



Australian
Competition &
Consumer
Commission

Australian Competition and Consumer Commission

Consultation Paper

**in relation to Australian Rail Track
Corporation's Hunter Valley Rail Network
Access Undertaking annual compliance
assessment**

9 August 2012



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1 Introduction

The Australian Rail Track Corporation Limited (**ARTC**) has made a submission to the Australian Competition and Consumer Commission (**ACCC**) in relation to the annual ACCC compliance assessment process provided for under the access undertaking for the Hunter Valley Rail Network which was accepted by the ACCC on 29 June 2011 (**the June 2011 HVAU**).

ARTC made an initial submission on 1 June 2012 in order to demonstrate its compliance with the requirements in section 4.10 of the June 2011 HVAU for the period 1 July 2011 to 31 December 2011 (**the Compliance Period**). On 13 July 2012 ARTC submitted revised versions of its submission and capital consultation document after identifying errors in the 1 June 2012 documentation. The ACCC is conducting its assessment based on the documentation provided on 1 June 2012 and the documentation provided on 13 July 2012, excluding the superseded submission and capital consultation document, (together, **the Compliance Assessment Submission**).

The ACCC is conducting a public consultation as part of its assessment of the Compliance Assessment submission, and seeks submissions from interested parties by 7 September 2012. While not required to undertake comprehensive industry consultation as part of its Annual Compliance assessment process, the ACCC is seeking industry views to inform its assessment of whether ARTC's assumptions and approach in its Compliance Assessment Submission are reasonable and appropriate. This will assist the ACCC in undertaking a thorough Annual Compliance review as required under the June 2011 HVAU. The ACCC considers that a comprehensive industry consultation will also provide transparency regarding the ACCC's process for assessing ARTC's compliance under section 4.10 of the June 2011 HVAU.

Terms in the June 2011 HVAU have the same meaning in this Consultation Paper unless separately defined.

1.1 Background

1.1.1 Industry context

ARTC is a Commonwealth Government owned corporation, established in 1998 for the purpose of managing and providing access to the National Interstate Rail Network. ARTC is vertically separated, providing 'below-rail' track access services and not 'above rail' services such as haulage. The Interstate Rail Network is subject to an access undertaking accepted by the ACCC on 30 July 2008.¹

The June 2011 HVAU regulates access to the Hunter Valley Rail Network (**the network**) operated by ARTC in New South Wales. ARTC leases the network from the New South Wales government under a 60 year lease granted on 5 September 2004.

The network is predominantly used to transport coal from mines in the Hunter Valley region to the Port of Newcastle for export. Approximately 16 coal producers have either existing or planned operations in the region, and it has been estimated that the

¹ See the ACCC website at <http://www.accc.gov.au/content/index.phtml/itemId/789738> for further details.

coal shipped on the network equates to around \$9 billion worth of export earnings per annum.

The network is also used by non-coal traffic, including general and bulk freight services (such as grain) and passenger services. It is also used to ship coal from the region's mines to domestic customers, such as power stations.

The network was previously subject to the New South Wales Rail Access Undertaking (**NSWRAU**) administered by the NSW Independent Pricing and Regulatory Tribunal (**IPART**). As a consequence of the decision to accept the June 2011 HVAU, access regulation of the network is now governed by the ACCC and the June 2011 HVAU.

1.1.2 Annual ACCC Compliance Assessment

Section 4 of the June 2011 HVAU regulates ARTC's access revenue. ARTC's financial model in section 4 implements a revenue cap, which constrains the maximum access revenues ARTC may earn over the term of the June 2011 HVAU in accordance with the application of the Building Block Model. The financial model also includes a 'loss capitalisation' component for Pricing Zone 3, where there is currently relatively lower demand for rail access services and where ARTC is most likely to under-recover costs in the short term.

Section 4 of the June 2011 HVAU also provides for an annual compliance assessment to be carried out by the ACCC in respect of ARTC's financial model for the previous calendar year. In accordance with section 4.10 of the June 2011 HVAU, ARTC must submit to the ACCC by April 30 in respect of the previous calendar year:

- Documentation detailing roll-forward of the regulatory asset base (**RAB**) (with respect to Pricing Zone 3) and the RAB Floor Limit, and comparisons between RAB and RAB Floor Limit with respect to Pricing Zone 3;
- Where RAB is at or below RAB Floor Limit, documentation detailing calculations relevant to reconciliation of Access revenue with the applicable Ceiling Limit and any allocation of the total unders and overs amount including in Pricing Zone 3; and
- A copy of the Final Audit Report in relation to the System Wide True Up Test.²

Schedule G of the June 2011 HVAU sets out additional detail in relation to the provision of information by ARTC and the indicative timing of the annual compliance review.

Transitional arrangements

Given the timing of the commencement of the operation of the June 2011 HVAU and that the Compliance Assessment process provided for under section 4 is in respect of a calendar year, ARTC and the ACCC agreed that conducting an annual compliance assessment in accordance with the June 2011 HVAU for the second half of the 2011 calendar year (1 July 2011 to 31 December 2011) represented an efficient means of managing ARTC's obligations under the June 2011 HVAU during transition from the

² Under subsection 4.10(f)(x) of the June 2011 HVAU.

NSWRAU. Key adjustments to the compliance process in order to reflect the half year compliance period are detailed below at section 2.3.

Extension

The June 2011 HVAU requires ARTC to submit the required Compliance Assessment documentation to the ACCC by 30 April in respect of the previous calendar year.³ ARTC contacted the ACCC on 20 April 2012 seeking an extension of the due date of the Compliance Assessment documentation to 31 May 2012, due to a delay by IPART in finalising its Annual Compliance process under the NSWRAU for the 2010/11 financial year. The ACCC informed ARTC on 1 May 2012 that the reasons for the extension request were reasonable and, in these circumstances, it would not pursue ARTC for a breach of the June 2011 HVAU in the Federal Court.

No Access Holder Agreements in place

ARTC informed the ACCC that Access Holder Agreements under the June 2011 HVAU were not in operation during the Compliance Period. A period and process of transition was agreed to with industry and endorsed by the ACCC as part of finalising the June 2011 HVAU. Access Revenue was collected from rail operators during the Compliance Period under existing Access Arrangements (under the NSW regime), based on 2011 Interim Indicative Access Charges and other Charges as contemplated under the June 2011 HVAU.

The ACCC notes that from 1 February 2012 Access Holders transitioned to executed and operational Access Holder Agreements and subsequent Annual Compliance processes will recognise these agreements.

1.2 Indicative timeline for assessment

Schedule G of the June 2011 HVAU sets out an indicative timeline for the Annual Compliance Assessment process. Subsection 5(a) of Schedule G states that the Annual Compliance Assessment process should ideally be completed within the calendar year following the year which is the subject of the review, and sets out a timetable which assigns an indicative timeframe which the ACCC and ARTC will adhere to. Schedule G does note, however, that this timetable is subject to change in light of prevailing circumstances.

As noted above, ARTC requested an extension to submit the Annual Compliance documentation to the ACCC. ARTC formally lodged the Compliance Assessment Submission with the ACCC on 31 May 2012, and provided a revised version of the submission on 13 July 2012.

The ACCC is requesting industry submissions on the Compliance Assessment Submission by 7 September 2012. Following this consultation, and after inviting comments from ARTC in relation to the stakeholder comments, the ACCC will aim to make a decision on the compliance assessment process by December 2012, in accordance with the indicative timeline set out in Schedule G of the June 2011 HVAU.

³ Under subsection 4.10(a) of the June 2011 HVAU.

It is possible that the compliance assessment may be undertaken in a shorter timeframe than that contemplated by Schedule G of the June 2011 HVAU; however, this will be a matter to be determined by the ACCC in light of the relevant circumstances.

1.3 Consultation

The ACCC has published ARTC's Compliance Assessment Submission on its website for stakeholder consideration.

The ACCC requests that any submissions address the extent to which the Compliance Assessment Submission appropriately addresses the requirements in section 4.10 of the June 2011 HVAU.

The ACCC's current intention is that there will be a single round of consultation before the ACCC makes a final decision in relation to the Compliance Assessment Submission. However, the ACCC may consult further with industry if it considers there is a need to do so having regard to the submissions made in response to this Consultation Paper.

1.4 Making a submission

Submissions on ARTC's Compliance Assessment Submission should be addressed to:

Mr Matthew Schroder
General Manager
Fuel, Transport and Prices Oversight Branch
Australian Competition and Consumer Commission

GPO Box 520
Melbourne Vic 3001

Email: transport@acc.gov.au

1.4.1 Due date for submissions

Submissions **must** be received by **7 September 2012**. It is in your interest that the submission be lodged by this date.

1.4.2 Confidentiality

The ACCC strongly encourages public submissions. Unless a submission, or part of a submission, is marked confidential, it will be published on the ACCC's website and may be made available to any person or organisation upon request.

Sections of submissions that are claimed to be confidential should be clearly identified. The ACCC will consider each claim of confidentiality on a case by case basis. If the ACCC refuses a request for confidentiality, the submitting party will be given the opportunity to withdraw the submission in whole or in part.

For further information about the collection, use and disclosure of information provided to the ACCC, please refer to the ACCC publication "*Australian Competition*

and Consumer Commission / Australian Energy Regulator Information Policy – the collection, use and disclosure of information” available on the ACCC website.

1.5 Further information

The Compliance Assessment Submission and other relevant material, including supporting submissions from ARTC and the currently accepted June 2011 HVAU, are available on the ACCC’s website at the following link:

<http://www.accc.gov.au/content/index.phtml/itemId/1533206>

Alternatively, go to the ACCC’s homepage at www.accc.gov.au and follow the links to ‘For regulated industries’ and ‘Rail’ and ‘ARTC Hunter Valley Access Undertaking 2011’ and ‘Annual compliance - 1 July to 31 December 2011’.

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

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

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2 The Compliance Assessment Submission

2.1 ARTC obligations

The Compliance Assessment Submission seeks to implement the requirements contained in section 4.10 of the June 2011 HVAU. Subsection 4.10(a) requires that ARTC submit to the ACCC by 30 April each year in respect of the previous calendar year:

- (i) *documentation detailing roll-forward of the RAB and the RAB Floor Limit, and comparisons between RAB and RAB Floor Limit;*
- (ii) *where documentation in (i) above demonstrates that RAB is at or below RAB Floor Limit, documentation detailing calculations relevant to reconciliation of Access revenue with the applicable Ceiling Limit and calculation of any allocation of the total unders and overs amount; and*
- (iii) *where documentation in (i) above demonstrates that RAB is above RAB Floor Limit in Pricing Zone 3, documentation demonstrating that Indicative Access Charges, or Interim Indicative Access Charges, as applicable, satisfies the requirements in section 4.3(b).*

Subsection 4.10(b) requires that the documentation submitted by ARTC to the ACCC will, unless otherwise agreed with the ACCC and having regard to the relevant circumstances applicable at the time, meet the information provision guidelines and the timeframes set out in Schedule G of the June 2011 HVAU.

The ACCC may also request from ARTC any additional information it reasonably considers is required in order to carry out the annual compliance assessment process (subsection 4.10(c)).

2.2 ACCC obligations

Subsection 4.10(d) requires the ACCC to determine whether ARTC has undertaken:

- (i) *roll-forward of the RAB and RAB Floor Limit in accordance with the Undertaking and, where the roll forward is not in accordance with the Undertaking, determine what closing RAB or RAB Floor Limit would be in accordance with the Undertaking;*
- (ii) *when required, the calculations relevant to reconciliation of Access revenue with the applicable Ceiling Limit and calculation of any allocation of the total unders and overs amount in accordance with the Undertaking, and where the calculations are not in accordance with the Undertaking, determine what total unders and overs amount or allocation would be in accordance with the Undertaking having regard to the operation of its unders and overs account.*

The June 2011 HVAU provides for ARTC to include actual operating expenditure incurred into the RAB, as long as it is incurred on an efficient basis. Under subsection 4.10(e) the ACCC is also required to determine whether ARTC has incurred Efficient

costs and Efficient operating expenditure in accordance with subsection 4.5(b) of the June 2011 HVAU, and determine the change (if any) to:

- (i) the total unders and overs amount or allocation; and
- (ii) closing RAB in section 4.4(a),

that results from Economic Cost under subsection 4.5(b) only including Efficient costs and Efficient operating expenditure determined in accordance with subsection 4.5(b).

2.3 Agreed Adjustments to the Annual Compliance Process

Prior to acceptance of the June 2011 HVAU, the NSWRAU provided for IPART to undertake a similar annual compliance assessment but in relation to each financial year. The June 2011 HVAU provides for an annual compliance assessment process in respect of each calendar year. As noted above, ARTC and the ACCC have agreed to a half year Compliance Period in respect of the current Compliance Assessment process. Some minor transitory adjustments have been made to elements of the June 2011 HVAU compliance assessment process in order for these elements to operate effectively over the half year period.

The key adjustments agreed to by the ACCC and ARTC are as follows:

- Access revenue and operating expenditure is that arising during the period 1 July 2011 to 31 December 2011;
- Depreciation is determined for the Compliance Period on a pro-rated basis (50%);
- Assets commissioned during the Compliance Period are 'deemed' to have been commissioned at the mid-point of the Compliance Period (1 October 2011) for the purposes of determining depreciation. Financing costs and return are also determined on a consistent basis;
- Return is determined for the Compliance Period on a pro-rated basis (50%);
- CPI is determined for the Compliance Period on a pro-rated basis (50%);
- For those relevant assets not ascribed a regulatory asset value under the NSWRAU as at 30 June 2011, a depreciated optimised replacement cost (**DORC**) valuation for those assets approved by the ACCC is rolled forward from the date of the DORC valuation to 30 June 2011 in accordance with the roll forward methodology prescribed in the NSWRAU in order to determine Initial RAB in relation to these assets;
- Capital Expenditure and disposals is that arising during the Compliance Period;
- Total unders and overs amount is determined by reconciliation of Access revenue arising in the Compliance Period. Allocation of the total unders and overs amount to each relevant Constrained Coal Chain Customer is determined for the Compliance Period.

- The starting balance (as at 1 July 2011) of each of the Constrained Coal Customer Accounts will be zero, unless an amount accruing from the 2010/11 compliance assessment under the NSWRAU is agreed by ARTC and the Constrained Coal Customer to act as the relevant starting balance.⁴

⁴ This occurs under subsection 4.9(b)(vi) of the June 2011 HVAU.

3 RAB and RAB Floor Limit Roll Forward

Section 4.4(a) of the June 2011 HVAU sets out the process for rolling forward the RAB and RAB Floor Limit for a Segment or group of Segments.

3.1 Initial valuation

The initial valuation of the network was carried out by IPART in 2001. Based on IPART's report, the Minister of Transport advised the infrastructure manager at the time, Rail Infrastructure Corporation, of the opening asset values to be used effective from 1 July 1999. The 1999 opening values were rolled forward as part of IPART's annual compliance review under the NSWRAU to determine the closing values for 2003/04 ahead of ARTC's commencement of its lease of the network in 2004/05.

Since that time, asset values have been rolled forward as part of IPART's annual compliance assessment under the NSWRAU.

3.1.1 Regulatory asset value under the NSWRAU

Upon commencement of the June 2011 HVAU, section 4.4(a)(i) provides for applicable parts of the RAB to be ascribed a regulatory asset value in accordance with the NSWRAU in force at the time immediately preceding the commencement date of the June 2011 HVAU (i.e. 1 July 2011). IPART finalised its assessment of the 2010/11 financial year on 4 May 2012, resulting in a closing regulatory asset value of \$844,600,015 for the Constrained Network assets and \$856,656,124 for all assets covered by the June 2011 HVAU under the NSWRAU as at 30 June 2011.⁵

3.1.2 Proposed DORC valuations

For segments not ascribed a value under the NSWRAU, section 4.4(a)(ii) provides that a valuation determined using the DORC methodology, which is approved by the ACCC.

Dartbrook to Gap

During the assessment of the June 2011 HVAU, the ACCC approved the DORC value of the Dartbrook to Gap segments as at 1 July 2008, which was rolled forward in accordance with the asset valuation toll forward principles under the NSWRAU. The initial RAB for Dartbrook to Gap is \$161,141,627.⁶

Port Waratah Coal Loop Assets

As part of its Annual Compliance Submission (see Attachment 3 – ARTC Standard Gauge Rail Network DORC – Leased Port Waratah Coal Loop Assets) ARTC seeks to include in the initial value of the RAB (**Initial RAB**) the value of certain parts of the Port Waratah Coal Services coal loop (**the Port Waratah Coal Loop Assets**) that came under ARTC maintenance and management in late 2006. The Port Waratah Coal Loop Assets were not previously ascribed a value under the NSWRAU as these assets were not covered by the regulated coal network defined by that undertaking.

⁵ ARTC, *Submission to ACCC in respect of the HVAU: Roll forward asset base, ceiling test, unders and overs account*, 13 July 2012, p. 10.

⁶ ARTC, *Submission*, p. 10.

As the Port Waratah Coal Loop Assets are now covered under the June 2011 HVAU, ARTC is required to include a regulatory asset value for these assets to ensure that ARTC does not breach Floor and Ceiling Limits for Segments covered by the June 2011 HVAU.

As part of its Annual Compliance Submission, ARTC has proposed a DORC value for ACCC approval for the Port Waratah Coal Loop Assets as at 1 July 2010, which is rolled forward in accordance with the asset valuation roll forward principles under the NSWRAU to 1 July 2011. This approach is the same as that accepted by the ACCC for the Compliance Period in relation to other assets that do not have a RAB value ascribed under the NSWRAU. ARTC carried out a DORC assessment for the Port Waratah Coal Loop Assets on largely the same basis to that used in relation to its submission made to IPART as part of the 2010/11 annual compliance under the NSWRAU.⁷ This valuation was prepared internally by ARTC, and ARTC submits that it has been subject to regulatory consultation by IPART, and has received stakeholder support.

ARTC submits that the Initial RAB applicable to the Port Waratah Coal Loop Assets as at 1 July 2011 is \$1,388,683.⁸

Questions for comment

- Does industry have any comments on the proposed DORC valuation as set out in Attachment 3 of ARTC's Compliance Assessment Submission?

3.1.3 Total network starting regulatory asset value

Based on the closing regulatory asset values determined under the NSWRAU and the proposed DORC valuations for both Dartbrook to Gap and the Port Waratah Coal Loop Assets, ARTC submits that the initial valuation of the network is \$1,019,186,434.⁹ The breakdown of the value of each Segment forming part of the Hunter Valley Access Undertaking is outlined at Appendix E of ARTC's Annual Compliance submission.

3.2 RAB Roll Forward

3.2.1 RAB Roll Forward calculation

In relation to the Segments identified in Schedule E of the June 2011 HVAU as forming part of Pricing Zone 3 (unconstrained network), the RAB will be rolled forward annually in accordance with the following methodology under section 4.4(a) of the June 2011 HVAU:

$$\begin{aligned} \text{RAB}_{t \text{ start}} &= \text{RAB}_{t-1 \text{ end}} = \\ & (1 + \text{RoR}) \times \text{RAB}_{t-1 \text{ start}} - \text{Out-turn Revenue}_{t-1} + \text{Out-turn Opex}_{t-1} + \text{Net Capex}_{t-1} \times (1 + 0.5 \times \text{RoR}) \end{aligned}$$

⁷ ARTC, *ARTC Standard Gauge Rail Network DORC: Leased Port Waratah Coal Loop Assets*, p. 6

⁸ ARTC, *Submission*, p. 10.

⁹ ARTC, *Submission*, p. 16.

where:

$RAB_{t \text{ start}}$ is RAB at the start of the relevant calendar year (t) (which, for the first year following the Commencement Date, would be the Initial RAB)

$RAB_{t-1 \text{ end}}$ is the RAB at the end of the preceding calendar year (t-1)

$RAB_{t-1 \text{ start}}$ is the RAB at the start of the preceding calendar year (t-1)

RoR is the nominal pre-tax Rate of Return

Out-turn Revenue_{t-1} is the total Access revenue earned by ARTC in the preceding calendar year (t-1) but will not include:

- i) a Capital Contribution received from an Applicant or an Access Holder; or
- ii) Access revenue returned to a Contributor as a result of the operation of a user funding agreement between the Contributor and ARTC

Out-turn Opex_{t-1} is the total operating expenditure incurred by ARTC in the preceding calendar year (t-1) on an Efficient basis, determined in accordance with sections 4.5(a)(i), (iv) and (vii) and 4.5(b)

Net Capex_{t-1} is the net additions to the RAB in the preceding calendar year (t-1), that is out turn Capital Expenditure by ARTC less the written down value of any disposals during the preceding calendar year (t-1) on a Prudent basis, including interest cost incurred during construction up to 1 July in the calendar year the asset was commissioned, capitalised in the year the asset was commissioned and determined by reference to the relevant form of the Rate of Return (to the extent that Capital Expenditure is incurred on a Prudent basis, including interest cost), but will not include Capital Contributions.

3.2.2 Component values

As discussed above, the Initial RAB is based on the closing value of the relevant 2010/11 values approved by IPART, or as determined through a separate roll-forward of DORC asset values approved by the ACCC.

IPART determined that the closing asset values for Pricing Zone 3 assets are ascribed a regulatory asset value under the NSWRAU as at 30 June 2011 as follows:

Muswellbrook to Dartbrook Jct

Muswellbrook to Dartbrook Jct was ascribed a value under the NSWRAU. This was rolled forward in accordance with the NSWRAU asset valuation roll forward principles to 1 July 2011 and had a closing 2010/11 RAB value of \$7,600,128.¹⁰

For assets not ascribed a value under the NSWRAU, the following is proposed:

Dartbrook to Gap

The ACCC has approved a DORC value as part of the June 2011 HVAU as at 1 July 2008, which is rolled forward in accordance with the asset valuation roll

¹⁰ ARTC, *Submission*, p. 36.

forward principles under the NSWRAU to 1 July 2011. The Initial RAB for Dartbrook to Gap is \$161,141,627.¹¹

3.2.3 Total Pricing Zone 3 regulatory asset value

The total Pricing Zone 3 opening regulatory asset value is \$168,741,755.¹²

3.2.4 Closing RAB for Pricing Zone 3

Applying the RAB roll forward formula outlined in section 3.2.1 of this paper, ARTC has determined the closing value of the RAB in Pricing Zone 3 for the Compliance Period to be as follows:

Table 1 – Pricing Zone 3 RAB roll forward

Value		Unconstrained	Constrained
Opening RAB	<i>RAB t-1 start</i>	168,741,755	-
Return On Opening RAB	<i>RoR x RABt-1 start</i>	9,981,075	-
Less Revenue	<i>Out-turn Revenue_{t-1}</i>	-11,107,743	-
Plus Opex	<i>Out-turn Opex_{t-1}</i>	5,107,112	-
Plus Net Capex	<i>Net Capex_{t-1}</i>	19,489,902	-
Plus Return On Capex	<i>Net Capex_{t-1} x (1 + 0.5 x RoR)</i>	576,414	-
Closing RAB	<i>RAB_{t-1} end</i>	192,788,515	-

Table source: ARTC, *Submission*, p. 12.

3.2.5 ACCC process

The ACCC is required under section 4.10(d)(i) to determine whether ARTC has undertaken roll-forward of the RAB in accordance with the June 2011 HVAU. If the roll-forward of the RAB is not in accordance with the June 2011 HVAU the ACCC is required to determine what the RAB would be in accordance with the June 2011 HVAU.

ARTC provided to the ACCC (on a confidential basis) a copy of the spreadsheet underpinning the calculations for the roll forward of the RAB in Pricing Zone 3 as part of its Annual Compliance Submission.

3.3 RAB Floor Limit Roll Forward

3.3.1 RAB Floor Limit Calculation

In accordance with section 4.4(b) of the June 2011 HVAU, the RAB Floor Limit for a Segment or group of Segments will be:

- i) *as at the Commencement Date, the Initial RAB;*
- ii) *rolled forward annually according to the following methodology*

$$\text{RAB Floor Limit}_{t \text{ start}} = \text{RAB Floor Limit}_{t-1 \text{ end}} =$$

$$(1 + \text{CPI}_{t-1}) \times \text{RAB Floor Limit}_{t-1 \text{ start}} + \text{Net Capex}_{t-1} - \text{Depreciation}_{t-1}$$

¹¹ ARTC, *Submission*, p. 40.

¹² ARTC, *Submission*, p. 16.

where:

RAB Floor Limit_{t start} is the RAB Floor Limit at the start of the relevant calendar year (t) (which, for the first year following the Commencement Date, would be the Initial RAB).

RAB Floor Limit_{t-1 end} is the RAB Floor Limit at the end of the preceding calendar year (t-1).

RAB Floor Limit_{t-1 start} is the RAB Floor Limit at the start of the preceding calendar year (t-1).

CPI_{t-1} is the inflation rate for the preceding calendar year (t-1), determined by reference to the CPI for the September quarter of that year.

Net Capex_{t-1} is the net additions to the RAB Floor Limit in the preceding calendar year (t-1) that is out-turn Capital Expenditure by ARTC less the written down value of any disposals during the preceding calendar year (t-1) on a Prudent basis, including interest cost incurred during construction up until 1 July in the calendar year the asset was commissioned, capitalised in the year the asset was commissioned and determined by reference to the relevant form of the Rate of Return (to the extent that Capital Expenditure is incurred on a Prudent basis, including interest cost), but will not include Capital Contributions.

Depreciation_{t-1} is Depreciation applicable to the RAB Floor Limit in the preceding calendar year (t-1).

The RAB Floor Limit is rolled forward for the entire network for the purposes of:

- in Pricing Zones 1 and 2 calculating components of full economic cost; and
- in Pricing Zone 3 for comparison with the RAB to determine if loss capitalisation applies. See section 3.4.

3.3.2 Component values for Pricing Zones 1 and 2

As discussed above, the Initial RAB is based on the closing value of the relevant 2010/11 values approved by IPART, or as determined through a separate roll forward of DORC asset values approved by the ACCC.

IPART determined that the closing asset values for the constrained network (Pricing Zones 1 and 2) assets are ascribed a regulatory asset value under the NSWRAU as at 30 June 2011 of \$844,600,015.¹³

For Pricing Zones 1 and 2 assets not ascribed a value under the NSWRAU, ARTC proposes the following:

Port Waratah Coal Loop Assets

As highlighted in section 3.1.2 above, ARTC is seeking the ACCC's approval for its proposed DORC valuation of the Port Waratah Coal Loop Assets.

¹³ ARTC, *Submission*, p. 10.

ARTC has proposed a DORC valuation of \$1,388,683.¹⁴

3.3.3 Total Pricing Zones 1 and 2 regulatory asset value

The total Pricing Zones 1 and 2 opening regulatory asset value is \$845,988,698.¹⁵

3.3.4 Closing RAB Floor Limit for Pricing Zones 1 and 2

For Pricing Zones 1 and 2 (the constrained network), the closing RAB Floor Limit is \$882,161,764.¹⁶

3.3.5 Closing Network RAB Floor Limit

Applying the RAB Floor Limit roll forward formula, ARTC have determined the RAB Floor Limit value for the total network during the Compliance Period is as follows:

Table 2 – Network RAB Floor Limit roll forward

Values		Network
Opening Value	$RAB\ Floor\ Limit_{t-1}\ start$	1,019,186,434
CPI	$CPI_{t,t}$	18,611,231
Cap Ex	$Net\ Capex_{t,t}$	62,623,603
Depreciation	$Depreciation_{t,t}$	-25,421,354
Loss on Disposal		-1,412,613
Closing Value		1,073,587,301

Table source: ARTC, *Submission*, p. 16.

3.3.6 ACCC process

The ACCC is required under section 4.10(d)(i) to determine whether ARTC has undertaken roll-forward of the RAB Floor Limit in accordance with the June 2011 HVAU. If the roll-forward of the RAB Floor Limit is not in accordance with the June 2011 HVAU the ACCC is required to determine what the RAB Floor Limit would be in accordance with the June 2011 HVAU.

As part of its Annual Compliance Submission, ARTC provided (on a confidential basis) the ACCC with a copy of the spreadsheet underpinning the calculations for the roll forward of the RAB Floor Limit.

3.4 Pricing Zone 3 RAB and RAB Floor Limit Comparison

The closing RAB value for Pricing Zone 3 assets for the Compliance Period is \$192,788,515.¹⁷ The closing RAB Floor Limit value for Pricing Zone 3 assets for the Compliance Period is \$186,996,217.¹⁸

This demonstrates that for Pricing Zone 3 the RAB is greater than the RAB Floor Limit, and confirms that Pricing Zone 3 is an unconstrained part of the Network in

¹⁴ ARTC, *Submission*, p. 10.

¹⁵ ARTC, *Submission*, p. 36.

¹⁶ ARTC, *Submission*, p. 36.

¹⁷ ARTC, *Submission*, p. 12.

¹⁸ ARTC, *Submission*, p. 16.

accordance with section 4.10(a)(ii). This means that ARTC did not recover full economic costs in Pricing Zone 3 and the “shortfall” can be capitalised for recovery in future years.

Given that the RAB is greater than the RAB Floor Limit in Pricing Zone 3, subsection 4.10(a)(ii) of the June 2011 HVAU does not apply. Therefore, ARTC is not required to detail calculations relevant to reconciliation of Access revenue with the applicable Ceiling Limit and calculation of any allocation of the total unders and overs amount.

3.5 Capital Expenditure

Capital Expenditure on new and existing assets to be included in the RAB and RAB Floor Limit for the Compliance Period is set out in Appendix B of ARTC’s Compliance Assessment Submission.

Sections 7 to 11 of the June 2011 HVAU sets out a framework in respect of Capital Expenditure, including ARTC’s compliance obligations with respect to initiation of, industry consultation on, and funding of Capital Expenditure in relation to the network. Specifically, these sections provide a framework for industry endorsement of Capital Expenditure through the Rail Capacity Group (**RCG**) for inclusion in the RAB.

ARTC has informed the ACCC that the RCG was not formally convened during the Compliance Period due to no Access Holder Agreements being executed. The Rail Infrastructure Group (**RIG**) which operated to ensure that ARTC complied with the consultation requirements under the NSWRAU was continued during the Compliance Period as an interim substitute mechanism for and until the RCG was convened. ARTC has submitted that the RIG consisted of similar industry representation and the basis on which consultation was carried out during the Compliance Period was similar to that contemplated for the RCG under the June 2011 HVAU.

Evidence of access seekers’ endorsement of Capital Expenditure as required under Schedule G was submitted to the ACCC on a confidential basis. In relation to the historical roll forward of DORC asset values not ascribed a regulatory asset value under the NSWRAU, evidence of prior industry endorsement through the RIG was also provided on a confidential basis to the ACCC.

If Capital Expenditure has been endorsed by the RIG/RCG in accordance with Section 9 of the June 2011 HVAU, the ACCC is not required to consider whether that Capital Expenditure is prudent (section 4.10(d)(iii)).

Questions for comment

- Does industry have any comments on the capital projects undertaken by ARTC?
- Does industry have any comments on the capital spend by ARTC?

3.6 Disposals

In relation to assets ascribed a regulatory asset value under the NSWRAU, ARTC has calculated:

- Disposal values, based on the written down RAB values (with reference to the Booz Allen Hamilton DORC database determined under the NSWRAU in 2001); and
- ARTC's net loss on disposal, calculated as the written down RAB value less any recovery on disposal (either through an adjustment to inventory or recovery as scrap sales).

Net loss on disposals for assets not ascribed a regulatory asset value under the NSWRAU has been determined where applicable using asset valuation data supporting the DORC valuation already approved by the ACCC as part of the June 2011 HVAU, or the asset valuation data supporting the DORC valuation proposed in the submission. Total net loss on disposals is \$1.413 million for the network (see Table 2 above). A copy of the spreadsheet calculating the RAB disposal values and net loss on disposals referenced to the relevant asset valuation was provided to the ACCC on a confidential basis.

3.7 Interest during construction

Net Capex includes capitalisation of interest cost incurred during construction for segment specific assets up until 1 July of the year that the asset is commissioned, and is determined by reference to the relevant Rate of Return under section 4.4(a). The June 2011 HVAU provides that interest must be incurred on a prudent basis to incentivise ARTC to commission projects on time.

Similarly, ARTC is also able to earn an allocation of a return on non-segment specific assets, where the value of these assets includes the capitalisation of interest cost incurred during construction up until commissioning of the asset, capitalised at the time of commissioning and determined by reference to the relevant Rate of Return as stated in subsection 4.5(a)(iv).

Appendix F of ARTC's Annual Compliance Submission provides the excerpt of how ARTC has calculated the interest during construction amounts. For the 2010/11 financial year, interest is capitalised using the nominal Rate of Return approved by IPART under the NSWRAU. For the half year 1 July 2011 to 31 December 2011 ARTC has used the nominal Rate of Return approved under the June 2011 HVAU. ARTC has only capitalised interest on the amount of capital spend incurred prior to the commissioning year.

The total amount of interest during construction calculated by ARTC is as follows:¹⁹

- Bengalla Loop - \$1,224,149
- Wilpinjong Loop - \$547,074

¹⁹ ARTC, *Submission*, p. 15.

- Koolbury Loop - \$1,115,005

Questions for comment

- Does industry have any comments regarding the calculation of interest during construction?

4 Ceiling test

The Ceiling Test Model (provided to the ACCC on a confidential basis) is used to test the Access revenue for mines or a combination of mines against the applicable Ceiling Limit in order to determine the Constrained Network and Constrained Group of Mines as contemplated under section 4.3 of the June 2011 HVAU.

The Ceiling Test Model calculates the amount of Access revenue and the Economic Cost across the Segments utilised by a mine or a 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 Network.

The table below illustrates the results from ARTC's Ceiling Test Model.

Table 3 – Ceiling Test December 2011

		ARTC Total	ARTC Total
		June 2011	December 2011
		Actuals	Actuals
millions		Net Tonne billed	GTK
GTKs			
	<i>Export</i>	96.09	10.70
	<i>Domestic</i>	5.28	0.66
	<i>Total</i>	101.37	11.35
Revenue			
	Total Revenue	150.07	95.56
Costs			
	<i>Variable</i>	17.00	9.15
	<i>Fixed</i>	16.69	7.54
	<i>Shared Maintenance</i>	15.78	7.86
	<i>Total Maintenance Costs</i>	49.47	24.55
	<i>Expensed Project Costs</i>	6.66	
	<i>Project Development Costs</i>	0.00	
		0.00	
		1.78	
	<i>Network Control</i>	6.26	3.40
	<i>Corporate Overheads</i>	11.11	5.65
	<i>Total Operating Cost</i>	75.29	33.59
	Depreciation	28.58	21.00
	Net Loss on Disposal	1.80	0.89
	Total Cost	105.67	55.48
	Profit/Loss	44.40	40.08
	Total ROA	65.34	39.32
	Full Economic Costs	171.01	94.79
	Revenue - Costs	-20.93	0.77
	Average Asset Base	816.70	864.08

Table source: ARTC, *Submission*, p. 22.

4.1.1 Access Revenue

Section 4.3(a) of the June 2011 HVAU requires that the Access revenue from any Access Holders or group of Access Holders must not exceed the Economic Cost of those Segments, on a stand alone basis, identified as forming part of Pricing Zones 1 and 2 in Schedule E.

The Ceiling Limit may be relaxed in Pricing Zone 3. Section 4.3(b) of the June 2011 HVAU requires that Access revenue from any Access Holder or group of Access Holders in Pricing Zone 3 must not exceed the Ceiling Limit where the RAB for those Segments is equal to or falls below the RAB Floor Limit for those Segments at the end of the calendar year – i.e. where loss capitalisation occurs.

ARTC's spreadsheets illustrate that the RAB is greater than the RAB Floor Limit in Pricing Zone 3, therefore Pricing Zone 3 is an unconstrained part of the Network as ARTC have not recovered full economic costs through Access revenue. As such, loss capitalisation continues to apply and in accordance with section 4.10(a)(ii) ARTC is not required to detail calculations relevant to reconciliation of Access revenue with the applicable Ceiling Limit.

Given that the RAB is greater than the RAB Floor Limit In Pricing Zone 3, subsection 4.10(a)(ii) does not apply. Therefore, ARTC is not required to provide documentation detailing calculations to reconcile Access revenue with the applicable Ceiling Limit and calculations of any allocation of unders or overs amounts.

4.1.2 Economic Costs

Economic cost is defined under section 4.5 of the June 2011 HVAU, and includes both segment and non-segment specific costs.

Economic costs are divided into the following categories:

Depreciation

Section 4.7 states that depreciation is charged each year on the opening balance of the inflation adjusted RAB Floor Limit, as well as for a period of half a year on the prudent capital expenditure associated with assets commissioned in that year. All assets, including new assets, are depreciated by 22 years from 2010, which corresponds to the average expected life of the mines that utilise the network.

Return on assets

Subsection 4.5(a)(iii) allows ARTC to earn a return on assets determined by applying a real pre tax rate of return to the average RAB Floor Limit. The real pre tax rate of return is 9.1 per cent per annum. For the Compliance Period, the real pre tax rate of return is 4.55 per cent, as it is a six month period.

Maintenance costs

Maintenance costs include major periodic maintenance (**MPM**) and reactive corrective routine maintenance (**RCRM**). Actual MPM costs have been used as in previous years under the NSWRAU, rather than an 'average' level of MPM. Both MPM and RCRM costs are reported for each segment and split between fixed and

variable based upon an engineering assessment of the extent to which the activity varies in proportion with volume.

Total variable costs for each segment are divided by total gross tonne kilometres (**GTKs**) (including non-coal and unconstrained GTKs) to derive a variable cost per GTK for each segment. All fixed maintenance costs for each segment forming part of the Constrained Network is included in the Ceiling Limit in accordance with the June 2011 HVAU.

Overall maintenance costs for the Compliance Period are largely in alignment with costs incurred during 2010/11. Maintenance costs for the Constrained Network during the Compliance Period are \$24.45 million.²⁰

Network control

Network control includes labour and materials associated with the delivery of train control and signalling, train planning and programming and operations and customer management. It also includes the terminal management costs associated with the delivery of yard control, signalling and incident management.

Network control costs are apportioned to the Hunter Valley on the basis of area coverage of the train control and signalling function. Where this is not relevant, network costs are apportioned on a train kilometre basis in accordance with section 4.6 of the June 2011 HVAU.

Network control costs for the Compliance Period increased by 6.8% based on a half year comparison with network control costs approved by IPART in its 2010/11 compliance review. This aligns to the increased Constrained Network train km (compared to other parts of the ARTC network) used to allocate network control costs. Network control costs for the Constrained Network during the Compliance Period were \$3.4 million.²¹

Corporate overheads

Corporate overheads include labour and materials associated with the delivery of services such as human resources, legal, information technology, finance and procurement.

Corporate overheads are allocated to the network by train km, on the same basis to that used in 2010/11 year and in accordance with section 4.6 of the June 2011 HVAU.

Corporate overheads costs for the Constrained Network during the Compliance Period were \$5.65 million.²² This is an increase of \$0.1 million over that approved by IPART in the 2010/11 compliance review, despite there being an increase in Constrained Network train km used to allocate overheads costs relative to trends on other parts of the ARTC network. This suggests that corporate overheads costs on a unit cost basis have reduced during the Compliance Period.

²⁰ ARTC, *Submission*, p. 22.

²¹ ARTC, *Submission*, p. 22.

²² ARTC, *Submission*, p. 22.

4.1.3 Efficient cost

Section 4.10(e) of the June 2011 HVAU provides that the ACCC will determine whether ARTC has incurred Efficient costs, and that only efficient operating expenditure is included in the RAB or the total unders and overs amount or allocation. The ACCC has the ability to disallow from inclusion in the RAB for the following period any operating expenditure that ARTC has incurred inefficiently.

Section 14 of the June 2011 HVAU defines efficient as:

“**Efficient**” means, in respect to costs and operating expenditure, costs incurred by a prudent service provider managing the Network, acting efficiently, having regard to any matters particular to the environment in which management of the Network occurs including:

- (a) the Hunter Valley Coal Chain where a key objective in maintenance planning is to maximise coal chain throughput and reliability;
- (b) ARTC’s obligations to maintain the Network having regard to the terms of applicable Access Agreements and Access Holder Agreements existing at the time; and
- (c) ARTC’s obligations under the law, applicable legislation (including regulations) or the NSW Lease.

Regardless of whether the costs or operating expenditure incurred is under the RAB or RAB Floor Limit roll forward, it must be incurred on an efficient basis in order to promote the efficient use of and investment in the network.

Questions for comment

- Does industry have any comments on whether the level of costs incurred by ARTC during the Compliance Period (including maintenance, network control and corporate overhead costs) were incurred in an Efficient manner (as defined in section 14 of the June 2011 HVAU)?

5 Unders and overs accounting

Section 4.9 of the June 2011 HVAU requires ARTC to calculate the total unders or overs amount as part of its Annual Compliance Submission to the ACCC under section 4.10(a)(ii). Unders and overs accounting is the outcome of the reconciliation of Access revenue with applicable Ceiling Limits undertaken by ARTC.

As agreed with the ACCC,²³ ARTC will determine the total unders and overs amount by reconciliation of Access revenue arising in the Compliance Period and otherwise determined in accordance with the June 2011 HVAU, against the Ceiling Limit.

ARTC is required to calculate the total overs and unders in the following manner under section 4.9(b):

(a) For each Constrained Coal Customer, ARTC will:

- (i) establish a Constrained Coal Customer Account;*
- (ii) determine the annual allocation of the total unders or overs amount to each Constrained Coal Customer in accordance with the methodology specified at (iii);*
- (iii) determine an allocation of the total unders or overs amount, for each Constrained Coal Customer 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 following the application of the system wide true-up tests and the annual individual reconciliation, and where applicable, in accordance with the equitable allocation to be carried out under **section 10.2**;*
- (iv) add or subtract the annual allocation for the calendar year from the opening balance in each applicable Constrained Coal Customer Account in determining the closing balance of the applicable Constrained Coal Customer Account for that calendar year;*
- (v) advise each Constrained Coal Customer of the details of its Constrained Coal Customer Account; and*
- (vi) reconcile the Constrained Coal Customer Accounts by one of two methods, being:*
 - (A) ARTC bringing the closing balance of each Constrained Coal Customer Account back to zero by refunding or collecting the applicable amount to or from, respectively, each Constrained Coal Customer; or*
 - (B) mutual agreement between the parties, which must result in an outcome that is equitable for all Constrained Coal Customers.*

As highlighted in section 1.1 of this document, no Access Holder Agreements were executed during the Compliance Period. Consequently, ARTC has only established

²³ As part of the Regulatory Transitioning Approach, see Attachment 2 of ARTC's Annual Compliance Submission.

Constrained Coal Customer Accounts for rail operators, as Access revenue has only been earned during this period under Access Agreements with rail operators. ARTC expects that Constrained Coal Customer Accounts will be established for producers in due course as contractual arrangements transition across to Access Holder Agreements held by producers during 2012.

5.1.1 1 July 2011 to 31 December 2011 Unders & Overs Balance

In undertaking the unders and overs accounting for the Compliance Period, Total Access Revenue earned by ARTC from the Constrained Group of Mines was compared to the Economic Cost of the Constrained Network, including the operating costs, depreciation, net loss on disposal and half of the real return of 9.10% based on the average RAB Floor Limit for the Compliance Period.

The difference between Access revenue for the Constrained Group of Mines and the Economic Cost of the Constrained Network (Ceiling Limit) for the Compliance Period is as follows:

Table 4 – Unders and overs accounting 1 July – 31 December 2011

	ARTC TOTAL	
	June 2011	December 2011
	Actuals	Actuals
<i>millions</i>		
ARTC Unders/Overs		
Opening Value	1.27	-20.93
Refunds/Payments	-1.27	20.93
Yearly adjustment	-20.93	0.77
Closing Value	-20.93	0.77

Table source: ARTC, *Submission*, p. 26.

As required by section 4.9(b)(ii), ARTC provided a spreadsheet to the ACCC (on a confidential basis) that determines allocations of the total unders and overs amount for the Compliance Period.

6 System Wide True Up Test Audit

The June 2011 HVAU incorporate complex liability arrangements in the Indicative Access Holder Agreement. The System True Up Test is used to determine ARTC's liability for failure to make train path usages available, by determining whether sufficient capacity was available on the network in a given period to meet all contracted entitlements. If not, a rebate of take-or-pay charges may accrue to affected users.

As required under section 4.10(f) of the June 2011 HVAU, ARTC engaged BDO (SA) Pty Ltd (**BDO**) as auditor for the annual True Up Test audit, to ensure the integrity of the test and avoid perceptions of conflicts of interest on the part of ARTC. BDO prepared a Final Audit Report with regard to the status of the annual True Up Test requirement. The report was submitted to the ACCC on 30 April 2012.

BDO concluded that ARTC was not required to perform a System True Up Test during the Compliance Period. The report noted that a review of Access Holder documentation did not identify any Access Holders with both an AHA and Operator Sub-Agreement executed prior to 31 December 2011, which together comprise the basis on which ARTC grants an Access Holder access to the Network. As such, there were no operational agreements in place for the assessment period supporting ARTC's performance with regard to the Annual True Up Test.

Consequently, the Annual True Up Test was not performed for the period 1 July 2011 to 31 July 2011 as there were no operational AHAs in place.