

Hunter Valley Coal Network 2015 Operating Expenditure Review

Submission To

Australian Competition and Consumer Commission

September 2018

The ARTC logo is displayed in a large, white, sans-serif font. The letters 'A', 'R', and 'C' have horizontal bars above and below them, respectively, while the 'T' has a bar above it. The logo is centered in the upper half of the page, overlaid on a dark background.

ARTC

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INTRODUCTION

The Australian Rail Track Corporation (ARTC) appreciates the opportunity to make a submission to the Australian Competition and Consumer Commission (ACCC) to assist in its review of ARTC's operating and maintenance expenditure for the 2015 calendar year (2015 Opex Review). The 2015 Opex Review forms part of the ACCC's assessment of ARTC's compliance with the financial model in the Hunter Valley Access Undertaking (HVAU) for 2015.

The outcomes of the 2015 Operating Expenditure Review (Opex Review) are critically important to both ARTC and its Customers, with the potential for it to have service delivery and financial implications going forward. With this in mind, ARTC has been purposeful in providing the ACCC with information on the Network, Customer and Supply Chain context for the Hunter Valley in parallel with responding to the ACCC's extensive information request. This is to ensure that the ACCC and its German consultants WIK Consult (WIK) and TUV Rheinland (TUV) have a clear understanding of the operating environment and Customer needs as they undertake the 2015 Opex Review.

ARTC has committed a significant amount of time and resources to support the Opex Review to date, which has included:

- ARTC responding in detail to the ACCC's information request and subsequent questions; and
- ARTC hosting a three-day workshop in Newcastle on 2-4 July 2018 with representatives from the ACCC, WIK and TUV in attendance. The workshops entailed presentations on the Network, Customer and Supply Chain context, a tour of ARTC's train control centre in Broadmeadow and site visits to Network locations in the lower Hunter Valley.

For transparency, ARTC also provided the opportunity for its Hunter Valley Customers to be taken through the contextual presentations in August 2018.

In support of this submission, ARTC attaches two reports as follows:

- An independent report by Gattorna Alignment that provides an overview of the context for ARTC's role in the Hunter Valley Coal Chain at **Appendix A**. Gattorna Alignment are an internationally renowned supply chain expert; and
- A report by Deloitte that provides independent analysis of the efficiency of ARTC's operating and maintenance expenditure for 2015 at **Appendix B**.

In addition to the contextual presentations provided to the ACCC during the workshops, these reports summarise key aspects of:

- The fundamentals of the Hunter Valley Coal Chain, ARTC's critical role, the Customer value from supply chain coordination and in particular maintenance and capacity alignment;
- The Hunter Valley Network, its operational and historical characteristics, safety and lease requirements, as well as the individual features that are unique to each Pricing Zone;
- The complexity of the rail traffic in the Hunter Valley, with the predominance of heavy haul coal combined with the need to provide access for passenger services and a range of other bulk and intermodal services;
- ARTC's transformation and growth project which resulted in a corporate and organisational restructure with the establishment of two separate business units, Hunter Valley and Interstate, with a focus on service delivery to Customers;
- The global seaborne thermal coal market environment, Customer base and a sustained or growing volume profile that is shifting to the extremities of the Network; and
- The predominance of outsourcing of major periodic maintenance and the relationship in this delivery mode to delivered capacity.

The above details are not repeated in this submission.

It is important to note that ARTC has provided this submission in the absence of a transparent economic assessment methodology. The ACCC has agreed in-principle to discuss the methodology with ARTC prior to a draft determination and as such, ARTC may submit a supplementary submission once the ACCC provides this information on their methodology. ARTC's key concern with any benchmarking data is that it needs to be in the context of the network specific issues and characteristics, and not be undertaken in isolation from the broader operational and planning context.

HUNTER VALLEY NETWORK AND COST DRIVERS

The Hunter Valley Network is the arterial in the Hunter Valley between Coal Producer's mines, the Coal Terminals at the Port of Newcastle and other discharge points. ARTC's approach to maintaining and operating the Hunter Valley Network is shaped by the need to uphold the safety and reliability of the Network, meet Customer capacity and availability needs and deliver value for money and efficiency.

The Hunter Valley Network was not purpose built for the traffic intensity and tonne axle loads that traverse the tracks and instead there has been a series of network upgrades to enable today's operation. This is particularly evident in Pricing Zone 3. Each of the Pricing Zones have distinct infrastructure configurations, geotechnical conditions and volume profiles that drive the costs within each zone. Mixed use of the Network means that ARTC cannot fully optimise its maintenance regime for heavy haul traffic. This multi-use dimension creates complexity and distinguishes the Hunter Valley Network from other Network comparators.

The need for alignment across the Coal Chain is a key driver for ARTC's possession strategy that shapes the patterns of maintenance of the Hunter Valley Network. To deliver contracted capacity and minimise disruption requires ARTC to conduct its maintenance in condensed and planned time windows. With only so much time available in the delivery of committed capacity to its Customers, resources (people, materials and equipment) must be secured to maximise the work that is carried out in these windows. ARTC has been transparent in its information sessions for this Opex Review that, in some circumstances, this solution may not be the cheapest delivery method if reviewed in isolation. However, it provides overall value to Customers through availability of capacity across the Coal Chain. This is particularly important for the single line section of track in Pricing Zones 2 and 3 where demand is approaching the threshold of capacity.

2015 was not a typical year and cannot be easily compared against 2014 and prior years. ARTC was nearing the end of an extended period of infrastructure investment to enhance capacity to support the coal industry and had commenced a major transformation program to place Customers at the forefront of its business activities and performance metrics. The organisational restructure to establish the two Business Units resulted in roles moving from corporate to the Hunter Valley, and new roles established to drive Customer service outcomes to enhance the value proposition of the Hunter Valley Network.

Total net tonnages remained relatively stable off the back of strong historical growth rates, with gross tonne kilometres increasing due to the skew of volumes to more distant load points. The coal price continued its sustained decline and Customers were driven to rapidly reduce their cost base to maintain competitiveness. This increased cost focus and pressures for ARTC.

EFFICIENCY OF OPERATING COSTS FOR 2015

Deloitte independently undertook a review of ARTC's maintenance costs and found that the costs were efficient within ARTC's commercial, operational and technical constraints. There was limited benchmarking of costs where possible, however it was noted that the characteristics of the Hunter Valley Coal Network operating conditions results in scarcity of like-for-like comparators for the purpose of benchmarking analysis.

Deloitte reviewed ARTC's operating cost areas for corporate overhead, business unit management and network control. Overhead costs allocated to the Hunter Valley Network were found to be efficient, with a subset of corporate overhead costs benchmarked against a cross-industry peer group also found to be efficient.

Network controls were found to be comparable to the costs of its closest peer. Business unit management costs were unable to be benchmarked by Deloitte given a lack of publicly available information. With the difficulty in identifying appropriate comparators at a Network level, ARTC is concerned that discrete cost areas or projects will be considered in isolation. There is interdependency between many cost categories for ARTC and costs should be considered as an overall suite to maintain and operate the Hunter Valley Coal Network. Whilst efficiency assessments at a micro level could demonstrate ups and downs, movements in one cost area will have a ripple effect to other costs or result in changes in service delivery outcomes.

NEXT DEVELOPMENT PHASE

With the evolution in supply chain maturity, condition monitoring capability, Customer desire for operational efficiencies, growth in volumes and use of technology, innovation and analytics, ARTC needs to position itself to respond with agility to changing circumstances in order to meet Customer demands and needs. This evolution will and has seen a shift in resourcing and cost drivers across different aspects of the business. Therefore, costs in future years will not necessarily be comparable against 2015.

The ARTC Network Control Optimisation project is one example of a Rail Customer Group endorsed project that is currently underway which will transform service delivery and dynamic capability in the Hunter Valley. As a result of this project, new operating cost elements will be introduced into the Systems and Technology and Network Control areas, but these costs are offset through deferral of capital and the opportunity for Customers and other stakeholders in the Coal Chain to derive efficiencies and savings.

ARTC will continue to work with the ACCC and its Customers to ensure the best outcome for the Hunter Valley Coal Network and we welcome further engagement from the ACCC and industry on this process.

APPENDIX A

GATTORNA ALIGNMENT INDEPENDENT REPORT

APPENDIX B

DELOITTE INDEPENDENT REPORT