Consultation Paper

Proposed variation to

Australian Rail Track Corporation's 2011 Hunter Valley Coal Network Access Undertaking

Wednesday, 13 January 2021

Stakeholder submissions due: Wednesday, 24 February 2021

Contents

1. Purpose

This paper seeks feedback on Australian Rail Track Corporation's (**ARTC**) proposed variation to the 2011 Hunter Valley Coal Network Access Undertaking submitted to the Australian Competition and Consumer Commission (**ACCC**) on 23 December 2020 (**December 2020 variation**). The 2011 Hunter Valley Coal Network Access Undertaking (**HVAU**) sets out the framework for access to the rail network operated by ARTC in the Hunter Valley region of New South Wales.

The December 2020 variation has been submitted to the ACCC for assessment under Part IIIA, section 44ZZA of the *Competition and Consumer Act 2010* (Cth) (**the Act**) to replace the current HVAU (Version 7).[1] This Consultation Paper has been released to invite initial public submissions on the December 2020 variation. This consultation is undertaken in accordance with section 44ZZBD of the Act.

[1] The current version of the HVAU, as submitted to the ACCC in September 2018, was accepted by the ACCC on 29 November 2018 and is available at: https://www.accc.gov.au/system/files/Current%20undertaking%20-%20September%202018%20variation%20of%20the%202011%20HVAU.pdf.

2. Overview of paper

The December 2020 variation does not seek to change all sections of the HVAU, and some sections contain more substantive proposed changes than others. As such, this paper focuses discussion on the substantial changes set out in the December 2020 variation. This discussion is in Chapter 3, while Chapter 4 includes key questions relating to ARTC's proposed variations on which the ACCC seeks stakeholder responses.

The changes proposed by ARTC and questions posed in this paper are not, however, designed to limit stakeholders' submissions. The ACCC has not formed any final views on the December 2020 variation and stakeholders are encouraged to make comments on any aspect of the December 2020 variation.

2.1. Request for submissions

The ACCC encourages all stakeholders to provide a written submission.

Submissions should be addressed to:

Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001
Email: transport@accc.gov.au

2.2. Due date for submissions

All submissions provided by **Wednesday, 24 February 2021** will be considered by the ACCC. Note that subsection 44ZZBD(3) of the Act allows the ACCC to disregard any submissions made after this date. Please contact the Director of Regulated Access - Rail (see contact details below) prior to this date if you would like to make a submission but require additional time.

2.3. ACCC assessment

The ACCC may accept variations for an undertaking if it thinks it is appropriate to do so.[2] The ACCC has not yet formed a view on the appropriateness of the December 2020 variation. Statements in this Consultation Paper should not be taken as indicative of the ACCC's view of the appropriateness of the December 2020 variation under the Act, nor the likelihood of its acceptance.

In determining appropriateness, the ACCC must have regard to a number of matters listed in sections 44AA, 44ZZA and 44ZZCA of the Act (see **Appendix A** for an extract of the clauses).

Issues that the ACCC must have regard to in deciding whether to accept a variation to an access undertaking are set out in subsection 44ZZA(3) of the Act.

[2] *Competition and Consumer Act,* Part IIIA, Division 6, Section 44ZZA(7).

Under this subsection the ACCC must have regard to, among other things, the:

- legitimate business interests of ARTC,
- public interest, and
- interests of access seekers, both current and future.

The ACCC is also required to have regard to the objectives set out in section 44AA, which are to promote the economically efficient operation of, use of and investment in the infrastructure (in this case, the Hunter Valley rail network) thereby promoting effective competition in upstream and downstream markets, and to provide a framework and guiding principles to encourage a consistent approach to access regulation.

Further, the ACCC must have regard to whether any proposed application meets the pricing principles set out in section 44ZZCA of the Act.

ARTC's submission responds to the issues that the ACCC is to have regard to under the Act in Section 4 of its Explanatory Guide.[3]

2.4. ACCC engagement

The ACCC is keen to hear all views regarding ARTC's proposed December 2020 variation. As well as receiving written submissions, the ACCC will also be seeking to engage with stakeholders and interested parties throughout the assessment process, particularly during consultation periods.

If the ACCC does not contact you within three weeks of the release of this Consultation Paper to arrange a meeting and you would like to discuss any matter relating to the proposed December 2020 variation, please contact the Director of Regulated Access - Rail to arrange a meeting (see contact details below).

2.5. Timeline for assessment

Under subsection 44ZZBC(1) of the Act, the ACCC must make a decision in relation to the application[4] within the period of 180 days commencing at the start of the day the application is received (**the expected period**).

Subsection 44ZZBC(2) of the Act also provides for 'clock-stoppers', meaning that some days will not count towards the 180 days of the expected period in certain circumstances. In particular, the clock stops when the ACCC publishes a notice inviting public submissions in relation to an undertaking application, or when the ACCC gives a notice requesting information in relation to an application.

The Act does not prescribe a consultation process for the ACCC to follow. The normal process for such a decision would be to undertake an initial consultation (i.e. this paper). Following feedback from the initial consultation, the ACCC would publish a Draft Decision. The ACCC would then consult on its Draft Decision before making its Final Decision. However, one of the matters the ACCC is consulting on with stakeholders is whether the ACCC could move directly to a Final Decision following the initial consultation period.

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[3] ARTC, *Hunter Valley Coal Network Access Undertaking Version 8 Explanatory Guide,* December 2020, p. 11. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

[4] An application applies to a proposed new undertaking or variation to existing undertaking.

Allowing for clock-stoppers to conduct multiple consultation periods, the 180 days of the expected period is expected to conclude around September 2021. However, ARTC and Access Holders have separately requested that, subject to ACCC approval, the December 2020 variation become operational by 1 July 2021. This would require the ACCC to publish its decision by no later than 9 June 2021, noting that section 44ZZBA of the Act requires 21 days to lapse after publication of the ACCC decision for this decision to become operational.

As ARTC has stated that the new, lower prices will only be passed on by ARTC once the new HVAU variation is operational. Publication of the ACCC's decision by 9 June avoids the requirement to backdate certain elements of the December 2020 variation and for ARTC to provide rebates to its customers.

Based on this accelerated timeframe, the ACCC's draft timeline for its assessment of the December 2020 variation is outlined in Table 1. The timeline currently includes a Draft Decision, however, this may change subject to ACCC's assessment and stakeholder feedback.

Table 1: Draft timeline for assessment

Milestone	Approximate timing
December 2020 variation application received	23 December 2020
Consultation Paper / consultation period	13 January 2021 to 24 February 2021
Draft Decision published	Early April 2021
Draft Decision consultation period	April 2021
Final Decision published	Mid- to late June 2021
Operational date (21 days after publication)	Mid-July 2021

While the ACCC will seek to make its decision prior to 9 June 2021, the more realistic timeline is mid- to late-June (which is contingent on no delays occurring during the assessment process).

2.6. Confidentiality

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

If stakeholders wish to provide a confidential submission, the ACCC asks that stakeholders provide a full copy of the document and a public version with the confidential information omitted, which will be published on the ACCC's website.

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

For further information about the use of information provided to the ACCC, please refer to the ACCC publication '*ACCC & AER Information Policy – the collection, use and disclosure of information*', available on the ACCC website at: https://www.accc.gov.au/publications/accc-aer-information-policy-collection-and-disclosure-of-information.

2.7. Further information

The December 2020 variation and other relevant material, including supporting submissions from ARTC, are available on the ACCC's website at the following link: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

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

The current 2011 HVAU (Version 7) is available on the ACCC's website at: https://www.accc.gov.au/system/files/Current%20undertaking%20-%20September%202018%20variation%20of%20the%202011%20HVAU.pdf.

For any queries, or if you would like to meet with the ACCC about any matters raised in this document, please contact:

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Infrastructure & Transport – Access & Pricing Branch
Phone: +61 8 8456 3536
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3. Proposed variations

3.1. HVAU Section 2 – Scope and administration of the undertaking

3.1.1. Extension and variation to the Undertaking (Sections 2.2 and 2.3)

The December 2020 variation proposed by ARTC seeks to extend the existing expiration date of the HVAU from 31 December 2021 to 31 December 2026. This is a five year extension of the expiration date approved by the ACCC in the Version 6 variation to the HVAU.[5]

While the December 2020 variation is seeking to extend the expiration date by five years, ARTC is also seeking for the December 2020 variation to be effective as of 1 July 2021, six months prior to the current expiration date of 31 December 2021. This is regardless of the date the variation would come into operation, which would be 21 days after the ACCC publishes a decision to accept the December 2020 variation.

While the December 2020 variation itself would be in effect from 1 July 2021 to 31 December 2026, some provisions in the HVAU would not be in use for the entirety of the variation. For example, Schedule J, sections 4.1 to 4.10, the proposed inflation mechanism and increased track utilisation rates have various timeframes for use, as separately identified.

Details about these and all other substantive changes proposed in the December 2020 variation are discussed further below.

3.1.2. Other proposed variations in Section 2 of the HVAU

The December 2020 variation includes a commitment from ARTC to commence consultation with stakeholders in the second half of 2024 on the terms to apply for a revised HVAU that would be in use after 2026.

The variation also seeks minor changes in information published on ARTC's website by including links to the ACCC's annual compliance assessments.

3.2. HVAU Section 4 – Access pricing principles

Section 4 (and the new Schedule J) of the HVAU sets out the modelling used by ARTC to set prices for the Hunter Valley rail network. For background information on the mechanics of the model currently used in the HVAU, please refer to Chapter 2 of the ACCC's *Final Determination, Australian Rail Track Corporation's compliance with the Hunter Valley Coal Access Undertaking financial model for calendar year 2017*.[6]

3.2.1. Pricing Zone 3's contribution to fixed costs in Pricing Zone 1 (Sections 4.1 and 4J.1)

The Hunter Valley rail network includes shared assets that all Access Holders use, referred to as fixed assets in the HVAU. In particular, Access Holders in Pricing Zones 2 and 3 are

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5 The Version 6 variation was approved by the ACCC on 29 June 2017.

6 ACCC, *Final Determination, Australian Rail Track Corporation's compliance with the Hunter Valley Coal Access Undertaking financial model for calendar year 2017*, 25 September 2020, pp. 8-11. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/annual-compliance-assessment-2017/accc-final-determination-hvau-annual-compliance-2017.

required to also use Pricing Zone 1 assets to reach the Port of Newcastle, meaning Pricing Zone 1 assets are common to all Access Holders.

The current HVAU sets out that Pricing Zone 3 Access Holders contribute variable maintenance costs and incremental capital costs to Pricing Zone 1. In contrast, Pricing Zone 2 Access Holders contribute their variable maintenance costs and incremental capital costs, plus a share of the fixed costs in Pricing Zone 1.

The December 2020 variation proposes from 2023 onwards, Pricing Zone 3 Access Holders pay their share of fixed costs relating to their use of Pricing Zone 1 assets. That is, all Access Holders will contribute to the fixed costs in Pricing Zone 1 from 2023. Prior to 2023, Pricing Zone 3 Access Holders will not contribute to the fixed costs in Pricing Zone 1, as is currently the case under the HVAU. This change is linked to the removal of loss capitalisation for Pricing Zone 3 Access Holders at the end of 2022 (see section 3.5.2 of this paper for more detail on the loss capitalisation mechanism).

The December 2020 variation proposes that Pricing Zone 3 Access Holders contribute 33 per cent of their share of fixed costs in Pricing Zone 1 in 2023, before increasing their contribution to 100 per cent of their share of fixed costs in Pricing Zone 1 from 2024 onwards.

3.2.2. Creation of a single ceiling limit test (Sections 4.3 and 4J.3)

The December 2020 variation proposes that the Hunter Valley rail network change from a dual ceiling limit test to a single ceiling limit test. Currently Pricing Zones 1 and 2 have a combined revenue ceiling, while Pricing Zone 3 is not subject to a ceiling limit test due to the loss capitalisation mechanism. That is, Pricing Zone 3 is currently unconstrained.

The end of the loss capitalisation mechanism on 31 December 2022 will mean Pricing Zone 3 will become constrained and therefore be subject to its own ceiling limit test. Instead of having a separate ceiling limit test for Pricing Zone 3, ARTC proposes to bring Pricing Zone 3 under the same ceiling limit as Pricing Zones 1 and 2.

A single ceiling limit test will mean that any under or over recovery of revenue by ARTC will be proportionally distributed across the entire constrained network, regardless of which pricing zone the under or over recovery of revenue is attributable to (see section 3.5.2 of this paper for more detail on the unders and overs mechanism).

3.2.3. Inflation mechanism for the Regulatory Asset Base (Sections 4.4 and 4J.4)

The HVAU specifies the methodology for rolling forward the Regulatory Asset Base (**RAB**) Floor Limit. The roll forward comprises impacts due to capital expenditure, disposals, depreciation and inflation.

The HVAU sets out that the annual inflation rate to be used in the roll forward is the percentage change in the Sydney All Groups Consumer Price Index (**CPI**) in the 12 months to the September quarter.

The December 2020 variation proposes an inflation mechanism that will prevent a decrease in the RAB Floor Limit due to a decrease in CPI. The mechanism will be in use from 1 January 2022 to 26 December 2026 and will operate in the same way as the current mechanism in years when the inflation rate is positive. However, if the movement in the CPI is negative, the inflation rate would be set to zero and the RAB Floor Limit would, all else being equal, remain constant.

Subsequent future increases in CPI would essentially follow a banking mechanism, where the RAB Floor Limit would not increase due to changes in the CPI until CPI has 'caught up' to what it was prior to the CPI decrease. Assuming that CPI increases over time, there would be no long term impacts due to this mechanism. However, it would result in a higher RAB Floor Limit in the short term should deflation occur, and therefore ARTC's targeted level of revenue may be higher than otherwise.

A fully worked example of how the inflation mechanism will operate can be found in ARTC's Explanatory Guide.[7]

3.2.4. Depreciation (Sections 4.7 and 4J.7)

Regulatory asset models, including the model outlined in the HVAU, allow for a full return of assets as recorded in the RAB. This return of assets (referred to as depreciation), is provided over time. As such, the time period used to recover the return of assets from previous investments is an important factor for calculating the annual depreciation allowance.

The annual depreciation allowance is usually based on the remaining useful life of the asset and is often calculated using a straight-line method. The current HVAU uses a concept called Remaining Mine Life (**RML**) to calculate the depreciation allowance. The RML is a proxy for the remaining useful life of the coal mines in the Hunter Valley. That is, the HVAU has tied the useful life of the Hunter Valley rail network to the operation of coal mines in the Hunter Valley, and not the remaining useful life of the rail assets themselves.

Based on the RML concept, depreciation for the current HVAU was set using a RML of 23 years as at 1 July 2016. This final value was a negotiated outcome between stakeholders and ARTC in the Version 6 variation of the 2011 HVAU.[8] Under the current HVAU, the RML will have decreased to 18 years by 1 July 2021.

The December 2020 variation proposes an increase of the RML to 21 years as at 1 July 2021. ARTC has stated that this is also a negotiated outcome between stakeholders and ARTC.[9]

All else being equal, the new RML effectively provides a price decrease to Access Holders from 1 July 2021.

3.2.5. Rate of return (Sections 4.8 and 4J.8)

The rate of return (**ROR**) is the financial return on capital required by debt and equity providers. While the basics of the ROR calculation are generally accepted, there are different views on the precise values to be included in a ROR calculation. A key element in determining the value of a ROR includes the assessment of the risks involved in providing the service.

The current ROR in use in the Hunter Valley rail network was a negotiated outcome between stakeholders and ARTC in the Version 6 variation of the HVAU. The accepted outcome was

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7 ARTC, *Hunter Valley Coal Network Access Undertaking Version 8 Explanatory Guide,* December 2020, p. 18. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

8 ARTC, *Application by ARTC to vary the Hunter Valley Access Undertaking to extend term*, 6 June 2017 p. 1. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/june-2017-variation-of-the-2011-hunter-valley-access-undertaking/variation-application.

9 ARTC, *Hunter Valley Coal Network Access Undertaking Version 8 Explanatory Guide*, December 2020, p. 19. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

a real pre-tax ROR of 5.38 per cent, and an associated nominal pre-tax ROR of 7.91 per cent.[10]

For the December 2020 variation, ARTC proposes a real pre-tax ROR of 4.60 per cent, and a nominal pre-tax return of 6.43 per cent. ARTC has stated that this ROR is also a negotiated outcome between stakeholders and ARTC.[11]

The proposed ROR is to apply from 1 July 2021, six months earlier than set out in the current HVAU. All else being equal, this proposal also effectively provides a price decrease to Access Holders from 1 July 2021.

3.2.6. Revision to Access Charges in 2021 (Sections 4.22 and 4.23)

The current HVAU stipulates that ARTC must set and notify Access Holders of Access Charges by 1 November for the following calendar year. However, to accommodate the changes to the ROR and depreciation incorporated in the December 2020 variation, ARTC proposes to adjust the Access Charges set in November 2020 for the 2021 calendar year for the period of 1 July 2021 to 31 December 2021.

ARTC has stipulated that the change in prices will only be implemented once the December 2020 variation is operational, which will be 21 days after the ACCC has published its final decision. If this occurs after 1 July 2021, then ARTC will issue adjustment credits on Access Holders' invoices, to ensure the revised Access Charges are effective from 1 July 2021.

Additionally, ARTC has stated that it will incorporate the Access Charges that are to apply from 1 July 2021 to 31 December 2021 in the December 2020 variation at a later date, but prior to ACCC approval of the variation. The ACCC will publish these Access Charges once they are provided by ARTC and incorporate these into its overall assessment of the December 2020 variation.

3.2.7. Other proposed variations in Section 4 of the HVAU

The December 2020 variation includes proposed drafting changes to provide clarification regarding terms of payment in association with the unders and overs mechanism. These proposed drafting clarifications are also included in the Indicative Access Holder Agreements (**IAHA**).

The variation also seeks alterations to the true-up test (**TUT**) audit. The December 2020 variation seeks to separate the TUT audit from the annual compliance process, so the TUT audit documentation can be submitted to the ACCC separately if required. The variation also seeks to change the definition of an independent auditor, allowing ARTC to engage an auditor it has previously used for professional advice on matters other than the TUT audit, subject to a maximum fee limit paid by ARTC.

The December 2020 variation includes proposed amendments to the service envelope characteristics for each pricing zone, which are used to determine each pricing zone's service charges.

Furthermore, the variation seeks to update the timing of ARTC's annual compliance submission when the process is running behind schedule. Should the submission not be

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10 ARTC, *Hunter Valley Coal Network Access Undertaking*, 29 November 2018, p .38. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking.

11 ARTC, *Hunter Valley Coal Network Access Undertaking Version 8 Explanatory Guide*, December 2020, p.19. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

able to be provided by 30 April of the following calendar year, ARTC must promptly agree a revised timetable with the ACCC and also give notice to the ACCC and Constrained Coal Customers of its indicative estimate of the total unders and overs amount for the relevant year.

3.3. HVAU Section 5 – Capacity management

3.3.1. Track Utilisation Capacity Assumption (Section 5.1)

The track utilisation rate indicates the percentage of time the tracks in the Hunter Valley rail network are available to be used. It is a direct input into the system assumptions that ARTC uses to calculate available contractable capacity, with increases in utilisation leading to increases in available contractable capacity.

The current track utilisation rate is 70 per cent for the constraining single sections of the rail network. ARTC has agreed with Access Holders to increase the track utilisation rate in its capacity assumption from 70 per cent to 73.5 per cent for the period 1 January 2022 to 31 December 2026. This increase in the utilisation of the rail network will increase the contractable capacity available to Access Holders, as well as allow for certain capital expenditure to be deferred to future time periods.

ARTC has indicated that the increased utilisation rate “will provide up to 8 Mtpa of extra capacity and offset circa $146 million in capital investment.”[12] Table 2 below, from ARTC’s Explanatory Guide, identifies the estimated increase in capacity and capital expenditure deferrals by pricing zone.[13]

Table 2: Estimated capacity and deferred capital expenditure due to increased track utilisation

Pricing Zone	Estimated Capacity	Deferred Capital Projects
PZ2	2.8 Mtpa	Widden Creek loop ($57 million)
PZ3	5.2 Mtpa	Togar North loop ($23 million) Wingen loop ($20 million) Bells Gate South extension ($46 million)

3.4. HVAU Section 9 – Industry consultation

3.4.1. Membership of RCG (Section 9.2)

The Rail Capacity Group (**RCG**) is the main operational engagement vehicle for ARTC and Access Holders. A crucial existing function of the RCG is to approve future capital expenditure and, as discussed below, to engage with ARTC on operating expenditure from 1 January 2022.

Currently, the RCG membership is limited to one representative for each of:

- The largest Access Holder, by contracted coal kilometres, in each pricing zone,

[12] ARTC, *Hunter Valley Coal Network Access Undertaking Version 8 Explanatory Guide,* December 2020, p. 9. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

[13] Ibid.

- Any other Access Holder with more than 7 per cent contracted coal kilometres (i.e. one representative each),
- All other Access Holders with less than 7 per cent contracted coal kilometres (i.e. one representative for all),
- Above-rail Operators with more than 10 per cent contracted coal kilometres (in a non-voting capacity), and
- The Hunter Valley Coal Chain Co-ordinator (in a non-voting capacity).

The December 2020 variation proposes to expand the membership of the RCG, to include all Access Holders with Coal Access Rights, irrespective of their pricing zone or contracted coal kilometres. However, voting rights will continue to be determined and weighted in accordance with the existing criteria in the HVAU.

3.4.2. RCG consultation – maintenance plan (Section 9.11)

As per the current HVAU, the ACCC conducts an ex post assessment as to whether ARTC's operating expenditure is efficient. This is currently done in arrears through the annual compliance process.

Historically, it has been considered that an operating expenditure efficiency mechanism should be designed and implemented to improve incentives to achieve efficient outcomes. ARTC previously proposed the development of such a model in its 2017 HVAU application.[14] However, after working for some time on trying to develop this model, both ARTC and Access Holders have informed the ACCC that they do not wish to pursue an operating expenditure efficiency mechanism for the HVAU.

Instead, the December 2020 variation formalises engagement with and transparency to Access Holders regarding operating expenditure. This is to be achieved through circulation of ARTC's Maintenance Plan, which will outline ARTC's plans for maintenance activities and costs (i.e. operational expenditure) on the Hunter Valley rail network in the forthcoming year, commencing in calendar year 2022. The Maintenance Plan will also include an overview of ARTC's forward 10 year asset management plans. ARTC will consult with the RCG on the Maintenance Plan, to ensure Access Holders have oversight of operational expenditure ARTC carries out on the rail network.

Additionally, ARTC will provide a costing manual to the RCG, which is an explanation of the application of the cost allocation rules set out in Schedule I. ARTC has not proposed any material changes to the existing Schedule I.

3.5. HVAU Schedule J – Access pricing principles for 2021 and 2022

3.5.1. Inclusion of Schedule J

The December 2020 variation proposes a new Schedule, Schedule J. Schedule J is consistent with Sections 4.1 to 4.10 of the current HVAU (Version 7), in that it essentially replicates the current modelling mechanisms, including a loss capitalisation account for Pricing Zone 3 Access Holders. However, Schedule J includes variations to the ROR and depreciation proposed under Version 8 of the HVAU, rather than those approved under Version 6 of the HVAU.

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[14] ARTC, *2017 Hunter Valley Coal Network Access Undertaking Explanatory Guide*, December 2016, p. 6. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/hunter-valley-access-undertaking-2017/undertaking-application.

Schedule J will be effective from 1 July 2021 to 31 December 2022, during which time the loss capitalisation account balance for Pricing Zone 3 Access Holders will be paid down to zero. After that time, Pricing Zone 3 Access Holders will be included in the same unders and overs mechanism applicable to Access Holders in Pricing Zones 1 and 2 (see section 3.2.2).

As such, from 1 January 2023, Sections 4.1 to 4.10 of the main HVAU document will take effect and Schedule J will become redundant. Sections 4.1 to 4.10 do not include any references to the loss capitalisation account, as this mechanism will not be in use from 2023 onwards.

3.5.2. End of the loss capitalisation account (Section 4 and Schedule J)

Due to the need to forecast prices in advance, there is always a difference between ARTC's actual Economic Cost and its actual regulated revenue outcomes, for any given year. The HVAU currently establishes two separate mechanisms to rectify this difference and to ensure ARTC recovers only its efficient costs. Both mechanisms are revenue cap mechanisms, where a revenue cap guarantees the monopoly provider a set amount of revenue and the Access Holders take on the risk of changes in volume.[15] The revenue cap is referred to as a revenue ceiling in the HVAU.

The first mechanism is an annual reconciliation process, also referred to as the unders and overs mechanism, which is currently applied to the constrained section of the rail network (Pricing Zones 1 and 2). At the end of each year, if ARTC has recovered revenue in excess of the revenue ceiling, that excess revenue is refunded to Access Holders. However, if the ceiling is not reached, Access Holders must make additional payments to cover the shortfall.

The second mechanism is a longer term reconciliation process known as the loss capitalisation mechanism. This mechanism was established in the original HVAU (in 2011), in recognition of the low cash flows arising from the development of new mines in Pricing Zone 3. At that time, the expectation was that the loss capitalisation account would build up over the first few years, as the mines undertook their investments. Then, as the mines became established and volumes increased, Pricing Zone 3 Access Holders would start to refund the earlier losses. The ACCC's compliance assessments have shown that the loss capitalisation account increased from 2011 to 2015, but decreased in 2016 and 2017.

The December 2020 variation is based on the loss capitalisation account being fully recovered by 31 December 2022. ARTC and Pricing Zone 3 Access Holders have agreed to spread any additional payments required to balance the loss capitalisation account (at 31 December 2022) over a 12 month period. Any payments will be due after finalisation of the ACCC's 2022 compliance assessment.

From 2023, Pricing Zone 3 will enter the constrained network, where its Access Holders will be included in the annual unders and overs process (see section 3.2.2 for further detail).

3.5.3. Ad hoc revenue exclusion for 2021 (Section 4J.3)

Customer contracts under the HVAU (IAHAs) require Access Holders to nominate the volume of train paths required over the next 10 years, with particular focus on the following 12 months. If any excess capacity remains after all contracted capacity is allocated across the rail network, the IAHAs provide for Access Holders to request additional train paths over and above their contracted allowance. Payment for ad hoc paths is provided for in the IAHAs, which also provide for rebates of ad hoc charges for these paths at the end of the

[15] In contrast, a pricing mechanism imposes volume risk on the monopoly provider by guaranteeing the price and allows the revenue and costs to fluctuate with volume.

year, where the sum of an Access Holder's contracted and ad hoc paths usage is below the Access Holder's maximum contracted paths for the given year. Any additional revenue generated by ad hoc train paths is included in ARTC's Access Revenue and therefore the unders and overs reconciliation process.

For the December 2020 variation, ARTC proposes a one-off alteration to the normal calculation of Access Revenue. Specifically, ARTC is proposing to retain 50 per cent of net revenues (after annual reconciliation) from ad hoc paths (defined as 'ARTC Ad Hoc Revenue Share'), which will not be included in the Access Revenue amount used for the unders and overs reconciliation.

For calendar year 2022 onwards, all ad hoc train path revenue will again be included in ARTC's Access Revenue and will therefore be fully accounted for in the unders and overs reconciliation, as has occurred previously under the HVAU.

ARTC has included a worked example of how the ad hoc revenue exclusion will work in its Explanatory Guide.[16]

3.5.4. Annual compliance assessment for 2018 (Section 4J.10)

ARTC has indicated to the ACCC and Access Holders that it estimates an under recovery of revenue from Access Holders for 2018 of approximately $30 million. This figure is subject to review by the ACCC as part of its annual compliance assessment process. Nonetheless, ARTC expects that Access Holders will need to make significant additional repayments to account for this shortfall in 2018.

The December 2020 variation proposes that the 2018 annual compliance process be carried out in accordance with Version 6 of the HVAU, albeit with a different timeframe for the recoupment of the under-recovered revenue from Access Holders. The variation proposes to defer payment by Access Holders to rectify this under recovery of revenue for six months after the date of the ACCC's final determination (typically this would be rectified within 30 days of the ACCC's final determination). ARTC's under recovered amount will then be payable by Access Holders in 12 equal monthly instalments from that date.

3.5.5. Other proposed variations in Schedule J of the HVAU

The December 2020 variation includes a commitment from ARTC to use 'best endeavours' to provide the 2019 and 2020 annual compliance documentation to the ACCC in a single submission.

3.6. Indicative Access Holder Agreements

3.6.1. Tier 1 Changes to IAHAs (Clause 5.4 and Schedule 3 – Clause 6)

In order to incorporate some of the proposed changes relating to pricing in Section 4 of the December 2020 variation, ARTC has included two Tier 1 changes to the IAHAs to ensure the flow through of these pricing changes, and to take into account the possibility that the December 2020 variation operational date will not be until after 1 July 2021. Tier 1 provisions are mandatory provisions for all IAHAs.

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16 ARTC, *Hunter Valley Coal Network Access Undertaking Version 8 Explanatory Guide,* December 2020, pp.15-16. Available at: https://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/december-2020-variation-of-the-2011-hunter-valley-coal-network-access-undertaking.

Clause 5.4 has been updated to ensure that the IAHAs allow for two sets of prices to be charged and, if required, retrospective credits be issued in 2021, and to ensure the correct calculation of the ad hoc revenue exclusion and TOP rebates.

ARTC has also proposed making Clause 6 in Schedule 3 a Tier 1 provision. This relates to making payment obligations under the HVAU enforceable, such as the under and over amounts that result from the annual reconciliation process. It stipulates that payment must be made within 20 business days of the amount being finally calculated or determined.

3.7. Other issues

In addition to the sections of the December 2020 variation addressed throughout Chapter 3, a number of other smaller changes have occurred in the remaining sections.

Sections 1.5 and 1.6 of the December 2020 variation have been altered to reflect the reduced timeframes associated with ACCC requests for information, as well as the introduction of a new provision to allow the ACCC to make informal requests for background or clarifying information relating to the HVAU.

Section 10.1 has been altered to reflect that the applicable tax rate will be part of the no worse off assessment for any user funded projects that occur on the rail network. However, the altered provision does not define how any adjustment would be determined or applied.

Section 14 contains a number of new and amended definitions to correspond with the previous changes outlined in this document. They have also been amended to allow for cross referencing with the new Schedule J. A number of redundant definitions have also been removed as they are no longer applicable to the HVAU.

4. Consultation

This Chapter outlines areas in which the ACCC seeks stakeholder views on the package of variations proposed by ARTC. However, the ACCC encourages stakeholders to provide feedback on any or all aspects of the proposed variations they choose.

If you are a stakeholder of any kind to the Hunter Valley rail network:

1. **Do you accept the proposed December 2020 variation?**
2. **Do you have concerns or issues of any of the individual variations?**
3. **Do you have any comments on the matters that the ACCC must have regard to under the CCA (see Appendix A)?**
4. **In your view, should there be any further amendments made to the December 2020 variation?**

As discussed in section 2.5 of this paper, the ACCC's assessment would typically take around nine months to complete, allowing for a draft and final determination to be released and consultation to take place. However, ARTC and current Access Holders have separately requested the ACCC finalise its decision by 30 June 2021.

In the interests of meeting the 30 June 2021 target, the ACCC will consider alternative processes to those outlined in section 2.5, such as not publishing a Draft Decision. The ACCC is therefore seeking feedback from stakeholders on the level of importance stakeholders place on the Draft Decision (and associated consultation) for the proposed December 2020 variation.

If you are a stakeholder of any kind to the Hunter Valley rail network:

5. **Is your preference for the ACCC to publish a Draft Decision document, and have an associated consultation period, as part of its assessment of the December 2020 variation?**

Appendix A: Assessment considerations as listed in the Competition and Consumer Act 2010

Part IIIA, Division 6, Subdivision A, Section 44ZZA – Access undertakings by providers

(3) The Commission may accept the undertaking, if it thinks it appropriate to do so having regard to the following matters:

(aa) the objects of this Part;

(ab) the pricing principles specified in section 44ZZCA;

(a) the legitimate business interests of the provider;

(b) the public interest, including the public interest in having competition in markets (whether or not in Australia);

(c) the interests of persons who might want access to the service;

(da) whether the undertaking is in accordance with an access code that applies to the service;

(e) any other matters that the Commission thinks are relevant.

Note 1: There are grounds on which the Commission may reject the undertaking if it contains, or should contain, fixed principles: see section 44ZZAAB.

Note 2: The Commission may defer consideration of the undertaking if it is also arbitrating an access dispute: see section 44ZZCB.

Part IIIA, Division 1, Section 44AA – Objects

The objects of this Part are to:

(a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and

(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

Part IIIA, Division 6A, Section 44ZZCA – Pricing principles for access disputes and access undertakings or codes

The pricing principles relating to the price of access to a service are:

(a) that regulated access prices should:

- (i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
- (ii) include a return on investment commensurate with the regulatory and commercial risks involved; and

(b) that the access price structures should:

- (i) allow multi-part pricing and price discrimination when it aids efficiency; and
- (ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and

(c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

Note: The Commission must have regard to the principles in making a final decision under Division 3 and in deciding whether or not to accept an access undertaking or access code under Division 6.