



HUNTER VALLEY ACCESS UNDERTAKING 2010

EXPLANATORY GUIDE

(SEPTEMBER 2010)

ARTC Explanatory Guide 2010 HVAU

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ARTC Explanatory Guide 2010 HVAU

1 Introduction

1.1 Purpose of explanatory guide

The purpose of this explanatory guide (**Explanatory Guide**) is to explain the reasons for the changes made to the Hunter Valley Access Undertaking submitted to the ACCC in April 2009 (**2009 HVAU**), incorporated in the Hunter Valley Access Undertaking submitted to the ACCC in August 2010 (**2010 HVAU**), as well as changes to the Indicative Agreements.

The amendments included in the 2010 HVAU, the Indicative Access Holder Agreement 2010 (**2010 IAHA**) and Operator Sub Agreement 2010 (**2010 OSA**) include:

- changes made in response to recommendations made by the ACCC in its Draft Decision on the 2009 Hunter Valley Access Undertaking, published on 5 March 2010 (**Draft Decision**);
- changes made in response to further issues raised by ACCC staff members in subsequent discussions with ARTC in April - August 2010;
- changes made in response to concerns raised by industry stakeholders in April - August 2010; and
- amendments made following internal review and discussion within ARTC.

This guide also sets out the reasons why certain recommendations made by the ACCC or by industry stakeholders which have not been included in the 2010 HVAU were considered but not fully accepted.

1.2 Other key explanatory documents

The Explanatory Guide addresses those changes made to the 2009 HVAU and 2009 OSA submitted to the ACCC on 22 April 2009. In respect of the IAHA, this guide explains those changes made to the Indicative Access Holder Agreement submitted to the ACCC on 23 December 2009 (as provided to industry stakeholders). This version of the Indicative Access Holder Agreement, which is available on the ACCC's website¹, was considered by the ACCC in the Draft Decision.

This guide should be considered in light of other key explanatory documents previously provided by ARTC to the ACCC and stakeholders, including:

- The explanatory guide submitted to the ACCC to accompany the 2009 Hunter Valley Access Undertaking (13 May 2009);²
- ARTC's response to the ACCC Issues Paper (26 June 2009);³

1 ACCC website: <http://www.accc.gov.au/content/index.phtml/itemId/870137>

2 <http://www.accc.gov.au/content/index.phtml/itemId/917837>

3 <http://www.accc.gov.au/content/index.phtml/itemId/917837>

- ARTC’s response to submissions to the ACCC on the Hunter Valley Access Undertaking (21 September 2009);⁴
- ARTC’s Interim Indicative Pricing explanatory guide (October 2009)⁵;
- ARTC’s response to ACCC Pricing Information Request (1 December 2009);⁶ and
- ARTC’s response to the ACCC’s Draft Decision on the Hunter Valley Access Undertaking 2009 (31 March 2009)⁷.

1.3 Outline of Explanatory Guide

This Explanatory Guide sets out the background to the development of the Hunter Valley Access Undertaking (section 2 of this Explanatory Guide) and the specific steps that ARTC has gone through in developing the 2010 HVAU and Indicative Agreements (section 3 of this guide).

ARTC has provided a detailed explanation of the key changes made in the 2010 HVAU and the 2010 IAHA in sections 4 and 5 and has set out ARTC’s proposed approach to the regulatory transitional arrangements (transitioning from Independent Pricing and Regulatory Tribunal (**IPART**) to ACCC annual compliance) in section 6.

In Appendix 1, ARTC has included tables explaining substantive changes on a clause by clause basis for each of the 2010 HVAU, 2010 IAHA and 2010 OSA.

The complete list of appendices to this Explanatory Guide include:

- Appendix 1 - Explanation of changes made in the 2010 HVAU, 2010 IAHA and 2010 OSA;
- Appendix 2 - ARTC revised remaining mine life estimate;
- Appendix 3 - ARTC revised Rate Of Return proposal;
- Appendix 4 - Creation of additional capacity;
- Appendix 5 - Transition of regulatory arrangement;
- Appendix 6 - Pricing Zone 3 Price Cap proposal; and
- Appendix 7 - Revised Interim Indicative Access Charges.

4 <http://www.accc.gov.au/content/index.phtml/itemId/917837>

5 <http://www.accc.gov.au/content/index.phtml/itemId/917837>

6 <http://www.accc.gov.au/content/index.phtml/itemId/917837>

7 <http://www.accc.gov.au/content/index.phtml/itemId/920858>

2 Background

2.1 Initial application

The 2009 HVAU, 2009 IAHA and 2009 OSA were submitted to the ACCC on 22 April 2009. These documents were submitted following extensive consultation with stakeholders. Two earlier drafts had been provided to stakeholders (and the ACCC) in July 2008 and January 2009 and ARTC participated in several workshops with industry participants, the operators of the coal terminals at the Port of Newcastle, above rail operators and the Hunter Valley Coal Chain Logistics Team (**HVCCLT**) (as it then was).

An explanatory guide to accompany the 2009 HVAU was submitted to the ACCC shortly after lodgement in May 2009. The detailed consultation carried out with industry prior to the submission of the 2009 HVAU is set out in section 6.2 of that guide.⁸

2.2 Subsequent discussions and amendments

Following submission of the 2009 HVAU, ARTC continued to engage in significant consultation with industry stakeholders in 2009 and 2010.

ARTC met with all above rail operators and prospective access holders including export coal producers, domestic coal users and non-coal users. ARTC participated in workshops with the Hunter Valley Rail Access Task Force (**HRATF**) of the New South Wales Minerals Council and prepared another two versions of the IAHA in response to submissions received by stakeholders.

ARTC also took part in a series of sessions with Port Waratah Coal Services (**PWCS**) and Port Jackson Partners aimed at resolving alignment concerns raised by producers, and engaged in and contributed to the ‘box ticking’ exercise proposed by PWCS. A number of amendments have been made by ARTC to reflect the alignment concerns discussed in these sessions.

ARTC also provided significant further supporting public information to the ACCC in response to industry and ACCC requests, including detailed pricing projections.

A more detailed description of the extensive consultation that ARTC has engaged in is set out in section 2.1 of ARTC’s response to the ACCC’s Draft Decision.⁹

2.3 Extension of time

Section 44ZZBC of the *Trade Practice Act 1974 (Cth)* (**TPA**) provides that the ACCC must use its best endeavours to make a decision on an undertaking application within six months from the day on which it receives the application. Given that the 2009 HVAU was submitted on 22 April 2009, the target time frame would have been 22 October 2009. However, in October 2009, the ACCC extended the period for making a decision on the HVAU for a further six months (in accordance with section 44ZZBC(2) of the TPA). As a result, the ACCC was required to use its best endeavours to make a decision by 22 April 2009.

⁸ <http://www.accc.gov.au/content/index.phtml/itemId/917837>

⁹ See footnote 7 above.

2.4 Position Paper and Draft Decision

The ACCC provided ARTC with a Position Paper on the non-price aspects of the 2009 HVAU on 10 February 2010. This was subsequently followed by a Draft Decision covering both price and non-price aspects of the 2009 HVAU that was issued by the ACCC on 5 March 2010.

In the detailed response to the Draft Decision which was submitted to the ACCC on 31 March 2010, ARTC addressed each of the recommendations made by the ACCC on the 2009 HVAU, 2009 IAHA (or December 2009 IAHA, as applicable) and 2009 OSA and where a recommendation made by the ACCC was unnecessary or inappropriate, ARTC set out the reasons why this was the case.

2.5 Withdrawal

On 19 April 2010, ARTC withdrew the 2009 HVAU, IAHA and OSA. As set out in the letter to the ACCC withdrawing the 2009 HVAU, it was ARTC's intention to conclude any further industry consultation and submit a revised HVAU to the ACCC for consideration in the near future. As set out in the withdrawal letter, ARTC supports the ACCC's desire for a quick resolution of the HVAU, given the significant advancements made over the past sixteen months in developing a long term contractual framework for the Hunter Valley coal chain.

2.6 Continued application of NSW RAU

It is important for the ACCC and industry to be aware that there is no gap in regulation in the period before the 2010 HVAU is accepted by the ACCC.

The NSW Rail Access Undertaking (**NSW RAU**) which is administered by IPART and has been in force since September 2004, will continue to apply to the Network until the ACCC accepts an undertaking covering the Network under Part IIIA of the TPA. A copy of the NSW RAU is available on the ARTC website.¹⁰

If an access seeker wishes to negotiate and agree an access agreement prior to the commencement of the 2010 HVAU, the access seeker will obtain the benefit of the protections set out in the NSW RAU which will apply to those negotiations.

3 Development of the 2010 HVAU

3.1 Response to the Draft Decision

In addition to responding to the preliminary concerns expressed by the ACCC in the Draft Decision on the 2009 HVAU, ARTC also set out in its response to the Draft Decision, the amendments it proposed to make to the 2009 HVAU, IAHA and OSA. In some areas, ARTC proposed specific drafting and in other areas ARTC indicated the broad framework it proposed to adopt.

The 2010 HVAU, 2010 IAHA and 2010 OSA broadly reflect those proposals but with additional amendments made to reflect ARTC's subsequent consideration of the issues and its follow up discussions with the ACCC and industry stakeholders.

¹⁰ http://www.artc.com.au/library/nsw_rail_access_undertaking.pdf

3.2 Discussion of key issues with ACCC

Subsequent to the ACCC's Draft Decision, ARTC has had a number of discussions with the ACCC to clarify key issues and ARTC's proposed approach to address the ACCC's particular issues. Specific issues canvassed with the ACCC included:

- the process and principles to govern the trading of track capacity;
- the treatment of non-coal access rights;
- consultation with the Hunter Valley Coal Chain Coordinator (**HVCCC**);
- the treatment of extensions and connections to the Network;
- pricing certainty;
- ARTC incentives under the True Up Test (**TUT**);
- the operation of the TUT including the treatment of tolerance under the TUT;
- equitable treatment of access holders in the event of capital contributions;
- review of proposed mine life;
- consideration of producer proposals to introduce a scheduling cap aimed at quarantining the impact of cancellations;
- the determination of key performance indicators under the HVAU and the IAHA;
- the supply of forecast volume and expenditure by ARTC to industry stakeholders and the perceived justification for a price cap;
- Rate of Return parameters;
- treatment of ancillary services;
- the meaning of 'commercially viable';
- investment certainty; and
- termination, assignment and novation rights.

Following those meetings with the ACCC, ARTC has considered its proposed approach and made amendments in the 2010 HVAU, 2010 IAHA and 2010 OSA.

3.3 Meeting with industry stakeholders

ARTC has maintained an open dialogue with industry stakeholders and has continued to meet with coal producers on their request. This included workshops held with single producers, groups of producers and with the industry through a workshop with the HRATF on 27 July 2010 where ARTC discussed key issues identified by the HRATF with the HVAU and Indicative Agreements.

Particular issues raised by coal producers include the review of mechanisms around incentives for efficiently using capacity, the independence and application of the system-wide TUT, certainty of investment and positive incentives for ARTC to perform. These issues are covered in sections 4.9, 4.17, 4.19 - 4.22, 5.9, 5.12, and 5.14 of this Explanatory Guide.

4 Key changes to the 2010 HVAU

4.1 Greater recognition of passenger priority obligation (sec 1.1)

As set out in its response to the Draft Decision, ARTC proposed to amend:

- section 1.1(d) to explicitly refer to ARTC's obligations regarding passenger priority set out in the *Transport Administration Act 1988* (NSW); and
- section 1.1(g) to explicitly recognise that the Network is used by non-coal traffic.

ARTC has made these amendments to section 1.1(d) and (g) of the 2010 HVAU.

4.2 Recognition of coal chain principles (sec 1.3 and 2.3(b))

In its response to the Draft Decision, ARTC proposed to recognise the long term solution by amending section 1.1(f) of the 2009 HVAU to explicitly refer to the long term solution proposed by the 2008 Greiner Review (**Long Term Solution**) and also by amending section 2.4(d) to make it clear that ARTC's five year review of the 2010 HVAU will take into account the Long Term Solution.

Following discussions with stakeholders, ARTC understands that the reference to a Long Term Solution would be unsatisfactory.

Accordingly, ARTC has instead recognised in section 1.3 of the 2010 HVAU the following key coal chain principles:

- the long term certainty of access to a contracted portion of coal capacity sought by coal producers (of which track capacity is one component);
- the availability of a reliable process through which track capacity can be negotiated (within the broader context of the Hunter Valley Coal Chain);
- the development of a set of System Assumptions to apply across the Coal Chain and for ARTC to participate in the development of System Assumptions and to reflect relevant and agreed track-related System Assumptions in Access Holder Agreements;
- there should be workable alignment between the allocation and utilisation of track capacity and the allocation and utilisation of capacity at the coal terminals at the Port of Newcastle.

These principles will also be taken into account when ARTC carries out its five year review of the HVAU under section 2.3 of the 2010 HVAU. Further, ARTC has provided under clause 1.5(b) of the 2010 IAHA that all Tier 1 (mandatory) provisions are to be interpreted by reference to these principles (and the objectives of the HVAU set out in section 1.2 of the 2010 HVAU).

4.3 Consultation with the HVCCC

In the Draft Decision, the ACCC recommended that the 2009 HVAU contain robust consultation mechanisms setting out the processes that ARTC will follow when consulting with the HVCCC. The ACCC recommended that these include specific timeframes and address the specific nature of ARTC's obligations to take into account the HVCCC's comments, as well as the requirement that ARTC review and consider in good faith any operational concerns raised by the HVCCC in relation to maximising the operational efficiency of the Hunter Valley supply chain.

The approach set out in the 2010 HVAU (and incorporated into the 2010 IAHA) is as follows.

4.3.1 HVCCC/ARTC consultation obligations (sec 3.2 etc and Schedule F)

In recognition of the ACCC's concerns with ARTC's commitments to consult with the HVCCC in the 2009 HVAU, ARTC has included in Schedule F of the 2010 HVAU a set of principles that ARTC will use its best endeavours to follow when consulting with the HVCCC.

- ARTC will request the HVCCC to provide ARTC with its view by a specified date, as reasonably determined by ARTC.
- Where the HVCCC provides its view by the notified date, ARTC will consider that view in good faith.
- Where ARTC disagrees with the view and there is sufficient time for the HVCCC to reconsider its view, ARTC will provide its reasons to the HVCCC and will ask the HVCCC to reconsider in light of the ARTC's reasons by a specified date (as reasonably determined by ARTC).
- Where the HVCCC provides its revised view by the notified date, ARTC will consider the revised view expressed by the HVCCC in good faith.

These principles will apply to a proposed obligation to consult with the HVCCC under the 2010 HVAU and 2010 IAHA when a specific process is not identified (including sections 3.2, and 5.4(a)(ii) of the 2010 HVAU and clauses 3.2(b)(i) and 6.1 of the IAHA).

During consultation with the HRATF, the industry sought a general requirement that, in addition to providing reasons to the HVCCC as to why ARTC did not follow the HVCCC's views, ARTC should also provide written reasons to affected Access Holders. Apart from the additional administrative burden this would place on ARTC, and the need to deal with specific confidentiality requirements, ARTC considers that this is inconsistent with the purported need to have a central coordinating body for the purposes of consultation in the first place.

Specific principles (set out immediately below) will cover ARTC's commitment to obtain the HVCCC's view on the impact of a proposal on Coal Chain Capacity.

4.3.2 Obtaining HVCCC view on Coal Chain Capacity impact (sec 5.1, 6.1, 6.2)

Where the 2010 HVAU requires ARTC to seek the HVCCC's view on the impact of a proposal on Coal Chain Capacity, the following steps will apply:

- ARTC will seek the HVCCC's view as to whether the proposal will have an impact on Coal Chain Capacity;
- Where the HVCCC provides its view/recommendation within 20 Business Days or such other time as agreed with ARTC, ARTC will consider the view expressed by the HVCCC in good faith. (This reflects the timetable under the Memorandum of Understanding between ARTC and the HVCCC that sets out the framework within which the parties will, in a spirit of mutual cooperation, consult with each other and undertake related tasks in order to fulfil the objectives set out in the access undertaking submitted to the ACCC and the objects of the HVCCC as set out in the HVCCC Members' Agreement).
- Where ARTC disagrees with the view expressed by the HVCCC and ARTC reasonably considers there is sufficient time, given the particular circumstances, for the HVCCC to reconsider its views, ARTC will provide its reasons to the HVCCC (either orally or in writing) and will ask the HVCCC to consider ARTC's reasons.
- Where the HVCCC provides its revised view/recommendation within the specified timeframe, ARTC will consider the revised view of the HVCCC in good faith.

These steps would be followed where ARTC seeks the HVCCC's view on Coal Chain Capacity under section 5.1 of the 2010 HVAU, when an Applicant seeks a Connection under section 6.1 and when an Applicant requests Additional Capacity under section 6.2.

4.4 Certainty of terms and conditions and introduction of Tier 1 (mandatory provisions) (sec 3.14 and Schedule A)

ARTC has made a number of amendments to section 3.14 in the 2010 HVAU and in Schedule A of the 2010 HVAU to address concerns expressed by the ACCC and stakeholders regarding the availability of the different forms of access agreement set out in section 3.14 and the certainty of terms and conditions to be included in those access agreements.

Section 3.14(b) makes it clear that an applicant is entitled to any of the relevant forms of access agreement set out in section 3.14, provided the applicant meets the applicable conditions as set out in that section.

4.4.1 Export coal access rights (sec 3.14(b))

ARTC will offer an applicant seeking access rights to transport coal to the Port of Newcastle:

- the 2010 IAHA if the applicant is seeking Indicative Services (or Interim Indicative Services during the Interim Period) and satisfies the Network Exit Capability requirement and the specific prudential requirements identified in section 3.14(b)(i)(A);
- an updated AHA (based on the 2010 IAHA) which will include all those provisions identified as Tier 1 (mandatory) provisions in Schedule A:1 of the 2010 HVAU, and will include those provisions identified as Tier 2 (negotiable) provisions in Schedule A:1 - unless both parties agree otherwise;

- an access agreement based on the terms and conditions made available to another applicant (where applicable), as published on ARTC’s website (*current available market terms and conditions*). This access agreement must include those clauses from the 2010 IAHA identified as Tier 1 (mandatory) provisions in Schedule A:1.

The Tier 1 (mandatory) provisions identified by ARTC in Schedule A:1 reflect those provisions which need to be consistent across all access holders access rights to transport coal to the Port of Newcastle to ensure workable alignment. These provisions cannot be amended by negotiation and will therefore be consistent across all Access Holder Agreements with coal producers seeking to transport coal to the Port of Newcastle.

In addition to the Tier 1 (mandatory) provisions identified in section 4.1.6 of ARTC’s response to the Draft Decision, ARTC has identified the following provisions as Tier 1 (mandatory) provisions in Schedule A:1, on the basis that these provisions also need to be consistent for all export coal producers:

- 2010 IAHA clause 1.5: Tier 1 (mandatory) provisions;
- 2010 IAHA clause 11.1(b)(iii): variation of a Train Path for the purposes of maximising the use and reliability of the Network;
- 2010 IAHA: clause 15: Confidentiality
- 2010 IAHA clause 16.5: Treatment of Traded Path Usages.

4.4.2 Domestic coal access rights (sec 3.14(b))

ARTC has recognised that not all of the provisions identified as Tier 1 (mandatory) provisions in Schedule A:1 need to be included in access holder agreements for access rights to transport coal to a destination other than the Port of Newcastle (that is domestic coal). ARTC has therefore identified a subset of the Tier 1 (mandatory) provisions in Schedule A:1 that need to be included in domestic coal agreements.

In particular, an access holder agreement for access rights to transport coal to a destination other than the Port of Newcastle will not need to include provisions covering:

- 2010 IAHA clause 3.1: Grant of Train Paths for transport of coal;
- 2010 IAHA clause 3.3: Tolerance;
- 2010 IAHA clause 3.14: Network Exit Capability requirement;
- 2010 IAHA clause 11.4: Removal of paths for under-utilisation;
- 2010 IAHA clause 15: Confidentiality; and
- 2010 IAHA clause 16.5: Treatment of traded Path Usages
- 2010 IAHA Train Path Schedule: Clause 4.1 (Network Exit Capability Condition Precedent; and Clause 4.2: Removal of Path Usages for failure to satisfy Network Exit Capability Condition Precedent).

These provisions will be identified as Tier 2 (negotiable) provisions for ‘domestic coal’ agreements and will therefore be addressed in the access holder agreement unless the parties agree otherwise.

4.4.3 Non-coal access rights

The ACCC has expressed concern regarding the apparent uncertainty of the terms and conditions to be included in an access agreement for Non-Coal Access Rights on the Hunter Valley.

As set out in the response to the Draft Decision, ARTC intends to offer applicants for Non-Coal Access Rights an access agreement which is based on the terms and conditions set out in the Interstate Indicative Track Access Agreement (**Indicative TAA**), adjusted to take into account the specific circumstances of the Hunter Valley network.

ARTC has made it clear in section 3.14(c) of the 2010 HVAU how the terms and conditions in the Interstate TAA will be adjusted:

- the network will be amended to cover the Hunter Valley network (as defined under the 2010 HVAU) rather than the Interstate network; and
- the Tier 1 (mandatory) provisions for Non-Coal Access Rights identified in Schedule A:2 must be incorporated into the access agreement. The only Tier 1 (mandatory) provisions for Non-Coal Access Rights that ARTC has identified are the Capacity Shortfall provisions (set out in section 5.4-5.7 of the 2010 HVAU).

ARTC does not propose to make any other amendments to the terms of the Indicative TAA. Indeed, ARTC expects that in practice nearly all applicants for Non-Coal Access Rights on the Hunter Valley will already have a Track Access Agreement for the Interstate network and ARTC proposes to simply add a schedule to these agreements to cover the transportation of goods on the Hunter Valley network, which will extend the definition of Network and to include the capacity shortfall provisions identified as the only Tier 1 (mandatory) provision for Non-Coal Access Rights.

4.5 Definitions of revenue and Ancillary Services (section 4.2)

As indicated in its Draft Decision, ACCC considered that:

- ARTC should be restricted to charging an efficient price for ancillary services (such as services relating to the trading of train paths) or provide for earnings from ancillary services to be included within the definitions of revenue and cost employed under the 2009 HVAU; and
- the ACCC should be granted the power to arbitrate where the access seeker disputes whether charges are efficient if the access seeker is required to acquire ancillary services as a pre-requisite to access to the Network.

ARTC does not consider it necessary to make any changes to address this issue.

- The ACCC's comments are predicated on the assumption that there are critical ancillary services which are necessary to enjoy the access rights and which will be charged separately from the access charges. This is not correct. The definition of Indicative Access Charges and Charges in the HVAU are defined

by reference to Access Rights which in turn means the making available of paths and the right to use those paths by running trains. The services which ARTC must provide, and which are necessary to enjoy the access rights, are included in the price.

- The ACCC has given the example of a charge on trading. The IAHA does not include a charge for approving trades and ARTC does not intend to levy charges. The ability to trade Access Rights is necessary to enjoy those rights and, as such, the cost of providing that service is included in the price and recovered through the ceiling test.
- ARTC will have a separate agreement with operators for ancillary train movements (i.e. movements which cannot be attributed to an individual access holder) if necessary. Such services will not be carrying coal and will be treated the same as non-coal for pricing and ceiling test compliance.

Although ARTC is of the view that changes are not necessary, ARTC proposes to amend the definition of “Out-turn Revenue” in the 2010 HVAU to mean the “total Access revenue earned by ARTC...”. ARTC considers this addresses the ACCC’s concerns about ensuring that earnings from charges levied for ancillary services which are necessary to gain access to the Network are captured within the revenue model in the 2010 HVAU. Similarly, earnings from charges levied for ancillary services which are not necessary to gain access are not captured in the revenue model.

4.6 Loss capitalisation (sec 4.3)

4.6.1 Single RAB and Rate of Return (sec 4.3)

Following the ACCC’s concerns in the Draft Decision with the use of multiple RABs and WACC for existing and new investment, and despite noting the ACCC’s acceptance of the economic benefits of applying multiple WACCs, the 2010 HVAU has adopted a single RAB for each Pricing Zone and a single WACC for the Network. For consistency, ARTC has also now proposed a single estimate of remaining mine life to apply to the Hunter Valley coal network, but has left provision in the 2010 HVAU for different estimates if appropriate at some future time.

Further detail in relation to remaining mine life and Rate of Return proposals is provided at sections 4.10 and 4.11 of this Explanatory Guide.

In recognition of the fact that the approved Rate of Return may take different forms (e.g. pre-tax, post tax etc), ARTC has made it clear in section 4 of the 2010 HVAU where the Rate of Return is referred to, that it is the relevant form of the Rate of Return which is applicable (e.g. the definition of Net Capex).

4.6.2 RAB Roll Forward Formula

In section 4.3(a) of the 2010 HVAU, ARTC has made a consequential amendment to the roll forward formula to clarify that capitalised economic **losses** will also include a return on Net Capex incurred during the year. The return is calculated for half of that year (i.e. the expenditure is deemed to have been incurred on 1 July). This is consistent with the **treatment of interest during construction (IDC)** in Net Capex (see section 4.8 of this Explanatory Guide).

ARTC has also clarified that any roll forward undertaken prior to the commencement of the 2010 HVAU in order to determine the initial RAB will be undertaken in accordance

with the asset valuation roll forward principles in the NSW RAU as at August 2010, or as otherwise agreed between ARTC and the Independent Pricing and Regulatory Tribunal. The latter clarification is intended to address any transitional arrangements that may apply (see Appendix 5).

4.6.3 Zone 3 Price Cap (sec 4.2(d))

In the Draft Decision, the ACCC expressed concern that the application of the loss capitalisation model may result in pricing uncertainty where ARTC has the opportunity to include unrecovered prior economic losses.

As set out in ARTC's response to the Draft Decision, there are only likely to be unrecovered prior economic losses in Pricing Zone 3. This is because the volumes in Pricing Zone 3 are (at the current pricing levels) insufficient to recover full economic cost in a year.

While ARTC considers that its pricing (and hence revenue) in Pricing Zone 3 must be subject to market constraints (presuming the mines in Pricing Zone 3 are unable to pay more, their volumes are likely to be lost if ARTC increased the access charges in this Pricing Zone – this constraint causes the current under-recovery), ARTC has proposed a cap on the annual pricing variation of 25% in any one year in Pricing Zone 3 in recognition of the ACCC's concerns. This cap is contained in section 4.2(d) of the 2010 HVAU.

While section 4.2(d) is not explicitly identified as applicable to Pricing Zone 3, it is only in Pricing Zone 3 that the applicable RAB will likely be greater than the applicable RAB Floor Limit.

Supporting documentation underpinning ARTC's proposal in this regard is provided at Appendix 6.

4.7 Costs to be efficient (sec 4.4(b))

In the Draft Decision the ACCC expressed the view that the use of the term 'industry efficient' in the definition of costs was not appropriate and recommended that ARTC either define the term or adopt a commonly used test for efficient expenditure.

As set out in ARTC's response to the Draft Decision, it is not uncommon for efficiency definitions in rail regulation to make some reference to the industry as a benchmark and examples were provided from the WA Rail Access Regime and the QR Network Access Undertaking.

Nevertheless, in recognition of the ACCC concerns, ARTC has, in section 4.4(b) of the 2010 HVAU, specified how efficiency in the context of ARTC's costs in the Hunter Valley should be assessed:

- (a) *All costs described in sub-sections (a)(i) and (iv), all applicable costs described in sub-section (a)(vii), and all operating expenditure in section 4.3(a) are to be assessed on an efficient basis, where efficient costs will reflect the costs incurred by a prudent service provider, acting efficiently, in accordance with accepted good rail infrastructure practice, to achieve lowest sustainable cost of delivering rail infrastructure services, in the context of:*
 - (i) *the Hunter Valley Coal Chain where a key objective in maintenance planning is to maximise coal chain throughput and reliability;*

- (ii) *ARTC's obligations to maintain the Network having regard to the terms of applicable Access Agreements and Access Holder Agreements existing at the time;*
- (iii) *ARTC's obligations under the law, applicable legislation (including regulations) or the NSW Lease; and*
- (iv) *broader benefits that may arise from delivery through alliance or internally.*

*All costs are to be assessed on a stand alone basis having regard to the factors identified in **sub-section (b)**.*

This efficiency 'test' applies to the costs incurred by ARTC as Segment Specific Costs, Non-Segment Specific Costs, any costs applicable to Additional Capacity and the determination of Operating Expenditure (Opex) included in the roll forward of the RAB.

4.8 Treatment of interest incurred during construction (sec 4.3)

As set out in its response to the Draft Decision, ARTC's proposal is for IDC to be capitalised and included in the RAB in the year the asset is commissioned. This approach, which is consistent with the approach adopted in the NSW RAU, is contained in the 2010 HVAU.

ARTC has made a number of amendments to section 4 to clarify this treatment:

- Section 4.3(a) and (b): IDC is included in the definition of Net Capex, where IDC is calculated up until 1 July (half year) in the year of commissioning, which is consistent with the calculation of Depreciation and return under the 2010 HVAU;
- Section 4.4(a)(iii) (previously 4.4(c) in the 2009 HVAU): clarification that in determining a return on Segment Specific Assets, the value of the Segment Specific Assets will be determined in accordance with section 4.3(b) which provides that IDC is included in the definition of Net Capex;
- Section 4.4(a)(vi) (previously 4.4(f) in the 2009 HVAU): clarification that in determining an allocation of a return on Non-Segment Specific Assets (which are generally not rolled forward in the same way as the regulatory asset base), the value of the Non-Segment Specific Assets will include 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 (approved) form of the rate of return. Non-Segment Specific Assets would, among other things, include ARTC buildings and general plant used in the Hunter Valley and, for ARTC corporate purposes, outside of the Hunter Valley (for allocation to Hunter Valley Segments as appropriate);
- Section 4.4(a)(vii) (previously 4.4(g) in 2009 HVAU): removal of the reference 'including interest reasonably incurred during construction' which will have the effect of ensuring such interest is not taken into account as an expense when determining the costs of Additional Capacity relevant to the Economic Cost of a Segment under section 6;
- Section 6.4(g)(v): clarification that:

- where a project is delayed and is delivered after the latest approved or endorsed delivery date, then any IDC for the period between the latest approved or endorsed date and the actual delivery date will be deemed not Prudent (and will therefore not go into the RAB) (section 6.4(g)(v)(C));
- where, however, a project has a delivery timeframe of more than 12 months and the RCG consents to a staged delivery of a project, any capital expenditure and IDC associated with that stage will be capitalised and incorporated in the RAB in the year of completion of that stage (section 6.4(g)(v)(B)).

These changes will have the effect of ensuring ARTC does not double count interest incurred during construction, nor will ARTC recover interest during construction in relation to capital expenditure which is not Prudent, nor any delay in delivery resulting from ARTC management which is not Prudent.

4.9 Treatment of capital contributions (secs 4.3, 4.8(b)(iii) & 6.2(f))

4.9.1 Equitable treatment between access holders and ARTC

As set out in section 6.2(b) of the 2009 HVAU, an Applicant for Additional Capacity may fund the construction of the Additional Capacity by way of a Capital Contribution. Section 6.2(g) of the 2009 HVAU provided that, where a subsequent Access Holder uses the Additional Capacity, an equitable form of reconciliation will apply between the original Applicant who funded the Additional Capacity and the subsequent user where total Access Revenue exceeds the Ceiling Limit for the relevant Pricing Zone.

ARTC has made a number of changes to this section (now 6.2(f) of the 2010 HVAU) and included a new section 6.2(g), in order to provide greater clarity and certainty around how Capital Contributions will be treated. These changes and additions have been made to address concerns raised by producers around uncertainties surrounding recovery of Capital Contributions made and how other users of capacity made available by a Capital Contribution would be treated.

ARTC has made these changes in order to substantially increase certainty around:

- recovery of a capital contribution made by an Applicant or Access Holder (**Contributor**);
- ARTC pricing in relation to Additional Capacity made available through a Capital Contribution;
- treatment of other users of that Additional Capacity including the addition of a set of principles for dealing with cost recovery and pricing; and
- allocation of Additional Capacity made available through assets funded by a Capital Contribution.

Specifically, ARTC has incorporated at section 6.2(g) of the 2010 HVAU a set of principles that seek to ensure an equitable form of reconciliation is achieved:

- (a) ARTC is no worse off as a result of Additional Capacity made available through assets funded by a Capital Contribution (**Contributed Assets**).

- (b) Only Capital Expenditure that is Prudent (through endorsement by the RCG or determined through the ACCC) will be included in the RAB for pricing purposes and shared equitably among users in the relevant Pricing Zone. That is, Prudent Capital Expenditure is socialised among all users in the relevant Pricing Zone as occurs in relation to Prudent Capital Expenditure incurred by ARTC.
- (c) Subject to paragraph (a), the resulting additional Access revenue collected through ARTC Charges will be allocated between ARTC and the Contributor such that cost recovery on assets funded by ARTC and Contributed Assets are equitable. This has particular application where ARTC is earning less than the approved Rate of Return on the existing asset base funded by ARTC.
- (d) The Contributor cannot achieve cost recovery higher than the approved Rate of Return on Contributed Assets. This matches the corresponding constraint on ARTC in investing in regulated infrastructure, intended to reflect the risks faced in such investment.
- (e) As the cost of the Contributed Assets is recovered from all users in the Pricing Zone, no priority in the allocation of Additional Capacity made available through the assets for the Contributor will apply.
- (f) Where Capital Expenditure is incurred through a Capital Contribution that is not Prudent, ARTC Charges will not recover any capital cost associated with that Capital Expenditure, except where another Access Holder elects to use the resulting Additional Capacity, considered not Prudent. In this case, the charge for that use will reflect capital cost recovery of the Capital Contribution and the relative use of the Additional Capacity made available through the Contributed Assets. Subject to paragraph (a) above, all revenue collected will be allocated between ARTC and the Contributor such that cost recovery on assets funded by ARTC and Contributed Assets are equitable. This has particular application where ARTC is earning less than the approved Rate of Return on the existing asset base funded by ARTC. The Contributor will receive priority in the allocation of Additional Capacity made available through Contributed Assets resulting from a Capital Contribution that is not Prudent.

Further the RCG voting arrangements apply where the Additional Capacity made available through Contributed Assets result in an increase in the Indicative Access Charge by more than 10%. This requires a higher level of support by all users in the Pricing Zone when the pricing impact is greater than 10%.

4.9.2 Ongoing maintenance and capital costs

Section 6.2(f) of the 2009 HVAU was initially included to make it clear that, in the event there was no Capital Contribution involved, where a subsequent user commenced using Additional Capacity (in addition to the initial user) and where access revenue received exceeded the Ceiling Limit, then the pricing would need to be adjusted for both users so that access revenue did not exceed the Ceiling Limit.

As set out in its response to the Draft Decision, upon review, ARTC accepts that this provision is unclear, particularly in light of the presence of loss capitalisation and, as pointed out by a stakeholder, where coal and non-coal use was involved. ARTC now believes that the pricing principles in the 2010 HVAU will act to ensure ARTC does not collect more access revenue than the Ceiling Limit except where there are unrecovered prior economic losses. As such, the application of the ceiling test and price

differentiation provisions will ensure both users are treated equitably. Accordingly, ARTC has removed section 6.2(f) of the 2009 HVAU from the 2010 HVAU.

4.9.3 No return on capital contributions

It should be noted, however, that as a result of ARTC being unable to recover any depreciation in relation to Additional Capacity funded by a Capital Contribution that ARTC will not be in a position to replace that Additional Capacity, if required, at the end of the useful life of the Segment or group of Segments, as approved under the 2010 HVAU, unless ARTC is able to recover the cost of that Additional Capacity replaced, through some form of depreciation charge. Alternatively, replacement of that Additional Capacity could be funded by a further Capital Contribution (or some other similar arrangement) made at that time.

4.10 Remaining mine life estimate

The 2009 HVAU required an estimate of Hunter Valley remaining mine life for the purposes of determining depreciation to be proposed. In the initial application, ARTC provided supporting documentation, by way of an assessment undertaken by Booz & Co, which recommended an estimate of remaining mine life as follows:

Region	Remaining Mine Life Estimate
South of Muswellbrook	24.1 years
West of Muswellbrook	21.8 years
North of Muswellbrook	20.2 years

In the Draft Decision, together with recommendations aimed at clarifying the treatment of depreciation in the 2009 HVAU, the ACCC made the following statements:

“The ACCC’s preliminary view is that the proposed mine lives are unlikely to be appropriate when having regard to the factors under section 44ZZA(3) of the Act. The ACCC’s preliminary view is that if ARTC revised the mine lives to address the ACCC’s concerns, the revised mine lives would be more likely to be appropriate.”¹¹

“In relation to the comments by MJA (Marsden Jacob Associates) on the Booz & Co report, the ACCC has the following comments:

- *In relation to new mines that are not yet in production and are highly uncertain, it does not seem inappropriate to exclude these mines from the mine life calculation as there is no guarantee these will ever come into production. To the extent these do come on line in future years, these could be considered in future mine life estimates;*

¹¹ ACCC Draft Decision, pp. 580-581.

- *In relation to clearly identified errors in the data used by Booz & Co, ARTC will need to update its estimates to reflect corrections for clear errors. This will include accounting for domestic coal consumption to the extent this affects the estimated mine life;*
- *In relation to the discrepancy between ARTC estimates of production based on mining information and ABARE estimates, it does not seem unreasonable for ARTC to use the higher production figures. The ACCC notes these figures are based on miners own production estimates and the use of higher more conservative figures should further reduce any stranding risk facing ARTC;*
- *As noted above, the ACCC does not consider that it is inappropriate to exclude non coal traffic from the estimation of assets lives.*

If ARTC submits revised asset lives to the ACCC which address the issues identified above, the revised asset lives are more likely to be considered appropriate.”¹²

Following the release of the ACCC’s Draft Decision, ARTC undertook a review of the Booz assessment in light of the results of the MJA assessment and the ACCC’s concerns stated in the Draft Decision. The results of the review and revised remaining mine life proposal was provided to the ACCC for consideration in June 2010.

ARTC considers that the revised proposal addresses each of the issues raised by the ACCC in the Draft Decision.

In undertaking the review, ARTC has reconsidered its proposal of remaining mine life estimates for each of the 3 Regions above (Pricing Zones) at this time. The revised estimate of remaining mine proposed by ARTC to the ACCC in June 2010 is a single estimate for the Hunter Valley being 22 years as at 2010.

The results of ARTC’s review and revised remaining mine life proposal (with confidential information removed) is provided at Appendix 2.

4.11 Rate of Return proposal

The 2009 HVAU included a proposal by ARTC of the Rate of Return to apply to the Network covered by the HVAU. In the initial application, ARTC provided supporting documentation, by way of an assessment undertaken by Synergies Economic Consulting, and proposed WACC parameters and a separate WACC to apply to existing assets as at the 2009 HVAU Commencement Date and to assets commissioned during the term of the 2009 HVAU as follows:

	Nominal, post-tax	Real, pre-tax
Assets existing as at the 2009 HVAU Commencement Date	10.47%	10.29%
Assets commissioned during the term of the 2009 HVAU	10.67%	10.54%

¹² ACCC Draft Decision, pp. 588.

In the Draft Decision¹³, the ACCC took the following preliminary views in relation to ARTC’s proposal:

“ ...

- *ARTC’s proposed WACC parameter values are unlikely to be appropriate when having regard to the factors under section 44ZZA(3) of the Act.*
- *If ARTC revised the WACC parameter values proposed by it according to the ACCC’s suggestions, it is more likely that ARTC’s overall WACC would be appropriate.”*

The Draft Decision recommended a single Rate of Return to apply all Hunter Valley Coal Network assets as follows (based on similar time based parameters):

	Nominal, post-tax	Real, pre-tax
Hunter Valley coal network assets	9.07%	7.00%

In its response to the ACCC’s Draft Decision, ARTC considered each of the ACCC’s preliminary views, and proposed a revised position in relation to each of the WACC parameters that was either aligned to the ACCC’s recommendation in the Draft Decision or, where it was not, reasons for adopting a different position.

At Appendix 3 of this Explanatory Guide, ARTC has now proposed a revised single Rate of Return to apply the Hunter valley coal network assets. The revised Rate of Return proposal is consistent with ARTC’s position in relation to each parameter expressed in its response to the Draft Decision. ARTC has proposed a revised Rate of Return as follows:

	Nominal, post-tax	Real, pre-tax
Hunter Valley coal network assets (based on current time based parameters)	10.84%	9.16%
Hunter Valley coal network assets (for comparison, based on current time based parameters and the ACCC Draft Decision including the more recent AER precedents for gamma and debt risk premium)	9.78%	7.73%

Since making its response in late March, and since the ACCC’s Draft Decision, ARTC notes widespread economic reporting of a significant slowdown in the recovery from the global financial crisis and, indeed, deterioration in global economic conditions and

13 ACCC Draft Decision, pp. 480.

capital markets over the last few months. There is also now reporting of increased probability of double dip recession and the need for further economic stimulation in many economies.

ARTC considers that this represents a significantly more uncertain economic and financial climate than was the case at the time of the Draft Decision.

ARTC notes that, in the draft decision, the ACCC took views in relation to certain parameters that were influenced to varying extent by a perception at the time that there was strong recovery from the global financial crisis around the world being reported.

Examples include the position to:

- exclude a 'convenience yield' adjustment to the risk free rate (although in mid 2009 ARTC conceded that such an adjustment may no longer be necessary due to improvement in bond rates at that time); and
- reduce the market risk premium determined by the AER (6.5%) in April 2009 to 6%.

ARTC now seeks the ACCC to re-consider its position in relation to certain parameters in light of the economic and financial uncertainty that now exists and is likely to continue for some time into the future.

In coming to its proposal, ARTC has had regard to recent regulatory developments since the Draft Decision giving rise to uncertainty in relation to two parameters, gamma and the debt risk premium. Due to this uncertainty, ARTC considers it prudent to retain the existing regulatory position. ARTC has therefore recommended settings aligned to the historical ACCC position or to the ACCC recommendation in the Draft Decision as relevant.

In light of such uncertainty, ARTC has also proposed in section 4.7 the 2010 HVAU to be able to revisit Rate of Return and propose, for ACCC approval, a revised Rate of Return at the time when existing uncertainty surrounding the regulatory position on gamma and debt risk premium is resolved, and to take into account any revised outcomes in relation to regulatory developments regarding gamma and debt risk premium in that review.

ARTC is in the process of investing heavily in the Hunter Valley Network and has a large future investment program. The level of the rate of return proposed by the ACCC is of great concern to ARTC. In the Draft Decision, the ACCC proposed a rate of return that is 225 basis points below the low end of the range originally proposed by ARTC.

ARTC estimates that the low end of the WACC range it originally proposed would be 9.75% (real-pre-tax) if measured on the same basis now. ARTC has now reduced its proposal above by around 60 basis points from the low end of its original proposal.

Had the ACCC's proposal in the Draft Decision been measured now (using the AER precedent for gamma and debt risk premium), ARTC estimates that the real, pre-tax return would lie around 7.73% (see above). This is still nearly 150 basis points below ARTC's revised proposal.

The magnitude of the gap between the ACCC's position in the Draft Decision and ARTC's reduced proposal now made is of great concern to ARTC, particularly with

respect to its ability to obtain financing to undertake the substantial investment program expected by the industry in order to meet expected future demand.

ARTC recognises that the 2010 HVAU now incorporates, at the industry's request, greater certainty and prescription around the ability of an applicant to fund an investment itself. Nevertheless, it is ARTC's strong expectation that it will be the party that the industry expects to fund, at least, the substantial majority of planned investment program.

Over the last few years, the industry and ARTC have gone to great lengths, including through the 2008 Greiner Review, the development of port access arrangements, and development of ARTC's Hunter Valley Coal Network Access Undertaking, to substantially improve the commercial framework underpinning the future operation of, and investment in, the Hunter Valley coal supply chain. It has been clear to ARTC that the ACCC has taken an active interest and role in this industry development and has publicly expressed the importance it sees in the role of these developments in the future growth of this supply chain.

ARTC recognises the common regulatory practice to rely on efficient benchmarks and precedents in regulatory outcomes in other industries, when determining appropriate levels of return in a particular circumstance. However the ACCC has responsibility as the regulator for ensuring efficient and timely investment in the coal supply chain and the importance of this objective must be recognised, perhaps even more so than for some other regulated infrastructure where the interrelationships with other markets in the supply chain, and growth and investment objectives may be different.

This has already been recognised in regulatory considerations relating to other supply chains with similar characteristics to that in the Hunter Valley.

The Rate of Return now proposed by ARTC will see the overall level of access pricing in the Hunter Valley fall by around 3.4%. If the ACCC were minded to finally accept a lower Rate of Return consistent with its proposal in the Draft Decision, this may represent a favourable short term outcome for the industry, but increases uncertainty around ARTC's ability to deliver its investment program, to the extent that the Rate of Return understates ARTC's cost of capital.

Where the cost of access to the Hunter Valley coal network represents a very small fraction of the current price of coal in international markets (around 1%) the potential risk of under-investment, and detrimental impact on the industry is high compared to the benefit of any reduction in access pricing.

4.12 Annual Compliance Assessment (sec 4.9)

In the Draft Decision, the ACCC expressed the view that while the unders and over methodology in the 2009 HVAU is likely to be appropriate, ARTC's proposed annual compliance assessment is unlikely to be appropriate. The ACCC indicated that the annual compliance assessment is more likely to be appropriate if:

- an obligation on ARTC is included to provide the ACCC within a set timeframe with any information that the ACCC considers necessary; and
- section 4.9(b)(iii) is revised to not limit the ACCC from having regard to submissions of industry participants.

4.12.1 Provision of information under Schedule G

ARTC has included in the 2010 HVAU a new Schedule G which provides a detailed template of the information that is to be provided to the ACCC as part of the Annual Compliance Assessment and an indicative timetable for the provision of information and the steps to be carried out as part of the Annual Compliance Assessment.

In section 4.9(b) of the 2010 HVAU, ARTC commits to meet the information provision guidelines and timeframes set out in Schedule G, unless otherwise agreed with the ACCC, and having regard to the relevant circumstances applicable at the time.

ARTC has also included in section 4.9(c) of the 2010 HVAU an obligation on ARTC to use reasonable endeavours to provide information requested by the ACCC in accordance with section 3 of Schedule G as soon as reasonably practicable.

Schedule G also sets out the scenarios where further information can be sought by the ACCC from ARTC and how confidential information is to be dealt with by the ACCC and ARTC.

In response to concerns expressed by the HRATF about the lack of transparency and independence in relation to the application of the system-wide TUT (Schedule 2 of the 2010 IAHA) and the annual reconciliation leading to calculation of the TOP Rebate and Ad Hoc Charge Rebate (clause 5.4 of the 2010 IAHA), ARTC has proposed in Schedule G of the 2010 HVAU to include provisions requiring it to provide details (including spreadsheets) of all system-wide TUTs and the annual conciliation to the ACCC as part of the annual compliance assessment (see section 5.12.2 of this Explanatory Guide).

Schedule G is based on material that ARTC currently provides to IPART under the NSW RAU, in accordance with approved and published IPART guidelines¹⁴ updated to take into account the specific circumstances of the Hunter Valley network.

4.12.2 ACCC: having regard to views of industry participants

ARTC's intention is that the ACCC would not have regard to submissions of parties involved in RCG consultation in relation to capital expenditure that has been endorsed by the RCG. Submissions would not be needed as Capital Expenditure endorsed by the RCG is deemed to be Prudent and is therefore included in the RAB. The ACCC would only need to be satisfied that the RCG endorsement had been obtained, which would be furnished in ARTC's compliance submission to the ACCC.

ARTC has clarified its approach in the amendments made to section 4.9(d)(iii) of the 2010 HVAU. The ACCC may have regard to the submissions of relevant industry participants in determining whether ARTC has complied with the provisions regarding the roll forward of the RAB and RAB Floor Limit, but where Capital Expenditure has been endorsed by the RCG, the ACCC will not consider whether that Capital Expenditure is Prudent.

4.12.3 Information about price variation Cap in Pricing Zone 3

In recognition of the cap on the annual price variation when the RAB in a Pricing Zone is greater than the RAB Floor Limit (section 4.2(d)), ARTC has extended the

¹⁴ IPART, *NSW Rail Access Undertaking Annual Review of Compliance*, IPART Guidelines - November 2006, copy available at: <http://www.ipart.nsw.gov.au/>.

information to be provided under section 4.9(a) to include documentation demonstrating that Indicative Access Charges, or Interim Indicative Access Charges (as applicable) satisfy the requirement in section 4.2(d) (see the new subsection 4.9(a)(iii)). This will enable the ACCC to assess whether ARTC has complied with the commitment made by ARTC in section 4.2(d).

4.13 Determination of efficient train configuration/ Indicative Service (sec 4.16)

In the Draft Decision, the ACCC recommended that the 2009 HVAU include an obligation on ARTC to determine the efficient train configuration within a set period and an obligation to set pricing for all indicative services on the basis of this efficient train configuration. The ACCC recommended that the efficient train configuration be submitted within four years and that:

- the consultation process should be clearly set out in the 2009 HVAU;
- the ACCC should have the ability to arbitrate disputes if agreement cannot be reached between the parties on what is efficient; and
- pricing based on the efficient train configuration must become effective within four to five years from the commencement of the 2009 HVAU and must apply to all coal services on the Network regardless of when the contracts were entered into.

4.13.1 Indicative Service is the efficient train configuration

As set out in its response to the Draft Decision, the Indicative Service to be adopted by ARTC under section 4 of the 2009 HVAU (following approval by the ACCC) was intended to be the efficient train configuration.

In the 2010 HVAU, ARTC has made this clear and has set out in section 4.16 the steps it will take to determine the Indicative Service which it considers will deliver optimum utilisation of Coal Chain Capacity (section 4.16(a) of the 2010 HVAU).

4.13.2 Detailed process for determination of efficient train configuration

In section 4.16 - Determination of the Indicative Service (efficient train configuration), ARTC has proposed the following steps:

- Within 12 months of ARTC being reasonably satisfied that the modelling undertaken by the HVCCC is sufficiently robust to enable an efficient train configuration that optimises Coal Chain Capacity to be accurately determined and, in any event within four years of the commencement of the 2010 HVAU, ARTC will submit the proposed characteristics of the indicative service which it considers will deliver optimum utilisation of Coal Chain Capacity (given certain System Assumptions) and will seek approval of the ACCC to vary the 2010 HVAU to adopt the proposed characteristics as the Indicative Service (section 4.16(b)).
- ARTC will also submit to the ACCC the proposed indicative access charges for the indicative service and supporting documentation (section 4.16(d)).
- The characteristics of the indicative service put forward by ARTC will be developed in consultation with the HVCCC and ARTC will use its best endeavours to agree the characteristics with the HVCCC before submitting

them to the ACCC. The principles set out in Schedule F of the 2010 HVAU will apply to the consultation with the HVCCC (section 4.16(a) and (c)).

- If the ACCC accepts the characteristics put forward by ARTC, those characteristics will form the Indicative Service and the Indicative Access Charges accepted by the ACCC will apply in the year immediately following the date the variation to the 2010 HVAU accepting the Indicative Service and Indicative Access Charges comes into effect (section 4.16(e)).
- Charges for Coal Access Rights for services other than the Indicative Services will be determined in accordance with the charge differentiation characteristics set out in section 4.14.
- If the ACCC does not accept the characteristics put forward by ARTC, the Interim Indicative Service and the Interim Indicative Access Charges will continue.

There is no need for ARTC to specify in this provision the additional consultation steps that the ACCC will follow. Consent for the variation will be required from the ACCC and the ACCC may invite public submissions in accordance with section 44ZZBD of the TPA.

It is also not necessary to provide a dispute resolution mechanism (with ACCC arbitration) as the efficient train configuration/Indicative Service only comes into effect if it is accepted by the ACCC.

4.13.3 Impact on non-indicative (coal) services

The ACCC has queried how the introduction of an efficient train configuration as the Indicative Service will impact on existing users of the Network and whether it will change the incentives of the existing access holders.

- **Interim Period:** Access holders who have sought Access Rights to operate one of the two Interim Indicative Services on the Network will be entitled to the 2010 IAHA. The Interim Indicative Access Prices for those services will, for each year following the first calendar year, be determined (on an annual basis) in accordance with Schedule 3 to the 2010 IAHA and section 4.18 of the 2010 HVAU.
- **Following the determination of the Indicative Service:** Once the Indicative Service has been determined (i.e. the end of the Interim Period), only those access holders operating the Indicative Service will be entitled to the Indicative Access Charges accepted by the ACCC under section 4.16.

Access holders with Coal Access Rights for an Interim Indicative Service will not be entitled to the Indicative Access Charge (unless the Interim Indicative Service they are using has been accepted by the ACCC as the Indicative Service) and the charges for their access rights will be formulated in accordance with the charge differentiation principle set out in section 4.14(a) of the 2010 HVAU.

A key factor taken into account in determining the charges for Coal Access Rights using other than the Indicative Service is the Indicative Access Charges (section 4.14(a)(i)). Other factors, determinative of efficiency such as the

consumption of track capacity and Coal Chain Capacity are also taken into account.

The Charges for non-Indicative Services will therefore be linked to Indicative Access Charges (as accepted by the ACCC) for the new efficient train configuration and to the extent the non-Indicative Service consumes more track capacity or Coal Chain Capacity, then Charges for those Services would be expected to be higher.

4.13.4 Explicit power to reconfigure train configurations not appropriate

In the Draft Decision, the ACCC appeared to suggest that the access agreements for all access holders should include a specific power enabling ARTC to require the access holder to reconfigure its trains where the reconfiguration would significantly increase coal chain throughput.

As set out in ARTC's response to the Draft Decision, ARTC does not consider such a broad ranging power appropriate. Further, ARTC considers that the ACCC's recommendation is inconsistent with the concerns the ACCC expressed in the Draft Decision with the potential far reaching nature of clause 11.1(b)(iii) of the 2009 IAHA, which prior to the amendments put forward in the December 2009 IAHA, allowed ARTC to permanently vary a Train Path on the grounds of maximising the use and the reliability of the Network.

4.14 New Interim Indicative Access Charges proposed

In October 2009, ARTC submitted Interim Indicative Access Charges (**IIAC**) for the Interim Indicative Services to apply from 1 January 2010. ARTC proposed to include the proposed IIACs in the 2009 HVAU. ARTC included detailed supporting information in an explanatory guide. The proposed IIAC were determined using ARTC modelling provided confidentially to the ACCC at the time, and based on assumptions made by ARTC at the time, predicated on the best information available to ARTC at the time in relation to 2010 volume forecasts, as well as operating and capital expenditure budgets.

In that submission to the ACCC, ARTC pointed out the possibility that if there were material variations in volume or cost forecasts arising before acceptance of the 2009 HVAU, it would seek to propose further revised IIAC to reflect such variations. Following withdrawal of the 2009 HVAU, ARTC has reviewed information available to it and now confirms that it will be necessary to further revise the IIACs for inclusion in the 2010 HVAU.

ARTC has revised the IIAC to reflect more recently available information using largely identical modelling to that used in 2009 with variations arising as a result of more recent coal volume forecasts, budget information and improved network description. ARTC is providing the financial model on a confidential basis to the ACCC as it did in 2009.

The proposed IIAC are intended to apply as at the Commencement Date of the 2010 HVAU. On the basis that the 2010 HVAU will be accepted in 2010, it is intended that the proposed IIACs would apply during the period between the Commencement Date and the end of 2010. ARTC recognises that the actual period of application may be short. It is ARTC's intention to develop and propose 2011 IIACs in accordance with the process provided in the 2010 HVAU, when the required information becomes available.

The revised IIAC and supporting documentation (provided on a similar basis to that in 2009) is provided at Appendix 7.

4.15 Provision of forecast information and volumes (sec 4.18 & 4.19)

4.15.1 Removing any information asymmetry

In the 2010 HVAU, ARTC introduced a new subsection in section 4 setting out the detailed information that ARTC will provide all access holders of Coal Access Rights on an annual basis (section 4.19 of the 2010 HVAU).

As set out in section 4.19, ARTC will provide access holders with:

- ARTC's forecast operating expenditure for each of the next ten years (section 4.19(a)(i));
- ARTC's forecast capital expenditure for each of the next ten years (section 4.19(a)(ii));
- the aggregate contracted coal volume for each of the next ten years (section 4.19(a)(iii)(A)); and
- the minimum aggregate contracted coal volume for each of the next 10 years (section 4.19(a)(iii)(B)).

The provision of this information will address any information asymmetry between ARTC and access holders of coal access rights, in effect placing access holders in the same position as ARTC in enabling them to determine their likely access charges going forward. This approach is consistent with the approach proposed by producers to address their concerns in relation to pricing uncertainty.

Importantly, ARTC is committing to provide access holders with two sets of volume information (both over a ten year period): the actual volumes that have been contracted by all access holders (sec 4.19(a)(iii)(A)) and the minimum contract volume (sec 4.19(a)(iii)(B)). The additional information set out in 4.19(a)(iii)(B) (minimum contracted volumes) is included in response to the ACCC's concerns that even if an access holder had information on the annual contracted volumes for the next ten years, the access holder would be unable to ascertain the risk that their access charges would increase in subsequent years should other access holders with contracted coal terminate their access agreements early. The information now being made available will enable the Access Holder to test price exposure to such risks.

4.15.2 Mitigates need for a price cap

Following ARTC's commitment to provide access holders with the information set out in section 4.19 (and also in section 4.18), access holders will have the same information about forecast expenditure and contracting which would inform any future decision by ARTC to increase access charges.

With the removal of this information asymmetry, and given the critical elements set out below, there can be no justification for the price cap proposed by the ACCC in the Draft Decision.

- Introducing a pricing cap is inconsistent with the RCG endorsement process in section 6 of the 2010 HVAU. ARTC cannot commit to a pricing cap when its

major cost (the cost associated with capital expenditure in the construction of Additional Capacity) is controlled by the industry. Over the term of the 2010 HVAU, around 80% of the forecasted increase in Full Economic Cost (which, along with volume, governs the level of constrained pricing in Pricing Zone 1 and Pricing Zone 2) results from an increase in the capital charge associated with new investments over the period. The industry can either have the ability to determine ARTC's capital expenditure or ARTC can retain control and certainty over its costs including capital expenditure and the industry can obtain the benefit of a price cap.

- Access Holders' TOP commitments are not open ended - their commitment does not justify the introduction of a long term pricing cap. An Access Holder's commitment to TOP Charges is limited to existing capacity. An Access Holder's obligation to pay TOP Charges for new capacity only arises when that Additional Capacity is built, and the construction of that capacity is dependent on RCG endorsement of each stage of the project creating the capacity.
- A pricing cap would also place the wrong incentives on ARTC and jeopardise ARTC's commitment to the creation of Additional Capacity. Where it is not certain that ARTC will be able to recover the costs associated with the creation of Additional Capacity through increased charges, ARTC will be unlikely to commit to the creation of new capacity. While loss capitalisation provides a mechanism for ARTC to recover its investment costs in the long run (if the market permits) it does not guarantee recovery.
- ARTC already faces significant constraints on its ability to increase Indicative Access Charges due to the application of the Ceiling Limit and the application of ACCC arbitration when two thirds of access holders dispute the Indicative Access Charges notified by ARTC. Moreover, both the IAC and the IIAC are approved by the ACCC.

4.16 Inclusion of System Assumptions (sec 5.1)

In section 5.1 of the 2010 HVAU, ARTC commits to participate in the development of System Assumptions (and use reasonable endeavours to agree System Assumptions with the HVCCC and the other service providers) and to have regard to System Assumptions when carrying out assessments of track capacity.

This amendment which was foreshadowed by the reference to System Assumptions in the December 2009 version of the IAHA reflects concerns voiced by producers (and subsequently by the ACCC) that an agreed set of System Assumptions is applied across the Hunter Valley Coal Chain.

As set out in its response to the Draft Decision, it is critical that ARTC is not forced into accepting and applying track related System Assumptions which it does not agree with. The definition of System Assumptions in both the 2010 HVAU and the 2010 IAHA protects ARTC from this scenario.

This is important because there is no agreed mechanism as to how System Assumptions will be determined and there is at the very least a theoretical possibility that the HVCCC could adopt System Assumptions that ARTC does not agree with.

- As a Service Provider, ARTC's voting entitlements under the HVCCC Services Agreement are significantly less than those of coal representatives for ordinary

resolutions, and even for special resolutions ARTC's vote as a member is equivalent to the vote of one producer representative.

- The PWCS Long Term Ship or Pay Agreement which specified a set of System Assumptions to be developed by the HVCCC in a System Assumptions Document¹⁵ also did not specify how the System Assumptions were to be developed and it is not clear how they would be determined in the event of disagreement.

It is also necessary for ARTC to reserve the ability to determine additional track related System Assumptions which may not be contained in the System Assumptions document. The list of System Assumptions referred to in the PWCS Long Term Ship or Pay Agreement (to be developed by the HVCCC) are port centric and do not specifically identify the track related assumptions that need to be developed.

If the HVCCC fails to identify these specific assumptions, ARTC needs a backstop where it is able to determine these assumptions itself.

Changes to the definition of System Assumptions may also have implications on ARTC's ability to deliver its contractual entitlements as the System Assumptions determine ARTC's assessment of Capacity in the contract.

4.17 Review of mechanisms to identify and assign capacity losses (sec 5.9)

As set out in section 5.9 of this Explanatory Guide, certain producers have proposed the introduction of a scheduling cap and measures aimed at 'quarantining' the impact of cancellations on the responsible producer. ARTC has considered the proposals submitted by producers in detail but concluded that there were significant problems with the producers' proposals, including their reliance on the informal and relatively ad hoc assignment of fault currently operating in the Hunter Valley Coal Chain (via the Live Run Superintendent Group).

However, in recognition of producer's concerns, ARTC:

- (a) strengthened the cancellation procedure (now contained in clause 11.6 of the 2010 IAHA, and discussed below in section 5.9 of this Explanatory Guide); and
- (b) in section 5.9 of a version of the HVAU provided to industry in June 2010 for comment, had committed to carry out a review of the cancellation policy and procedure.

Following consultation of that June 2010 version of the HVAU, industry sought a broader review that would include an assessment of policy and procedures with respect to capacity losses more generally rather than a review limited to assessing cancellation policies.

In response, in section 5.9 of the 2010 HVAU, ARTC proposes to, within 12 months of the commencement of the 2010 HVAU, undertake a review of the policy and processes for identifying and allocating losses of Capacity caused by Access Holders and their Operators and potential incentive mechanisms to minimise such losses where they have

15 See the definition of "System Assumptions" in clause 1 of the Long Term Ship or Pay Agreement Instrument of Agreement: Port Waratah Coal Services Limited

a material impact on Capacity or Coal Chain Capacity or the Capacity entitlements of Access Holders.

As part of that review, ARTC will invite industry participants to submit proposals. ARTC will consider these proposals in good faith (with the HVCCC in accordance with the principles set out in schedule F) and if a proposal meets the criteria set out in section 5.9(c), ARTC will submit that proposal to the ACCC and seek a variation to the 2010 HVAU to incorporate the framework into the 2010 HVAU and the 2010 IAHA.

4.18 Extensions and connections (sec 6.1)

In the Draft Decision, the ACCC expressed concern with the perceived ability of ARTC to refuse to build an Extension (where it is to be built on ARTC land) unless the access seeker agreed to pay charges determined by ARTC thereby giving ARTC the ability to extract monopoly rents or frustrate access to the Network.

As set out in its response to the Draft Decision, it is ARTC's view that the obligation to connect in section 6.1 of the 2009 HVAU ensures that ARTC cannot extract monopoly rents through withholding access to ARTC controlled land.

ARTC also considers that the ACCC's concerns are divorced from the practical reality of connections of spur lines (also known as private siding lines) to ARTC track in practice:

- To the extent a spur line requires the construction of track on ARTC's corridor, this will be a very small section of track.
- ARTC offers all parties seeking to connect to ARTC's network a standard connection agreement. Under the terms of this contract, the access seeker will typically construct the turnout (points, signal and de-rail device) and the line connecting the turnout to the access seeker's site. On completion of construction and certification, ownership of the turnout will vest in ARTC and ownership of all or part of the line may vest in ARTC or the access seeker. In the vast majority of cases, the line will be owned by the access seeker (including the portion which is on ARTC's land).

In order to provide further clarity, as indicated in its response to the Draft Decision, ARTC has amended section 6.1 to address the concerns of the ACCC.

4.18.1 Amendments to section 6.1(b)

ARTC has made it clear in section 6.1(b) that the obligation on ARTC to consent to a request for a connection in section 6.1(a) covers consent to the construction of the Turnout (defined to mean the points, signal and de-rail device connecting, or for operating the connection of, track to the Network) and consent to the construction of track on ARTC's Hunter Valley corridor to the extent that this is necessary to connect the Turnout to the owner's track, and provided the applicant agrees to reasonable terms.

This obligation does not commit ARTC to construct the track on behalf of the applicant and leaves open the possibility that either the applicant or ARTC will be responsible for the construction of the track.

4.18.2 Other amendments to section 6.1(a)

ARTC has also made it clear in section 6.1(a)(vi) of the 2010 HVAU that a party seeking to connect to ARTC's network will be required to agree to reasonable terms for the construction, maintenance and operation of the connection.

ARTC has also taken this opportunity to make it clear in section 6.1(a)(vii) of the 2010 HVAU that ARTC will only consent to a connection where it is able to do so under the terms of the NSW Lease or any other arrangement ARTC is party to in respect of the relevant land and it will provide for extracts of the relevant terms to be made available on request (subject to any confidentiality restrictions or obligations).

The effect of these amendments is that a party seeking to build an extension (such as a spur line) that must connect to the ARTC network, will have a choice in either accepting ARTC terms and conditions for building and gaining access to that extension, or building the extension itself and gaining access to ARTC land to build a Connection to ARTC's Network on reasonable terms and conditions. This will mitigate any ability for ARTC to extract monopoly rents or frustrate access.

In addition to the above changes, ARTC has also deleted clause 5.7, which deals with extensions (see section 5.5 of this Explanatory Guide).

4.19 Commercial viability test (sec 6.2 and 6.3)

In the Draft Decision, the ACCC made a number of recommendations on the provisions regarding Additional Capacity in section 6 of the 2009 HVAU.

In respect of the commercial viability test in section 6.2(a)(i) and section 6.3(b)(i), the ACCC expressed the following views:

- The phrase "in ARTC's opinion", used in section 6.2(a)(i) in determining commercial viability and in section 6.2(a)(iii) in determining technical and economic feasibility, is subjective and should include a reasonableness requirement (the same point is made in respect of section 6.3(b)(i) and (ii) of the 2009 HVAU).
- The criteria and processes which ARTC will take into account in determining 'commercial viability' under section 6.2(a)(i) are unclear and should be set out.

ARTC considers that it has addressed these concerns in the amendments included in sections 6.2 and 6.3 of the 2010 HVAU as follows.

4.19.1 Greater specification of 'commercial viability' test

ARTC has set out in section 6.2(a)(i) the criteria it will take into account in determining whether a project is commercially viable.

- *the terms and conditions of the relevant Access Agreements;*
- *the circumstances for ARTC to service and raise financing through debt and equity for Additional Capacity;*
- *opportunity costs to ARTC given the relative risk and returns associated with the Additional Capacity financing relative to other investment opportunities;*

- *net effect on ARTC's balance sheet, gearing ratios and any other debt covenants in existence at the time,*

The criteria specified in section 6.2(a)(i) are objective measurements which ARTC is to assess according to 'its opinion'.

ARTC has considered the ACCC's recommendation that ARTC amend section 6.2(a)(i) (and section 6.3(b)(iii)) to provide that ARTC's opinion is to be 'ARTC's reasonable opinion' but considers that such an amendment is not appropriate:

- The criteria set out in section 6.2(a)(i) (and section 6.3(b)(iii)) are objective criteria and leave little room for an *unjustified* subjective assessment.
- ARTC's view of the above criteria, for example its view of the relative risk and returns associated with a project, may be different to the views of a coal miner, which operates under very different conditions and ARTC is concerned that its view could be trumped by an alternative view expressed by such a party.
- Assessing commercial viability is a critical task that would be carried out by ARTC. It is not appropriate that such a decision be second guessed.
- Further, should ARTC decide that the commercial viability criteria are not satisfied, the applicant always has the option of funding the Additional Capacity itself (see section 6.2(a)(ii) of the 2010 HVAU). Following consultation with HRATF, ARTC has clarified that the matters ARTC can consider in relation to a self funded project (essentially operational, technical and safety issues and legitimate business interests) do not overlap with the commercial viability factors specified above.

4.20 Creation of Additional Capacity

Appendix 4 contains a flow chart describing the pathways and options for creation of additional capacity in the Network.

4.21 RCG consultation process (sec 6.4)

4.21.1 RCG control of timeframes and delivery of projects

In the 2010 HVAU, ARTC has made a number of changes to make it clear that the RCG controls the timeframes for both consultation and approval of projects and the delivery of projects.

- In section 6.4(a)(iv), ARTC has made it clear that the stages of consultation set out in section 6.4(c) to (g) will be followed except where the RCG consents to a request by ARTC to adopt a modified consultation process (which would be the case where ARTC considers that the process set out in section 6.4 would unjustifiably compromise timely delivery of the project).
- The concept assessment report to be provided by ARTC to the RCG under section 6.4(d)(ii) will include indicative timeframes for the development, through delivery of the project (unless ARTC and the RCG agree otherwise). The RCG's endorsement of the concept assessment report, which will be sought if ARTC wants to proceed to the next stage, will include endorsement of the indicative timeframes under subsection (iii).

- The project assessment report to be provided by ARTC to the RCG under section 6.4(f)(ii)(C) will incorporate a project schedule, including time tolerances and project management plan under section 6.4(f)(ii)(E)(xi) setting out, among other things, project phases, milestones, deliverables. The RCG's endorsement of the project assessment report, which will be sought if ARTC wishes to proceed to project implementation, will include endorsement of the project schedule and these project phases, milestones and time tolerance (e.g. delivery +/-20 days)

4.21.2 RCG membership rules

Changes to RCG membership rules

In section 6.4(b)(ii) of the 2010 HVAU, ARTC has set out changes to the membership of the RCG aimed at ensuring the RCG membership will include a representative from each of the Pricing Zones.

The membership of the RCG set out in 2010 HVAU will include, one representative of:

- *each Access Holder who holds the largest volume of contracted coal GTK;*
- *any other Access Holder with more than 7% of contracted coal GTK on the Network, who is not already eligible to appoint a representative under sub-section (A);*
- *all Access Holders with less than 7% of contracted coal GTK on the Network;*
- *each Operator, in its capacity as an Operator, with more than 10% of contracted coal GTK on the Network (in a non-voting capacity);*
- *the HVCCC (in a non-voting capacity).*

It is important to note that access holders having less than 7% of contracted coal GTK on the Network will still have their interests represented and their views taken into account in votes of the RCG, including votes as to whether to endorse ARTC expenditure as Prudent. The member of the RCG representing access holders holding less than 7% of contracted coal GTK on the Network (who are not otherwise entitled to membership under section 6.4(b)(ii)(A)) is entitled to split its vote according to the percentage of contracted coal GTK held by each represented access holder and is expected to do so.

For example, if the representative member represented eight access holders (including itself) who between them held 40% of contracted coal GTK in Pricing Zone 1 with each access holder holding approximately 5% of contracted coal GTK, each access holder could instruct the representative member whether its interest should be counted as a vote in favour of, or against, a proposition. So if seven of the access holders instructed the representative to vote in favour of the proposition but the eighth represented access holder was against the proposition, the representative's member's vote would count as 35% in favour of the proposition and 5% against the proposition (for the purpose of determining endorsement under section 6.4(b)(i) and (ii) of the 2010 HVAU).

ARTC to take into account the views of Non-coal users

In the Draft Decision, the ACCC suggested that ARTC may want to include access holders of Non-Coal Access Rights in the RCG.

For the reasons set out in its response to the Draft Decision, ARTC does not think that this approach will be appropriate. ARTC has instead made it clear in section 6.4(c)(iv) that ARTC will, before finalising the Hunter Valley Corridor Capacity Strategy, invite comments from non-coal users (as well as coal users) and will consider the views submitted by those stakeholders in good faith and take them into account in finalising the strategy. ARTC has also clarified the steps it will go through in preparing the Corridor Capacity Strategy in response to concerns expressed by the ACCC in its Draft Decision.

4.21.3 Clarification as to how voting entitlement is determined

ARTC has proposed amendments to section 6.4(b)(v) and introduced a new section 6.4(b)(vi) to clarify how it will determine voting entitlement in the RCG:

- In assessing contracted coal GTK, ARTC will take into account all coal volumes contracted by access holders for the current calendar year and the next nine calendar years. This aligns with the commitment made by access holders in the 2010 IAHA (see clause 2.3(c) of the 2010 IAHA and clause 2.1 of the Train Path Schedule).
- ARTC has reserved a discretion under section 6.4(b)(vi) for ARTC to take into account anticipated coal GTK which ARTC reasonably expects will become contracted coal GTK (for any of the next ten years) immediately following the completion of the project which is the subject of the endorsement vote. This is necessary to ensure that the interests of a new entrant or of an existing access holder seeking to expand their contractual commitment and obtain Additional Capacity are properly reflected.

While an applicant may be prepared to sign an access holder agreement to contract for access rights to Additional Capacity prior to that Additional Capacity being endorsed by RCG, ARTC expects that this will not invariably be the case and considers it important for ARTC to retain this discretion to take into account the anticipated volumes of a new entrant.

This discretion will help ensure that existing coal producers in the Hunter Valley are unable to hold up new projects aimed at providing capacity to new entrants.

There may be concerns that permitting potential new or expanding players to participate in RCG voting may give rise to a situation that a new investment may be endorsed on the back of a potential new or expanding players vote and then the potential volumes do not eventuate, leaving existing participants exposed. Even where a project is endorsed in this way, ARTC is not required to commence a project, and is unlikely to do so, until such time as sufficient volume to underpin the project are committed.

4.21.4 Clarification of treatment of variations to budget and timetable (sec 6.4(g)((iii)(C))

The reports provided by ARTC to the RCG for endorsement at various stages will include forecast budgets and timelines for the project (unless otherwise agreed by ARTC and the RCG):

- The concept assessment report will include broad cost estimates and indicative timeframes for the development, through consultation and the delivery of the project (section 6.4(d)(ii)(B) and (E)).

- The project feasibility report will identify the estimated project costs with a +/- 20% range, a preliminary project management plan, including an initial estimate of timeline for milestones and an outline of the Project Assessment stage including an estimate of budget (section 6.4(e)(ii)(C), (F) and (H)).
- The project assessment report will include a project budget with a +/-10% margin (or a larger margin where appropriate for larger projects) and a project schedule including time tolerances, an estimate of contingency supported by risk assessment, cost analysis and basis for contingency, financial evaluation, including estimated impact on access pricing, a developed project management plan which may include project phases, milestones, and deliverables (section 6.4(f)(ii)(C),(D), (E) and (xi)).

Variations to the cost estimates and project schedule included in the two preliminary reports will be picked up in the RCG review of the project assessment report.

If a variation to the project budget or project schedule endorsed by the RCG as a part of the project assessment report (section 6.4(f)(ii)(C), is identified on procurement (the first step of the project implementation stage), ARTC may seek endorsement from the RCG for the variation under section 6.4(g)(i)(C). If the RCG does not endorse the full variation, ARTC may refer the matter to an independent expert (to be appointed in accordance with section 6.4(g)(i)(E)).

ARTC has made it clear in section 6.4(g)(i)(F) that it will proceed with a project regardless of whether the independent expert determines the full cost confirmed by ARTC (which is outside the range or contingency previously endorsed by the RCG) as Prudent, having regard to the reasonableness of the variation to the project schedule.

However, if the cost determined by the independent expert is less than the cost confirmed by ARTC or the variation to the project schedule is determined as unreasonable, then ARTC will have the opportunity to proceed with the project by way of open competitive tender (rather than alliance or internal evaluation). If ARTC does proceed with this route, the cost that will be taken as Prudent and included in the RAB, and project schedule to be considered reasonable, will be the cost and project schedule determined as a result of open competitive tender.

ARTC considers that this approach is appropriate as the independent expert may, in determining whether the cost confirmed by ARTC is Prudent or the project schedule is reasonable, use a cost and project schedule that would have been achieved by way of a competitive tender as a comparator and ARTC should not be bound to proceed by way of internal evaluation or alliance when this would incur higher costs. Permitting ARTC the option of undertaking a project using an open tender and at the tender price and schedule ensures industry obtains a prudent cost.

Following the commencement of project implementation, ARTC will be required to provide the RCG with progress reports at RCG meetings, the frequency of which will be agreed by the RCG. Unless agreed otherwise by ARTC and the RCG, the progress report will include 'exceptions' where the project will deviate outside of its planned cost margins (as set out in the project budget) or outside of the planned timing tolerance margins (as set out in project assessment) (section 6.4(g)(iii)(B)(v)).

If, following the commencement of project implementation, ARTC identifies a variation to the project budget or project schedule endorsed by the RCG, as part of the project assessment report (or a variation to a revised budget which has already been endorsed by the RCG under section 6.4(g)(i)(C) or arising from a review by the

independent expert under section 6.4(g)(i)(E)), ARTC may submit a revised costing or revised project schedule to the RCG for endorsement (section 6.4(g)(iii)(C)).

ARTC's obligations on submission of a revised costing to the RCG for endorsement, and failing endorsement of the full variation to the independent expert are set out in the section immediately below.

4.21.5 Certainty of completion and timing incentives (sec 6.4(g)(i)(F))

ARTC has made amendments to section 6.4(g)(iii) of the 2010 HVAU to clarify the obligations on ARTC to proceed with a project when there has been a variation to the project budget or project schedule which had been endorsed by the RCG:

- where a variation to a project budget or project schedule has been identified under section 6.4(g)(iii)(C), ARTC will submit a revised costing to the RCG but will continue with implementation of the project while a decision from the RCG is pending (section 6.4(g)(iii)(C)(i));
- where the RCG endorses less than the full variation to the budget and project schedule put forward by ARTC, ARTC may refer the matter to an independent expert and will continue with the project implementation while a determination of the independent expert is pending;
- if the independent expert decides the full extent of the variation to be taken is Prudent or the variation to the project schedule is reasonable, ARTC will continue with project implementation (section 6.4(g)(iii)(C)(v)); and
- if the independent expert determines less than the full variation to the budget put forward by ARTC or that the variation to the project schedule is unreasonable, ARTC may cease project implementation (or, having regard to the independent expert's decision, may submit a revised variation to the RCG under section 6.4(g)(iii)(C)(i) (see section 6.4(g)(iii)(C)(vi)).

It is also made clear that any expenditure incurred by ARTC in continuing a project pending endorsement by the RCG or an independent expert will be deemed a Prudent direct cost to the project (section 6.4(g)(iii)(C)(vii)).

As set out in its response to the Draft Decision, if there was a risk that ARTC's expenditure in continuing a project while waiting for a decision would not be deemed Prudent, ARTC would not be prepared to continue construction.

In order to provide further incentive for ARTC to deliver a project on time, at 6.4(g)(v)(C), ARTC has provided that any financing costs associated with the period between the actual delivery date and the delivery date endorsed by the RCG or the independent expert, as applicable, will not be able to be included in the RAB and recovered by ARTC. This ensures ARTC is not penalised for delays beyond its control or which could not have been reasonably foreseen. Effectively the penalty faced by ARTC could be 10% of the actual project cost where the relevant delay is one year. Even for a smaller project, say \$10m, this would be a \$1m disincentive. For larger projects (generally the one more at risk of delay), the disincentive could run into millions of dollars even for a moderate delay of a few months.

Whilst ARTC recognises that this may still be relatively small compared to the loss of volumes and un-utilised investments in other parts of the coal supply chain, ARTC considers that this represents ample disincentive to ARTC in the context of its own

business, and is more than commensurate with what would be expected given the relativity of ARTC as an input to the coal supply chain, against the output of that chain.

4.22 Performance measures (sec 8 and schedule D)

In the Draft Decision, the ACCC expressed the view that section 8 of the 2009 HVAU is unlikely to be appropriate and noted that ARTC should now be in a better position to develop and report key performance indicators for the Hunter Valley network (Network KPIs).

4.22.1 Schedule D of the 2010 HVAU

The 2010 HVAU contains Network KPIs in section 1 of Schedule D, including both coal specific and non specific metrics. ARTC has specified the responsibility for performance in relation to the KPIs, the reporting frequency, either quarterly or annually, and the reporting level - either Pricing Zone wide or across the Network.

In developing these KPIs, ARTC has taken into account a number of factors:

- The other performance measures, incentives and remediation obligations on ARTC and access holders in the 2010 HVAU and the 2010 IAHA. This includes the TUT (which places strong incentives on ARTC) and the incentive measures on access holders in clause 11.5 of the IAHA (to run trains according to the Service Assumptions) and in clause 11.6 of the 2010 IAHA (to minimise the number of service cancellations assigned).
- The additional reporting requirements on ARTC outside of the 2010 HVAU and in particular the Hunter Valley KPIs included in the NSW Lease.
- The significance of industry wide coal chain reporting by the HVCCC. The HVCCC reports regularly on the performance of the Coal Chain and the performance of individual elements of the coal chain. Such performance measures are critical to users of the coal supply chain, and have been reported historically by the body responsible for coal chain performance.
- The need for consistency with KPI reporting under the Interstate Access Undertaking. Reporting of different KPIs on the Interstate and Hunter Valley networks, should be avoided except where the particular commercial or operational circumstances warrant differentials and the benefits associated with the different indicators need to be weighed up against the additional cost of developing and maintaining different systems to produce KPIs.
- The need for consistency with ARTC's internal KPI reporting. Alignment of regulatory KPI reporting and ARTC's internal corporate reporting would assist in focussing ARTC performance.
- The need to recognise the presence of applicable System Assumptions. The 2010 HVAU and the 2010 IAHA impose incentives on ARTC to perform against agreed track related System Assumptions. By and large, the mechanism used in this regard is the TUT as ARTC will not be able to meet contractual commitments if it fails to perform against track related System Assumptions.

4.22.2 Section 8.1 and 8.2 of the 2010 HVAU

In section 8.1 of the 2010 HVAU, ARTC has set out its reporting obligations. The reporting frequency for each indicator is set out in the fourth column in the table in section 1 of Schedule D (e.g. quarterly or annually) and ARTC will commence reporting performance against each of these indicators following the completion of the first full relevant period after the commencement of the 2010 HVAU.

In section 8.2 of the 2010 HVAU, ARTC has set out its obligations to negotiate key performance indicators to be included in an access agreement (Agreement KPIs) and provided a framework for the selection of the Agreement KPIs. This is discussed in section 5.3 of this Explanatory Guide.

4.22.3 Section 8.3 of the 2010 HVAU and section 2 of Schedule D

ARTC has now included an obligation to comply with the performance incentive schemes included in section 2 of Schedule D. ARTC has raised with the ACCC and HRATF a number of possible incentive schemes and received generally positive feedback. ARTC is in the process of developing those schemes further with a view to having them included in the final approved undertaking.

5 Key changes to 2010 IAHA

5.1 Clarification of tolerance

ARTC has clarified the drafting in clause 3.1 to give a better description of tolerance. The previous drafting has given rise to some confusion that the entitlement to tolerance is a firm right equivalent to the right to Base Path Usages as opposed to a flexibility mechanism included to assist producers in managing use of Coal Access Rights where ships slip from one Allocation Period to another.

5.2 Determination of MTC (cl 3.3)

Under the 2009 IAHA, ARTC makes a commitment to make available each month, sufficient capacity to meet the Monthly Tolerance Cap (**MTC**). The purpose of the additional capacity made available as tolerance is to provide access holders with a degree of flexibility as to when they use their annual contracted paths (**ACP**) and ensure they are not rigidly tied to the Base Path Usage (**BPU**) for each period.

The 2009 IAHA did not set out how ARTC would determine the MTC and in the Draft Decision, the ACCC expressed the view that the TUT would more likely be appropriate if it is revised to include the specification and methodology of the terms MTC (and Network Path Capability (**NPC**)).

ARTC has addressed this concern in the 2010 IAHA and has provided a detailed methodology as to how it will determine the MTC for each month.

5.2.1 Step 1: Identification of Target MTC

A target MTC for each Pricing Zone for each Contract Year (**Target Monthly Tolerance Cap or TMTC**) will be identified in the Hunter Valley Corridor Capacity Strategy published in the previous year. As set out in the definition of TMTC, the target figure will be included in the Hunter Valley Corridor Capacity Strategy after consultation with the RCG. The level of TMTC will in practice reflect the amount of capacity that the industry is prepared to build to provide for system flexibility to meet

demand variation. The industry will be able to fund Additional Capacity in order to increase the level of tolerance available to the system.

The maximum TMTC for each Contract Year is 10%. This will act as a cap in the event that industry elects to create a higher level of system capacity. Given that each access holder is entitled to no more than 10% of their average path usages as tolerance in any one period, and the likelihood that not all access holders will require tolerance in any given month, a TMTC (or MTC) higher than 10% would not offer access holders greater flexibility by way of tolerance. Additional capacity in excess of 10% could still be available for ad hoc usage.

5.2.2 Step 2: Sculpting of the MTC for each Month

ARTC will sculpt the TMTC (say 10%) for each month of the Contract Year to reflect the maintenance requirements in each month and the expected impact this will have on capacity in that Pricing Zone. For example, in one month the MTC in Pricing Zone 1 may only be 8% due to the maintenance requirements in that month (i.e. it is a Maintenance Month) and in a subsequent month, the MTC in Pricing Zone 1 may be 12%. This process will be similar to the sculpting of each access holder's contracted entitlement into BPU carried out under clause 3.2(b) of the 2010 IAHA and will be carried out at the same time. Similarly, the MTC sculpting process would target the TMTC for the full year.

The TMTC set out in the Hunter Valley Corridor Capacity Strategy may rely upon additional capacity to be created by a project which has not yet been commissioned. For example, the RCG may have endorsed a new project in Pricing Zone 1 which has the purpose of creating an additional 2% of capacity to be available as tolerance thereby increasing the TMTC to say, 10%, as set out in the Hunter Valley Corridor Capacity Strategy. If that project is not due to be commissioned until May 2012, ARTC will, in determining the MTC for the months January - May 2012, be required to sculpt the MTC around a target which it believes reasonably reflects the track capacity available for tolerance prior to the completion of the project. In this example, ARTC would sculpt around an 8% target for January - May 2012, rather than the 10%. The MTC sculpted for the subsequent months will reflect the higher target of 10%. If the project creating the additional capacity for the purposes of tolerance is delayed and the additional capacity is not available by June 2012, ARTC will advise the access holders of the revised MTC for that Pricing Zone, prior to the commencement of each month.

For every year except the first contract year, ARTC will use reasonable endeavours to publish the MTC (for each month and for each pricing zone) by 30 September of the previous contract year and in any event prior to the commencement of the contract year.¹⁶ ARTC considers it important that this flexibility is retained given the uncertainties surrounding an untested practice.

For the first contract year, this timetable is clearly not practical and the MTC for each Pricing Zone in each month will be notified by ARTC to the access holder prior to the commencement of the agreement.

¹⁶ A contract year will be a calendar year, except in the case of the first contract year which may be shorter depending on the HVAU Commencement Date .

5.3 Agreement KPIs (cl 3.13 and Schedule D)

ARTC proposes to negotiate and agree key performance indicators (Agreement KPIs) for each Access Agreement prior to entry into the Access Agreement. The Agreement KPIs will be negotiated within the framework of the ARTC objectives set out in section 8 of the 2010 HVAU:

- the Agreement KPIs are consistent with the Network KPIs set out in Schedule D of the 2010 HVAU;
- the Agreement KPIs are consistent with applicable track related System Assumptions;
- the Agreement KPIs are consistent with other incentives and measures of ARTC's performance including the indicators contained in the NSW Lease; and
- in the case of an agreement for coal access rights, coal chain performance indicators (which are expected to be published by the HVCCC) and any particular incentives and measures of ARTC's performance set out in the 2010 IAHA such as the true-up test.

Section 8.2(b) of the 2010 HVAU also provides that, unless otherwise agreed by ARTC, the Agreement KPIs are to be a subset of the Network KPIs set out in Schedule D of the 2010 HVAU (as applicable) but with the reporting detail (level) specific to the Applicant. This means that in the case of an access holder agreement for Coal Access Rights, the Agreement KPIs will report a nominated selection of relevant KPIs relating to Network performance and system performance according to the measures set out in Schedule D.

ARTC has also made it clear in section 8.2(c) of the 2010 HVAU that an Operator will be included in the negotiation of Agreement KPIs if requested by the Access Holder, and will be involved in the review of performance against the Agreement KPIs if either ARTC or the access holder requests their involvement.

ARTC will report performance against the Agreement KPIs when requested by the access holder, within a reasonable period following the completion of the relevant reporting period (to be set out in the access agreement) and ARTC will meet with the access holder regularly to review performance against the Agreement KPIs.

5.4 Ad Hoc Charge Rebate (cl 5.4(b))

In reviewing the operation of clause 5.4 of the 2009 IAHA, ARTC identified that amendments were required to ensure that an access holder does not miss out on receiving a rebate (under the annual reconciliation provision) due to inclusion of Ad Hoc Paths in its Actual Path Usages (APU) - when measured against the Annual Contracted Paths (ACP).

ARTC has included in clause 5.4(b) of the 2010 IAHA, a mechanism to provide an access holder with a rebate of Ad Hoc Charges where the access holder would not have used its ACP had those Ad Hoc Paths not been made available (and paid for). This will avoid ARTC retaining the benefit of both the Ad Hoc Charges and the TOP Charges to the extent that an Access Holder used the ACP by way of Ad Hoc Paths.

Subsequent amendments have been made to clause 5.4(a) and (d) of the 2010 IAHA to distinguish between a Rebate for TOP Charges and a rebate for Ad Hoc Charges.

5.5 Extensions

Clause 5.7 of the December 2009 IAHA sets out the criteria which ARTC would have regard to in determining the charges for an Extension it builds. The ACCC has requested the whole of clause 5.7 be deleted on the basis that extensions are not covered by the 2010 HVAU. ARTC has agreed to do so.

5.6 Discretion to waive TOP Charges for Coal Access Rights for track possessions (cl 11.2)

In the course of ARTC's review of the 2009 IAHA, ARTC has reached the view that its discretion to waive the TOP Charges for Coal Access Rights during track possession for maintenance and repairs is inappropriate and is inconsistent with the nature of those rights and the purpose of the application of the TUT and Annual Reconciliation (TOP Rebate). ARTC has amended 11.2 to remove that discretion.

- (a) Almost all track possessions for maintenance will be planned well in advance and taken into account in the annual sculpting process (clause 3.3) and the impact of any unplanned maintenance activity on contractual entitlements is contemplated and remedied in the application of the TUT and the Annual Reconciliation.
- (b) ARTC recognises that this discretion, if exercised, would have granted an AH immediate relief but the removal of this immediacy is consistent with the principles of the System TUT and Annual Reconciliation where the Access Holder does not obtain a remedy until year end. Removing the discretion is consistent with ARTC's contractual obligation to provide Annual Contracted Path Usages (ACP) to the Access Holder in the Contract Year. If the Access Holder utilises ACP over the year, then ARTC has fulfilled its contractual obligation and any remedies (waived TOP Charges) provided during the year (under clause 11.2(c)) would, in the end, have been provided unnecessarily. Further, unless the Access Holder was to repay any TOP Charges waived under clause 11.2(c), the Access Holder would have received the annual entitlement (say 100 paths) but would have paid an amount less than the annual TOP Charges (i.e. only paid for 80 paths if the TOP Charges associated with 20 were waived). This shortfall in revenue would result in an 'under' for the year, which would be socialised amongst all relevant Access Holders through 'unders and overs' accounting. This socialisation is not considered equitable.
- (c) The discretion was originally included in the Indicative Access Holder Agreement as it was consistent with the same provision in the Indicative Interstate Access Agreement forming part of ARTC's Interstate Access Undertaking. At that time, neither the detailed nature, nor the impact of the System TUT and Annual Reconciliation had been formulated.
- (d) ARTC considers that the option to waive Charges as contemplated in clause 11.2(c) would only be reasonable where another more widely available remedy for capacity was not available, which is the case on the interstate network or in the case of non-coal Access Rights (which are not covered under the TUT and annual reconciliation remedies). Non-Coal Access Rights are able to be contracted under terms and conditions based on the Indicative Interstate Access Agreement, which includes a provision for waiving Charges equivalent to clause 11.2(c).

5.7 Removal of paths for under-utilisation (cl 11.4(a))

In the Draft Decision, the ACCC expressed the preliminary view that the capacity resumption provisions in the December IAHA had been inappropriately weakened and may not allow for effective enforcement of capacity resumption.

As set out in the response to the Draft Decision, ARTC will be prepared to amend the threshold to accord with what the ACCC considers appropriate.

Following discussions with the ACCC, ARTC has amended clause 11.4 in the 2010 IAHA to strengthen the obligations on ARTC in the event of under-utilisation. Where the number of services operated on behalf of an access holder is below the six month threshold, ARTC is required to request the access holder to provide reasons why it still has a sustained requirement for the path usages.

This amendment is aimed strengthening the anti-hoarding provisions without amending the threshold for resumption.

5.8 Use of Non-Compliant Services (cl 11.5)

Some producers have indicated to ARTC that they may wish to run trains which do not accord with the Service Assumptions agreed for a Train Path at the commencement of the agreement (a Non-Compliant Service). In particular, producers indicated that they want the flexibility to be able to change the number of services to be operated by their nominated operators part way through an agreement either temporarily or permanently (e.g. rather than Operator 1 and Operator 2 operating 50 services a month for the access holder, the access holder may want operator 1 to start operating 80 services a month and operator 2 only 20 services a month).

The access holder's right to use a service depends on their compliance with the Service Assumptions and, under the 2009 IAHA, an access holder would have needed to agree a variation to the IAHA in order to allow them to run a service which does not comply with the Service Assumptions set out in the Train Path Schedule, including switching the number of services to be operated by a particular operator.

ARTC has sought to address the potential rigidity of this approach in the 2010 IAHA by providing for temporary use of a Non-Compliant Service or a permanent change to the Service Assumptions with consent of the ARTC.

ARTC will not unreasonably withhold its consent to the temporary use of a Non-Compliant Service within a Period provided the access holder provides ARTC with three day's notice of its intention to use a Non-Compliant Service and ARTC is satisfied that the operation of the Non-Compliant Service will not have an impact on Coal Chain Capacity, capacity of the Network or the capacity entitlement of another access holder. ARTC is entitled to rely on the recommendations of the HVCCC on the impact of Non-Compliant Services or the operation of Services complying with the New Service Assumptions (as applicable) on Coal Chain Capacity. ARTC may adjust TOP charges to reflect the characteristics of the non-compliant services.

If an access holder wants to operate services which do not comply with Service Assumptions on a Train Path for more than one period, the access holder will need to seek consent again under clause 11.5(a) of the 2010 AHA or alternatively apply for a permanent variation of the Service Assumptions in the applicable Train Path Schedule. ARTC will not withhold its consent to a permanent variation of the Service Assumptions in the Train Path Schedule, provided the access holder provides ARTC with the requisite notice (30 days is proposed), the operation of services in accordance

with the service assumptions will not have an impact on Coal Chain Capacity, the capacity of the Network or the capacity entitlement of another access holder and it does not lead to a reduction in the amount of TOP Charges otherwise payable. ARTC will amend the train path schedule to reflect the new service assumptions and new TOP charges applicable to those service assumptions.

5.9 Cancellation of Services (cl 11.6)

5.9.1 Overview

In clause 11.5 of the December IAHA, provided to industry stakeholders and the ACCC, ARTC proposed a mechanism enabling ARTC to remove paths from an access holder where the access holder has cancelled a number of services in previous periods and those cancellations have had an impact on Coal Chain Capacity, track capacity or the capacity entitlement of other Access Holders.

This provision was included by ARTC in response to producer's concerns with the potential impact of excessive cancellations on track capacity. However, certain producers informed ARTC that this provision was inadequate to remedy their concerns and submitted proposals aimed at capping the number of paths a producer can schedule each period and quarantining the impact of excessive cancellations to the responsible producer.

ARTC closely considered the proposals submitted by producers and also reviewed the operation and procedures of the Live Run Superintendent Group (**LRSG**) which is currently responsible for the assignment of cancellations to service providers.

Following this review, ARTC considered that there were significant issues with the producers' proposals - including their reliance on the informal, immature and relatively ad hoc assignment of fault currently operating in the Hunter Valley Coal Chain via the LRSG and the creation of inappropriate incentives on operators in cancelling services and deciding whether to accept the assignment of cancellations via the LRSG.

However, in recognition of the producers' concerns, ARTC strengthened the provisions regarding the monitoring and treatment of excessive cancellations and has also included in section 5.9 of the 2010 HVAU, a proposal to review processes for identifying and allocating losses of Capacity caused by Access Holders and their Operators and potential incentive mechanisms to minimise such losses where they have a material impact on Capacity, or Coal Chain Capacity or the Capacity entitlements of Access Holders and to seek a request to vary the 2010 HVAU if appropriate (see section 4.17 of this Explanatory Guide).

5.9.2 Producer proposals

The key elements of the various proposals for allocation of cancellations put forward by industry were as follows.

- Under both proposals, subject to a few exceptions, an access holder is only able to schedule a number of paths (Scheduled Paths) up to its Scheduling Cap (i.e. Monthly BPU + Tolerance + the access holder's share of unplanned losses).
- An access holder will consume a Scheduled Path if they use or cancel one of their own paths or if the cancellation of another access holder's Scheduled Path was assigned to the access holder (i.e. their fault).

- Under one proposal, cancellation or assignment of a cancellation does not consume a Base Path Usage and does not affect the access holder's underlying contractual entitlement - except presumably to the extent that an access holder will not be able to schedule and use a BPU where it has exhausted its Scheduling Cap (**Proposal 1**). A second proposal appears to propose that a cancellation or assignment of cancellation will consume an access holder's contractual entitlement (**Proposal 2**).
- Under both proposals, ARTC may allow scheduling above the Scheduling Cap:
 - Under Proposal 1, ARTC may allow scheduling above the cap if there is no impact on another access holder's ability to schedule up to their Scheduling Cap or to allow accumulation of a cargo at the port.
 - Under the Proposal 2, ARTC may also allow scheduling above the scheduling cap where necessary to promote the efficient operation of the coal chain or where ARTC 'creates' more capacity.
 - Access holders' conduct (to ensure the constraint is not reached) will be monitored by the HVCCC and ARTC.
- Proposal 2 goes further than Proposal 1 and proposes that:
 - A shift in the mechanism for determining contractual entitlement of an access holder (an access holder will have a right to use paths up to a Scheduling Cap) and measures ARTC's performance by assessing whether ARTC allowed an access holder to schedule paths in excess of the sum of the Scheduling Cap. Adopting Proposal 2 will require amendments to the provisions on tolerance (indeed the proponents of that proposal suggest tolerance is no longer necessary) and significant amendments to the true-up test in Schedule 2 and clause 5.4 of the 2009 IAHA.
 - ARTC will be able to obtain the benefit of making paths available above the Scheduled Cap but does not set out how this would occur. This would appear to involve an adjustment to the ceiling test in the HVAU to enable ARTC to exclude Ad Hoc Charges received in certain scenarios from the ceiling.

5.9.3 Concerns with producer proposals

ARTC has a number of significant concerns about industry's proposals for assignment of cancellations.

- **Inappropriate reliance on the current cancellation assignment procedure** - Both proposals rely on the assignment of cancellations via the Cancellation Reporting procedure currently operating in the Hunter Valley, which suffers from various material limitations:
 - the cancellation policy and process are subject to ongoing review and it is not appropriate for ARTC to lock itself into the consequences of a procedure which is likely to change in the future;
 - the assignment of cancellations (fault) is not carried out by the HVCCC and nor is it carried out by an independent arbiter;

- cancellations are often due to multiple causes and it is not always possible to make an allocation and this issue can be compounded by breaks in the chain of cancellation (e.g. a delay caused by an event at a load point may be made up but then may be subsequently delayed due to a further external event);
 - cancellation cannot be assigned to a producer unless agreed by the producer;
 - the process is informal and leads to “horse trading” whereby participants agree to accept one cancellation if another party accepts another; and
 - the current procedure does not allow time for in-depth investigation.
- **Increased risk of disputes about cancellation assignment** - A move from the current environment in which no serious financial or commercial consequences attaches to cancellation to one that does (as contemplated in proposal 1) will increase the possibility of disputes as participants seek to avoid assignment of cancellations.
 - **Inappropriate incentives on operators** - The introduction of significant financial or commercial consequences may lead to a reluctance by above rail operators to cancel services or to delay making cancellations (even though this is to the benefit of the operation of the Network on the day) and this decision may be influenced by the presence of any penalty arrangements in their coal haulage arrangements with producers.
 - **Fundamental misconception of tolerance** - Both proposals envisage an access holder being able to schedule a number of paths up to a Scheduling Cap which includes a measure of tolerance plus a share of system losses. Further, Proposal 2 envisages that an access holder will have an entitlement to use paths up to the Scheduling Cap. Equating the availability of tolerance across the system with an individual entitlement to tolerance each period is a fundamental misconception. Tolerance is made available under the 2010 IAHA in order to provide an access holder with the flexibility to manage a ship slipping from one month to the next without significant consequences. It is not designed to be used by each and every access holder each Period. This is one of the reasons why the amount of tolerance available each month is subject to a Monthly Tolerance Cap.
 - **Proposal allowing consumption up to Cap is unworkable** - The proposal that each access holder is able to use a number of paths up to the Scheduling Cap is unworkable as this assumes there is a direct linear relationship between the number of cancellations and the number of paths available on the Network (i.e. if an access holder does not cancel a path then there is one more path available and, according to Proposal 2, access holders should get the benefit of the newly available path). The relationship between the number of paths available (Capacity) and the number of services cancelled is not, however, that precise. A cancellation does not necessarily consume a path usage, and an additional path will not necessarily be available should there be one less cancellation. Cancellations may be made to free up system capacity in the event of congestion and trains will often be rescheduled during a run.

- **Proposals envisage use of paths despite impacting other users** - The proposals envisage that ARTC may allow an access holder to schedule paths above their contractual entitlement (BPU) or above their Scheduling Cap in circumstances where it is necessary to enable the accumulation of cargo at the Port (Proposal 1) to promote the efficient operation of the coal chain or where ARTC ‘creates’ more capacity (Proposal 2). ARTC does not consider that it would ever be appropriate to permit an access holder to use additional paths if this affects other access holders. As with trades and sales of ad-hoc capacity, ARTC will need to rely on an assessment of the impact of the request to schedule paths above the cap on coal chain capacity, and where this is not obvious, the assessment will be made by the HVCCC. Such assessments may take time and may not be appropriate in the context of allowing scheduling beyond the Scheduling Cap.
- **Administratively complex and potential for delay** - Both proposals would introduce additional monitoring tasks on ARTC and/or the HVCCC to track an access holder’s consumption of its contractual entitlement to use paths and an access holder’s entitlement to schedule paths.
- **Proposed cap is very low in any event** - Under Proposal 1, the maximum number of path usages that can be taken from a coal producer for a single incident or event is two path usages. This cap is low and in effect disconnects the impact of a cancellation from the quarantining effect when the event or incident causes more than two cancellations - minimising the intended result sought by stakeholders. While most cancellations result in an impact to one or two services, this may change with the introduction of commercial consequences for cancellations (including flow-on penalties in the rail haulage agreement), as parties seek to recover lost capacity and minimise the cancellations assigned to them directly.

5.9.4 Key elements of clause 11.6

Despite the concerns above, ARTC has adopted a number of the features of the cancellation mechanism proposed by producers although not the concept of Scheduled Paths and a Scheduling Cap. The key elements of the proposal put forward by ARTC in clause 11.6 are:

- Unlike the previous drafting in clause 11.5 of the 2009 IAHA, clause 11.6(a) and (b) capture direct cancellations by an access holder and also indirect cancellations where another access holder’s service was cancelled due to the fault of the first access holder.
- Clause 11.6(a) relies on the assignment of cancellations by the LRSG (made up of the current service providers in the Hunter Valley and facilitated by a representative of the HVCCC).
- ARTC will rely on the HVCCC’s advice as to whether the cancellations have had an impact on track capacity, Coal Chain Capacity or the contractual entitlement of another access holder. Where this is the case, ARTC may remove paths from the access holder in the subsequent period. If ARTC is advised that this is the case, but decides not to take paths off the access holder, ARTC will be required to provide reasons to the HVCCC.

- Under the proposal in clause 11.6, the maximum number of paths that ARTC is able to remove from access holders in respect of any one event is two. This limit has been proposed at the request of producers.

5.10 Assignment, novation and ability to terminate on expiry NSW Lease (16.1(a))

As set out in its Draft Decision, the ACCC considered that the Access Holder should be able to terminate the agreement if the NSW Lease ends or if ARTC loses its right to grant access to the Network. As stated in ARTC’s response to the Draft Decision, such a right is not appropriate as ARTC has an obligation under the NSW Lease to include within all ARTC Agreements a right for the Lessor or its nominees to require the novation of the AHAs at the expiration in such circumstances.

Clause 21.4 of the NSW lease provides:

“ARTC agrees to include within all ARTC Agreements a right for the Lessor or its nominee, if it so elects, to take an assignment or require the novation of the applicable ARTC Agreement at the expiration or earlier termination of this Deed, at no cost to the Lessor and without the need for the consent of any party to the ARTC Agreements.”

ARTC has sought to ensure it complies with this obligation under clause 16.1(a) of the 2010 IAHA (and corresponding clause 19.1 of the 2010 OSA).

5.11 Trading (cl 16.2-16.8)

5.11.1 Overview

In the Draft Decision, the ACCC made a number of recommendations regarding the trading provisions in clauses 16.4-16.8 of the 2009 IAHA:

- Clause 16.2 of the 2009 IAHA should be amended to make it clear that ARTC is under an obligation to act reasonably in relation to requests by Access Holders for consent to assign, trade or novate their rights under the Access Agreement.
- All provisions in the IAHA relating to Capacity trading should be included in the 2009 HVAU.
- ARTC could devise a Network trading system which aligns with the system developed for the trading of capacity at the Port of Newcastle (the Capacity Trading System (CTS));
- The criteria and processes by which ARTC will consent to a trade that does not meet the criteria set out in clause 16.4(b) of the 2009 IAHA (i.e. non-safe harbour trade) are unclear and need to be set out with more clarity.
- The two week period for ARTC assessment of a non-safe harbour trade may provide an appropriate balance initially but this may not be the case in the longer term. Therefore the ACCC recommends that the processes and timeframes by which ARTC will develop processes and mechanisms in conjunction with the HVCCC under clause 16.8 which will enable ARTC to specify shorter time periods need to be clearly set out.

- The statement in clause 16.6 of the 2009 IAHA that ARTC may have regard to the views of the HVCCC could be strengthened particularly in relation to trades that affect Coal Chain Capacity.

ARTC proposed a number of amendments in the Response to the Draft Decision to address each of these concerns. These proposals have been adopted into clause 16 of the 2010 IAHA with minor amendment (see the explanation of clause 16.2 immediately below).

5.11.2 Clause 16.2

In the response to the Draft Decision, ARTC proposed amending clause 16.2 to provide that where an Access Holder seeks to *'license, assign, novate, sell, trade, sub-license or otherwise dispose ("transfer") of this agreement, its interest in the subject matter of this agreement or any right under this agreement'* ARTC's consent would not be unreasonably be withheld.

ARTC has however considered this proposal further and does not consider it appropriate to make this change.

- Clause 16.2 of the 2009 IAHA covers transfers broadly but most types of transfers will be permanent assignments, permanent trades or temporary trades. These are covered separately in clause 16.3 and 16.4 of the 2010 IAHA and under these provisions ARTC is required to consent to such transfers provided certain conditions are met.
- One transfer which may not be covered is an assignment or novation of the entire agreement and ARTC considers it should have discretion in relation to consent to such a transfer. Terms of the AHA may be negotiated with a particular applicant and may reflect the individual circumstances of the applicant - ARTC should not be required to extend these terms to an assignee of the access holder who may not be in the same circumstances as the access holder.

5.11.3 Key elements of changes to clauses 16.4-16.8

In response to ACCC concerns that it would not have the opportunity to review a system for the trade of network capacity to be developed post acceptance of the 2009 HVAU, ARTC removed (a) and (b) of clause 16.4 and replaced these provisions with a commitment to work with the HVCCC and the administrator of the Port trading system (the CTS Administrator), and introduced specific provisions designed to ensure trades of the Network capacity can work in alignment with trades of capacity at the Port.

The key changes to the 2009 IAHA are:

- Specific commitments by ARTC regarding requests by an Access Holder to carry out a non-safe-harbour trade (cl 16.4(d)). In particular:
 - ARTC will not unreasonably refuse its consent to a non-safe harbour trade provided it can ascertain that the trade will not have an impact on capacity, coal chain capacity or the capacity entitlement of another access holder.
 - ARTC will use reasonable endeavours to inform the HVCCC of its decision whether or not it consents to a trade as soon as possible;

- ARTC must inform the HVCCC of its decision whether to consent to a trade within two weeks of being informed of a trade (or within a lesser timeframe which has been notified by ARTC following consultation with the HVCCC).

ARTC did consider whether it was able to reduce the timetable for the approval of non safe-harbour trades below two weeks but concluded that it will be inappropriate and potentially risky to do so at this stage. There is only limited experience of trades of track capacity and none under the proposed system where capacity is directly held by coal producers. ARTC considers it important to see how trades will work in practice and the degree of complexity involved in making a capacity assessment before it makes a firm commitment to a shorter timeframe to approve trades. In this respect, ARTC has made a commitment in clause 16.8 to review the timeframe for consent of non-safe harbour trades (discussed below).

- ARTC may impose reasonable conditions on the approval of a non-safe harbour trade.
- Commitments to work with the Capacity Trading System developed for the trade of capacity at the Port of Newcastle (the CTS) and the HVCCC:
 - The draft CTS Trading Protocols provides for a CTS Clearing House which enables producers to identify counterparties to a trade of terminal capacity. ARTC has made it clear in clause 16.6(a) of the IAHA that an access holder may also use this platform to identify counterparties to a trade of track capacity.
 - ARTC will consider all trades of track capacity notified by the administrator of the CTS (the CTS Administrator) to ARTC and inform the CTS Administrator of whether the trade is a safe-harbour trade (and consent is therefore not required) or where the trade is a non-safe harbour trade, where ARTC consents to that trade (following the principles set out in clause 16.4(d)).
 - ARTC has amended clause 16.6(c), making it mandatory for ARTC to consider the HVCCC’s views on the impact of a trade of Coal Chain Capacity and the Capacity entitlement of other access holders.
- Reduction in timetable to make a decision: ARTC has made a commitment in clause 16.8(a) to review the timetable for ARTC to make a decision for non-safe harbour trades (currently two weeks). In carrying out this review, ARTC will seek the views of the HVCCC and will consider the views expressed by the HVCCC in good faith. If ARTC considers that it is able to reduce the timetable below two weeks, it will inform the HVCCC and access holders in writing of the new maximum period.

ARTC has made some additions to clause 16.4 to clarify that a trade must be for an unconditional Base Path Usage in the relevant Contract Year to fall within the safe harbour provisions and that the trading provisions apply to “internal” trading between load points of the one access holder.

ARTC has also amended clause 16.5 of the 2010 IAHA to clarify how a traded path will be treated for the purposes of determining the number of paths used by an access

holder (APU). This amendment makes it clear that a traded path will be deemed to be used by the former access holder and the subsequent use of the path by the new access holder will not count as an actual path usage by the new access holder (and will therefore not consume that access holder's BPU or ACP).

5.12 True-up test (Schedule 2)

5.12.1 Overview

The TUT measures whether the functional capacity of the Network (NPC) in each Pricing Zone for each Month and Quarter was sufficient to meet the paths contracted for that period, other pathing requirements and the system losses (together, the TPR). The difference between the NPC and the TPR is the System Availability Shortfall (SAS) and:

- where ARTC meets the test, the SAS = zero, and no Access Holder will accrue a rebate.
- if the SAS is greater than zero (i.e. the NPC was insufficient to meet the paths required), then the SAS forms the ceiling for the distribution of an accrued rebate of TOP Charges paid to individual Access Holders under clause 2.3 of the TUT (the second step).

The TUT is a system-wide measure applied to each Pricing Zone. This is required due to the problems of measuring performance against individual entitlements. ARTC is unable to identify the reasons why a contracted path was not used and as the failure to provide a path usage arises prior to the allocation of the path to an access holder (except in the 'live operation' period), it is impossible to identify which access holder did not receive the path. This can be contrasted to the position under the arrangements on the Interstate network where the failure to provide a particular path can be directly related to a contractual obligation to provide a scheduled path to the operator.

The first part of the TUT (2010 IAHA Schedule 2 clause 2.2) determines whether ARTC made available sufficient capacity in a Pricing Zone to meet:

- (a) the BPUs it contracted to provide to access holders;
- (b) the Pricing Zone MTC (i.e. ARTC's commitment to all access holders as a group);
- (c) any additional (i.e. Ad Hoc) coal paths provided;
- (d) the system losses caused by other parties (the lesser of actual and forecast losses);
- (e) actual system losses caused by ARTC (both maintenance and operational); and
- (f) commitments to non-coal traffic.

If ARTC makes available too many Ad Hoc Path Usages, or if the number of path usages lost due to ARTC system losses or ARTC maintenance are higher than forecast losses, the TPR would increase possibly to a level that exceeds the NPC that had been determined for that period. Therefore, such performance by ARTC would increase its risk of failing the TUT for that period). However, to the extent that any lost paths identified as ARTC system losses or ARTC maintenance and included in the TPR are

due to an Availability Exception (as defined in clause 3.6 of the 2010 IAHA), those lost paths will be subtracted from the TPR. This is to ensure ARTC is not penalised for events outside its control. Clause 2.2(a) of Schedule 2 has been amended to ensure that the effect of an Availability Exception is not double counted.

The second part of the TUT (2010 IAHA Schedule 2 clause 2.3) allocates the SAS between access holders who did not use their BPU in the relevant period in proportion to their share of the sum of all individual shortfalls. It is important to note that an access holder may accrue a rebate under the TUT regardless of whether or not it actually sought to use all of its BPUs.

At the conclusion of the contract year (defined as a calendar year), ARTC will carry out an Annual Reconciliation to determine whether the actual path usages used by the Access Holder during the year (including paths above the BPU in a period used as Tolerance or Ad Hoc Path Usages) was equal to or exceeded its ACP. This reflects the fact that any shortfall in an access holder's use of its BPU in one period may be balanced by 'over use' in a preceding or subsequent period via the use of Tolerance or Ad Hoc Path Usages. If, however, Ad Hoc Path Usages are included in determining the Actual Path Usages (APU) then the access holder will be entitled to a rebate for Ad Hoc Charges paid under clause 5.4(b).

The TUT is carried out a zonal basis and an access holder will accrue a rebate under clause 2.3 in respect of the TOP Charges they paid for a Train Path in respect of that Pricing Zone. The same approach is taken under the application of the Annual Reconciliation under clause 5.4 of the 2010 IAHA, where the access holder's Actual Path Usages (APU) is measured against its Annual Contracted Paths (ACP) for each Train Path in that Pricing Zone. To the extent the access holder is entitled to a rebate under clause 5.4, this is determined by reference to the TOP Charges paid for the Train Path in that Pricing Zone.

5.12.2 Provision of TUT information (Schedule 2, clause 2.6)

In Clause 2.6 of the 2010 IAHA, in order to address an HRATF issue in relation to the transparency of the system-wide TUT, ARTC has committed to publish the result of each system-wide TUT carried out throughout the year on its website (except where it is unable to do so due to confidentiality obligations to an individual access holder), as well as notify the Access Holder of any rebate accruing to that Access Holder throughout the year.

ARTC considers that the publication of that information and the provision of information (spreadsheets) to the ACCC as part of the annual compliance assessment under the 2010 HVAU should allay the concerns about the transparency of ARTC's processes in relation to application of the system wide TUT.

5.12.3 Treatment of tolerance

One producer has submitted to ARTC that an access holder should be entitled to a rebate under the TUT if it did not receive its contracted Tolerance, or as an alternative, its share of the MTC. This issue was also raised during consultation with the HRATF. This submission fundamentally misconstrues the purpose of the Tolerance provided under the 2010 IAHA and the nature of ARTC's commitment.

The purpose of tolerance

Tolerance provides the access holder with a degree of flexibility as to when to use its ACP during the year so the access holder is not rigidly tied to the BPU for each Period. Tolerance does not give an access holder any contractual entitlement above the sum of the BPUs (see discussion in section 5.1 of this Explanatory Guide).

As set out in the explanatory guide submitted to the ACCC with the 2009 HVAU, the purpose of Tolerance is to enable the access holder to adjust its contracted path usages from one period to the next, rather than provide additional path usages to top up the annual contracted requirement. If an access holder receives at least its ACP (i.e. its APU \geq ACP) then it has received its contractual entitlement and no rebate should be paid where the access holder receives its contractual entitlements.

ARTC's commitment to provide MTC is taken into account under the TUT

While the access holder should not be entitled to receive a rebate where it used its contractual entitlement in a period (BPU) but did not have the opportunity to 'flex' up in that period, ARTC has still made a firm commitment to the system provide the MTC each month and its performance against this commitment is measured under the TUT. The MTC for a Pricing Zone forms part of the TPR against which the NPC for that Pricing Zone is measured (clause 2.2 of 2010 IAHA Schedule 2).

Inappropriate to allow an access holder to accrue a rebate for not receiving Tolerance

Stakeholders have expressed the view that they should be entitled to a rebate under the TUT if they do not receive their 'share' of the MTC. There are a number of reasons why it is inappropriate for an access holder which used all of its BPU but did not use its 'share' of MTC (including when an access holder did not want it) to accrue a rebate.

- (a) The purpose of Tolerance is not to enable each and every access holder to use its 'fair share' each month - rather, it is designed to address out of turn or delayed arrival at the Port. E.g. in July, an access holder uses its maximum Tolerance in a Pricing Zone (say 13 paths) because its ship which had been due to arrive in June was delayed until July (and a stockpile was not allocated at the port until late in the month). The Access Holder may not have been able to use its BPU in June due to the ship being late and a stockpile not being allocated at the port until late in the month. In July the access holder needs to transport coal at a rate above that implied by its BPU and can use Tolerance to do so.¹⁷ In any event, access holders have the ability to trade Network capacity in alignment with trades of capacity at the Port. (See section 5.11.3 of this Explanatory Guide.)
- (b) Where there is no rebate applicable to Tolerance paths (as opposed to BPU), ARTC will be incentivised to ensure that an access holder who requires BPU will receive the BPU, ahead of another access holder that has already received BPU and is seeking to use Tolerance. ARTC understands that the industry wants to ensure that ARTC will allocate BPUs ahead of Tolerance.
- (c) The availability of Tolerance to any particular Access Holder is subject to the MTC available to the system. Tolerance (consuming the MTC) is made available on a first come, first serve basis throughout the month. It will not be

¹⁷ Note that ARTC may be able to also provide Ad Hoc Path Usages if spare track capacity exists, or alternatively, the access holder may acquire paths from another access holder via a trade.

possible to make each Access Holder's Tolerance available in a given month unless the industry invests in an amount of capacity to be made available for the MTC that exceeds the sum of each Access Holder's Tolerance (which is likely to be an inefficient outcome given the operation of the system).

- (d) ARTC would expect that the majority of access holders in any given month would not require Tolerance, only those seeking to address the above circumstance. ARTC should not have to rebate TOP where Tolerance is not used - the TOP Charge is determined as a monthly average of the ACP and has no relationship with either BPUs or Tolerance paths except that these add to APU in the annual reconciliation. Tolerance represents a means of flexibly using contracted path usages, not additional path usages.
- (e) Under the TUT, ARTC does not investigate the reasons why the BPU were not used and there is an implicit assumption that where ARTC fails the TUT, the BPUs were not used because they were not available (as opposed to not being used because the access holder did not require services equivalent to their BPU in the relevant period). It is not, however, appropriate to make a similar assumption in respect of Tolerance paths (which represent approximately only 10% of the paths used on the Network). Tolerance paths are only used after the BPUs are used and it is much more likely that Tolerance is not used due to reasons other than ARTC not making the path available (i.e. the access holder did not want to use the path). ARTC considers that this effective balancing of assumptions in the TUT represents a reasonable assignment of responsibility for paths not being used (when this is not known directly in each instance) and so a balance of the reasonable interests of ARTC and access holders.
- (f) There is no conceptual justification or mechanism for allocating MTC between access holders. Apportioning MTC between access holders in proportion to their individual Tolerance allocation is misguided and ignores the purpose of Tolerance to provide access holders with flexibility to manage out of turn or delayed arrivals. This argument appears to be based on the incorrect interpretation that an access holder has a right to Tolerance over and above its contracted paths, or that the access holder has some individual right to a portion of the MTC.

In practice, the use of Tolerance by an access holder is more likely to be the whole, or a substantial part, of its Tolerance allocation in a period and limiting Tolerance in a period to a 'fair share' of the MTC would deny access holders the necessary flexibility required to meet an out of turn ship arrival.

Apportioning tolerance among access holders is therefore far removed from the original concept of Tolerance. In effect, this would involve ARTC committing to provide each access holder each period with an additional tranche of track capacity on top of its BPU. If this is what access holders want, they would be better off securing a higher amount of track capacity and abandoning the concept of a shared flexibility arrangement. While ARTC could commit to do this (and adjust BPU accordingly), such an approach is contrary to the expressed wishes of producers, who indicated that flexibility is a very important component of the framework. Further, this approach may inevitably lead to over investment where capacity would be needed to meet the higher demand for BPU for all access holders, where demand is only likely to arise for some access holders in any given month.

5.12.4 Definition of NPC

The 2009 IAHA did not address how ARTC would define Network Path Capability and in the Draft Decision the ACCC expressed the view that the TUT would be more likely to be appropriate if it is revised to include the specification and methodology of the term Network Path Capability (NPC) (and Monthly Tolerance Cap (MTC)).

ARTC has addressed this concern and has set out in Schedule 2 of the 2010 IAHA what NPC is and how NPC will be determined.

NPC is a functional measure of the number of coal paths that a Pricing Zone is capable of providing in a particular Period. This measure will be determined prior to the commencement of the relevant Contract Year, following consultation with the HVCCC on the expected capacity of the Network. The consultation with the HVCCC will be covered by the principles set out in Schedule F of the 2010 HVAU.

There is provision to adjust NPC during a year to reflect changes to the delivery of capacity expansions that may arise during that year.

In determining the NPC of a Pricing Zone, ARTC will determine how many Functional Coal Paths the Pricing Zone is capable of providing on the assumption that the Network was only used for Coal Trains and the Coal Train used complied with the track related System Assumptions and any other measure of Network performance which ARTC reasonably considers will have an impact on the capacity of the Network (after consultation with the HVCCC).

ARTC will assess the number of Functional Coal Paths available in each Pricing Zone at a particular point in that Pricing Zone. The use of a single point estimate is a necessary proxy as capacity within a Pricing Zone will change with infrastructure capability changes through that zone (e.g. signalling headways, number of tracks etc). An alternative option to a single point measure would be 'average' capacity which would reflect the capacity at each junction and weighted towards the amount of traffic at each junction. However, such an approach would involve complex judgments as to how planned capacity losses (e.g. planned maintenance outages or system losses) should be allocated and the adoption of arbitrary assumptions given the multiplicity of sources and sinks for coal traffic. ARTC's view is that a single point estimate will deliver a superior (more accurate) estimate of capacity than a weighted average estimate. ARTC understands that this approach is consistent with capacity reporting undertaken by the HVCCC.

The single points selected by ARTC are representative of capacity in that Pricing Zone:

- Pricing Zone 1: Whittingham Junction is representative of the available capacity in Pricing Zone 1 for the majority of traffic taking into account the proportion using each part of the Pricing Zone and capacity at various points. A point closer to the port will overstate track capacity in Pricing Zone 1 (unduly favouring ARTC in the TUT), and a more westerly point (e.g. Muswellbrook or even Bengalla) would underestimate track capacity (disadvantaging ARTC).
- In both Pricing Zone 2 and Pricing Zone 3, the majority of coal volumes enter the zone at the more distant end – this contrasts with Pricing Zone 1 which has volumes entering along the entire length of the zone. As the pathing is routinely available in each of Pricing Zone 2 and 3 throughout the entire length of the zone, it is reasonable to measure NPC at the extreme end of the zone.

5.12.5 Application of TUT: worked example

Step 1: Does ARTC pass the TUT in the Pricing Zone in the relevant Period

- **Determination of NPC:** - Following consultation with the HVCCC, ARTC has identified prior to the commencement of 2012, the NPC for each Pricing Zone for each month of 2012 (the NPC for each quarter will be the sum of the NPC for each month of the relevant quarter).

Under the following example, the NPC for Pricing Zone 1 for January has been determined to be 190 paths (as measured at Whittingham Junction).

- **Determination of TPR:** - The following variables which make up the TPR for Pricing Zone 1 for January will be known (fixed) prior to the commencement of the relevant month:
 - The aggregate BPU for those access holders with a monthly allocation period for January - say, 120 paths (*Base Path Usages (aggregated)*);
 - the MTC for January - say 12 paths (*Tolerance Cap*);
 - the forecast system losses for other parties for each month, say 10 paths (*forecast system losses - other parties*); and
 - the number of services scheduled for non-coal trains, equivalent to say 10 coal paths (*Path usage consumption due to utilisation by non-Coal Trains*).

ARTC will also know its planned maintenance for January and the proportion of ARTC system losses that would typically occur during a month in that Pricing Zone.

At the end of January, ARTC will determine the value of the other variables which are added to make up the TPR in a Pricing Zone:

- **Ad Hoc Path Usages:** Under the diagram, this includes both the number of paths that ARTC sold as Ad Hoc Path Usages in January plus the number of BPUs that were used by access holders who had a quarterly allocation period (say 10 paths plus 20 paths).
- **ARTC's Actual Maintenance Requirements:** January was identified as a Maintenance Month (see clause 3.2(b)) and 10 paths were expected to be consumed for maintenance (this has been taken into account in the sculpting of the BPU which was lower in January to reflect this but note NPC for a period is not reduced to reflect planned maintenance). Due to delays taken by ARTC's sub-contractors, ARTC has lost a further five paths due as late running maintenance. Therefore this variable will be 15 paths.
- **ARTC's system losses:** Eight of these paths were lost due to 'Late running due to ARTC Network Management' and a further ten paths were lost due to a flood in the Pricing Zone which took a day to clear (18 paths in total).

- Actual member losses: Ten paths were lost due to multiple locomotive failures and a further two paths were lost due to delays in train availability (12 paths) (note it is the lesser of actual and forecast member losses that is included in the TPR).

The TPR for January for Pricing Zone 1, prior to the consideration of paths consumed due to Availability Exceptions, would therefore be 215 paths.

The next step is to subtract those paths that were not made available by ARTC due to the occurrence of an Availability Exception (as defined in clause 3.6). This step is necessary to ensure that ARTC is not penalised for events beyond its control.

The paths that will be subtracted under this proviso will include paths that ARTC is unable to make available due to an unforeseen event (e.g. flood, landslip, sabotage) or additional unscheduled demand for passenger trains (e.g. if ARTC is required to provide an additional 5 path usages to enable heritage trains to be run).

Paths which are not made available due a loss caused by another member (e.g. a failure of an operator's train) will not be subtracted. The TUT measures ARTC's performance not the performance of other members of the Hunter Valley coal chain and is reflected in the fact that the member losses included in the TPR are the lesser of actual or system member losses. Paths lost due to the performance of another member of the Coal Chain would not be an Availability Exception.

ARTC will only subtract those paths which have already been counted as a path required under the variables making up TPR. In determining TPR, ARTC may, instead of attributing each path lost due to an Availability Exception to a particular variable in the TPR, simply exclude these paths from the aggregation of TPR - under the former approach there is no need for their subsequent subtraction, otherwise double counting will result.

Figure 1: Example of determination of TPR

	January	Number of paths
1	<i>Base Path Usages (aggregated) for all monthly producers</i>	120
2	<i>MTC January</i>	12
3	<i>Ad Hoc and other relevant Path Usages for Coal Trains</i> - Ad Hoc Path Usages (10) - Path Usages consumed by Access Holders with a quarterly allocation period (20)	30 (10 + 20)
4	<i>Path usage consumption due to utilisation by non-Coal Trains</i>	10
5	<i>Lesser of actual v forecast system losses - other parties</i> - Forecast (10) - Actual (12)	10
6	<i>Actual Maintenance Requirement</i>	15

	January	Number of paths
7	Actual system losses - ARTC - Late running (8) - Flood (10)	18
	Total (pre subtraction for Availability Exceptions)	215
	Total (post subtraction for Availability Exceptions)	205

- **Does ARTC pass the TUT test?:** - The NPC for Pricing Zone 1 for January (190 paths) will be compared with the TPR for that Pricing Zone for that month (205). This results in a System Availability Shortfall of 15 paths for Pricing Zone 1 and ARTC would have accordingly failed the TUT for that Pricing Zone for January 2012.

Step 2: What rebate does an AH accrue?

The second step is to determine the TOP rebate that an Access Holder with a Train Path that crosses Pricing Zone 1 will accrue (clause 2.4 of Schedule 2 of the 2010 IAHA).

For the purposes of the example, say there are five Access Holders each with a single Train Path that crossed Pricing Zone (with a monthly allocation period).

The individual shortfalls are as follows:

Figure 2: January: Pricing Zone 1

	Actual Path Used	BPU	Individual Shortfall (IS)
AH A	25	30	5
AH B	27	25	0
AH C	10	10	0
AH D	8	10	2
AH E	7	10	3
Σ IS	10 paths		

Under this example, AH A, AH D and AH E are all entitled to accrue a rebate. AH B and AH C received (used) their total BPU and accordingly are not entitled to a rebate (the reasons for this are discussed immediately above).

In this example, because the sum of the individual shortfalls ($\Sigma(AH_1 IS \dots AH_N IS) = 10$) is less than the System Availability Shortfall (SAS) = 15, $SAS / \Sigma(AH_1 IS \dots AH_N IS)$ is deemed to equal 1. See Schedule 2, clause 2.4(b).

Applying the formula, $AH TOP_{PU}(\$) \times AH IS \times [SAS / \Sigma(AH_1 IS \dots AH_N IS)]$ (with the deeming above):

- AH A will accrue a rebate equivalent to 5 times the TOP Charge paid by AH A for a path usage in PZ 1 (i.e. the price it pays for 5 paths in PZ 1).
- AH D will accrue a rebate equivalent to 2 times the TOP Charge paid by AH D for a path usage in PZ 1.
- AH E will accrue a rebate equivalent to 3 times the TOP Charge AH E paid for a path usage in PZ 1.

ARTC will in effect rebate to these Access Holders, TOP Charges equivalent to the size of the Access Holders' shortfall against BPU.

5.13 Interpretation of Tier 1 mandatory provisions

As set out above, in response to the ACCC's concerns that negotiations could result in Access Agreements that frustrate the objectives of alignment and the long term solution, ARTC has identified those provisions which it considers need to be consistent across all access holder agreements as Tier 1 (mandatory) provisions.

In the Response to the Draft Decision, ARTC had proposed including an obligation on ARTC to inform the ACCC if a dispute arose in relation to a Tier 1 (mandatory) provision in an access holder agreement which could have had a broader adverse impact on coal chain capacity and, if this was the case, to facilitate the ACCC making submissions on the issue before an expert or the court.

Following discussions with the ACCC, ARTC has not proposed including such a provision in the 2010 IAHA and has instead proposed an interpretation provision in clause 1.5 of the 2010 IAHA. Clause 1.5(a) provides that a Tier 1 (mandatory) provision will have priority over any other provision including any provision in the TP Schedule which would otherwise have priority. Clause 1.5(b) provides that a Tier 1 (mandatory) provision will be interpreted by reference to the objectives of the 2010 HVAU and the coal chain principles recognised by ARTC in the 2010 HVAU.

Clause 1.5 of the 2010 IAHA itself is also identified as a Tier 1 (mandatory) provision for all access agreements for Coal Access Rights in Schedule A to the 2010 HVAU.

This approach addresses any concerns the ACCC may have regards the risk that negotiations could result in access agreements that frustrate the objectives of alignment.

5.14 TP Schedule - commercial viability and the ability to contribute (self fund)

Clause 4.3 of the Train Path Schedule includes a project completion condition precedent which is to be included whenever a tranche of capacity is conditional upon the completion of a project creating additional capacity in the Network. As provided in clause 4.3(b) of the Train Path Schedule, ARTC is not committed to complete a listed or new project if that new project is no longer commercially viable to ARTC.

ARTC recognises that its obligation to commit to new capacity under section 6 of the 2010 HVAU is subject to a commercial viability test and once it commits to the construction of this new capacity and enters into an access holder agreement on this basis, that it will typically be bound to construct the listed capacity. However, there may be occasions where it is inappropriate that ARTC be bound to construct this new capacity. For example, if there is a significant difference between the cost to ARTC of obtaining capital to construct the project and the regulated rate of return which ARTC is able to recover under the 2010 HVAU. In such a scenario, ARTC should not be obliged to construct the listed or new project at a loss.

The ACCC and a number of producers have requested that ARTC be more specific about the steps that it would take and its obligations in the event that a project is determined by ARTC to no longer be commercially viable under clause 4.3(b) of the Train Path Schedule.

In the 2010 IAHA, ARTC has amended clause 4.3(b) of the Train Path Schedule to provide that if a project is not commercially viable, then ARTC will be required to offer the access holder the opportunity to self fund the project (i.e. make a capital contribution). The test for “commercially viable” in clause 4.3(a)(iii) of the Train Path Schedule, has been amended to align with the commercially viable test as set out at section 6.2(a)(i) and section 6.3(b)(iii) of the 2010 HVAU. (See section 4.19 of this Explanatory Guide.)

If the access holder does decide to make a capital contribution, then the principles set out in the 2010 HVAU regarding the equitable treatment of capital contribution in relation to a ‘contributor’ access holder and other subsequent users of additional capacity funded by a capital contribution will apply (see clause 6.2(f) of the 2010 HVAU) (See Section 4.9 of this Explanatory Guide).

The access holder will, however, have a choice and will not be required to provide a capital contribution to fund the project. If the access holder does not want to self fund the project, then ARTC will enter into good faith negotiations with the access holder with the aim of securing alternative funding arrangements.

6 Transitional arrangements

The NSW RAU will apply in relation to the Hunter Valley coal network until such time as the 2010 HVAU is accepted by the ACCC and becomes effective. Due to a number of factors, this creates issues in relation to the scope and timing of the annual compliance assessment required under the two undertakings.

ARTC has considered these factors and has proposed arrangements for transitioning between the two undertakings in relation to the annual compliance requirements of each at Appendix 5.

ARTC Explanatory Guide 2010 HVAU

Appendix 1 - Explanation of changes made in the 2010 HVAU, 2010 IAHA and 2010 OSA

[Document to be provided separately]

ARTC Explanatory Guide 2010 HVAU

Appendix 2 - ARTC revised remaining mine life estimate

[Document to be provided separately]

ARTC Explanatory Guide 2010 HVAU

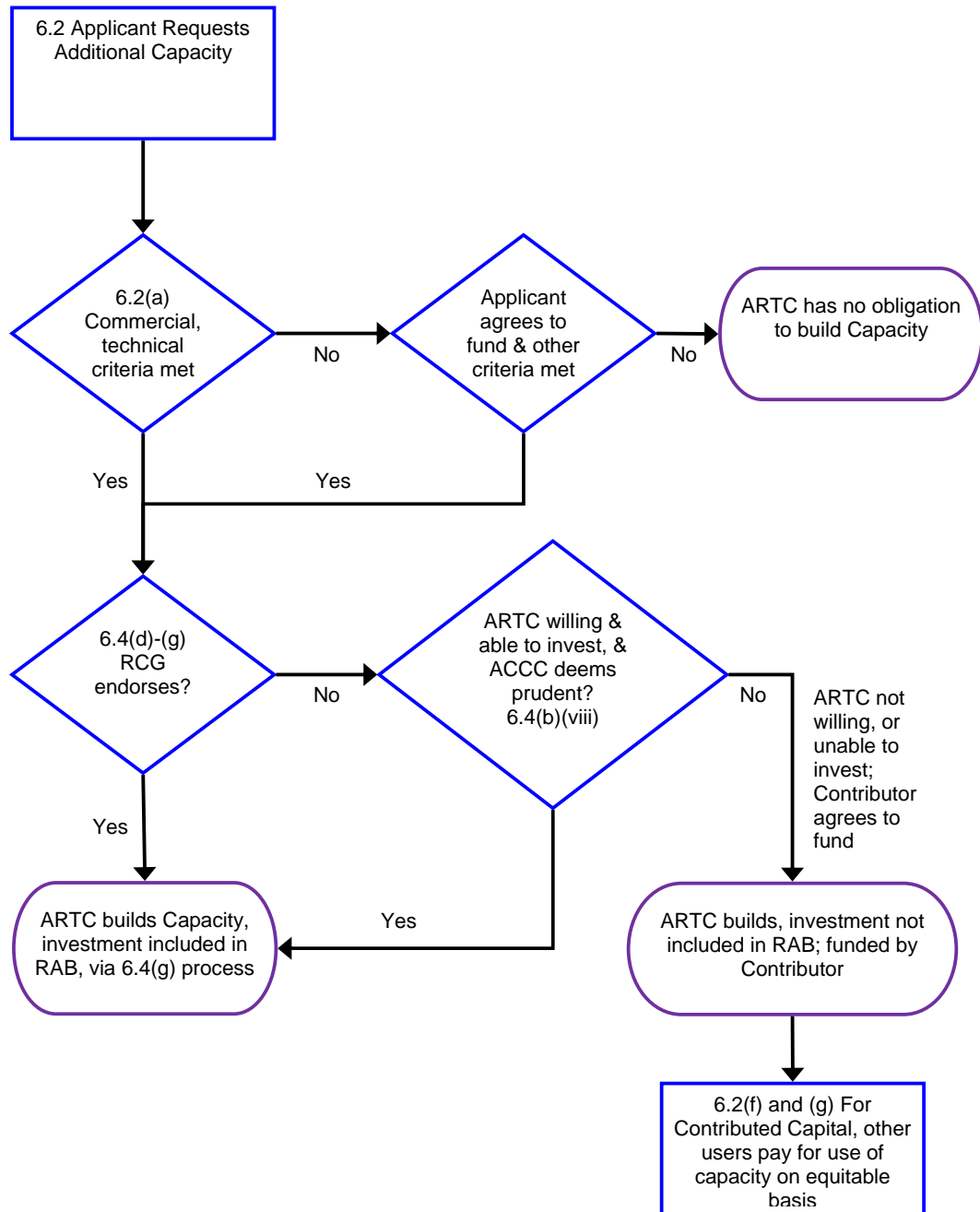
Appendix 3 - ARTC revised Rate Of Return proposal

[Document to be provided separately]

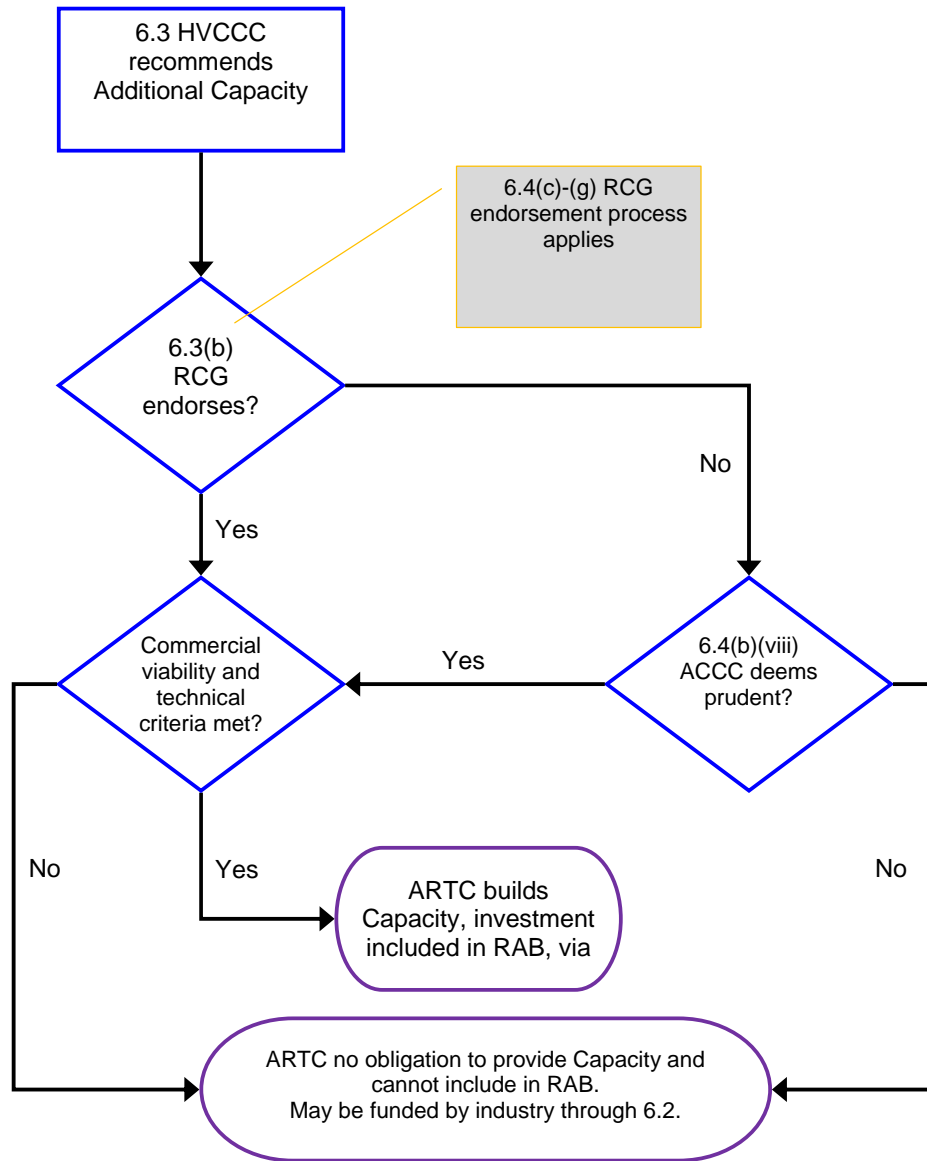
ARTC Explanatory Guide 2010 HVAU

Appendix 4 - Creation of additional capacity

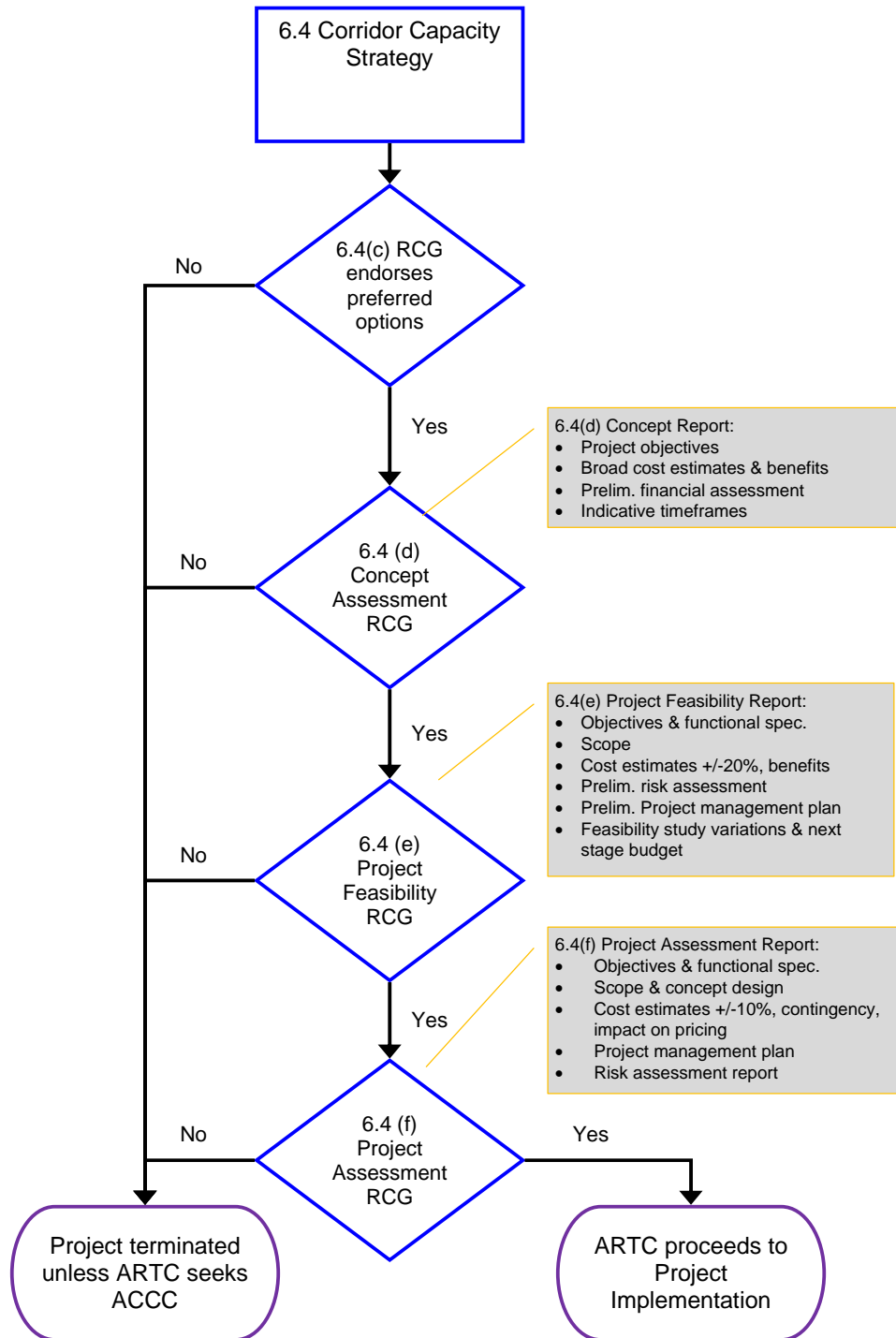
1 Investment Process - section 6.2, HVAU



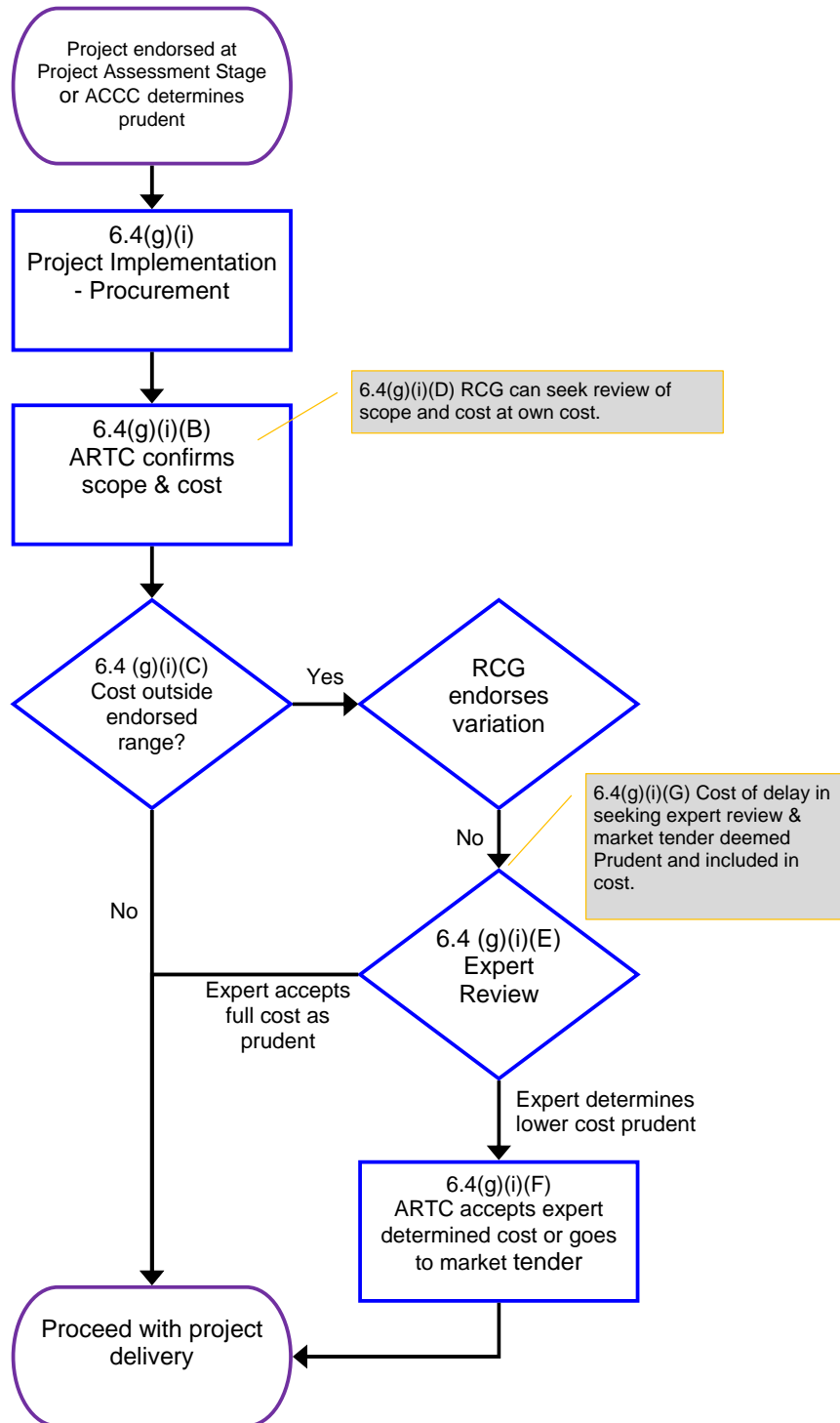
2 Investment Process - section 6.3, HVAU



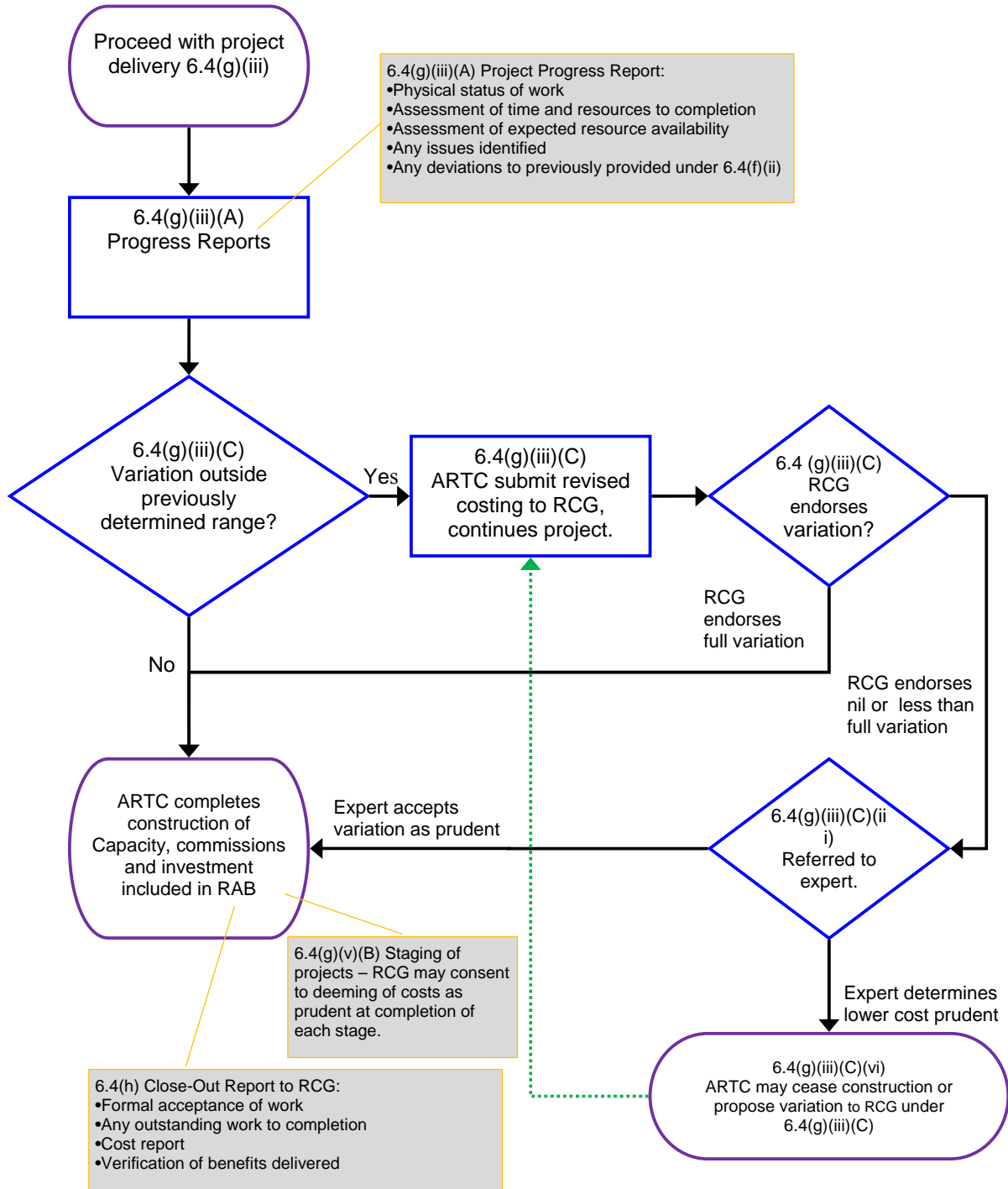
3 Investment Process - section 6.4, HVAU - Part 1



4 Investment Process - section 6.4, HVAU - Part 2



5 Investment Process - section 6.4, HVAU - Part 3



ARTC Explanatory Guide 2010 HVAU

Appendix 5 - Transition of regulatory arrangements

Proposal for transition of regulatory arrangements from NSW Rail Access Undertaking to the 2010 ARTC Hunter Valley Coal Network Access Undertaking

1 Overview

1.1 The NSW Rail Access Undertaking (NSWRAU)

The ARTC Hunter Valley Coal Network (Network) has been covered by the NSWRAU since September 2004. During this period, ARTC has been obliged to comply with the requirements of the NSWRAU, such compliance being annually reviewed by the Independent Pricing and Regulatory Tribunal of NSW (IPART).

A substantial element of that compliance is assessed by IPART each year in accordance with Schedule 3, clause 5 of the NSWRAU where ARTC is required to submit (by 31 October each year in relation to the previous financial year) to IPART documentation demonstrating its compliance with the Asset Valuation Roll Forward Principles (AVRFP)¹ and details demonstrating compliance with the ceiling test², including operation of the Unders and Overs Account³.

Under the NSWRAU, IPART determines ARTC's compliance in this regard. In determining compliance with the AVRFP, IPART is required to have regard to the submissions of users to the capital expenditure consultation process⁴ prescribed under the NSWRAU. In a practical sense, IPART also may have regard to submissions of stakeholders in relation to ARTC's compliance with the ceiling test and Unders & Overs Account as part of its normal consultation on the matter.

Greater prescription in relation to the specific information requirements in relation to the annual compliance assessment are contained in the IPART Guidelines⁵ approved in 2006.

1.2 The 2010 ARTC Hunter Valley Coal Network Access Undertaking (HVAU)

ARTC submitted its Hunter Valley Coal Network Access Undertaking to the Australian Competition and Consumer Commission (ACCC) for acceptance in April 2009. Following substantial formal and informal consultation with the ACCC and industry stakeholders since then, ARTC withdrew that undertaking in April 2010 for further consultation and expects to submit a revised HVAU in September 2010. Due to the substantial consultation that has already taken place, ARTC would expect the ACCC to undertake only limited further consultation, leading to acceptance of the HVAU at some time between August 2010 and December 2010.

This proposal in relation to transitional arrangements assumes ACCC acceptance of the HVAU at some time between August 2010 and December 2010.

The requirements of the annual compliance assessment to be conducted by the ACCC as proposed under the HVAU are not substantially different to that under the NSWRAU. However, irrespective of the actual timing of the ACCC acceptance of the HVAU, the

1 Provisions of Schedule 3, clause 3 of the NSWRAU by which the opening Regulatory Asset Base (RAB) in any year is adjusted to derive the closing RAB in that year.

2 Schedule 3, clause 1(b) of the NSWRAU.

3 Schedule 3, clause 4 of the NSWRAU.

4 Schedule 3, clause 3.4 of the NSWRAU.

5 NSWRAU, Annual Review of Compliance, IPART Guidelines, November 2006.

transitioning from compliance assessment under the NSWRAU and HVAU is complicated by several factors including:

- Annual compliance under the NSWRAU is based around a financial year whilst annual compliance under the HVAU is proposed to be based around a calendar year.
- Determination of an appropriate starting Regulatory Asst Base (RAB) for commencement of the HVAU.
- Arrangements under both the NSWRAU and HVAU provide for new assets to be commissioned in the middle of the 'compliance' year, for depreciation and return purposes, irrespective of the actual date of commissioning.
- Differences between the ARTC Hunter Valley network covered by the NSWRAU and HVAU.

Where it is assumed that acceptance of the HVAU will occur between August 2010 and December 2010, it is clear that the ARTC Hunter Valley network will be covered by the NSWRAU for the 2009/10 'compliance' year under that undertaking, and by the HVAU for the 2011 'compliance' year under that undertaking.

Part of the period between 1 July 2010 and 31 December 2010 will be covered by the NSWRAU, with the remainder covered by the HVAU. Strict adherence to the respective undertakings would require ARTC to submit relevant documentation to IPART by 31 October 2011 in relation to the period 1 July 2010 to HVAU date of effect, and to the ACCC by 30 April 2011 in relation to the period between the HVAU date of effect to 31 December 2010. Clearly, it will be difficult to achieve an effective and efficient outcome if these timings are strictly adhered to.

This proposal aims to:

- identify those elements of the annual compliance process that may require transitioning arrangements,
- identify the objectives of the transitioning arrangements that will ensure the interests of all parties involved are addressed efficiently
- put forward details of timing and responsibilities in relation to annual compliance during transition.

2 Aspects of annual compliance assessment creating issues that may require transitioning arrangements

2.1 Scope of access undertakings and annual compliance assessment (Network)

The NSWRAU and HVAU cover slightly different networks, for the purposes of annual compliance assessment. The differences largely lie around those parts of the Hunter Valley coal network that are currently unconstrained (see Table 1 below). As such, the impact on such outcomes of the RAB roll forward, the ceiling test and unders and overs and outcomes should be reduced.

Table 1

Part of the ARTC Hunter Valley coal network	Constrained/ Unconstrained	NSWRAU	HVAU
Dartbrook mine to Gap	Unconstrained	Not included in annual compliance assessment	RAB and RAB Floor Limit Roll Forward assessment only. Included in ceiling test if needed.
Telarah to Stratford	Unconstrained	Included in annual compliance assessment. Not part of constrained network.	Not covered. Covered by ARTC Interstate Access Undertaking (no annual compliance proposed)
Newcastle mains (Islington Junction to Maitland)	Unconstrained	Included in annual compliance assessment. Not part of constrained network.	Not covered. Covered by ARTC Interstate Access Undertaking (no annual compliance proposed)
Maitland to Telarah	Unconstrained	Included in annual compliance assessment. Not part of constrained network.	Not covered. Covered by ARTC Interstate Access Undertaking (no annual compliance proposed)
Telarah to Farley	Unconstrained	Included in annual compliance assessment. Not part of constrained network.	RAB and RAB Floor Limit Roll Forward assessment only. Included in ceiling test if needed.

The implications lie largely around RAB and RAB Floor Limit Roll Forward. Transitional arrangements in relation to these aspects of annual compliance are discussed at section 2.4 below.

2.2 Scope of annual compliance assessment (financial v calendar year)

The NSWRAU provides for ARTC to submit documentation by 31 October each year demonstrating compliance with the NSWRAU in relation to the previous financial year. The HVAU provides for ARTC to submit similar documentation by 30 April each year demonstrating compliance with the HVAU in relation to the previous calendar year. ARTC has proposed different arrangements in the HVAU in order to align more closely with the contracting year now adopted by the industry.

The adoption of an alternative 'compliance' year is largely an internal issue for ARTC. ARTC has historically based its financial budgeting and reporting around a financial year, but regular formal reporting and review is undertaken on at least a quarterly basis. As such, reporting on the basis of a calendar year for the Hunter Valley is expected to result primarily in rearrangement of reporting and changing budgeting and forecasting cycles.

The HVAU is expected to take effect at some time between August and December 2010. The HVAU takes effect 21 days after ACCC acceptance. Given this, annual compliance in relation to the NSWRAU and HVAU could have a cut-off/commencement date on any day between August and December 2010.

Clearly, from a data collection and reporting perspective, some form of alignment with ARTC's internal reporting would result in benefits for ARTC, the relevant regulator and the industry. This largely results from reduced resourcing, system development and cost of compliance. Further the extent of alignment will impact on compliance cost. Table 2 below shows options in relation to the extent of alignment in order of ARTC preference and owner compliance cost.

Table 2

Preference	Date of effect of HVAU	Final compliance period NSWRAU	Initial compliance period HVAU	Comments
1	Align to half year • 1 January 2011	1/7/10 – 31/12/10	1/1/11 – 31/12/11	Major formal ARTC reporting point Part year assessment under NSWRAU only Enables initial full year assessment under HVAU Fewer compliance assessments required May require some form of 'deeming' of effect date. Possible deviation from actual effect date up to 5 months.

Preference	Date of effect of HVAU	Final compliance period NSWRAU	Initial compliance period HVAU	Comments
2	Align to half year <ul style="list-style-type: none"> 1 July 2010 	1/7/09 – 30/6/10	1/7/10 – 31/12/10	Major formal ARTC reporting point Part year initial assessment under HVAU Enables full year final assessment under NSWRAU. Fewer compliance assessments required Will require some form of 'deeming' of effect date. Possible deviation from actual effect date up to 6 months.
3	Align to quarter <ul style="list-style-type: none"> 1 October 2010 	1/7/10 – 30/9/10	1/10/10 – 31/12/10	Minor formal ARTC reporting point Part year assessment under both undertakings May require some form of 'deeming' of effect date. Possible deviation from actual effect date up to 3 months.

Preference	Date of effect of HVAU	Final compliance period NSWRAU	Initial compliance period HVAU	Comments
4	Align to month <ul style="list-style-type: none"> • 1 August 2010 • 1 September 2010 • 1 November 2010 • 1 December 2010 	1/7/10 – 31/7/10 1/7/10 – 31/8/10 1/7/10 – 31/10/10 1/7/10 – 30/11/10	1/8/10 – 31/12/10 1/9/10 – 31/12/10 1/11/10 – 31/12/10 1/12/10 – 31/12/10	No formal ARTC reporting Part year assessment under both undertakings May require some form of 'deeming' of effect date. Possible deviation from actual effect date up to 2 weeks.
5	No alignment			No ARTC reporting Part year assessment under both undertakings No 'deeming' required

The achievement of specific outcomes in relation to compliance assessment can result from 'engineering' a desirable ACCC acceptance date, or deeming a date of effect for the purposes of compliance assessment by agreement with IPART and the ACCC. Some form of industry consultation may be required, but should reflect the impact that any deeming may have on financial outcomes, which should aim to be minimal in any event.

ARTC understands that there are other issues involved in relation to timing of ACCC acceptance or deeming, which should be considered in any decision.

2.3 Operating Expenditure

As operating expenditure is incurred and captured on an ongoing basis the time of transition should not be problematic. However, aligning the timing of transition to the timing of ARTC's internal financial and operational reporting will result in benefits to ARTC and the industry, by way of reduced compliance cost. To this end alignment at least to monthly financial and operational reporting would be beneficial, with alignment to a quarter or half year more beneficial.

2.4 Capital Expenditure and Regulatory Asset Base (RAB)

A key requirement in transitioning from the NSWRAU to the HVAU is establishing the final RAB in relation to the NSWRAU (or starting RAB for the HVAU) (Transition RAB). This is complicated by the nature of the annual RAB roll forward mechanisms under each undertaking. The mechanisms are rightly designed to be undertaken on an annual basis to align to annual compliance obligations under each undertaking. Characteristics inherent in the RAB roll forward design that may be problematic in transitioning include:

- annual roll-forward design contemplates a full year roll-forward
- annual roll-forward over different time periods (financial year – NSWRAU, calendar year – HVAU);
- deeming of the time of commissioning (and inclusion of CAPEX in the RAB) to the middle of the relevant time period; and
- the additional RAB roll forward under the HVAU required as part of loss capitalisation.

Issues to be addressed in undertaking respective RAB roll forwards during transition include:

- NSWRAU RAB roll forward and HVAU RAB Floor Limit roll forward carried out over a part year only. Pertinent elements of the roll-forward that need to be dealt with here are CPI, Capital Expenditure and Depreciation.
 - **CPI** - CPI is determined by the Australian Bureau of Statistics on a quarterly basis. However under the NSWRAU, the relevant CPI to be used is determined by comparing the average CPI for the four quarters in the year preceding the relevant year to the average CPI for the four quarters in the year two years preceding the relevant year. Under the HVAU, CPI is taken as the published figure for the September quarter for the relevant year. Under the NSWRAU, a part year roll forward could be based on a pro-rate of the full year escalation using the averages for each relevant preceding year. This approach would arguably align the currency of the Transition RAB to the date of transition.

Assuming transition on 1 October 2010, the Transition RAB value would have currency of September Quarter 2010. The initial compliance period under HVAU would be 1 October 2010 to 31 December 2010. With CPI escalation based on the September Quarter 2010 CPI under the HVAU, further escalation in the initial HVAU compliance period would not be necessary.

Assuming transition on 1 January 2011, the Transition RAB value would have currency of December Quarter 2010. The initial compliance period under HVAU would be 1 January 2011 to 31 December 2011. With CPI escalation based on the September Quarter 2011 CPI under the HVAU, escalation in the initial HVAU compliance period would be necessary but would need to reflect CPI escalation between December Quarter 2010 and September Quarter 2011. This should bring the RAB value to September Quarter 2011 currency.

Clearly transition aligned to a quarter or half year would simplify the CPI component of RAB roll forward.

- **Capital Expenditure** – Under both the NSWRAU and HVAU, capital expenditure is added to the RAB in the year of commissioning. Irrespective of

the date of transition and the resulting compliance periods it would seem reasonable to include all capital expenditure associated with projects commissioned in the compliance period in the RAB roll forward for that compliance period.

- **Depreciation** – Under the NSWRAU and the HVAU, depreciation included in the annual RAB roll forward is calculated on the basis of the current carrying RAB value of assets at the start of the compliance period and the life of the assets (average remaining mine life) as at the compliance year. In relation to assets commissioned in years prior to the compliance year 100% of depreciation is included in the annual RAB roll forward, and in the case of assets commissioned in the compliance year 50% of depreciation is included in the annual RAB roll forward. That is, assets are deemed to have been commissioned at the mid point of the compliance year.

In relation to a part year assessment, it would seem reasonable to include depreciation of prior year commissioned assets calculated as above and prorated over the part year.

Treatment of ‘deeming’

In relation to assets commissioned in the part year compliance period, some difficulties arise due to the deeming of the time of commissioning under both the NSWRAU and HVAU. Where the date of transition lies between August 2010 and December 2010, assets commissioned prior to the transition date under the NSWRAU are deemed to have been commissioned after the compliance period (1 January 2011 v 1 July 2010 to transition date) for the purpose of determining Transition RAB. Assets commissioned in the compliance period after the transition date (transition date to 31 December 2010) are deemed to have been commissioned prior to the compliance period and, indeed, the transition date (1 July 2010).

In this case, deeming would suggest that no depreciation should be included in the pre transition RAB roll forward for assets commissioned in that compliance period, whilst 100% of depreciation should be included in the post transition RAB roll forward with respect to assets commissioned in that compliance period.

Where the transition date was 1 January 2011, there would be no part year post transition compliance period and all assets commissioned prior to the transition date would be included in the Transition RAB at cost. Assets commissioned after the transition date would be deemed to be commissioned on 1 July 2011 in the initial post transition compliance assessment.

The asset life used for the pre transition RAB roll forward under the NSWRAU would be the approved life as at 1 July 2010 under the NSWRAU. The asset life used for the post transition RAB roll forward under the HVAU would be the approved life as at the date of transition as proposed by ARTC.

An alternative approach

Deeming of the date of commissioning of projects for the purpose of determining depreciation is largely incorporated in the two regimes to simplify calculations, compared to calculating depreciation from the actual date of commissioning of a project. The approach is also consistent with using a single estimate of economic life for the year. The trade-off for this is that deeming results in a less accurate determination of depreciation than calculating

depreciation from the actual date of commissioning of a project and using an economic life from the date of commissioning.

As all of the complicating aspects associated with determining depreciation for part year periods arise from the deeming of the commissioning date, it would seem that depreciation could be more robustly determined by just calculating depreciation in relation to each project based on the actual date of commissioning of the project and using an estimate of economic life from the actual date of commissioning of the project.

Ignoring the deeming aspects in the determination of depreciation would only apply in the immediate pre and post transition part year compliance assessments. Similarly, for these assessments, any deeming in relation to the treatment of financing costs would also be ignored for consistency. Where applicable, financing costs would be taken to the date of commissioning.

2.5 Depreciation and Return

Depreciation to be included in the regulatory cost base in each of the immediate pre and post transition compliance assessments is that which is included in each RAB roll-forward as described above.

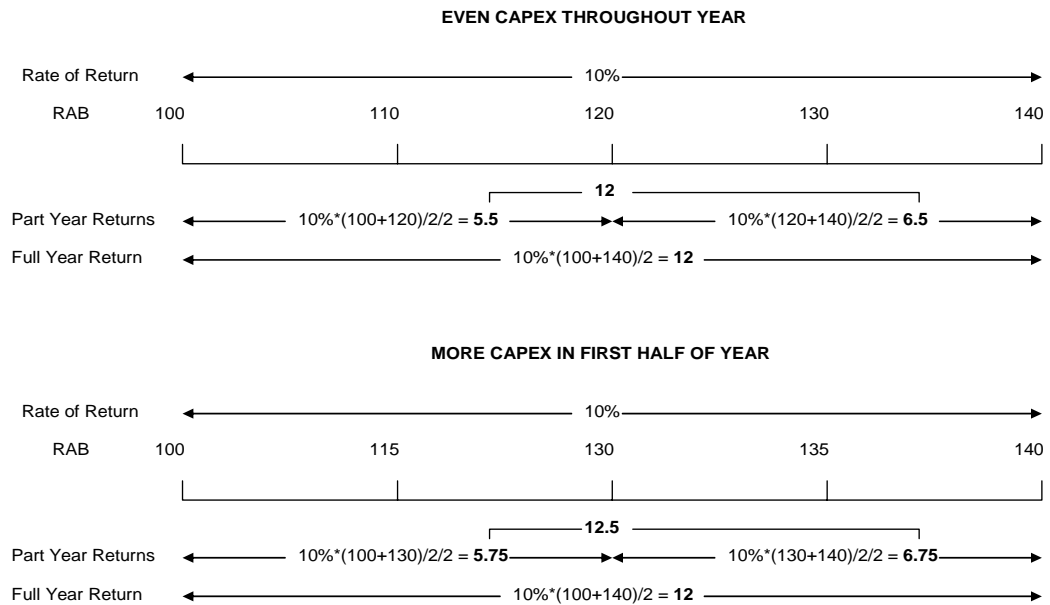
RAB Averaging

Return to be included in the regulatory cost base is based on the average value of the starting and ending RABs for the compliance year under both the NSWRAU and HVAU, where the difference between starting and ending RABs is an outcome of the annual RAB roll forward.

This approach, whilst not unreasonable, is underpinned by an assumption that CAPEX is incurred (i.e. projects are commissioned) evenly throughout the compliance year.

Where compliance assessments are undertaken on a part year basis, averaging the RAB assumes as above assumes that CAPEX is incurred evenly through the part year period. If two part year assessments replaced a full year assessment, averaging the RAB over each part year has the effect of aligning the return more closely with the pattern of CAPEX with the full year as Figure 1 below demonstrates.

Figure 1



Where more projects and CAPEX is commissioned in the first half of the year (as shown in Figure 1), a higher return than that based on an ‘even CAPEX spread assumption would seem to be reasonable and more reflective of cost incurred.

Similarly, where more projects and CAPEX is commissioned in the second half of the year (as shown in Figure 1), a lower return than that based on an ‘even CAPEX spread assumption would also seem to be reasonable and more reflective of cost incurred.

Financing costs would need to be treated on a consistent basis.

The application of different rates of return in to each part year compliance assessment would not seem unreasonable and would be reflective of actual cost of capital.

An alternative approach

Averaging of starting and closing RABs for the purpose of determining return is largely incorporated in the two regimes to simplify calculations, compared to calculating return from the actual date of commissioning of a project. The trade-off for this is that averaging results in a less accurate determination of return than calculating return from the actual date of commissioning of a project.

As all of the complicating aspects associated with determining return for part year periods arise from the averaging of starting and closing RABs, it would seem that return could be more robustly determined by just calculating return in relation to each project based on the actual date of commissioning of the project.

Ignoring the RAB averaging aspects in the determination of depreciation would only apply in the immediate pre and post transition part year compliance assessments.

Similarly, for these assessments, financing costs would be taken to the date of commissioning for consistency.

3 Transitioning objectives

Table 3 below prescribes ARTC’s consideration of the objectives of any transition arrangements to apply in relation to annual compliance assessment under the NSWRAU and HVAU, and which stakeholders have a vested interest in the achievement of each objective.

Table 3

Objective	ARTC	Regulator	Industry
<p>ARTC is financially no better off as a result of transitioning.</p> <ul style="list-style-type: none"> • proposed approach to transitioning does not overstate regulatory cost base • outcome must be as consistent as possible with applicable approved regulatory approach 			
<p>ARTC is no worse off as a result of transitioning.</p> <ul style="list-style-type: none"> • proposed approach to transitioning does not understate regulatory cost base • outcome must be as consistent as possible with applicable approved regulatory approach 			
<p>The total cost to ARTC of undertaking compliance assessments during transition is minimised.</p> <ul style="list-style-type: none"> • Minimal ‘one-off’ systems development or adaption • Consistent with existing reporting framework • Minimal HV business impact 			

Objective	ARTC	Regulator	Industry
<ul style="list-style-type: none"> Minimal administrative resources impact 			
<p>The cost to the regulator of carrying out compliance assessment during transition is minimised.</p> <ul style="list-style-type: none"> Minimal review cost (simple and transparent disclosure to regulator) Minimal consultation cost (simple and transparent disclosure to industry, industry support to minimise issues) 			
<p>The cost to the industry of participating in compliance assessments during transition is minimised.</p> <ul style="list-style-type: none"> Minimal consultation cost (simple and transparent disclosure to industry, industry support to minimise issues) 			

4 Proposal for transitioning

In developing the transition proposal below, ARTC has had regard for each of the above transitioning objectives. Any proposal will inherently result in some trade-offs between the objectives and some movement away from the provisions of access undertakings, but ARTC has sought to minimise such occurrences and has sought to achieve a practical and pragmatic outcome which it believes achieves a reasonable balance of the interests of ARTC, the relevant regulator and the industry.

PROPOSAL	PROPOSAL DETAIL
<p>PRE-TRANSITION COMPLIANCE ASSESSMENT</p> <p>Irrespective of the HVAU Commencement Date and date of effect, the following pre-transition compliance assessment will apply.</p> <ol style="list-style-type: none"> Compliance will be assessed over the 1 Jul 2010 to 31 December 2010 period (compliance period). 	<p>CEILING TEST</p> <ol style="list-style-type: none"> Revenue included will be that determined by the application of relevant access charges to volumes transported in the compliance period. Operating expenditure will be that incurred by ARTC during the compliance period. Where applicable, operating expenditure allocated to the cost base will be allocated on the basis of the relevant resource measure determined for the compliance

PROPOSAL	PROPOSAL DETAIL
<p>2. The assessment will be undertaken by IPART and compliance will be assessed in accordance with the NSWRAU, subject to some exceptions as described.</p> <p>3. ARTC will submit to IPART by 30 April 2011, in respect of the compliance period, documentation in accordance with Schedule 3 Clause 5 of the NSWRAU.</p>	<p>period.</p> <p>3. Depreciation will be determined as follows:</p> <p>a. With respect to assets included in the approved RAB as at 1 July 2010, depreciation will be 50% of the amount calculated by application of the approved remaining mine life estimate to the RAB for 2010-11 under the NSWRAU as at August 2010.</p> <p>b. With respect to assets commissioned during the compliance period, depreciation will be calculated on the basis of:</p> <p>i. the actual date of commissioning and over the period between the actual date of commissioning and the end of the compliance period (31 December 2010)</p> <p>ii. the capital expenditure approved to be included in the RAB</p> <p>iii. with respect to assets commissioned prior to the HVAU date of effect, the approved remaining mine life estimate reduced to reflect the period between 1 July 2010 and the HVAU date of effect applied to the RAB for 2010-11 under the NSWRAU as at August 2010 and, with respect to the assets commissioned after the HVAU date of effect, the approved remaining mine life estimate for 2010⁶ under the HVAU reduced to reflect the period between 1 July 2010 and the HVAU date of effect.</p> <p><i>[This represents a deviation from the approach</i></p>

6 The mine life approved by the ACCC for 2010 represents a point in time 1 July 2010.

PROPOSAL	PROPOSAL DETAIL
	<p><i>to determining depreciation provided under the NSWRAU. ARTC does not consider this deviation unreasonable as an approach to be applied for transition only, and the proposed approach will result in a more accurate determination of depreciation that the approach provided under the NSWRAU.]</i></p> <p>4. Return will be determined as follows:</p> <ul style="list-style-type: none"> a. With respect to assets included in the approved RAB as at 1 July 2010, return will be 50% of the amount calculated by application of the approved rate of return under the NSWRAU as at August 2010 to the average of the RAB as at 1 July 2010 and the RAB (with respect to those assets) as at 31 December 2010 determined in accordance with the RAB roll forward as prescribed below. b. With respect to assets commissioned during the compliance period, return will be calculated on the basis of: <ul style="list-style-type: none"> i. the actual date of commissioning and over the period between the actual date of commissioning and the end of the compliance period (31 December 2010) ii. the capital expenditure approved to be included in the RAB iii. with respect to assets commissioned prior to the HVAU date of effect, the approved rate of return under the NSWRAU as at August 2010 and, with respect to the assets commissioned after the HVAU date of effect, the approved Rate of Return under the HVAU. <p><i>[This represents a deviation from the approach to determining return provided under the NSWRAU. ARTC does not consider this deviation unreasonable as an approach to be</i></p>

PROPOSAL	PROPOSAL DETAIL
	<p><i>applied for transition only, the proposed approach will result in a more accurate determination of return that the approach provided under the NSWRAU.]</i></p> <p>RAB ROLL-FORWARD</p> <ol style="list-style-type: none"> 1. Starting RAB will be the RAB as at 1 July 2010 approved by IPART as part of the 2009-10 annual compliance assessment. 2. CPI incorporated in the RAB roll-forward for the compliance period will be based on 50% of the percentage change in the CPI from 2008-09 to 2009-10, calculated by using the average of the ABS Sydney All Groups CPI for the four quarters to June 2010 when compared to the average for the four quarters to June 2009, consistent with the NSWRAU. 3. CAPEX approved by IPART in relation to all assets commissioned in the compliance period will be incorporated in the RAB roll-forward. Any relevant financing costs approved by IPART to be capitalised into the RAB will be based on financing costs up to the date of commissioning. <i>[This is consistent with the approach proposed to determine depreciation and return during the compliance period.]</i> 4. Depreciation as determined above (3.) will be incorporated in the RAB roll forward. 5. Disposals approved by IPART in relation to all assets disposed of in the compliance period will be incorporated in the RAB roll-forward as determined by the written down value attributed to the assets in the RAB as at 1 July 2010. 6. Additions will be incorporated in the RAB roll-forward, valued at depreciated optimised replacement cost. 7. The closing RAB value will become the starting RAB for the purposes of the HVAU.

PROPOSAL	PROPOSAL DETAIL
	<p>8. Other than the elements of the asset valuation roll forward principles proposed to vary for the pre-transition compliance assessment above, the asset valuation roll forward principles prescribed in the NSWRAU (including approved remaining mine life) as at August 2010 would apply.</p> <p>UNDERS AND OVERS ACCOUNT</p> <ol style="list-style-type: none"> 1. ARTC will determine the total unders and overs amount by application of the proposed Ceiling Test. 2. ARTC will determine allocations of the total unders and overs amount to each relevant Access Seeker using an approach consistent with that prescribed in approved unders and overs policy under the NSWRAU, but applied to the compliance period only. 3. ARTC will attempt to return the account balance for each Access Seeker to zero with respect to the compliance period. The approved unders and overs balance as at 31 December 2010 will apply at the start of the post-transition compliance assessment.
<p>POST-TRANSITION COMPLIANCE ASSESSMENT</p> <p>Irrespective of the HVAU Commencement Date and date of effect, the following pre-transition compliance assessment will apply.</p> <ol style="list-style-type: none"> 1. Compliance will be assessed over the 1 January 2011 to 31 December 2011 period (compliance period). 2. The assessment will be undertaken by the ACCC and compliance will be assessed in accordance with the HVAU. 3. ARTC will submit to the ACCC 	<ol style="list-style-type: none"> 1. The ceiling test, RAB and RAB Floor Limit roll-forward and the operation of the unders and overs account will be carried out in accordance with section 4 Pricing Principles of the HVAU. 2. The initial value of the RAB and RAB Floor Limit in relation to those segments that have been ascribed a regulatory asset value in accordance with the NSWRAU in force as at the time immediately preceding the commencement date of the HVAU will be the closing value of the RAB approved by IPART as a result of the pre-transition compliance assessment. 3. The initial value of the RAB and RAB Floor Limit in relation to other segments will be the value as at 1 January 2011, as approved by the ACCC, on the basis of a roll-forward of the applicable asset values proposed by

PROPOSAL	PROPOSAL DETAIL
<p>by 30 April 2012 documentation in accordance with section 4.9 of the HVAU.</p> <p>4. ARTC will submit documentation detailing the initial value of the RAB and RAB Floor Limit in relation to other segments (not ascribed a regulatory asset value in accordance with the NSWRAU in force as at the time immediately preceding the commencement date of the HVAU).</p>	<p>ARTC in its HVAU application in April 2009 (to apply as at 1 Jul 2008) in accordance with the roll-forward methodology prescribed at section 4.3(b) of the HVAU (which is largely the same as the corresponding methodology prescribed under the NSWRAU as at August 2010) subject to where, in the case of roll forward from 1 July 2008 to 31 December 2008, the following specific application will apply</p> <ul style="list-style-type: none"> i. Starting RAB will be the RAB as at 1 July 2008 proposed by ARTC, and as approved by the ACCC ii. CPI incorporated in the RAB roll-forward for this period will be based on 50% of the percentage change in the CPI from June 2008 to December 2008, calculated by using the average of the ABS Sydney All Groups CPI iii. CAPEX approved by the ACCC in relation to all assets commissioned in this period will be incorporated in the RAB roll-forward. Any relevant financing costs are excluded iv. Depreciation as determined on a basis consistent with the approach proposed by ARTC in the 1 July 2008 valuation and considered reasonable the ACCC. v. Disposals approved by the ACCC in relation to all assets disposed of in this period will be incorporated in the RAB roll-forward as determined by the written down value attributed of disposed assets in the proposed RAB as at 1 July 2008. vi. The closing RAB value will become the starting RAB for the purposes of the 1 January 2009 to 31 December 2009 roll-forward

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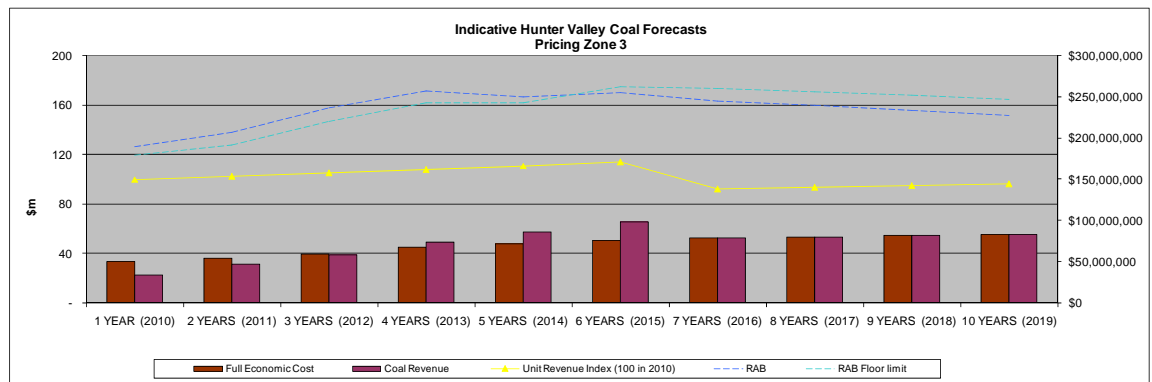
Appendix 6 - Pricing Zone 3 Price Cap proposal

Establishing a Price Zone 3 Price Cap for Indicative Services in the Hunter Valley

ARTC has utilised a 10 year forecast model (Hunter Valley Forecasts 2011-2019) to determine a reasonable price cap for Pricing Zone 3 as sought by the ACCC.

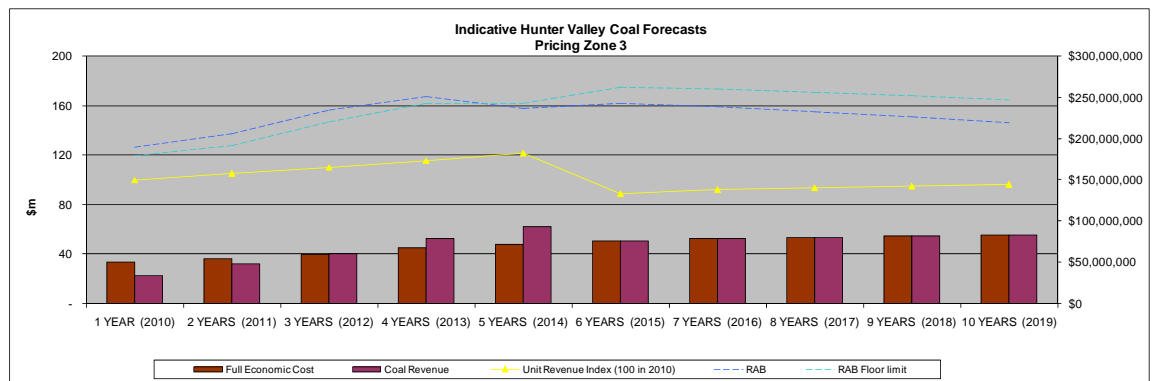
The model has been updated using the latest producer volume forecasts, ARTC's revised project values and timing, updated cost forecasts and proposed mine life and rate of return parameters. Based on this modelling and assuming price increases each year based on CPI forecasts, as shown in Chart 1 below, ARTC would reach a break-even point in Pricing Zone 3 in 2013 and a recovery of previous capitalised losses 2 years later in 2015.

Chart 1



A 5% price cap in Pricing Zone 3 (based on current assumptions) would bring forward the break-even point by one year to 2012 and recovery of capitalised losses in 2014 if applied in each year as shown in Chart 2 below.

Chart 2



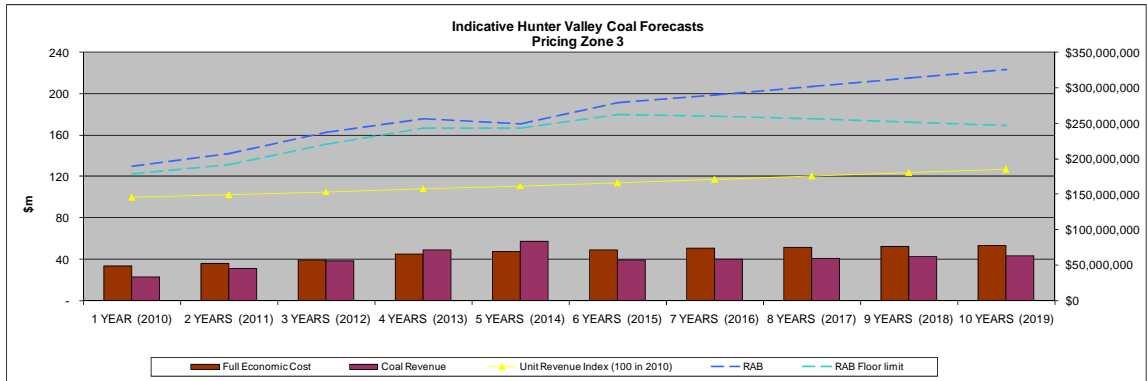
The model has been used to examine the effect on volumes and access pricing in Pricing Zone 3 following a significant loss in Pricing Zone 3 volume such as would be experienced as a result of the closure of a mine in this region.

In this analysis the Model was used to determine the effect of a 40% loss of volume in Pricing Zone 3 after 5 years (ie in 2015). ARTC considers that a 40% loss of volume would be

reasonably representative of the closure of one of the larger mines in Pricing Zone 3. ARTC has assumed, for this analysis, that this might represent a worst case scenario. It is possible, given the current and expected coal volumes using Pricing Zone 3 that the closure of more than one mine (e.g. such as where a producer becomes insolvent) could result in loss of more than 40%.

Chart 3 below demonstrates the effect of this change in Pricing Zone 3 based on CPI increases in access pricing over the term of the HVAU.

Chart 3

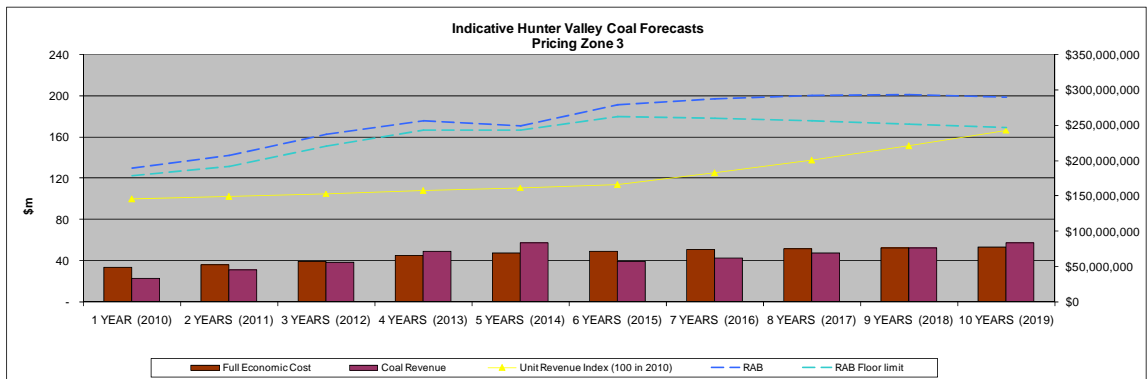


A loss of 40% of the volume in Pricing Zone 3 after 5 years with price increases limited to CPI results in ARTC:

- (a) Losing revenue such that the building blocks ceiling is no longer recovered, and not recovered in the foreseeable future after 2015, and
- (b) Suffering a deterioration against long term cost recovery (loss capitalisation) such that prior capitalised losses are no longer recoverable.

Implementing a 10% per annum price increase in Pricing Zone 3 from 2016 onwards in response to the volume loss would provide for a slow recovery towards the building blocks ceiling but would still cause ARTC to suffer a serious deterioration against long term recovery of capitalised losses (see Chart 4 below).

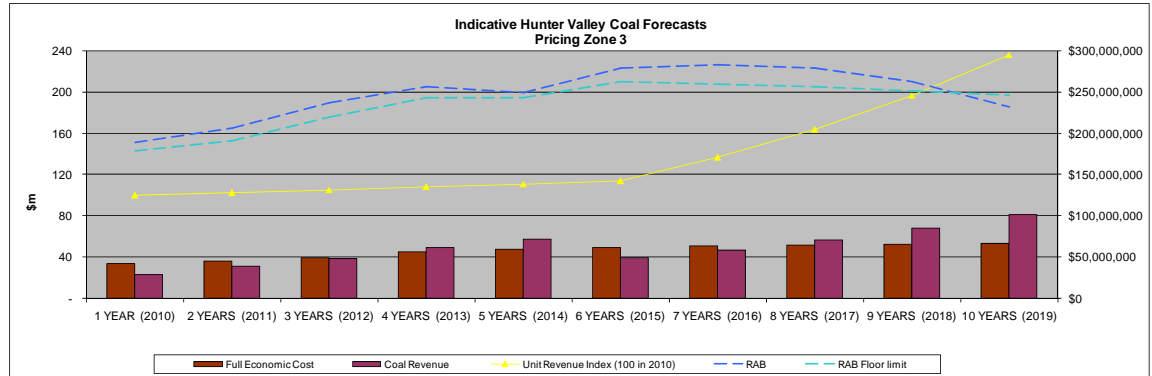
Chart 4



Increasing annual price increases to 20% per annum from 2016 onwards will allow ARTC to recover to the building blocks ceiling by 2017 and would allow ARTC to just recover capitalised losses within the 10 year time period (see Chart 5 below). This represents a worse

long term outcome than would result using CPI escalation with no volume loss (see the base case Chart 1).

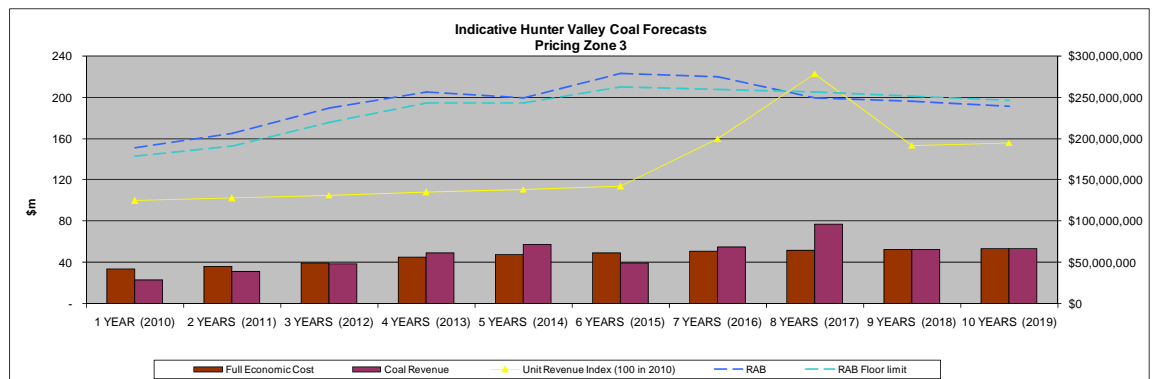
Chart 5



Increasing annual price increases to 40% per annum from 2016 onwards will allow ARTC to recover to the building blocks ceiling by 2016 and capitalised losses by 2017 (see Chart 6 below).

This results in ARTC carrying losses for an additional 2 years when compared with the situation where there is no volume decrease and pricing increases at CPI only (as in Chart 1).

Chart 6



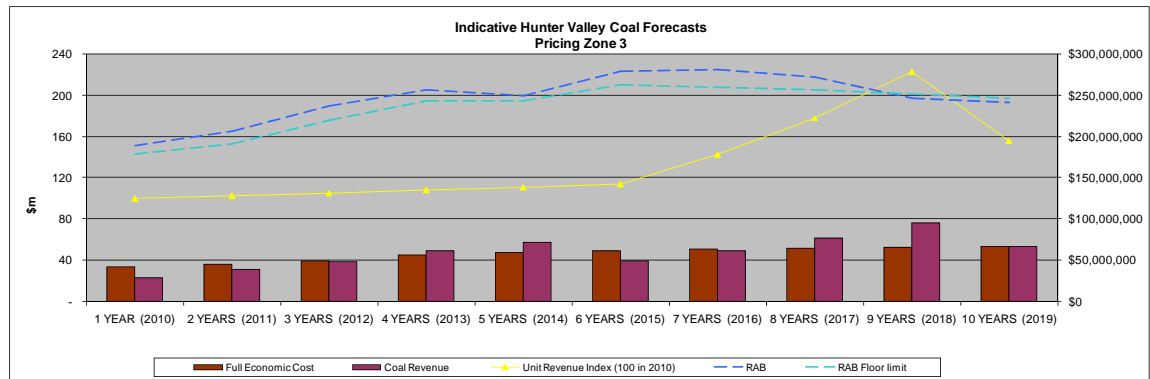
Whilst 40% annual price increases provide some protection of ARTC’s position against the loss of a major mine, ARTC recognises that 40% does not deliver any significant price certainty for producers. Under a 40% price cap, pricing could double in two years before becoming constrained again. Most Pricing Zone 3 mines will be paying higher access charges on a \$ per tonne basis than are paid by Pricing Zone 1 and 2 mines. Given that this scenario assumes that a major closure has occurred (eg due to depressed coal prices), further significant increases at the level of 40% pa compounding could impact on the continued viability of other mines sufficient to lead to the closure of additional mines.

A 20% price cap (see Chart 5) offers more price certainty (pricing could double over a five year period) but will not be sufficient to enable ARTC to recover losses within a reasonable time frame, where there would be a delay in recovering capitalised losses of 5 years over the situation where there is no volume decrease and pricing increases at CPI only (as in Chart 1).

ARTC's proposal therefore is a 25% price cap which would see ARTC sharing some of the market risk with industry. ARTC would carry a delay in recovery of capitalised losses for an additional 3 years when compared with the situation where there is no volume decrease and pricing increases at CPI only (as in Chart 1). The delay would be worse in the event of a volume loss greater than 40%. See Chart 7 below.

In this situation, application of an annual 25% price increase could see pricing nearly double over a three year period. That is, the cost of access would increase from around 1% of the coal pricing to 2%. Such a price increase also presumes that no additional volume would fully or partly replace the volume lost due to the significant mine closure.

Chart 7



In summary, under a 25% price cap, a scenario contemplating 40% business loss could see the cost of access up to 120% higher than present cost over the 10 years. Given the relativity of the cost of access to coal pricing, ARTC considers a 25% cap represents a reasonable balance of interests between ARTC and Pricing Zone 3 producers where the risks to ARTC associated with a delay in long term full economic cost recovery is not intolerable as is any price uncertainty for Zone 3 producers.

It should be noted that closure of the largest Pricing Zone 3 producer operations would result in volume loss in excess of 50%. As such, this proposal contemplates a conservative price cap with ARTC still exposed to further market risk.

The fact that current access pricing in Pricing Zone 3 fails to recover economic cost is evidence that coal pricing is constrained by present market conditions. Given this, there is no certainty that increasing pricing by 25% per annum for an extended period will increase access revenue, where such actions may cause remaining mines to close.

That is, placing a 25% cap on annual price variation does not necessarily place ARTC in a position where it can increase pricing at this level in an unfettered matter (even in its own interests).

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Appendix 7 - Revised Interim Indicative Access Charges

[Document to be provided separately]