Constrained Coal Customers[4].

ACCC's assessment of ARTC's compliance submission

ARTC first provided documentation to the ACCC on 24 May 2013 in accordance with the requirements in section 4 of the HVAU for the 2012 Compliance Period (the **Initial Compliance Submission**). ARTC submitted that 'loss capitalisation' applied in Pricing Zone 3 with cumulative losses[5] of $10.46 million and that it had a $5.73 million 'shortfall' in revenue in the 'constrained' part of the network. ARTC proposed to recover the 'shortfall' in revenue from Constrained Coal Customers.

Following consultation with stakeholders on the Initial Compliance Submission and the ACCC's own review of the supporting information submitted by ARTC (which included confidential financial models that were not available to stakeholders), the ACCC identified prudency of capital expenditure, efficiency of operating expenditure and allocation of revenues as the key issues.

1 The ceiling limit, which represents the maximum amount of revenue that ARTC is entitled to receive each calendar year, is determined by reference to the full economic cost of providing services. The full economic cost includes a return earned on assets, return of assets (depreciation) and efficient operating expenditure. Determination of the full economic cost, therefore, also requires the determination of the regulatory value of assets. The value of assets is rolled forward each year to account for depreciation and prudent capital expenditure.

2 The 'constrained' part of the Hunter Valley Coal Network comprises the majority of rail segments in Pricing Zones 1 and 2 where there is enough traffic volume to enable ARTC to recover the full economic cost of those segments. The 'unconstrained' part of the network comprises all of the rail segments in Pricing Zone 3 (as well as a small number of segments in Pricing Zone 1) where there is currently not enough volume to enable ARTC to fully recover economic cost.

3 For Pricing Zone 3 only, while it is part of the 'unconstrained' network, the HVAU allows ARTC to capitalise any 'shortfall' in revenue into the value of its assets for recovery in future periods.

4 Constrained Coal Customers are coal producers that originate in the 'constrained' part of the network.

5 Cumulative losses capitalised at the end of the 2012 Compliance Period includes capitalised losses from 2011 and 2012.

The ACCC sought further information from ARTC to enable a more robust assessment of expenditure amounts and met with ARTC on a number of occasions to discuss issues, such as its approach to revenue allocation that underpins the reconciliations with the applicable floor and ceiling limits. The ACCC and ARTC also worked through some calculation and methodological errors that were identified in ARTC's confidential financial model relating to, for example, interest during construction, disposals and depreciation.

Based on additional information that was confidentially provided by ARTC, the ACCC conducted a desktop review of operating expenditure that included a time-series analysis and comparison to relevant benchmarks where they were available. The ACCC determined ARTC's operating expenditure for the 2012 Compliance Period to be efficient. The ACCC also further clarified the consultation and endorsement by the Rail Capacity Group (the **RCG**)[6] of capital expenditure amounts submitted by ARTC and determined ARTC's capital expenditure for the 2012 Compliance Period to be prudent.

On this point, ARTC committed to making some changes to its stakeholder consultation processes for minor capital expenditure that were intended to improve transparency for future years in response to further clarification sought by the ACCC during this assessment. For example, ARTC proposed that "in the future the RCG be kept informed of the progress of the endorsed minor capital program where material changes are identified. That is, projects showing a forecast variance to costs to complete of +/-$50,000 of the amount endorsed or have encountered material change to timely delivery".[7] ARTC also noted that it intended to provide updates to the RCG on a six monthly basis. The ACCC considered that these would be a positive development in ARTC's consultative processes with stakeholders.

In relation to ARTC's approach to revenue allocation, the ACCC understands that the effect of ARTC's approach is that producers originating in Pricing Zone 3 pay only for the direct costs (defined in the HVAU as variable maintenance costs) as they traverse the rail network in Pricing Zone 1. As such, all of the remaining operating and capital costs of the rail network in Pricing Zone 1 are incurred by producers originating in Pricing Zones 1 and 2 even though they are unable to utilise the full capacity of that part of the network due to Pricing Zone 3 traffic.[8] ARTC submitted that its approach to revenue allocation is the outcome of the application of the combinatorial model.

The ACCC was of the view that it was important to consider the appropriateness of ARTC's approach to revenue allocation and the subsequent impact on cost recovery. The ACCC therefore sought further information from ARTC in relation to the approach to revenue allocation and its compliance with the HVAU. ARTC confidentially provided information to the ACCC which explained the basis for the approach and the effect of the approach on access charges. In particular, ARTC noted that its approach was accepted under the New South Wales Rail Access Undertaking (**NSWRAU**), overseen by the NSW Independent Pricing and Regulatory Tribunal (**IPART**). ARTC has retained its approach taken under the NSWRAU for the 2012 Compliance Period under the HVAU.

On the basis of the information currently before it, which includes confidential information provided to the ACCC by ARTC, the ACCC is satisfied that ARTC has complied with the HVAU financial model for the period under review.

ACCC's determination on ARTC's compliance for 2012

ARTC provided revised compliance documentation to the ACCC on 26 February 2014 (the **Revised Compliance Submission**) to address the calculation and methodological errors that were identified in the confidential financial model underpinning ARTC's Initial Compliance Submission. ARTC submitted that 'loss capitalisation' applied in Pricing Zone 3 but revised the cumulative losses capitalised into the Pricing Zone 3 asset base from $10.46 million to

6 The RCG is a representative group made up of a range of stakeholders, including access holders and above-rail operators and the HVCCC (in a non-voting capacity).

7 ARTC, *Revised Compliance Submission*, 26 February 2014, pp. 14-15.

8 This occurs while Pricing Zone 3 is part of the 'unconstrained' network and 'loss capitalisation' applies.

$10.44 million. ARTC also submitted that it had a ‘shortfall’ in revenue in the ‘constrained’ part of the network, but revised the amount to be recovered from Constrained Coal Customers from $5.73 million to $4.82 million.

The ACCC is satisfied that ARTC’s Revised Compliance Submission has addressed the issues identified with respect to its Initial Compliance Submission. For the reasons set out above (discussed in more detail in the remainder of this document) the ACCC has determined that ARTC’s reconciliation of revenues received with the applicable floor and ceiling limits for the 2012 Compliance Period as set out in its Revised Compliance Submission complies with the requirements in section 4 of the HVAU. The outcome of this determination is that ARTC has capitalised cumulative losses of $10.44 million in Pricing Zone 3 and ARTC is entitled to recover an additional $4.82 million in revenue from Constrained Coal Customers in accordance with section 4.9 of the HVAU.

Other matters

As noted above, ARTC has committed to providing more regular updates in relation to its minor capital works program in response to queries by the ACCC during this assessment about the clarity and transparency of information. The ACCC welcomes these moves but considers that there is value in also having a review which will consider issues such as the provision of information to stakeholders and the methodologies underpinning revenue allocation across the Hunter Valley coal network. The ACCC considers that such a review will assist in increasing transparency and informed decision making. Accordingly, the ACCC intends to undertake a public review in which stakeholders will be provided with an opportunity to submit their views.

1 Introduction

The Australian Rail Track Corporation is a Commonwealth Government-owned corporation that was established in 1998 and provides a single point of contact for parties seeking to run trains on the National Interstate Rail Network across Australia and the Hunter Valley Coal Network in NSW. ARTC is vertically separated, providing 'below-rail' services (such as the rail track infrastructure) but not 'above-rail' services (such as haulage). The National Interstate Rail Network and the Hunter Valley Coal Network are currently subject to two separate access undertakings that were accepted by the ACCC in 2008 and 2011 respectively.

The Hunter Valley Coal Network is predominantly used to transport coal from mines in the Hunter Valley region to the Port of Newcastle for export and to transport coal to domestic customers, such as power stations. The network is also used by non-coal traffic, including general and bulk freight services (such as grain) and passenger services.

The Hunter Valley Coal Network was previously subject to the NSW Rail Access Undertaking (the **NSWRAU**) administered by IPART. However, access to the Hunter Valley Coal Network has been regulated through the HVAU since the ACCC accepted the undertaking in June 2011. The HVAU applies for an initial five year period and is due to expire in June 2016. The ACCC expects that the assessment of any replacement undertaking proposed by ARTC would commence before the expiry of the existing HVAU.

The following sections provide information on the HVAU financial model and pricing principles and the annual compliance assessment that the ACCC conducts pursuant to section 4.10 of the HVAU.

1.1 HVAU financial model and pricing principles

Section 4 of the HVAU regulates the amount of revenue that ARTC is entitled to receive for the Hunter Valley Coal Network by implementing revenue floor and ceiling limits. The HVAU requires that ARTC at a minimum receives revenue that covers the 'direct costs'[9] of providing services with an objective of covering 'incremental costs' (the **Floor Limit**). The HVAU caps the maximum amount of revenue that ARTC is entitled to receive at the full economic cost of providing services (the **Ceiling Limit**).

The full economic cost of providing services is calculated using a 'building block model' and incorporates allowances for return on assets, return of assets (depreciation) and efficient operating expenditure. The calculation of economic cost, therefore, also requires a regulatory valuation of assets. The value of assets is rolled forward each year to account for depreciation and prudent capital expenditure (the **RAB Floor Limit**).

Reconciliation of revenue received with the Ceiling Limit is different for the various parts of the Hunter Valley Coal Network as follows:

- For the 'constrained'[10] part of the network, an 'unders and overs' accounting framework applies. If ARTC's revenue is less than full economic cost in a compliance period, then ARTC is entitled to recover the revenue 'shortfall' from Constrained Coal Customers. If ARTC's revenue exceeds full economic cost, then ARTC is required to refund the amount of over-recovery to Constrained Coal Customers.

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9 The HVAU defines 'direct costs' as efficient maintenance expenditure and other costs that vary with the usage of the network but excluding depreciation and 'incremental costs' as all costs that could be avoided in the medium term if a segment was removed from the network.

10 The 'constrained' part of the network comprises the majority of the Hunter Valley Rail Network in Pricing Zones 1 and 2 where ARTC is expected to recover its full economic cost.

- For Pricing Zone 3 only, which currently forms part of the ‘unconstrained’ network, ‘loss capitalisation’ applies.[11] ARTC is allowed to capitalise revenue shortfalls into the Pricing Zone 3 regulatory asset base for recovery in future periods. Once ARTC is able to recover the full economic cost of Pricing Zone 3 (including the losses capitalised from previous years), then the ‘unders and overs’ accounting framework as per the previous point applies.

1.2 ACCC annual compliance assessment

Section 4.10 of the HVAU provides for the ACCC to conduct an annual assessment to determine whether ARTC has complied with the HVAU financial model and pricing principles. In particular, the ACCC is required to determine whether:

- ARTC has undertaken prudent capital expenditure and incurred efficient operating expenditure in accordance with the requirements set out in the HVAU;

- ARTC has rolled forward the value of its assets in accordance with the HVAU for the ‘constrained’ part of the network (the RAB Floor Limit) and for Pricing Zone 3 (the RAB Floor Limit and the RAB);

- ‘loss capitalisation’ applies in Pricing Zone 3, which is determined by comparing the RAB Floor Limit and the RAB for that pricing zone; and

- ARTC has reconciled revenues with the applicable revenue floor and ceiling limits and determined the allocation of any under or over recovery of revenue from Constrained Coal Customers in accordance with the HVAU.

1.2.1 Consultation

The ACCC published a consultation paper on 12 June 2013. It invited comments from interested parties on the non-confidential version of the Initial Compliance Submission that ARTC provided to the ACCC on 24 May 2013 to demonstrate its compliance with the financial model and pricing principles specified in the HVAU.

The ACCC received submissions from:

- Asciano Ltd (**Asciano**)

- Glencore Coal Assets Australia Pty Limited (**Glencore**)

- Idemitsu Australia Resources Pty Ltd (**Idemitsu**)

- Vale Australia Pty Ltd (**Vale**)

- Whitehaven Coal Limited (**Whitehaven**)

A summary of the submissions is included in section 2 of this document.

1.2.2 Information requests

The ACCC requested additional information from ARTC as provided for under section 4.10(c) of the HVAU. This information related to the efficiency of ARTC’s operating expenditure, prudency of capital expenditure and approach to allocating revenues across the Hunter Valley Coal Network and was confidentially provided to the ACCC.

[11] The ‘loss capitalisation model’ applies to Pricing Zone 3 because there is currently relatively lower demand for rail services due to the start-up nature of coal mines in the region and, therefore, ARTC is not currently expected to recover its full economic cost. During the assessment of the June 2011 HVAU, the ACCC considered the ‘loss capitalisation model’ to be appropriate in the circumstances as a way to encourage investment in new assets where there was limited initial demand.

The ACCC and ARTC also worked through some calculation and methodological errors that were identified in ARTC's confidential financial model relating to, for example, depreciation, interest during construction and disposal of assets.

2 Key issues

This section sets out the ACCC's views on the following key issues relating to the 2012 Compliance Period:

- prudency of capital expenditure, including interest during construction and disposals (section 2.1);
- efficiency of operating expenditure (section 2.2);
- allocation of revenues (section 2.3);
- true-up test audit (section 2.4); and
- other matters, including depreciation (section 2.5).

2.1 Prudency of capital expenditure

Sections 4.4(a) and (b) of the HVAU provide that net capital expenditure is defined as capital additions to the RAB and RAB Floor Limit, plus interest costs incurred during construction, less the written down value of any disposals.

Importantly, the HVAU requires that, for capital expenditure to be included in the RAB and RAB Floor Limit, it must be incurred on a 'prudent' basis. Subsection 4.10(d)(iii) of the HVAU explicitly provides that, if capital expenditure has been endorsed by the RCG in accordance with the consultation obligations set out in section 9 of the HVAU, then the ACCC will accept that capital expenditure as prudent for inclusion in the RAB and RAB Floor Limit. The RCG is a representative group made up of a range of stakeholders, including access holders and above-rail operators and the HVCCC (in a non-voting capacity).

The HVAU also provides that interest costs incurred during construction up until 1 July in the calendar year that the asset was commissioned and determined by reference to the appropriate rate of return as well as interest costs and disposals incurred on a prudent basis.[12]

2.1.1 ARTC's Initial Compliance Submission

In its Initial Compliance Submission, ARTC sought to roll forward into its RAB Floor Limit total capital expenditure of $536,529,398 (including interest during construction of $52,473,777) less disposals of $9,345,385.[13]

ARTC confidentially gave to the ACCC evidence of RCG endorsement of 'Major' and 'Minor' capital expenditure amounts and provided details and calculations of interest during construction and disposals in its confidential financial model.

2.1.2 Stakeholders' comments

Stakeholders' comments have been arranged under three key issues: capital expenditure additions, interest during construction and disposals.

Capital expenditure additions

Idemitsu noted some further refinements to the RCG consultation processes were needed, in particular:[14]

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[12] See section 4.4 of the HVAU.

[13] ARTC, *Initial Compliance Submission*, 24 May 2013, p. 12.

> Idemitsu supports the continued and increased engagement with the Hunter Valley Coal Chain Coordinator (HVCCC) in assessing coal chain capacity associated with a capital project and determining optimal capital projects (prioritising capital projects). The outcome of this increased engagement should then be shared with the RCG and be included in all associated project documentation to enable Access Holders to fully understand the costs and benefits of the proposed project and permit informed decision making.

Idemitsu also noted that there appeared to be a minor discrepancy in ARTC's calculations for the split between 'Major' and 'Minor' capital expenditure, although also noting that the correct total figure appears to have been used in the RAB and RAB Floor limit calculations.[15]

Glencore raised concerns about the RCG consultation process and the cost base of projects ARTC put to the RCG for endorsement:[16]

> The RCG has a number of times noted concerns regarding the high cost base of key projects and challenged via the RCG the ARTC to justify and reconcile the identified cost base or the project methodology (alliance structures etc). However, in a situation where the network has been congested or constrained, and the development of key infrastructure would potentially reduce the constraint or congestion, a delay imposed by the RCG to allow the ARTC to review, prepare and provide information (and, where available, reconciliation) of the cost base was a number of times considered a high risk delay given the potential cost in capacity to the system.

Vale raised some concerns about the RCG consultation process and prioritisation of capital projects, submitting that:[17]

> After spending this significant amount of capital there still remains a large gap between the HVCCC declared capacity and the ARTC contract capacity for 2013 … Vale believes there needs to be greater co-ordination between ARTC and the HVCCC, as the owner of the coal chain model, to understand the coal chain benefits of each capital expansion. This level of detail and understanding should be developed together and provided as part of any submission to the RCG. Vale expects this level of understanding would provide more clarity to the RCG on expected system capacity gains and the prioritisation of expansions.

Asciano submitted that 'there should be a stronger focus by ARTC on capital expenditure designed to address track congestion'.[18]

Interest during construction

Vale queried ARTC's calculation of interest during construction, noting that:[19]

> The calculation of IDC appears to be inconsistent with the approach taken in prior years. The calculation this year appears to assume that first year project cashflows commence at the start of the year as the interest calculated is for the full year. In prior years the IDC calculation appears to assume a mid-year cashflow in determination of the IDC.

Asciano submitted that it has 'no particular issue with the approach used as long as interest is only taken into account once and the approach is used consistently by ARTC from one year to the next'.[20]

Disposals

Vale noted that a large proportion of the disposals value relates to re-railing of line segment 964 and raised concerns that 'a line segment is being disposed when, judging by the RAB value, it is not close to its end of life'.[21]

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[14] Idemitsu, *Submission in response to ACCC Consultation Paper*, 15 July 2013, p. 2.
[15] Ibid, p. 2.
[16] Glencore, *Submission in response to ACCC Consultation Paper*, 12 July 2013, pp. 1-2.
[17] Vale, *Submission in response to ACCC Consultation Paper*, 10 July 2013, p. 1.
[18] Asciano, *Submission in response to ACCC Consultation Paper*, 12 July 2013, p. 1.
[19] Vale, Op Cit, p. 2.
[20] Asciano, Op Cit, p. 1.

2.1.3 ACCC's assessment

The ACCC's assessment has been arranged under three key issues: capital expenditure additions, interest during construction and disposals.

Capital expenditure additions

As set out above, the HVAU explicitly provides that, if capital expenditure has been endorsed by the RCG, then the ACCC must accept that the capital expenditure is prudent. The ACCC reviewed the confidential documents provided by ARTC and was satisfied that these documents provided evidence of RCG endorsement for the 'Major' capital expenditure that ARTC sought to include in the RAB and RAB Floor Limit for the 2012 Compliance Period. However, the ACCC had some concerns with the evidence submitted by ARTC for 'Minor' capital expenditure. In particular, the ACCC was unable to reconcile the amounts and scope of works that ARTC sought to include in the RAB and RAB Floor Limit with the collective 'Minor' capital expenditure amount and scope of works endorsed by the RCG.

ARTC subsequently provided further supporting information to assist the ACCC's assessment and reconciliation for 'Minor' capital expenditure, including providing an explanation of material changes from the RCG endorsed amount and/or scope of works. The ACCC considers that this additional information sufficiently supports the collective 'Minor' capital expenditure amount being deemed prudent. Nevertheless, in light of the ACCC's additional enquiries and the identified difficulties in reconciling the amounts for 'Minor' capital expenditure, ARTC also proposed to make some changes to its RCG consultation processes that include providing the RCG with regular updates on the progress of endorsed expenditure (outlined in section 2.1.4 below). The ACCC considers that these changes to the RCG consultation processes will provide greater transparency to stakeholders about the capital expenditure amounts that they are endorsing, which will further inform future prudency assessments under the HVAU.

The ACCC acknowledges stakeholders' concerns regarding the RCG consultation processes more generally. The ACCC notes that the HVAU limits the scope for assessing the prudency of capital expenditure to only include those amounts not endorsed by the RCG and that ARTC has provided evidence of that endorsement for the 2012 Compliance Period. However, the ACCC strongly encourages ARTC to continue to work with stakeholders to refine and improve the consultation processes. The ACCC notes that the progress of the RCG consultation processes and how well they are working will inform any future undertaking that may replace the HVAU following its expiry in June 2016.

Interest during construction

The ACCC identified some methodological and calculation errors in ARTC's confidential financial model relating to interest during construction. For example, the ACCC identified that ARTC's calculations assumed a full year of interest costs in the first year of construction, whereas a half year should be assumed. The ACCC also identified that, in some instances, the incorrect rate of return had been applied in ARTC's calculations.

The ACCC raised these issues with ARTC, which subsequently re-evaluated its methodology and agreed that the calculation for interest during construction (using a five year period of construction as an example) should be:

Total IDC = IDC YR1 + IDC YR2 + IDC YR3 + IDC YR4 + IDC YR5, where

IDC YR1 = Capex YR1 x RoR x 0.5

IDC YR2 = Capex YR2 x RoR x 0.5

+ [Capex YR1 + IDC YR1] x RoR

IDC YR2 = Capex YR3 x RoR x 0.5

[21] Vale, Op Cit, p. 2.

+ [Capex YR1 + IDC YR1 + Capex YR2 + IDC YR2] x RoR

IDC YR4 = Capex YR4 x RoR x 0.5

+ [Capex YR1 + IDC YR1 + Capex YR2 + IDC YR2 + Capex YR3 + IDC YR3] x RoR

IDC YR5 = Capex YR5 x RoR x 0.5

+ [Capex YR1 + IDC YR1 + Capex YR2 + IDC YR2 + Capex YR3 + IDC YR3 + Capex YR4

+ IDC YR4] x RoR x 0.5

And, for years covered under IPART: RoR = 10.92%. For years covered under HVAU: RoR = 11.83%.

ARTC agreed to make the necessary changes in its revised compliance submission. These changes result in the total interest during construction amount being revised from $52,473,777 to $43,839,220.

Disposals

The ACCC sought further information from ARTC specifically relating to the disposal of $7,026,026 for the re-railing of line segment 964, noting Vale's particular concerns regarding the large proportion of disposals apportioned to the segment.

ARTC provided information to the ACCC that explained how the disposal amount arose and how the value of disposals was determined. In particular, ARTC advised that the amount related to the installation of concrete sleepers to replace timber sleepers and a smaller number of low profile concrete sleepers that were unsuitable for 30 tonne axle load use. ARTC also identified that it had incorrectly apportioned the total amount to line segment 964, when it should have been apportioned across segments 963, 964 and 965. ARTC further identified that it had made some calculation errors in its Initial Compliance Submission.

The ACCC reviewed ARTC's confidential information, including its revised calculation and methodology, and was satisfied that the approach taken by ARTC was consistent with previously used methodology and, for this reason, appeared to be appropriate.

ARTC agreed to make the necessary changes in its Revised Compliance Submission, noting that these changes result in the total disposal amount being revised from $9,345,385 to $8,490,116.

2.1.4 ARTC's Revised Compliance Submission

In its Revised Compliance Submission, ARTC sought to roll forward into its RAB Floor Limit total capital expenditure of $527,894,841 (including interest during construction of $43,839,220) less disposals of $8,490,116.[22] A comparison of ARTC's Initial Compliance Submission and Revised Compliance Submission is set out in table 2.1 below.

22 ARTC, *Revised Compliance Submission*, 26 February 2014, p. 11.

Table 2.1: Net capital expenditure in ARTC's Initial and Revised Compliance Submission

Value	ARTC's Initial Submission for 2012 ($)	ARTC's Revised Submission for 2012 ($)
Major capital expenditure	444 487 652	444 487 652
Minor capital expenditure	39 567 969	39 567 969
Interest during construction	52 473 777	43 839 220
Disposals	- 9 345 385	- 8 490 116
Net capital expenditure	**527 183 813**	**519 404 725**

As noted above, ARTC also committed to making some changes to its stakeholder consultation processes for minor capital expenditure as follows:[23]

> ARTC proposes that in the future RCG be kept informed of the progress of the endorsed minor capital program where material changes are identified. That is, projects showing a forecast variance to costs to complete of +/-$50,000 of the amount endorsed or have encountered material change to timely delivery.
>
> ARTC has initiated a process to amend the current RCG consultation and endorsement process accordingly. It is intended that updates regarding delivery of the minor capital program will routinely be provided on a six monthly basis.
>
> ARTC will continue to work with the RCG to develop a satisfactory process that it hopes will assist the ACCC in coming to a view as to whether expenditure in relation to the minor capital works program has been incurred on a prudent basis. To this end, ARTC will keep the ACCC informed of the progress in relation to this development process.

2.1.5 ACCC's determination

The ACCC is satisfied that the Revised Compliance Submission has addressed the key issues set out above in the ACCC's assessment of prudency of capital expenditure. The ACCC has therefore determined that the net capital expenditure set out in ARTC's Revised Compliance Submission for the 2012 Compliance Period is prudent. The ACCC also welcomes ARTC's commitments to its consultation and endorsement processes, which are intended to improve transparency and the information provided to stakeholders.

2.2 Efficiency of operating expenditure

Section 4.10(e) of the HVAU provides for the ACCC to assess the efficiency of the ARTC's operating expenditure. Efficient costs and operating expenditure in turn informs the determination of the Full Economic Cost and the maximum amount of revenue that ARTC is entitled to receive.

Section 2(c) of Schedule G of the HVAU requires ARTC to submit a detailed breakdown of the Full Economic Costs for the review period into standard operating cost line items, return and depreciation, as well as provide comparative values from the previous review period.

2.2.1 ARTC's Initial Compliance Submission

In its Initial Compliance Submission, ARTC reported operating expenditure of $92.3 million for the 'constrained' network[24] and $12.4 million for Pricing Zone 3[25].

[23] ARTC, *Revised Compliance Submission*, pp. 14-15.

ARTC provided an explanation of the increases in maintenance costs, network control and corporate overheads. ARTC compared the 2012 figures with the previous year, as well as its own forecast figures for the period. ARTC's confidential financial model that was provided to the ACCC also provided some more detail on operating costs.

ARTC submitted that the overall cost of maintenance work performed for the 2012 Compliance Period was largely in alignment with the costs incurred in 2011 and with forecasts that were advised to access holders. ARTC specifically noted that:[26]

> [Fixed] maintenance expenditure was forecast to increase by around 36% over that in 2011 to reflect increased cyclic activity and volumes. Actual maintenance expenditure in 2012 was only 21% over that advised in 2011 due largely to the lower than expected task.
>
> Actual variable maintenance was around 16% lower than forecast in the advice, which is consistent with lower than forecast volumes.

ARTC also noted that there had been 'a step change in resourcing required for the Hunter Valley Coal Network'.[27]

In relation to network control costs, ARTC submitted that cost increased compared to 2011 due to a combination of:[28]

- transitioning costs for new staff associated with high 2011 staff turnover;
- new positions to support the ARTC functions within the HVCCC; and
- new positions to enable workload management required due to growth of the Ulan line and Gunnedah basin volumes.

Finally, ARTC submitted that corporate overheads were largely in alignment with 2011 costs, with a small increase that reflects the increased share of constrained coal train kilometres.[29]

2.2.2 Stakeholders' comments

Vale noted that there was a significant increase in total operating costs in 2012 and that the information provided by ARTC was insufficient to justify the increase:[30]

> The ARTC submission notes a significant increase in total operating costs for 2012 compared to the 2011 full year equivalent. ARTC is showing an increase in costs over all categories listed in their Compliance Assessment submission. It is difficult to accurately comment on these numbers based on the information provided in the submission, although Vale is concerned by this general increase in total operating costs. Vale believes that an incentive measure needs to be developed to encourage ARTC to ensure any operating costs are incurred in an efficient manner.

Idemitsu also expressed concerns regarding the lack of detail in justifying the increase in operating expenditure in 2012:[31]

> Idemitsu acknowledges the increases in volumes across the network, particularly from the Ulan line and the Gunnedah Basin. However, given the information provided in the ARTC submission it is difficult to determine if such an increase is reasonable. Idemitsu would be supportive of any equitable and transparent mechanism which ensured ARTC incurs network operating costs in an "efficient" but lowest cost manner.

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24 ARTC, *Initial Compliance Submission*, p. 20.
25 Ibid, p. 10.
26 ARTC, *Initial Compliance Submission*, p. 22.
27 Ibid, p. 22.
28 Ibid, p. 23.
29 Ibid, p. 24.
30 Vale, Op Cit, p. 2.
31 Idemitsu, Op Cit, p. 2.

Asciano expressed its concern regarding a lack of performance incentive scheme:[32]

> In relation to ARTC operating expenditure Asciano is concerned that there is not yet a performance incentive scheme which will act to provide incentives for ARTC to ensure that operating costs, maintenance and corporate costs are incurred at an efficient level. Such a scheme is required under the current HVAU and while Asciano recognises that work on this incentive scheme is progressing Asciano believes that there should be stronger focus on finalising and implementing this scheme.

2.2.3 ACCC's assessment

ARTC's operating expenditure comprises:[33]

- maintenance costs (such as major periodical maintenance and reactive corrective routine maintenance);
- network control costs (such as labour and materials associated with train control, signalling and operations); and
- corporate overheads (such as labour and materials associated with head office functions, including human resources, legal, finance etc).

Maintenance costs make up the largest proportion of ARTC's total operating expenditure. Moreover, ARTC's total operating costs for the 'constrained' network increased by approximately $25.2 million (or 37.5 per cent) in 2012 compared to annualised figures from the previous compliance period. The bulk of the increase was attributable to maintenance costs, which increased by $20.1 million (or 41 per cent). The ACCC has therefore focussed its assessment on ARTC's maintenance costs. The ACCC has also considered ARTC's explanation for variances in network control costs and corporate overheads for the 2012 Compliance Period, as well as reviewing ARTC's financial model to confirm that ARTC has allocated its operating expenditure across the Hunter Valley Coal Network in accordance with the requirements under the HVAU. The ACCC's views on these are discussed below.

Maintenance expenditure

The ACCC has sought to assess the efficiency of ARTC's maintenance expenditure by conducting a trend analysis of expenditure amounts and also making comparisons against available benchmarks.

The ACCC notes that ARTC's operating expenditure for Pricing Zones 1 and 2 was deemed efficient and approved by IPART in accordance with the NSWRAU prior to the HVAU coming into effect in June 2011. The ACCC therefore considers that operating expenditure incurred under the NSWRAU provides a useful reference for a trend analysis. In relation to benchmarks, however, the ACCC notes that there is limited data available due to only a small number of comparable below-rail operators in Australia. Nevertheless, during this assessment, the ACCC has considered to what extent expenditure amounts by other below-rail operators provides useful insight into ARTC's expenditure.

As highlighted by stakeholders' comments above, ARTC initially provided limited information and explanation of increases in the level of operating expenditure it incurred for the 2012 Compliance Period. The ACCC requested further information from ARTC to enable a more robust assessment, which included more detail on the key maintenance activities driving the increase in maintenance costs.

In response to the ACCC's request, ARTC provided to the ACCC (on a confidential basis) contextual information to explain reasons for variances in expenditure amounts as well as more detail regarding the six major maintenance activities (out of a total of over one hundred

[32] Asciano, Op Cit, p. 1.

[33] ARTC, *Initial Compliance Submission*, pp. 21-24.

activities) that together made up the largest proportion of maintenance costs. The six major activities for 2012 were:

- ballast cleaning;
- full track conditioning (mudhole rectification);
- tamping (resurfacing);
- rail grinding;
- rail defects removal; and
- drainage works (cess and top drain maintenance).

ARTC described the nature of the activity, the fixed and variable track maintenance split applied by ARTC for each activity and the assumptions supporting the split. ARTC also provided five years of historical expenditure data for the top six track maintenance activities (where available) as well as forecast expenditure to 2019.

Based on the available information, the ACCC considered whether ARTC's underlying cost assumptions were appropriate and whether ARTC's overall level of expenditure as well as the amount of expenditure in each Pricing Zone was reasonable. These considerations are set out in the following paragraphs.

The ACCC reviewed the fixed and variable maintenance split applied by ARTC for each activity based on the additional information provided by ARTC. The split is important because the variable component is used by ARTC to determine the costs attributed to each mine-to-port combination in ARTC's financial model. The ACCC does not consider ARTC's split to be unreasonable when considered alongside the track maintenance splits outlined in reports by the Bureau of Transport and Regional Economics (BTRE) and the Queensland Competition Authority (QCA) and taking into account variances in track and train standards of the Hunter Valley Coal Network.

The ACCC has also reviewed the level of ARTC's maintenance expenditure on a per unit basis and compared the amounts to available benchmarks. As previously noted, there is limited available data for track maintenance expenditure on coal rail networks for comparison. However, the ACCC notes that a Booz & Company report prepared for IPART in 2011 found that Queensland Rail's (QR's) coal network provided a useful comparison for the Hunter Valley coal network.[34] Nevertheless, the ACCC also notes that compared to QR's coal network, the Hunter Valley Coal Network has a number of differentiating factors that would be expected to contribute to variances in costs. For example, the Hunter Valley Coal Network has:

- six times higher coal volumes, which leads to more coal dust contamination and higher maintenance expenditure. This is especially evident in Pricing Zone 1, where there are multiple tracks. In contrast, QR's coal network is single-track;
- five times more turnouts per track kilometre, which has a large influence on maintenance expenditure;
- high number of point motors and signals, which requires higher levels of ongoing maintenance.

Taking these differentiating factors into account, the ACCC's view is that the level of ARTC's maintenance expenditure on the Hunter Valley Coal Network is likely to have been efficient in 2012. For example, on a per track kilometre basis, ARTC's track maintenance expenditure has

[34] Booz & Company, *Review of Efficient Maintenance Costs of RailCorp's Hunter Valley Coal Network; Final report to IPART*, 17 November 2011, p. 11.

historically been lower than QR's coal network. ARTC's track maintenance expenditure for the 2012 Compliance Period was higher than historical figures, which were indexed to 2012 for comparison. However, as discussed below, the ACCC identified that the increase in the most recent period was mostly due to significant increases in two key maintenance activities (discussed below) and, removing the effects of these particular events, the ACCC found that ARTC's expenditure was in line with historical figures.

Finally, the ACCC reviewed ARTC's maintenance expenditure across pricing zones and over time. The ACCC did initially have some concerns with variances in expenditure that became evident from this analysis and sought further information from ARTC. For example, the ACCC identified significant increases in ballast cleaning and full track conditioning in certain pricing zones. However, based on further information provided by ARTC, the ACCC is satisfied that the increases were partially reflective of the cyclical nature of the tasks as well as an increase by ARTC in the timing and scope of the task to fall in line with worldwide heavy haul practices. The ACCC also found that, where there had been recent increases, ARTC provided forecasts that showed a decrease in future periods consistent with the program moving across pricing zones.

The ACCC notes that the forecast information confidentially submitted by ARTC to the ACCC as part of this assessment provided useful context to the cyclical nature of maintenance programs and will also assist in informing future annual compliance assessments.

Network control costs and corporate overheads

As set out in section 2.2.1, ARTC submitted that network control costs increased for the 2012 Compliance Period due to high staff turnover, which resulted in increased training for new network staff members, as well as new train management positions to cope with volume increases. ARTC submitted that corporate overheads increased in line with the greater share of constrained coal train kilometres compared with ARTC's total network train kilometres.

The ACCC's view is that ARTC's explanation for the level of network control and corporate overheads is reasonable. Taking these factors into consideration when comparing with historical figures, ARTC's expenditure is likely to have been efficient in 2012.

Other matters

On the basis that the overall level of ARTC's operating expenditure is likely to have been efficient in 2012, the ACCC has reviewed ARTC's financial model and found that ARTC has allocated costs in accordance with the provisions outlined in section 4.6 of the HVAU.

The ACCC notes stakeholders' specific comments regarding performance incentives for ARTC. Section 13.3 of the HVAU requires ARTC to develop performance incentives, which are expected to be submitted by ARTC to the ACCC for assessment over the next twelve months.[35] These performance incentives are intended to encourage ARTC, through financial reward, to improve operating, maintenance and capital expenditure efficiency. The ACCC considers that, once in place, these performance incentives will assist in ensuring the ongoing efficiency of ARTC's operating expenditure.

2.2.4 ARTC's Revised Compliance Submission

ARTC has retained the same level of operating expenditure in its Revised Compliance Submission as in the Initial Compliance Submission as set out in table 2.2 below.

[35] ARTC submitted a proposed performance incentive scheme to the ACCC in August 2012 in accordance with section 13.3 of the HVAU. However, in light of feedback from industry, ARTC withdraw its proposal from the ACCC's consideration in December 2012. ARTC is expected to submit a revised proposal within the next twelve months. For more information on this proposal, see the ACCC's website.

Table 2.2: Operating expenditure in ARTC's Initial and Revised Compliance Submission

Pricing Zone	ARTC's Initial and Revised Submission for 2012 ($)
Pricing Zone 1 and 2 'constrained' network[36]	92 339 013
Pricing Zone 3 'unconstrained' network	12 420 623
Total operating expenditure[37]	**104 759 636**

2.2.5 ACCC's determination

For the reasons set out in section 2.2.3, the ACCC has determined that ARTC's operating expenditure for the 2012 Compliance Period as set out in the Revised Compliance Submission is efficient.

2.3 Allocation of revenues

Section 1.1 of this paper provides a summary of the reconciliation of access revenue with the applicable floor and ceiling limits that applies under the HVAU. Importantly, where ARTC recovers less than the applicable ceiling limit in Pricing Zones 1 and 2, the HVAU provides for ARTC to recover the 'shortfall' from Constrained Coal Customers. Revenue shortfalls in Pricing Zone 3 are capitalised into the asset base to allow for recovery from Pricing Zone 3 originating coal producers in future years (i.e. 'loss capitalisation' applies).

Reconciling access revenue with the revenue cap requires that revenue received from access holders be allocated to particular segments and pricing zones for comparison with the applicable ceiling limits.

2.3.1 ARTC's Initial Compliance Submission

In its Initial Compliance Submission, ARTC's reconciliation of access revenue with the applicable ceiling limits involved allocating a portion of revenue collected from trains traversing Pricing Zone 1 to offset costs that were incurred in Pricing Zone 3. ARTC submitted that total revenue of $241.8 million was collected from Constrained Coal Customers and therefore allocated to the 'constrained' network[38] while $42.9 million was attributed to Pricing Zone 3[39].

2.3.2 Stakeholders' comments

ARTC's approach to revenue allocation was set out in confidential information provided in support of its Initial Compliance Submission. As such, stakeholders were not given an opportunity to comment on the approach during the ACCC's public consultation.

2.3.3 ACCC's assessment

The annual compliance assessment under the HVAU provides for the ACCC to determine whether ARTC's calculations relevant to the reconciliation of access revenue are in accordance with the HVAU. In this regard, the ACCC notes that the HVAU does not specify how revenue is to be allocated to particular pricing zones or segments for the purposes of compliance with the revenue cap. However, the HVAU does include objectives such as:

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36 Note that this excludes operating expenditure associate with a small number of segments in Pricing Zone 1 that are deemed to be 'unconstrained'

37 See footnote 13.

38 ARTC, *Initial Compliance Submission*, p. 20.

39 Ibid, p. 10.

- the use of transparent and detailed methodologies, principles and processes for determining Access revenue limits, terms and conditions (clause 1.2(c));

- reaching an appropriate balance between the legitimate business interests of ARTC, the interest of the public, and the interests of applicants seeking access rights to the network, including providing access in a transparent, efficient and non-discriminatory manner (clause 1.2(d)); and

- operating consistently with the objectives and principles in Part IIIA of the CCA and the Competition Principles Agreement (clause 1.2(e)). The objects of Part IIIA include promoting the economically efficient operation of, use of, and investment in infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets.

The ACCC understands that the effect of ARTC's approach to revenue allocation was that producers originating in Pricing Zone 3 pay only for the direct costs (defined in the HVAU as variable maintenance costs) as they traverse the rail network in Pricing Zone 1. The remainder of revenue received from Pricing Zone 3 producers was allocated to offset costs and reduce the capitalised losses in Pricing Zone 3. As such, all of the remaining operating and capital costs of the rail network in Pricing Zone 1 would be incurred by producers originating in Pricing Zones 1 and 2.[40] ARTC submitted that its approach to revenue allocation is the outcome of the application of the combinatorial model.

The ACCC is of the view that it is important to consider the appropriateness of ARTC's approach to revenue allocation and the subsequent impact on cost recovery. In particular, the ACCC notes that Pricing Zones 1 and 2 originating coal producers cover all of the fixed costs in Pricing Zone 1 even though they are unable to utilise the full capacity due to Pricing Zone 3 originating traffic.

The ACCC sought further information from ARTC in relation to the approach to revenue allocation and its compliance with the HVAU. ARTC provided confidential information to the ACCC which explained the basis for the approach and the effect of the approach on access charges. In particular, ARTC noted that its approach was accepted under the NSWRAU overseen by IPART. ARTC retained the approach taken under the NSWRAU for the 2012 Compliance Period under the HVAU.

On the basis of the information currently before it, including the confidential information provided to the ACCC by ARTC during this assessment, the ACCC is satisfied that ARTC has complied with the HVAU financial model for the period under review. In forming this view the ACCC notes that ARTC's approach was considered appropriate under the NSWRAU in the circumstances which existed in the Hunter Valley at that time.

2.3.4 ARTC's Revised Compliance Submission

ARTC has retained the same approach to allocation of revenue in its Revised Compliance Submission as in the Initial Compliance Submission, as shown in table 2.3 below. This approach underpins ARTC's submitted under-recovery of $4.82 million on the 'constrained' network[41] and the roll forward of the RAB in Pricing Zone 3 for the 2012 Compliance Period.

40 This occurs while Pricing Zone 3 is part of the 'unconstrained' network and 'loss capitalisation' applies.

41 ARTC, *Revised Compliance Submission*, p. 19.

Table 2.3: Revenue allocation in ARTC's Initial and Revised Compliance Submission

Pricing Zone	ARTC's Initial and Revised Submission for 2012 ($)
Pricing Zone 1 and 2 'constrained' network[42]	241 824 863
Pricing Zone 3 'unconstrained' network	42 878 785
Total revenue[43]	**284 703 648**

2.3.5 ACCC's determination

The ACCC has reviewed ARTC's approach to revenue allocation for the 2012 Compliance Period and, for the reasons outlined above in section 2.3.3, is satisfied that ARTC has complied with the HVAU financial model for the period under review.

2.4 True-Up Test audit

The HVAU incorporates liability arrangements in the Indicative Access Holder Agreement that provides for the payment of rebates to users for ARTC's failure to deliver contracted path usages. The payment of these rebates occurs following the completion of an annual reconciliation process, which is informed by the True-Up Test.

The True-Up Test 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.

Section 4.10(f) of the HVAU requires an independent audit of ARTC's compliance with the True-Up Test, to ensure the integrity of the test and avoid perceptions of conflicts of interest on the part of ARTC. ARTC engaged BDO (SA) Pty Ltd (**BDO**) as auditor for the True-Up Test, which the ACCC approved in accordance with section 4.10(f)(ii).

2.4.1 ARTC's Initial Compliance Submission

ARTC submitted that a 'True-Up Test was performed for the period 1 February to 31 December 2012, the period in which executed Access Holder Agreements were operational'.[44] BDO prepared a final audit report regarding ARTC's True-Up Test for 2012, which was provided to the ACCC on 24 May 2013 as part of ARTC's Initial Compliance Submission. ARTC submitted that BDO's final audit report concluded that it was not liable for any rebates for 2012.

2.4.2 Stakeholders' comments

Whitehaven raised concerns with ARTC's application of the True-Up Test for Pricing Zone 3 and the findings of BDO's report, particularly in relation to the month of December 2012. Whitehaven noted that the assessment outcome suggests no system shortfall for a month in which about two thirds of the path availability for the zone was lost for about two thirds of the time.[45] Whitehaven provided the following as an example:[46]

> In that month Whitehaven's pathing capacity was severely impacted by a prolonged line closure due to a derailment at Cox's Creek bridge near Boggabri. The derailment occurred on 28th November on the bridge over Cox's Creek causing major structural damage to the bridge. The main line north of this

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[42] Note that this excludes revenue allocated to a small number of segments in Pricing Zone 1 that are deemed to be 'unconstrained'

[43] See footnote 13.

[44] ARTC, *Initial Compliance Submission*, p. 29.

[45] Whitehaven, *Submission in response to ACCC Consultation Paper*, 3 July 2013, pp. 2-3.

[46] Ibid, pp. 2-3.

> point was closed until ARTC were able to complete repair works to the bridge and bridge approaches on 20th December. As a result of this line closure, no system capacity was available to Whitehaven for services from its Narrabri Mine, nor for Idemitsu from their Boggabri Mine, during this 22 day period.
>
> Whitehaven estimates that the current demand levels from Narrabri and Boggabri load points exceeds two thirds of the total coal pathing requirements from Zone 3. Whitehaven have assessed that we alone lost in the order of 50 trains from Narrabri during the period that the line was closed, and have paid ARTC ToP charges for this unrealisable pathing capacity worth in excess of $2 million.

Idemitsu made reference to Whitehaven's submission and shared its concerns regarding the results of the True-Up Test for December 2012. Idemitsu noted that it paid take or pay charges despite it being unable to utilise its paths in Pricing Zones 1 and 3 for a period of 22 days and is concerned that there was no shortfall in system availability recognised for this period. Idemitsu noted that, if this is the correct application of the HVAU, then considerable review needs to be part of the next undertaking.[47]

Glencore submitted that a number of the comments noted in the audit report for the True-Up Test need to be challenged and tested before any subsequent access holder liability is applied (i.e. the validation of track capacity 'sold' to access holders, the statement that "no system shortfall was recorded in the period" and that only "minor exceptions" were noted by the auditor.[48] In support of this view, Glencore noted a number of areas where it believes ARTC is not managing the rail network efficiently.[49]

2.4.3 ACCC's assessment

The True-Up Test is subject to audit by an independent party with the appropriate qualifications in order to ensure the integrity of the test. The ACCC notes that BDO's final audit report concludes that:[50]

> In our opinion, ARTC has complied, in all material respects, with Schedule 2 of the Access Holder Agreements under the HVAU for the year ended 31 December 2012.

The ACCC specifically notes BDO's comments that:[51]

> No system availability shortfall was recorded for any period during the year meaning no accruals were required to be paid.

On the basis of BDO's report, the ACCC considers it appropriate to accept the outcome of the True-Up Test for the 2012 Compliance Period. However, the ACCC acknowledges the concerns raised by stakeholders in relation to the findings of the True-Up Test. The ACCC notes that section 13.4 of the HVAU requires ARTC to conduct a review of the operation and effectiveness of the TUT in consultation with stakeholders after 31 December 2013. The ACCC's Final Decision on the HVAU specifically noted the following as the reason for the review:[52]

> The ACCC considers that the system TUT is an innovative but complex feature of the HVAU, and while it may work to ensure ARTC is accountable for its performance, it is untested. A review of the system TUT in light of practical experience of the operation of the HVAU is therefore a valuable and appropriate inclusion. The ACCC would expect the review to demonstrate that the TUT has worked as intended, and has provided an appropriate mechanism by which to ensure ARTC's accountability. If this is revealed not to be the case, the ACCC may at the relevant time re-examine the appropriateness of the TUT and TOP rebate scheme in the context of ARTC's performance and accountability framework. At this stage, however, when combined with the revisions made to address the ACCC views in the Position Paper, the ACCC considers that the inclusion of the review supports a conclusion that the performance and accountability framework is appropriate.

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47 Idemitsu, Op Cit, pp. 2-3.

48 Glencore, *Submission in response to the ACCC's Consultation Paper*, 12 July 2013, pp. 2-4.

49 Ibid, pp. 2-3.

50 BDO, *Independent Compliance Audit Report to Australian Rail Track Corporation Ltd*, provided to the ACCC by ARTC on 24 May 2013, p. 1.

51 ibid. p. 3.

52 ACCC, *Final Decision; Hunter Valley Coal Network Undertaking*, 29 June 2011, p. 67.

The ACCC encourages ARTC and industry to take the review as an opportunity to consider the issues raised and whether any changes to the True-Up Test are necessary.

2.4.4 ARTC's Revised Compliance Submission

ARTC has retained the same outcome from the True-Up Test in its Revised Compliance Submission as in the Initial Compliance Submission.

2.4.5 ACCC's determination

For the reasons outlined above in section 2.4.3, the ACCC does not object to the outcome of the True-Up Test for the 2012 Compliance Period, which found that ARTC is not liable for any rebates for 2012.

2.5 Other matters

During the assessment process, the ACCC also sought further clarification from ARTC on its methodology and calculation of depreciation, which is set out in ARTC's confidential financial model that is not provided to industry. The ACCC has reviewed the further information provided by ARTC and is satisfied that ARTC has applied a methodology that is consistent with the requirements under the HVAU.

The ACCC notes that ARTC has revised the total depreciation amount from $66,543,599 in its Initial Compliance Submission to $66,368,462 in its Revised Compliance Submission as a result of changes in capital expenditure amounts discussed in section 2.1.

Further, as outlined in section 2.1, ARTC has committed to providing more regular updates to stakeholders in relation to its minor capital works program in response to queries by the ACCC during this assessment about the clarity and transparency of information. The ACCC welcomes this move by ARTC but considers that there is value in also having a review which will consider issues such as the provision of information to stakeholders and the methodologies underpinning revenue allocation across the Hunter Valley coal network. The ACCC considers that such a review will assist in increasing transparency and informed decision making. Accordingly, the ACCC intends to undertake a public review in which industry stakeholders will be given an opportunity to provide their views.

3 Determination

This section sets out the ACCC's determination in relation to the annual compliance assessment under ARTC's HVAU for the 2012 Compliance Period. In particular, the ACCC's determination on the following key components of the assessment:

- RAB roll forward for Pricing Zone 3 (section 3.1);
- RAB Floor Limit roll forward for the entire network and for Pricing Zone 3 (section 3.2)
- Comparison of the RAB and RAB Floor Limit for Pricing Zone 3 (section 3.3)
- Reconciliation of revenue with the applicable Ceiling Limit (section 3.4)
- Allocation of unders and overs amount to access holders (section 3.5)

3.1 RAB roll forward

Section 4.10(d)(i) of the HVAU requires the ACCC to determine whether ARTC has undertaken the roll forward of the RAB in accordance with the HVAU. The RAB is rolled forward in Pricing Zone 3 for comparison with the RAB Floor Limit to determine if 'loss capitalisation' applies. Section 4.4(a) of the HVAU outlines how the RAB is to be rolled forward annually.

3.1.1 ARTC's Compliance Submission

Applying the RAB roll forward formula outlined above, ARTC determined the closing value of the RAB in Pricing Zone 3 for the 2012 Compliance Period to be as follows:

Table 3.1: Pricing Zone 3 RAB roll forward[53]

Value	ARTC's Initial Submission ($)	ARTC's Revised Submission ($)
Opening RAB for Pricing Zone 3	**192 214 184**	**192 214 184**
add Return on Opening RAB	22 738 938	22 738 938
less Revenue	42 878 785	42 878 785
add Operating Expenditure	12 420 623	12 420 623
add Net Capital Expenditure	96 228 800	95 853 777
add Return on Net Capital Expenditure	5 691 933	5 669 751
Closing RAB for Pricing Zone 3	**286 415 693**	**286 018 488**

3.1.2 ACCC determination

Based on the Revised Compliance Submission, the ACCC has determined that ARTC has undertaken the roll forward of the RAB for Pricing Zone 3 in accordance with the HVAU. In making this determination the ACCC has had regard to the formula in section 4.4(a) of the HVAU and the inclusion of efficient costs and prudent capital expenditure, as discussed in section 2 of this document. Accordingly, the closing RAB for those segments in Pricing Zone 3 as at 31 December 2012 is $286,018,488.

[53] ARTC, *Revised Compliance Submission*, p. 9.

3.2 RAB Floor Limit roll forward

Section 4.10(d)(i) of the HVAU requires the ACCC to determine whether ARTC has undertaken the roll forward of the RAB Floor Limit in accordance with the HVAU. The RAB Floor Limit is rolled forward for the following purposes:

- in Pricing Zones 1 and 2, for calculating components of full economic cost; and
- in Pricing Zone 3, for comparison with the RAB to determine if 'loss capitalisation' applies.

Section 4.4(b) of the HVAU specifies how the RAB Floor Limit is to be rolled forward annually.

3.2.1 ARTC's Compliance Submission

Applying the RAB Floor Limit roll forward formula outlined above, ARTC determined the RAB Floor Limit closing value for the total network for the 2012 Compliance Period as follows:

Table 3.2: Network RAB Floor Limit roll forward[54]

Value	ARTC's Initial Submission ($)	ARTC's Revised Submission ($)
Opening RAB Floor Limit for entire network	**1 073 587 301**	**1 073 587 301**
add CPI	24 717 225	24 717 225
add Net Capital Expenditure[55]	527 184 013	519 404 725
less Depreciation	66 543 599	66 368 462
Closing RAB Floor Limit for entire network	**1 558 944 940**	**1 551 340 789**

ARTC also determined the RAB Floor Limit closing value for those segments in Pricing Zone 3 during the 2012 Compliance Period for the purpose of comparing it to the RAB, as follows:

Table 3.3: Pricing Zone 3 RAB Floor Limit roll forward[56]

Value	ARTC's Initial Submission ($)	ARTC's Revised Submission ($)
Opening RAB Floor Limit for Pricing Zone 3	**186 996 217**	**186 996 217**
add CPI	4 305 218	4 305 218
add Net Capital Expenditure[57]	96 228 800	95 853 777
less Depreciation	11 574 613	11 575 394
Closing RAB Floor Limit for Pricing Zone 3	**275 955 622**	**275 579 819**

3.2.2 ACCC determination

Based on the Revised Compliance Submission, the ACCC has determined that ARTC has undertaken the roll forward of the RAB Floor Limit in accordance with the HVAU for the 2012

54 ARTC, *Revised Compliance Submission*, p. 12.
55 Net Capital Expenditure = Capital Expenditure + Interest During Construction - Disposals
56 Ibid, p. 13.
57 Net Capital Expenditure = Capital Expenditure + Interest During Construction - Disposals

Compliance Period. In making this determination the ACCC has had regard to the formula in section 4.4(b) of the HVAU and the inclusion of efficient costs and prudent capital expenditure, as discussed in section 2 of this document. Accordingly, the closing RAB Floor Limit for the total network at 31 December 2012 is $1,551,340,789 and the closing RAB Floor Limit for Pricing Zone 3 is $275,579,819.

3.3 Comparison of the RAB and RAB Floor Limit for Pricing Zone 3

As outlined in sections 3.1 and 3.2 above, the ACCC has determined that the closing RAB value for Pricing Zone 3 for the 2012 Compliance Period is $286,018,488 and the closing RAB Floor Limit for Pricing Zone 3 is $275,579,819.

Given that the RAB is greater than the RAB Floor Limit in Pricing Zone 3, 'loss capitalisation' applies and ARTC is not required reconcile access revenue with the applicable Ceiling Limit for Pricing Zone 3 (see section 4.3(b) of the HVAU).

The ACCC notes that, based on the Revised Compliance Submission, the cumulative losses capitalised into the Pricing Zone 3 asset base as at the end of the 2012 Compliance Period is $10,438,669.[58]

3.4 Reconciliation of revenues with the applicable Ceiling Limit

Section 4.10(d)(ii) of the HVAU requires the ACCC to determine whether ARTC has reconciled access revenue with the applicable Ceiling Limit in accordance with the HVAU.

The Ceiling Limit for Pricing Zones 1 and 2 requires that access revenue from any Access Holder or group of Access Holders must not exceed the Economic Cost of those segments which are required on a standalone basis for the Access Holder or group of Access Holders (see section 4.3(a) of the HVAU). As per section 3.3 above, ARTC is not required to reconcile access revenue with the Ceiling Limit for Pricing Zone 3.

ARTC's ceiling test model calculates the amount of access revenue and the Economic Cost across the segments utilised by a mine or combination of mines. The combination of mines that is closest to, or exceeds, the economic cost for the relevant segments is called the 'Constrained Group of Mines' and the segments comprise the 'constrained' part of the Hunter Valley Coal Network.

3.4.1 ARTC Revised Compliance Submission

ARTC reconciled the access revenue received for Pricing Zones 1 and 2 with Full Economic Cost for the 2012 Compliance Period as follows:

58 Cumulative losses capitalised = Closing RAB – Closing RAB Floor Limit for Pricing Zone 3, which at the end of the 2012 Compliance Period includes capitalised losses from 2011 and 2012.

Table 3.4: Ceiling test[59]

Value	ARTC's Initial Submission ($)	ARTC's Revised Submission ($)
Operating Expenditure	92 339 014	92 339 014
add Depreciation	54 747 590	54 571 672
add Net loss on disposal	2 150 505	1 744 277
add Return on assets	98 317 624	97 988 734
Full economic cost for 'constrained' network	**247 554 733**	**246 643 697**
Revenue received for 'constrained' network	**241 824 863**	**241 824 863**
Difference for 'constrained' network	**- 5 729 870**	**- 4 818 834**

3.4.2 ACCC determination

Based on the Revised Compliance Submission, the ACCC considers that ARTC has undertaken the reconciliation of access revenue with the applicable Ceiling Limit in accordance with the HVAU. In making this determination the ACCC has had regard to the components of economic cost in clause 4.5(a) of the HVAU, the inclusion of efficient operating expenditure (as discussed in section 2.2 of this document) and the allocation of revenue (as discussed in section 2.3 of this document). This reconciliation has determined an under-recovery of $4,818,834 for the 2012 Compliance Period.

3.5 Allocation of unders and overs amount to access holders

Section 4.10(d)(ii) of the HVAU requires the ACCC to determine whether ARTC has allocated the total 'unders and overs' amount to access holders in accordance with the HVAU. The 'unders and overs' amount is determined through the reconciliation of access revenue received with the applicable Ceiling Limit for the 'constrained' network as set out in section 3.4 above.

Based on the Revised Compliance Submission, ARTC's total under-recovery for the 'constrained' network for the 2012 Compliance Period was $4,818,834. The proportion of this amount that is allocated to each Constrained Coal Customer in accordance with section 4.9 of the HVAU is based on:

> the proportion of revenue paid for access rights over the Constrained Network by each Constrained Coal Customer, net of any rebate of the take or pay component of the Charges paid to that Constrained Coal Customer.

As required by section 4.9(b)(ii), ARTC provided a spreadsheet to the ACCC (on a confidential basis) that set out the allocation of the total 'unders and overs' amount for the 2012 Compliance Period. The ACCC has determined that ARTC has calculated the allocations in accordance with the HVAU. In making this determination, the ACCC has had regard to the outcome of the True-Up Test for the 2012 Compliance Period (as discussed in section 2.4 of this document) and the principles of allocation in section 4.9 of the HVAU. Accordingly, ARTC's under-recovery of $4,818,834 for the 2012 Compliance Period is to be recovered from Constrained Coal Customers.

59 ARTC, *Revised Compliance Submission*, p. 19.