AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Consultation Paper

Australian Rail Track Corporation's compliance with the financial model in the Hunter Valley Coal Network Access Undertaking for 2017

14 May 2020

Foreword

The Australian Competition and Consumer Commission (**ACCC**) is conducting a public consultation as part of its assessment of the Australian Rail Track Corporation's (**ARTC**) compliance for the 2017 calendar year with the Hunter Valley Coal Network Access Undertaking (**HVAU**). The ACCC is seeking submissions from interested parties with respect to ARTC's submission.

Under the HVAU, ARTC is required to submit documentation to the ACCC for an annual assessment of its compliance with the HVAU financial model.

Questions of particular interest to the ACCC are set out in section 3 of this consultation paper. However, comments are welcome on any aspect of ARTC's submission.

The ACCC's intention is that there will be a single round of consultation before the ACCC makes a final determination in relation to ARTC's compliance in 2017. 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 and any additional issues identified in ARTC's compliance submission.

Submissions are due by Friday, **26 June 2020** and should be addressed to:

Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Competition and Consumer Commission
Email: transport@accc.gov.au

Confidentiality

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 relevant publication available on the ACCC's website.[1]

Further Information

ARTC's submission for 2017 compliance and other relevant information, such as the applicable HVAU, are available on the ACCC's website.[2] Public submissions made during the current process will also be published on the ACCC's website. If you have any queries about matters raised in this document, please contact:

Mr Justin Martyn
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1 Available at http://www.accc.gov.au/publications/accc-aer-information-policy-collection-and-disclosure-of-information

2 Available at http://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking

Contents

Executive Summary

ARTC has submitted compliance documentation for 2017 to the ACCC for assessment pursuant to the HVAU.

The HVAU financial model allows ARTC to recover revenue equivalent to its efficient costs in each calendar year for the Constrained Network (currently comprising rail Segments in Pricing Zones (**Zones**) 1 and 2). The financial model also allows ARTC to capitalise revenue shortfalls for the unconstrained part of the network (i.e. Zone 3) into its regulatory value of assets for recovery in future years.

ARTC submitted that it had a $10.7 million over-recovery of revenue for the Constrained Network in 2017, which is to be refunded to Zone 1 and 2 Access Holders. ARTC has also submitted that 'loss capitalisation' continued to apply in Zone 3 and that the net balance of losses capitalised into the Zone 3 asset base as at the end of 2017 is $60.1 million, a reduction of $11.0 million over the year.

Additionally, section 4.4(a) of the HVAU provides for a one-off adjustment and refund to Zone 3 customers for the backdating period 1 July 2016 to 30 June 2017. ARTC submitted that the refund for 1 July 2016 to 31 December 2016 (**2016 H2**) is reflected as an adjustment of $7.4 million to the Zone 3 closing 2016 RAB value. A further adjustment for the remaining period will be made after the 2017 compliance determination is finalised.

For 2017, ARTC submitted that total net capital expenditure was $41.2 million, including $16.5 million for the Constrained Network and $24.7 million for Zone 3 (Table 1).

ARTC also submitted that its operating expenditure was $108.8 million for the Constrained Network and $60.5 million for Zone 3 (Table 3). A key component of operating expenditure is maintenance costs. This was $99.7 million ($58.2 million for the Constrained Network and $41.5 million for Zone 3). Compared to 2016, this represents an overall increase in maintenance costs of 0.6 per cent. A decrease of 5.1 per cent for the Constrained Network was offset by an increase of 9.7 per cent for Zone 3.

ARTC's 2017 compliance documentation is available on the ACCC's website.[3]

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[3] Available at https://www.accc.gov.au/regulated-infrastructure/rail/annual-compliance-assessment-2017/compliance-submission

1. Introduction

ARTC is an Australian Government-owned corporation that was established in 1998 and provides a single point of contact for parties seeking to run trains on the Interstate Network across Australia and the Hunter Valley Rail Network in New South Wales. ARTC is vertically separated, providing ‘below-rail’ services (such as the rail track infrastructure) but not ‘above-rail’ services (such as haulage).

The Hunter Valley Coal Chain is the largest coal export operation in the world. It consists of about 40 coal mines owned by around 20 coal producers and four above-rail operators transporting coal to three coal terminals. A key component of the Hunter Valley Coal Chain is ARTC’s Hunter Valley Rail Network which is the below-rail infrastructure used to transport coal from the Hunter Valley to the Port of Newcastle for export. The Hunter Valley Rail Network is also used for coal transport to power stations, non-coal traffic, including general and bulk freight (such as grain) and passenger services.

ARTC has a natural monopoly over this below-rail infrastructure that forms the Hunter Valley Rail Network. ARTC’s monopoly position creates an ability for it to charge monopoly prices, operate inefficiently and undertake inefficient investment.

1.1. Hunter Valley Coal Network Access Undertaking

Access to ARTC’s Hunter Valley Rail Network is currently regulated through the HVAU, which sets out the terms and conditions for Access seekers (both current and future). The ACCC accepted the 2011 HVAU submitted by ARTC under Part IIIA of the *Competition and Consumer Act 2010* (**the Act**). The Hunter Valley network was previously subject to the NSW Rail Access Undertaking and administered by the NSW Independent Pricing and Regulatory Tribunal.

The HVAU initially applied for a five year period, expiring on 30 June 2016. Between May 2016 and November 2018, the ACCC accepted five separate applications submitted by ARTC to vary and/or extend the HVAU.

The HVAU was varied on 29 June 2017 to change a number of provisions in the undertaking, including retrospective changes to the rate of return, remaining mine life and the introduction of Schedule I which sets out amendments to ARTC’s overhead cost allocation methodology (**June 2017 variation**).[4]

As a result of the most recent variations, the HVAU is currently set to expire on 31 December 2021.

More information on the HVAU and its variations and extensions can be found on the ACCC website: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking.

Capitalised terms used in the remainder of this paper are terms that are defined in section 14.1 of the HVAU.

[4] The HVAU applicable from 1 January to 30 June 2017 is available at https://www.accc.gov.au/system/files/public-registers/other/1199839-1-Variation.pdf.

The HVAU applicable from 1 July to 31 December 2017 is available at https://www.accc.gov.au/system/files/public-registers/other/1203007-1-June-Variation.pdf.

1.2. HVAU financial model and pricing principles

Section 4 of the HVAU regulates the amount of revenue that ARTC is entitled to recover from Access Holders for the Hunter Valley Rail Network. In particular the HVAU sets out two different methodologies for the Constrained Network and Zone 3.

Section 4.3 of the HVAU caps the maximum amount of revenue (**Ceiling Limit**) that ARTC is entitled to receive from Access Holders at the Full Economic Cost of providing services. Section 4.4 of the HVAU sets out how the Regulatory Asset Base (**RAB**) and RAB Floor Limit are rolled forwarded each year.

1.2.1. Constrained Network methodology

The RAB Floor Limit is a critical component for determining the Full Economic Cost for the Constrained Network. The Full Economic Cost of providing services is calculated using a ‘building block model’, which requires a regulatory valuation of assets. The initial regulatory value of assets is rolled forward each year to add prudent capital expenditure and deduct depreciation and disposals. This is known as the RAB Floor Limit in the HVAU (section 4.4(b)). The Full Economic Cost is the sum of the return on the RAB Floor Limit, depreciation and operating expenditure.

For the Constrained Network, the HVAU applies an ‘unders and overs’ accounting framework that enables ARTC to recover the Full Economic Cost of providing services in each compliance period. If ARTC’s revenue for the Constrained Network is more than the Economic Cost in a compliance period, then ARTC is required to refund the ‘overs’ amount to Constrained Coal Customers (and vice versa).

1.2.2. Zone 3 methodology

For Zone 3 customers, the HVAU sets out a loss capitalisation model, where the RAB is the critical component. The RAB comprises the regulatory value of Zone 3 assets (RAB Floor Limit) and the accumulated losses incurred in Zone 3. It is rolled forward each year to include new capital expenditure, return on the RAB, and the annual loss (profit). Zone 3 remains excluded from the Constrained Network as long as its RAB exceeds the RAB Floor Limit – effectively while there is still a net accumulated loss.

Under the HVAU, once ARTC is able to recover the Economic Cost of Zone 3 (including the losses capitalised from previous years), it becomes part of the Constrained Network and the ‘unders and overs’ accounting framework (as per the Constrained Network, detailed above) takes effect.

Additionally, the June 2017 variation to the HVAU (section 4.4(a)) allows for a one-off adjustment to Zone 3 customers relating to the backdating of rate of return and remaining mine life values for the period 1 July 2016 to 30 June 2017. ARTC submitted that, for 2016 H2, the refund to Zone 3 customers is reflected as an adjustment of $7.4 million to the 2016 closing RAB value (rolled forward for the 2017 assessment).

1.3. ACCC 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 for the calendar year. In particular, the ACCC is required to determine whether:

- ARTC has undertaken prudent capital expenditure and incurred efficient operating expenditure
- ARTC has rolled forward the regulatory value of its assets
- Zone 3 forms part of the Constrained Network or whether 'loss capitalisation' continues to apply
- ARTC has reconciled revenues with the applicable revenue floor and ceiling limits and determined the allocation of any under- or over-recovery of revenue to Constrained Coal Customers.

ARTC submitted its 2017 annual compliance documentation to the ACCC on 23 April 2020. The key components of this submission are set out in section 2 of this consultation paper. ARTC's non-confidential submission is available on the ACCC's website.[5] The relevant provisions of the HVAU relating to the annual compliance assessment are outlined in Appendix A of this consultation paper.

[5] Available at https://www.accc.gov.au/regulated-infrastructure/rail/annual-compliance-assessment-2017/compliance-submission

2. Key areas for the 2017 compliance assessment

The ACCC has identified the following key areas as being relevant for 2017:

- allocation of the 'unders and overs' amount to Access Holders (section 2.1)
- prudency of capital expenditure (section 2.2)
- efficiency of operating expenditure (section 2.3)
- introduction of Schedule I corporate overhead cost allocators from 1 June 2017 (section 2.4)
- true-up test audit (section 2.5)
- any other matters of interest to stakeholders.

2.1. 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.

ARTC submitted that the total over-recovery for the Constrained Group of Mines for 2017 was $10.7 million. 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.*[6]

ARTC noted that, at the time of setting access prices for 1 January 2017 to 30 June 2017 (**2017 H1**), the proposed 2017 HVAU application was not finalised. ARTC therefore maintained the same access charges applicable from 1 June 2016 to 31 December 2016 for 2017 H1, with the intention of backdating the rate of return and remaining mine life approved in a new HVAU to 1 July 2016.[7]

Consequently, ARTC submitted that:

> *The backdating of the HVAU commercial parameters in 2017 H1 resulted in a larger over-recovery of revenue from the Constrained Group of Mines than would otherwise have been the case through differences with the forecast cost and volume assumptions.*[8]

For Zone 3 Access Holders, section 4.4(a) of the HVAU was varied (as part of the June 2017 variation) to make a one-off adjustment to Zone 3 Customers with respect to the backdating period.[9] Specifically:

> *Any one off adjustment to the revenue for Pricing Zone 3 Access Holders in respect of the backdating period 1 July 2016 to 30 June 2017 will be offset against Out-turn Revenue in the relevant calendar year for the purposes of this clause.*

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6 See section 4.9(b)(iii) of the HVAU.

7 ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 27.

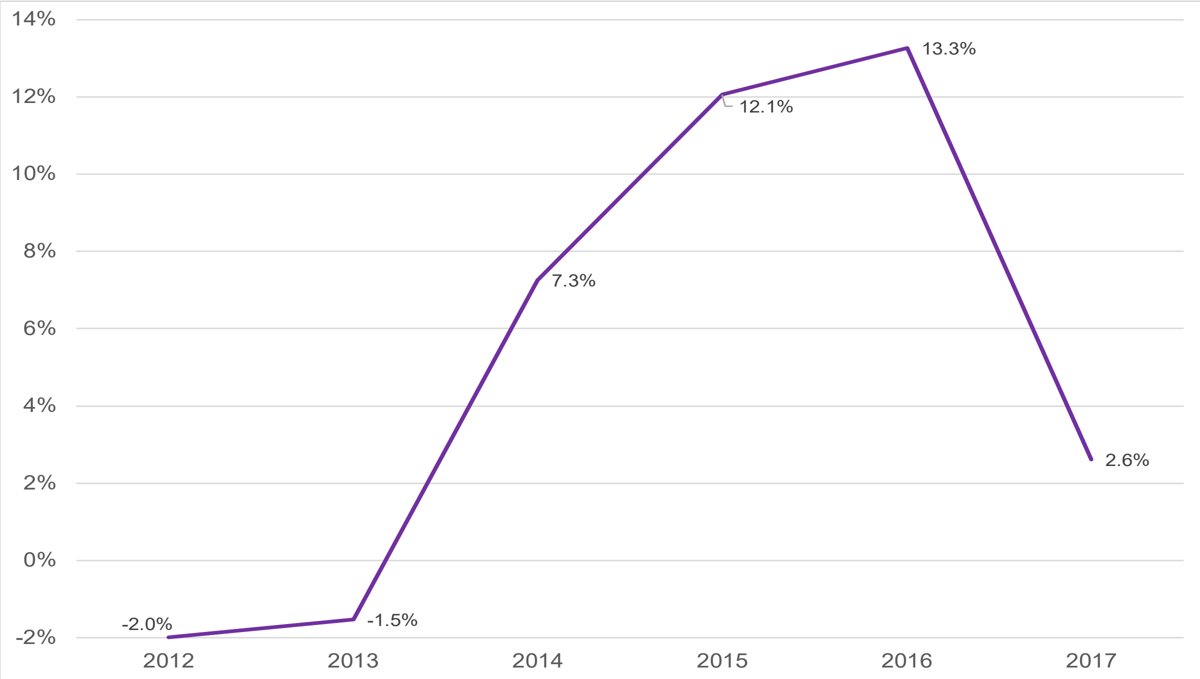
8 Ibid.

9 ACCC, *Decision – Australian Rail Track Corporation's application to vary the 2011 Hunter Valley Access Undertaking*, 29 June 2017, p. 18.

ARTC submitted that the portion of the one-off backdating adjustment that relates to 2017 H1 will be confirmed with Zone 3 Access Holders and refunded following the publication of the ACCC's 2017 Compliance Final Determination.[10] For 2017 H1 ARTC submitted that, similar to the 2016 H2 adjustment (of $7.4 million), this will be reflected as an adjustment to the Zone 3 closing 2017 RAB value rolled forward in its 2018 compliance submission.[11]

Figure 1 displays the 'unders and overs' amount as a percentage of total Access revenue. In 2017, ARTC's over-recovered revenue as a percentage of total Access revenue fell to its lowest level since 2013.

Figure 1: Over (under) recovery amount as a percentage of total Access revenue



To comply with section 4.9(b)(ii) of the HVAU, ARTC provided a confidential spreadsheet to the ACCC that set out the allocation of the total 'unders and overs' amount for 2017.

2.2. 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. 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.

Section 4.10(d)(iii) of the HVAU explicitly provides that, if capital expenditure has been endorsed by the Rail Capacity Group (**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 Hunter Valley Coal Chain Coordinator (**HVCCC**) (in a non-voting capacity).

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10 ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 15.

11 Ibid.

Table 1 sets out ARTC's net capital expenditure for 2017 was $41.2 million, including $16.5 million for the Constrained Network and $24.7 million for Zone 3.

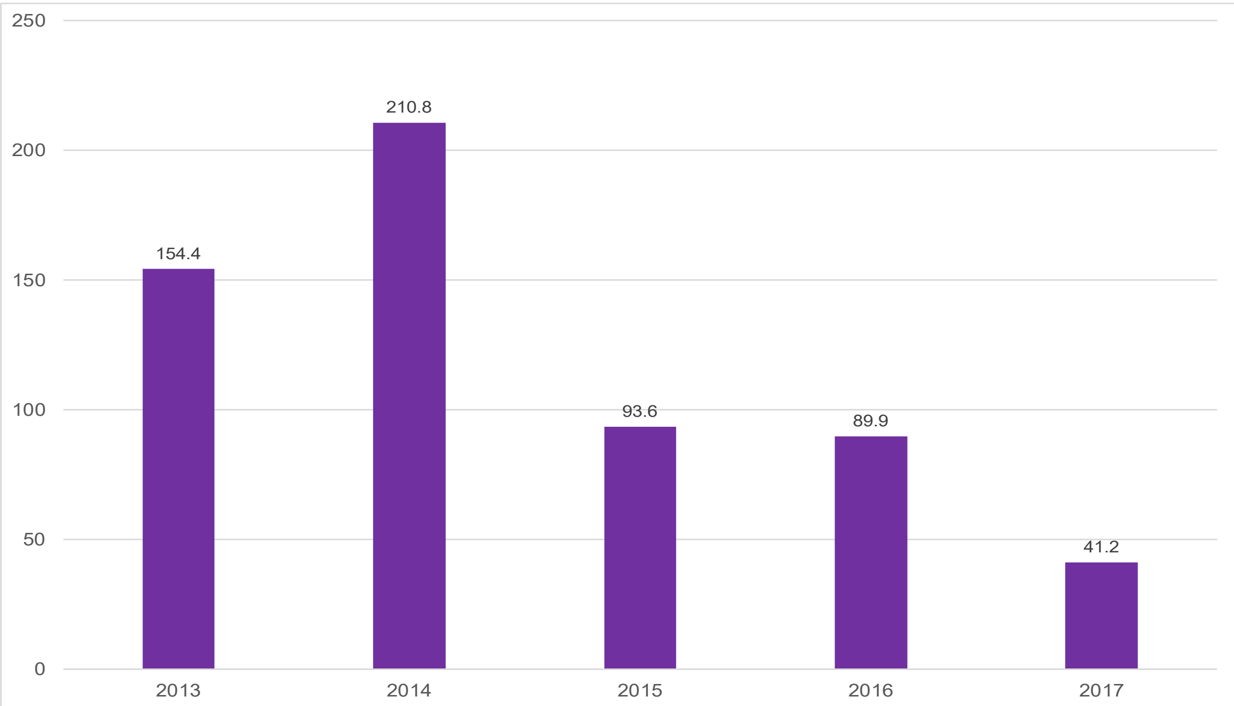
Table 1: Net capital expenditure, ($ million), 2017 ARTC Submission

Capital expenditure	Constrained Network	Zone 3	Total[12]
Major	2.1	0.0	2.1
Minor (Corridor Capital)	19.8	27.5	47.3
Interest during construction	-	-	-
Disposal value reduction	(5.4)	(2.8)	(8.1)
Net capital expenditure	16.5	24.7	41.2

Note: Totals may not add due to rounding.

Figure 2 shows ARTC's net capital expenditure for the Hunter Valley network, which has decreased each year since 2014.

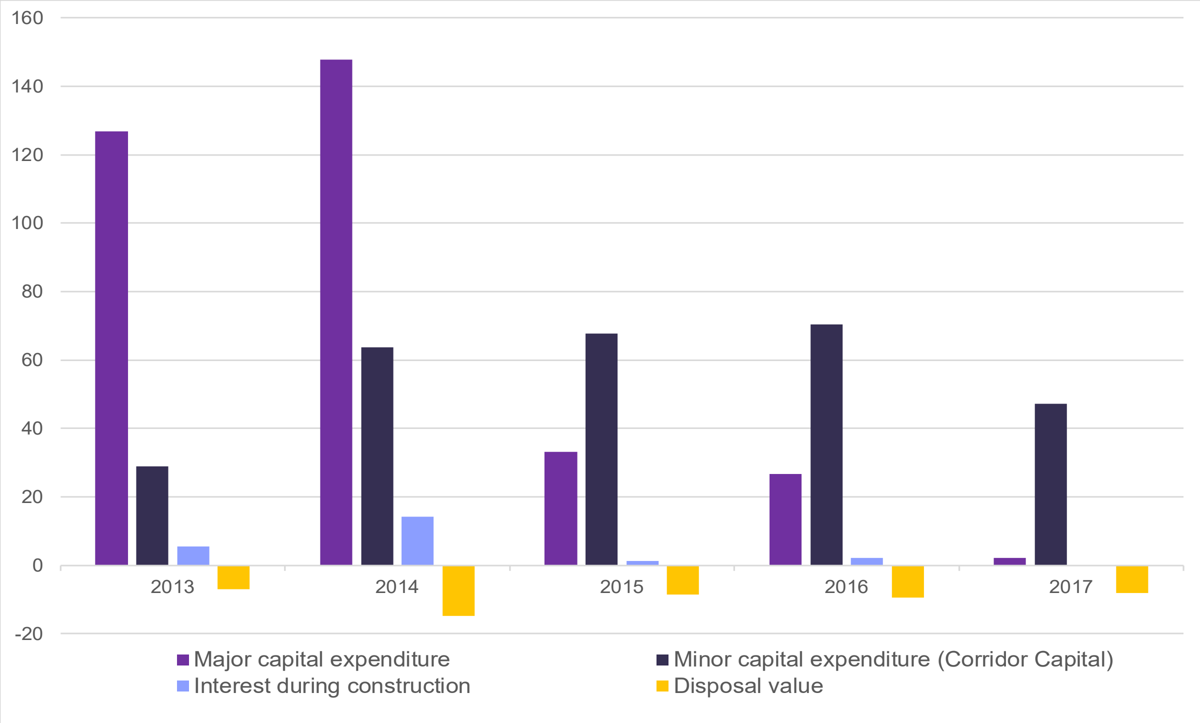
Figure 2: Net Capital Expenditure ($ million), 2013-2017



12 ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, pp. 14, 17.

Figure 3 displays each of the components of net capital expenditure over time. 2017 is the first year that both major and minor capital expenditure have decreased from the previous year.

Figure 3: Net Capital Expenditure ($ million) by category, 2013-2017



Major capital expenditure

ARTC submitted that there were no major projects commissioned during the 2017 calendar year.

However, ARTC noted that post-commissioning costs incurred during 2017 included costs associated with site reconditioning and rehabilitation, land acquisition, noise barriers and signalling.[13] Table 2 outlines the major project capital expenditure that ARTC has included in the RAB Floor Limit for 2017.

Table 2: Major Projects included in the RAB Floor Limit in 2017

Project Code	Project Name	Value Added to RAB Floor Limit ($)[14]
5255	Maitland to Minimbah Third Road	49 759
6387	Hexham Relief Roads Stage 1	257 293
8667	Kooragang Arrival Roads Stage 2	1 785 192
Total		**2 092 243**

Note: Totals may not add due to rounding.

[13] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 21.
[14] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 37.

Minor capital expenditure

Regarding the minor capital works (also referred to by ARTC as corridor capital), ARTC submitted that:

> *HVAU section 9.1(e)(ii) provides for the minor capital works (also referred to as Corridor Capital) programme to be considered by the RCG as a group rather than as individual projects. During 2017, ARTC undertook a process with the RCG in relation to the Corridor Capital programme, where the programme was presented for endorsement, indicative works and costings within that programme were provided, the programme was endorsed, and the works delivered.*
>
> *It is noted that changes at the detailed project level can occur in terms of the scope, priority and timing depending on prevailing circumstances such as identified network conditions and access to the network. During 2017, ARTC kept the RCG informed of the progress of the endorsed Corridor Capital programme. Updates regarding delivery of the Corridor Capital programme were delivered quarterly to the RCG with all variances reported. The consultation documents provided to the RCG in this regard during 2017 form confidential Attachments CAP2.1, CAP2.2, CAP2.3 and CAP2.4 to Attachment 2.*[15]

ARTC has provided information on the RCG's endorsement of both major and minor capital expenditure to the ACCC on a confidential basis.

2.3. Efficiency of operating expenditure

Section 4.10(e) of the HVAU provides for the ACCC to assess the efficiency of ARTC's operating expenditure. Efficient costs and operating expenditure, in turn, inform 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.

Table 3 sets out ARTC's 2017 operating expenditure by the main operating expenditure components. ARTC submitted an operating expenditure of $108.8 million for the Constrained Network and $60.5 million for Zone 3.

[15] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, pp. 20-21.

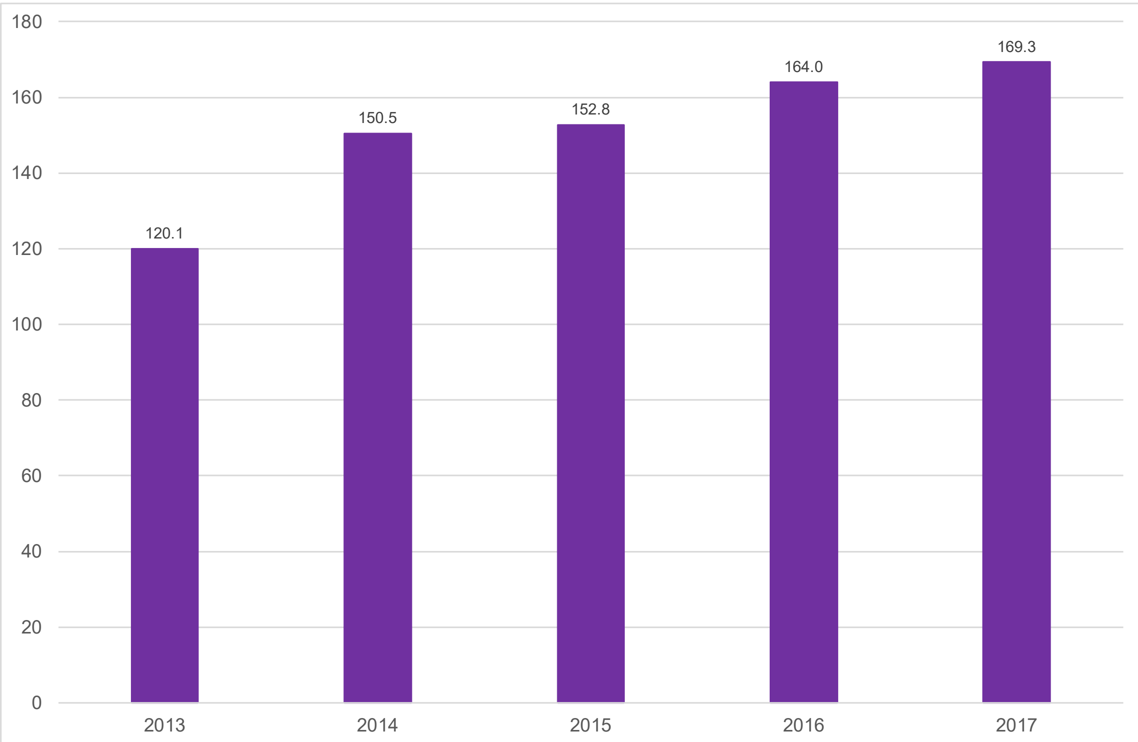
Table 3: Operating expenditure, ($ million), 2017 ARTC submission

Operating expenditure	Constrained	Zone 3	Total[16]
Maintenance costs	58.2	41.5	99.7
Business unit management costs	21.7	8.1	29.8
Corporate overheads	13.9	4.4	18.3
Network control	10.4	3.7	14.1
Net loss on disposals	4.7	2.7	7.4
Expensed project costs	-	-	-
Total operating expenditure	108.8	60.5	169.3

Note: Totals may not add due to rounding. The Total column refers to the sum of the two columns – not the whole network.

Figure 4 displays ARTC's historical operating expenditure for 2013 onwards. ARTC's operating expenditure on the Hunter Valley have been increasing yearly since 2013.

Figure 4: Total Operating Expenditure, ($ million), 2013-2017



Operating expenditure has risen over time, with varying fluctuations in individual expenditure components. 2017 operating expenditure increased by 3.0 per cent for the Constrained Network and 3.6 per cent for Zone 3.

16 ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 14;

ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Annual Compliance Assessment – Attachment 1: Hunter Valley Network Operating Costs*, 23 April 2020, p. 4.

Figure 5 shows the six categories of ARTC's historical operating expenditure on the Hunter Valley network since 2013.

Figure 5: Operating Expenditure ($ million), by category, 2013-2017

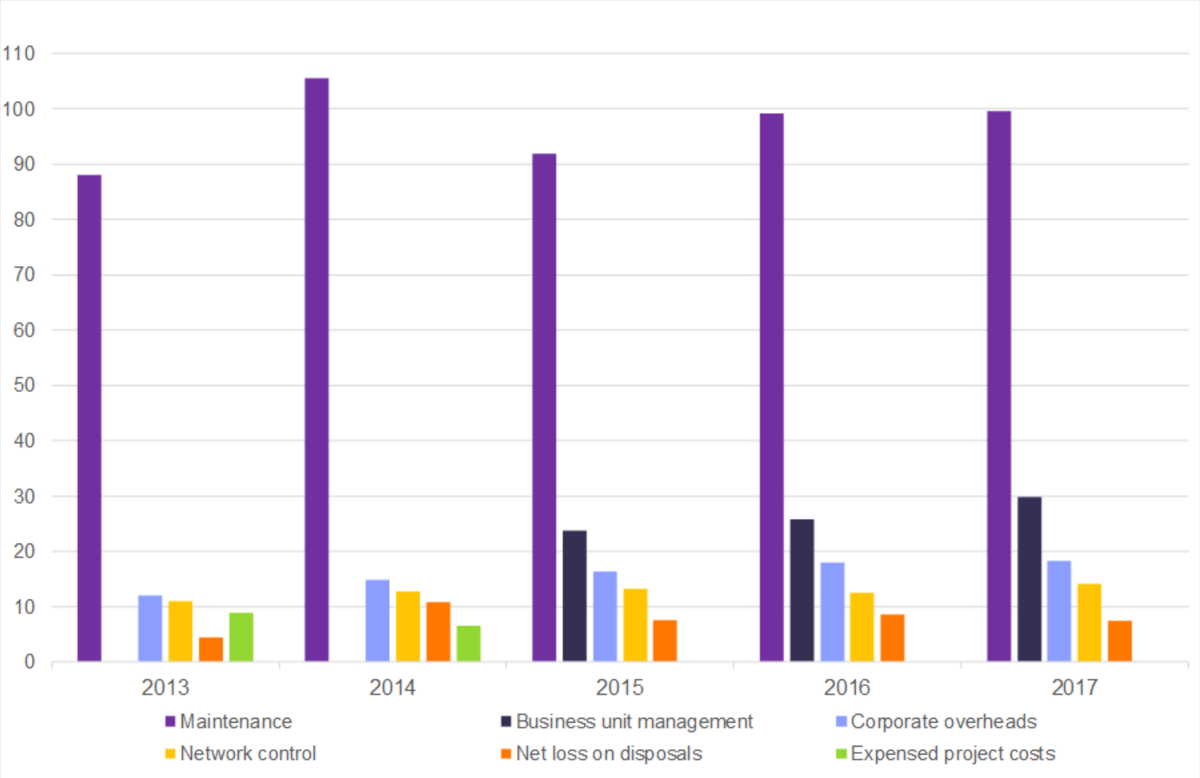


Figure 5 illustrates the strong dominance of maintenance expenditure on total operating expenditure. Maintenance cost is discussed further below.

Business unit management costs was introduced in 2015, due to a corporate restructure, covering costs previously included in maintenance costs. This expense is now the second-highest expense and has increased each year. Business unit management costs comprise Hunter Valley direct costs and encompasses four functions:

- Hunter Valley Customer Service and Operations
- Hunter Valley Asset Delivery, including the Provisioning Centres
- Hunter Valley Asset Development
- Hunter Valley Management and Support.

2.3.1. Maintenance costs

ARTC's proposed maintenance costs for 2017 is $99.7 million, of which $58.2 million relates to the Constrained Network and $41.5 million relates to Zone 3. Compared to 2016, this represents an overall increase of 0.6 per cent. A decrease of 5.1 per cent for the Constrained Network is offset by an increase of around 9.7 per cent for Zone 3.

ARTC provided details on the top ten maintenance activities by value for the Network and each of the Zones. The two most significant maintenance activities for 2017 were ballast cleaning and rail grinding.

Ballast cleaning was the largest maintenance activity in 2017, and it decreased by 35.3 per cent.[17] ARTC noted that in 2017 ballast cleaning was undertaken only in Zone 3.

Rail grinding was the second largest maintenance activity in 2017. Rail grinding expenditure in 2017 increased by 19.3 per cent. ARTC noted the increase in rail grinding was due to an increase in the scope of rail grinding delivered.[18]

2.3.2. Procurement

In the Final Determination for 2015 the ACCC stated, for future assessments, it required assurance from ARTC that its procurement policies were satisfied; and if not, justification on why such procurements should be considered efficient.[19]

In its 2017 annual compliance submission, ARTC submitted that there were no changes made to ARTC's procurement procedure, however, development started on a new ARTC-wide procurement framework.[20] ARTC noted that a new procurement manual was implemented in early 2018, along with enhancements to ARTC's procurement and contracting processes.[21]

Consistent with its 2016 compliance submission, ARTC provided the ACCC with a confidential outline of the procurement processes that it applied to a cross section of contracts relating to 2017 costs to demonstrate the efficiency and value for money in ARTC's procurements.[22]

2.4. Corporate Overhead Cost Allocators (Schedule I)

The HVAU requires that, where possible, Non-Segment Specific Costs are directly attributed to a Segment, otherwise there is an allocation of the costs to Segments in line with the cost allocation methodology prescribed in the HVAU.[23]

For 2017, there are two different methodologies to allocate Non-Segment Specific Costs that cannot be directly attributed to a Segment:

- For the period from 1 January to 30 June 2017: the allocation methodology is based on gross tonne kilometres (**GTK**) where the Non-Segment Specific Cost is associated with track maintenance or train kilometres (**Train Km**) where the Non-Segment Specific Cost is not associated with track maintenance[24]
- For the period from 1 July 2017 to 31 December 2017: the allocation methodology is based on section 4.6 and Schedule I of the HVAU (introduced in the June 2017 variation to the HVAU).

Schedule I delineates the allocation methodology that ARTC is required to apply to its Non-Segment Specific Costs and the return on and depreciation of its Non-Segment Specific

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[17] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Annual Compliance Assessment – Attachment 1: Hunter Valley Network Operating Costs*, 23 April 2020, pp. 5-9.

[18] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Annual Compliance Assessment – Attachment 1: Hunter Valley Network Operating Costs*, 23 April 2020, pp. 5-10.

[19] ACCC, *Final Determination – Australian Rail Track Corporation's compliance with the Hunter Valley Coal Network Access Undertaking financial model for the 2015 calendar year*, 5 April 2019, p. 37.

[20] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 10.

[21] Ibid.

[22] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 11.

[23] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 7.

[24] Ibid.

Assets. Where costs are not able to be directly attributable to Hunter Valley corridors, they must be allocated according to the allocation method set out in Table 4.

Table 4: Schedule I Cost Allocation Methodology[25]

Cost category	Allocation method
Executive	Direct Stay-in-Business Costs
Finance	Direct Stay-in-Business Costs
Strategy and corporate development	Train Km
People	FTE
Insurance	Premium based
Safety accreditation	Track Km
Property	Track Km
Communications	Train Km
IT infrastructure and systems	FTE
Management of enterprise services	Direct Stay-in-Business Costs
Environment	Train Km
Engineering services	GTK
Corporate safety	GTK
Workplace health & safety	FTE
Risk	GTK
Allowance for efficiency projects	Direct Stay-in-Business Costs

Note abbreviations: Train Kilometres (Train Km); Full Time Equivalent (FTE); Track Kilometres (Track Km); Gross Tonne Kilometres (GTK).

Source: Schedule I of the HVAU.

25 ARTC, *Hunter Valley Coal Network Access Undertaking*, 29 June 2017, pp. 142-143.

2.5. True-up Test audit

RSM Australia (**RSM**) has audited ARTC's compliance with the system True-up Test (**TUT**) obligations under Schedule 2 of the Indicative Access Holder Agreement annexed to the HVAU for the 2017 compliance period. The TUT determines whether ARTC is liable for any rebates to users for ARTC's failure to deliver contracted path usages.

RSM's final audit report concluded that ARTC had complied, in all material respects, with Schedule 2 of the Access Holder Agreements under the HVAU for the year ended 31 December 2017.[26]

RSM identified two low-risk compliance issues with respect to the timeframe for publishing TUT reports and a discrepancy noted in the calculation of system losses.[27] In its submission ARTC responds to RSM's audit findings and does not propose to re-publish updated results of the TUT to account for non-material issues.[28]

Additional details about the TUT results can be found in RSM's audit report.[29]

[26] RSM Australia, *Australian Rail Track Corporation – Hunter Valley Access Undertaking – System Wide True Up Test Audit – Reasonable Assurance Engagement Report*, April 2018, p. 6.

[27] RSM Australia, *Australian Rail Track Corporation – Hunter Valley Access Undertaking – System Wide True Up Test Audit – Reasonable Assurance Engagement Report*, April 2018, pp. 7-9.

[28] ARTC, *Hunter Valley Coal Network Access Undertaking – 2017 Compliance Assessment Submission*, 23 April 2020, p. 31.

[29] Available at: https://www.accc.gov.au/regulated-infrastructure/rail/annual-compliance-assessment-2017/compliance-submission

3. Questions

The ACCC welcomes stakeholder views on any aspect of ARTC's 2017 compliance submission. In particular, do stakeholders have any comments about:

Allocation of 'unders and overs' amount to Access Holders

1) the amount of over-recovered revenue or the process undertaken by ARTC to return the over-recovered revenue to stakeholders in recent years?

2) the one-off adjustment to the Access revenue for Zone 3 Access Holders in respect of the backdating period 1 July 2016 to 30 June 2017?

Capital expenditure

3) ARTC's compliance with the HVAU regarding:

   (a) the cost of major capital projects to be rolled into the regulatory value of assets for 2017?

   (b) the level of capital expenditure in relation to minor capital projects and the costs of those projects to be rolled into the regulatory value of assets for 2017?

4) the process conducted by ARTC in relation to consultation with, and endorsement of, capital expenditure by the RCG?

Operating expenditure

5) whether the level of operating expenditure incurred by ARTC during the 2017 compliance period was incurred in an efficient manner (as defined in section 14 of the HVAU), including ARTC's maintenance, business unit management, corporate overhead and network control costs, as well as its loss on disposals?

6) ARTC's procurement policies and procedures?

Application of Schedule I (corporate overhead cost allocators)

7) overhead cost allocators and the application of Schedule I of the HVAU?

True-up Test audit

8) ARTC's application of the TUT for 2017 or on the findings / conclusion set out in the audit report prepared by RSM?

Appendix A: Annual compliance assessment provisions in the HVAU

Section 4.10 of the HVAU provides for the ACCC to conduct an annual compliance assessment to determine whether ARTC has complied with the access pricing principles under the HVAU. These provisions are set out below (capitalised terms are defined under section 14 of the HVAU).

a) ARTC will submit to the ACCC by 30 April each year in respect of the previous calendar year:[30]

    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 the 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).

b) 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.

c) If the ACCC reasonably considers that it requires additional information, other than that provided by ARTC in accordance with Schedule G, in order to carry out its assessment under section 4.10(d), it may request this information from ARTC in accordance with section 3 of Schedule G and upon receipt of such a request ARTC will use reasonable endeavours to provide the information to the ACCC as soon as reasonably practicable.

d) The ACCC will 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;

    iii. in determining whether ARTC has complied with the provisions of section 4.4 in rolling forward the RAB or the RAB Floor Limit, the ACCC may have regard to the submissions of relevant industry participants but if Capital Expenditure has been endorsed by the RCG in accordance with section 9, the ACCC will not consider whether that Capital Expenditure is Prudent;

[30] Section 4.10(a) was amended in the September 2018 variation to the HVAU to allow the submission by the later of 30 April each year and 4 months from the ACCC's final determination of the previous year's Compliance Assessment. This variation took effect from 1 January 2019. Section 4.10(h) of the HVAU notes that the varied section 4.10(a) applies for the 2017 compliance assessment.

iv. the ACCC will publish its findings on its website and/or circulate to Access Holders in relation to the matters for its determination; and

v. ARTC will revise the closing RAB and manage Constrained Coal Customer Accounts in accordance with any determination by the ACCC.

e) The ACCC will determine whether ARTC has incurred Efficient costs and Efficient operating expenditure in accordance with section 4.5(b), 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 section 4.5(a) only including Efficient costs and Efficient operating expenditure determined in accordance with section 4.5(b).

Section 4.10(f)(x) of the HVAU also provides that ARTC will provide the final written report of the True-Up Test, as prepared by the independent auditor, to the ACCC to review as part of the annual compliance assessment process under the HVAU.