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By email

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Dear Mr Schroder

HRATF response to 2011 Hunter Valley Access Undertaking (HVAU) 2017 variation application

The Hunter Rail Access Taskforce (**HRATF**) welcomes this opportunity to respond to the application by ARTC requesting consent to vary its 2011 HVAU to implement the amendments contemplated by clause 2.3(d) of the HVAU (the **2017 Variation**).

The 2017 Variation addresses only two substantive issues, being the introduction of path based pricing and a varied approach to the treatment of incremental costs. In relation to incremental costs, the 2017 Variation implements a modified pricing approach in which:

(a) a dual ceiling limit applies (with a separate ceiling for PZ3 even after recovery of capitalised losses has been completed);

(b) Prizing Zone 3 (PZ3) customers will contribute the Incremental Capital Cost associated with their use of segments in PZ1; and

(c) recovery of incremental capital cost will be allocated based on contracted tonnage (c.f. actual use) and will be recovered through take or pay charges.

The ACCC published a consultation paper on 16 January, seeking input from stakeholders on the Variation and with specific questions.

This submission provides both general feedback on the proposed changes as well as responding, in Annexure A, to the questions raised specifically by the ACCC.

Overview

In summary, as the ACCC is aware from the HVAU renewal process over 2015-17, producers in the HRATF do not share a common position on the introduction of path based pricing.

However, in the interests of moving the regulatory framework forward, those producers that do not support the move are prepared to accept this development on the basis that it forms a “package” with the other changes that are more widely supported – in particular, ensuring that Incremental Capital Cost recovery is allocated based on contracted tonnage.[1]

With this position in mind, the HRATF supports the approval of the 2017 Variation by the ACCC, for the reasons set out in this letter. While there are well-known inadequacies with the HVAU (and the broader regulatory process regarding amendments to the HVAU), theses should not prevent ARTC and industry moving forward with this package of agreed changes as soon as possible.

In doing so, the HRATF notes that:

- There are a number of specific areas where the approach to drafting has resulted in some complexity – particularly in relation to how the dual Ceiling “overs and unders” process will work following the Variation. HRATF has been assisted by the Explanatory Guide in setting out how this is intended to work in practice. However the outcome of the process should be monitored to ensure that it aligns with expectations.
- In particular, there are a number of aspects of the drafting which HRATF understand is not intended to materially change the currently proposed allocation of cost recovery as between different producers. For example:
  - the change in recovery of TOP ICC charges from using Contracted TKM to Contracted Gtkm (which may have an impact on cash flow timing but not on the portion of cost recovered from any individual producer);
  - the shift in voting entitlement within the RCG from Gtkm to Train KM (which is understood to have no impact on membership rights and an immaterial impact on voting entitlements);
  - the technical features of the Services Envelope (which ARTC has indicated has been framed in order to capture the maximum operating configuration of all contracted trains operating in the Hunter Valley); and
  - the drafting approach to Ceilings being referenced to Train Paths rather than Access Holders (which is understood to be a drafting change that does not affect the approach to the annual compliance or overs and unders process).

  In each case, we understand that the applicable amendments will not materially affect the operation of the relevant elements of the HVAU or disadvantage any individual producer relative to others. Provided this is correct, the HRATF has no objection to what has been proposed. However, we would welcome confirmation from the ACCC and ARTC that our understanding is accurate. If HRATF is wrong in this assumption, we would request the opportunity to further consider and respond on the changes – once the impact has been disclosed.
- On some issues, HRATF considers that the approach adopted by ARTC is inadequate – particularly in relation to providing assurance around the quality of consultation with the RCG in

[1] One HRATF producer does not support the use of contracted tonnes for the purpose of allocating incremental capital costs.

relation to cost allocation decisions. While these issues should not delay or prevent approval of the Variation, they highlight the need for the ACCC to ensure that it continues to engage with industry directly to ensure that cost allocation decisions have the broader support of stakeholders.

- HRATF notes its previous criticism regarding the approach adopted by ARTC to determining allocators as part of the 2011 HVAU extension – which lacked transparency and had the effect of shifting $6-8m from non-coal users to the coal sector. These general criticisms remain and highlight that more transparency around cost allocation is an area that needs to be revisited and improved as part of the next HVAU reset.
- The Variation does not address a range of 'unfinished business' from the earlier process.[2] We note this at page 5 below.

Finally, HRATF wishes to acknowledge that the latter stages of the process for developing the 2017 Variation involved genuine and constructive engagement by ARTC with the HRATF and other stakeholders. While this engagement could (and should) have occurred earlier, which again placed considerable time pressure on everybody, the HRATF acknowledges the effort made by ARTC to communicate and work collaboratively on the amendments during November and December.

Path Based Pricing (and new multi-part tariffs[3])

HRATF does not hold an agreed or common position on path based pricing – and so it does not express a view on the relative efficiency impact of moving to this alternative model (including whether or not this better aligns with the statutory principles in section 44ZZA or the pricing principles in section 44ZZCA of the Competition and Consumer Act 2010 (**CCA**)).

Nonetheless, to the extent that path based pricing is being implemented as part of a package of changes that is generally accepted by HRATF, we make the following observations:

(a) HRATF accepts the approach to implementation of the new tariff framework proposed in the amended clause 2.3 and clause 2.4, including

    (i) the new tariffs will apply from 1 January 2018, irrespective of the timing of any ultimate approval of the 2017 Variation by the ACCC. Given the shift back to a calendar year compliance timetable, the HRATF agrees with ARTC that this reduces the complexity associated with further part-year compliance modelling and adjustments; and

    (ii) the mandatory amendment of existing IAHAs to introduce the new tariff structure and path based pricing. For the model to operate fairly and in a non-discriminatory manner, it is imperative that all Coal Customers operate from the same pricing structure. This also ensures continued alignment of the HVAU with related commercial agreements.

(b) The approach adopted to the amendments, including the introduction of the new Train Path Schedule Spreadsheet in Schedule 3 of the Indicative Access Holder Agreement (**IAHA**), appears to be sensible and appropriate.

(c) While the HRATF would not object to the characteristics of the 'Services Envelope' being able to be modified by ARTC with the endorsement of the RCG, we understand that the ACCC may consider that a material change of this kind requires a formal variation. We accept this

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[2] A reference was made to this in the HRATF letter to the ACCC in response to the 2011 HVAU extension, on 20 June 2017.

[3] The changes now introduce a three part tariff into the Hunter Valley, with an Incremental Capital Cost TOP charge (reflecting PZ1 costs allocated on Contracted $/GTK basis), a Fixed Cost TOP charge (allocated based on Contracted $/Train KM basis) and Non-TOP charges (allocated on actual GTK basis).

alternative – given the potential for changes in the Services Envelope to impact upon different producers, differently. Transparency and engagement around any amendments are critical.

(d) While the updated formulae in Schedule 3 are complex, they appear workable based on the worked examples provided by ARTC to producers.

The operation of the changes will need to be kept under review, particularly during the first annual compliance process, to ensure that it reflects the understood operation of the new framework.

Incremental Cost – allocation based on Contracted tonnage

Except for one of its members, the HRATF has previously expressed support for returning to a tariff model that allocates Incremental Capital Costs on the basis of Contracted tonnage, as had been the case prior to the 2013 annual compliance assessment. HRATF generally refers to and reiterates its previous submissions in this regard.[4]

HRATF strongly supports this change, which we understand is intended to rebalance the proportion of costs recovered through TOP charges back to its historical level (which had been in the order of 85-90%). HRATF shares the view expressed by ARTC that doing so better aligns capital investment incentives and cost recovery (of historical capex) with the contract decisions by a Coal Customer that underlie those investments, rather than having them potentially affected by later changes in actual volume decisions by itself and other Coal Customers.

HRATF agrees with ARTC that this better reflects the causal relationship between capital investment by ARTC and the long-term TOP commitments required to be made by Coal Customers in contemplation of that investment.

Overall, HRATF submits that the recovery of capital costs through TOP provides the most appropriate set of incentives in support of efficient use of, and investment in, infrastructure (per the objectives in section 44ZZA). We set out more detail on this issue in the Annexure at question 21.

Incremental Capital Costs – approach to cost allocation and approval by RCG

As currently framed in the 2017 Variation, the 'default' position for new capital projects means that they are most often likely to be treated as Incremental Capital Costs – rather than Fixed Costs. Over time, this may have the effect of shifting a greater proportion of costs from Fixed to Incremental Costs, which is likely to mean a gradual shift in the proportion charged from Train KM basis to an increased proportion being on a Gtkm basis.

As a general principle, when determining the capital cost allocation (i.e. Fixed or Incremental Capital) for new projects or activities, the HRATF accepts that it is appropriate for projects to be treated in a consistent manner, both over time and with respect to other similar or past projects. To the extent that the purpose, causal factors and cost drivers for an activity or capital project are similar[5], it will ordinarily be appropriate to allocate those costs consistent with the earlier approach.

However, the question of whether a project or activity is similar and should be treated in the same manner as another project or activity may be one about which views differ – with significant consequences for Coal Customers.

The question whether costs are Incremental or Fixed will determine both the approach to cost recovery (Gtkm or Train KM) as well as whether PZ3 producers are required to contribute to the

[4] HRATF submission to ACCC, ARTC 2017 Hunter Valley Access Undertaking, 6 February 2017 at page 27.

[5] See clause 4.5(g) of the varied HVAU as explained at page 18 of the Explanatory Guide.

recovery of those costs in PZ1. To that end, the HRATF notes that the proposed changes to clause 9.2 mean that:

- while the RCG is consulted by ARTC in relation to the proportions and allocation methods for projects proposed to be treated as Incremental Costs, the process and timing around this consultation is not defined[6] and there is no requirement for this to be agreed with or endorsed by the RCG; and
- the RCG does not appear to have any opportunity (at least formally) to propose to ARTC that a new project or activity is treated in a particular manner.

It is not clear to HRATF why decisions in relation to cost allocation and recovery are not required to be endorsed by the RCG or, if endorsement is not obtained, approved directly by the ACCC – as happens in respect of the capital approval decision itself. As well as being consistent with the underlying capital approval process, this would recognise that the parties facing the direct commercial risk from cost allocation decisions are Coal Customers themselves, and not ARTC. ARTC is likely to be largely indifferent to the extent to which costs are allocated or recovered as Incremental or Fixed, because the only real impact is whether these are recovered on a Gtkm or Train KM basis.

Transparency and engagement is crucial in this process and Coal Customers must have an adequate opportunity to consider the relevant engineering assessment and to approve or reject the approach through the RCG. While the HRATF acknowledges that it may still remain open to the RCG to reject a project entirely if the cost allocation approach proposed by ARTC is unacceptable, this seems to confuse two issues (i.e. the RCG may accept the need for a project, but wish for the cost allocation to be different to that proposed by ARTC).

If the 2017 Variation is implemented in its current form, HRATF submits that the ACCC should take an active role in ensuring that cost allocation decisions in respect of new projects or activities are being adequately consulted upon with the RCG – and if endorsement is not sought from the RCG, the ACCC should have regard to Coal Customers' concerns when considering whether to approve the proposed approach.

Once a capital cost allocator has been applied to a project or activity (subject to appropriate consultation with Coal Customers and approval by the ACCC), the HRATF agree that the allocator should be applied consistently for the lives of the applicable assets. In this regard, the HRATF acknowledge that, since the 2013 Compliance Assessment, ARTC has included an engineering assessment as part of its compliance assessment submission. It is hoped that this degree of detail will now also form part of the materials used to support any capital project endorsement by the RCG.

Incremental Cost – dual ceiling

HRATF acknowledges that the approach adopted by ARTC to the application of PZ3 Incremental Cost and Variable Cost to PZ3, appears to have the effect of entrenching a 'dual ceiling' test even after any current loss capitalisation balance has been fully repaid.

Linked to the dual Ceiling is the reconciliation of Pricing Zone 3 revenues (associated with Segments in Pricing Zone 1) with the Variable Maintenance and Incremental Capital Costs associated with those Segments. Under clause 4.8A, this reconciliation occurs outside of either of the Pricing Zone 1 or 3 Ceilings. The Explanatory Guide sets out how this is to occur.

While the process proposed appears workable – it is complex and it may well be that once loss capitalisation arrangements are no longer required, the current 'dual Ceiling' model may be able to be

[6] The Explanatory Guide (at page 19) also does not provide any minimum requirements around notice or process for consultation.

modified, including bringing reconciliation of Prizing Zone 3 Customer contributions to PZ1 costs within one of the Ceilings. However, as ARTC has indicated that the loss capitalisation balance is unlikely to be fully paid down in the current HVAU period, HRATF consider that this is not an issue that needs to be addressed as part of the present HVAU process.

Provided that the overall cost and revenue allocation (in the context of the unders and overs process) operates as proposed in the Explanatory Guide, HRATF are content with the arrangements as proposed by ARTC for the period of the extended HVAU term.

Final observations – HVAU unfinished business

HRATF notes that there remain a range of concerns with the HVAU that have not been addressed by the 2017 Variation that remain unfinished business.

For example, the HRATF notes that given the failure by ARTC to develop a workable opex efficiency framework as part of the original HVAU extension, the ACCC has flagged that it will be taking a more comprehensive review of the opex efficiency as part of the existing annual compliance process.

The HRATF supports a more thorough and transparent ex post review of opex efficiency. In doing so, producers note that:

- it is critical that any review can be undertaken by the ACCC (and any external consultants) in a manner that does not unduly delay the annual compliance process – which is critical to the timing of rebate payments to producers, reflecting the updated tariffs following the HVAU extension – if there is likely to be any further delay, either from the present variation or other processes (such as the Compliance Assessment) that ARTC would engage with the ACCC and industry around bringing forward payment of the rebate, which can now be identified;

- a considerable amount of detailed information about opex and its allocation was developed as part of the aborted attempt to develop an opex efficiency mechanism in early 2017. HRATF would encourage the ACCC and its consultants to use this information and data for the purpose of the current process, to avoid 'reinventing the wheel'; and

- a major concern of the HRATF has been the lack of timely information about opex and how efficiency has been assessed (both by ARTC and the ACCC). We would welcome an opportunity to review the detailed analysis undertaken as part of the ACCC's review. To the extent that there are any confidentiality or other sensitivities in this regard, appropriate confidentiality arrangements can be agreed (as occurred in the development process for the opex efficiency framework).

There were also a range of other changes to the HVAU that were considered in the context of the HVAU reset during 2016-17. A number of these were reasonably non-controversial, but have not been taken forward by ARTC. These are not matters that should delay the approval of this Variation, but the process does again highlight the need for a more robust process ahead of the next reset, so that there is a more concrete regulatory path to close out issues.

Finally, in terms of responding to the specific drafting adopted by ARTC, HRATF notes that it has already worked collaboratively with ARTC on the drafting approach adopted in the 2017 Variation submitted and has no further specific comments. ARTC has also adopted a number of the drafting changes proposed to definitions associated with Incremental Cost, which are responsive to concerns raised in HRATF's earlier submissions.

As for other HRATF submissions, individual members may make their own submissions in respect of the 2017 Variation and the ACCC consultation.

Please direct any correspondence in relation to the issues raised in this submission to me, copying our HRATF advisers, Alex Sundakov (Alex.Sundakov@castalia-advisors.com) and Simon Muys (smuys@gtlaw.com.au).

Yours Sincerely,

Craig Forster
Chair – Hunter Rail Access Taskforce

ANNEXURE

HRATF responses to ACCC consultation questions

	Question	Response / reference
1.	*If accepted, is it clear when the variation would come into effect?*	There is some ambiguity about the start date in two respects: (a) First, legally, it is not entirely clear whether this is consistent with section 44ZZBA(1), which does not appear to contemplate an alternative operative date by agreement (the original drafting had mapped the statutory timeframe of 21 days). That being said, HRATF does not object to the delayed commencement, if the ACCC considers it is legally permissible to do so. (b) Second, it is not entirely clear whether the start date is intended to be the first day of the next month following three months from the commencement date, or whether it commences on the first day of the month which is three months following commencement. HRATF understands the drafting to mean the former. So, for example, if accepted by the ACCC on 20 February, the Varied HVAU is intended to become operative on 1 May 2018.
2.	*Is the proposed approach to backdating the Proposed Variation for the purposes of the Annual Compliance for 2018 appropriate?*	Yes. HRATF is comfortable that the approach adopted at clause 2.3(d) provides sufficient clarity that the 2018 Annual Compliance Assessment will commence for the full calendar year.
3.	*Are there any concerns about applying the Proposed Variation for the purposes of Annual Compliance starting from the 2019 compliance period?*	Yes – HRATF would not support delaying until 2019. The key package of reforms proposed by the Variation (Path based pricing, Incremental Cost and realignment of TOP) are supported by the majority of stakeholders. Indeed, HRATF understood that the original intention of requiring ARTC to develop, consult on and submit the Variation by the end of 2017 was so that there would not need to be any further delay in moving to the modified and preferred approach. HRATF strongly submits that the approach proposed by ARTC (of providing for the 2018 compliance assessment to include the varied approach to path based pricing, incremental cost and TOP/three part tariffs) be accepted.
4.	*Are the definitions of Variable Maintenance Costs,*	The definitions proposed for these terms reflect the views expressed previously by HRATF. To the extent that concepts such as the 'long run'

	Question	Response / reference
	Incremental Capital Costs and Fixed Costs clear?	are open to interpretation, this is unavoidable but important – and allows the term scope to be applied case to case.
5.	*Is the approach for allocating costs to Variable Maintenance Costs, Incremental Capital Costs and Fixed Costs appropriate?*	See comments above at page 4-5 (Incremental Capital Cost – approach to cost allocation and approval by RCG). HRATF has previously voiced its concerns with the approach adopted by Deloittes/ARTC to cost allocation of Non-Segment Specific costs, which had the apparent effect of shifting costs from non-coal users to the coal sector. More broadly, the primary concern with the allocation process for HRATF remains transparency, and assurance that industry will be involved in the process. It remains unfortunate that a detailed cost allocation methodology has not been developed under the HVAU as exists under other regulatory regimes. However, HRATF acknowledge that the allocation of common and non-segment specific costs was improved through the introduction of the cost allocation principles in Schedule I. For the purpose of allocating between Variable Maintenance Costs, Fixed Costs and Incremental Capital Costs, HRATF agrees both that: • regard should be had to 'the purpose, causal factors and costs drivers' of the expenditure (clause 4.5(e)); and • the allocation principles should be applied consistently over time, and as between similar projects (clause 4.5(g)). Both of these general principles are non-controversial. In the absence of a proper cost allocation methodology, HRATF notes that it will be particularly important that Access Holders are provided with full copies of any engineering assessment undertaken under clause 4.5(e) (which appears to be contemplated at clause 9.2(a)) and that views of industry are obtained – if not by ARTC, then by the ACCC when undertaking its compliance assessment of cost allocation during the relevant year. HRATF would welcome the ACCC making this expectation explicit in any decision.
6.	*Is it clear how Fixed Costs will be allocated to Access Holders?*	HRATF recognises that the approach to setting out the cost allocation 'waterfall' is complex in clause 4.5 and lacks clarity. This appears to be a result, at least in part, of the challenges associated with allocating ICC and Variable costs to PZ3 Access Holders outside of the PZ3 Ceiling, in order to preserve the approach to the RAB roll forward, given loss capitalisation. Fixed Costs are all costs not otherwise allocated as ICC or Variable Costs, and the allocation as between Fixed Costs and ICC is addressed under clause 4.5(e).

	Question	Response / reference
		HRATF also notes the pack annexed to the Explanatory Guide, which sets out in more detail a worked example of how cost allocation in Constrained and Unconstrained PZs is intended to operate. This makes clear that all Fixed Costs (Capital and Operating) will be allocated to one of the two Ceilings, and will then be recovered by ARTC through TOP charges, on a contracted basis (clause 4.13). The recovery of Fixed Costs through contracted TOP is also set out in the amendments to Schedule 3 of the IAHA. Provided that the approach adopted to Annual Compliance is consistent with the explanatory pack, then HRATF is comfortable that the allocation approach, although complex, is workable.
7.	*Is the use of Contracted Gtkm or Train Km rather than Gtkm or Train Km commitments appropriate as the method of allocating Incremental Capital Costs to Access Holders.*	Yes – see above at page 4 (Incremental Cost – allocation based on Contracted tonnage). With the exception of one member, HRATF strongly endorses the shift back to use of Contracted volumes as the basis for the allocation of both ICC and Fixed Costs. This is both appropriate and more consistent with the statutory object in section 44AA – providing appropriate incentives for efficient investment in new infrastructure. This is also consistent with the requirement that multi-part pricing be used, where this aids efficiency (section 44ZZCA).
8.	*Given section 4.5(h) of the Proposed Variation, is it appropriate that these costs are excluded from the Economic Cost of a Segment.*	Yes. HRATF supports the approach of removing from the PZ1 Ceiling: • the variable maintenance costs for non-coal customers; • the variable maintenance costs associated with Access Holders that are not Constrained Customers for that segment (i.e. PZ3 customers); and • the Incremental Capital Costs of PZ3 customers. These costs (i.e. those that are removed from the Ceiling) are then also reconciled to revenues under clause 4.8A, which makes clear that an equivalent value of revenue is also excluded when reconciling revenues against each Ceiling. We note that, in the future, there may be benefit in identifying a way of ensuring all costs and revenues are reconciled within Ceiling Limits, but at present we consider the approach (of reconciling these outside of any Ceiling) appears to be workable, if complex.
9.	*In addition to that set out in section 4.5(h) of the Proposed Variation, should any other costs be excluded from the*	HRATF considers that no further explicit costs appear to be required to be removed. It is evidently the case that the Economic Cost used to determine each Ceiling also only permits efficient costs to be recovered, and so as a practical matter inefficient costs will also be excluded. This does not require any further amendment. HRATF notes the work being done by the

	Question	Response / reference
	Economic Cost of a Segment.	ACCC to more robustly test the efficiency of opex, in particular, as part of the current Compliance Assessment.
10.	*Is the definition of Floor Contribution clear?*	HRATF endorses the change from 'Floor Limit' to 'Floor Contribution', which better reflects that the Floor value has now come to mean a revenue contribution, rather than a reflection of a floor cost – as had originally been intended under the NSWRAU. The specification of Floor Contributions in clause 4.2 is sufficiently clear, as also expanded upon in the Explanatory Guide.
11.	*Is it appropriate that the Floor Contribution for Pricing Zone 3 producers traversing Pricing Zone 3 is equal to the Variable Maintenance Cost of those segements?*	This is evidently an issue limited to PZ3 customers. HRATF understands that the reason for ARTC taking the currently proposed approach is that there are no Incremental Capital Costs in PZ3 (i.e. the definition of Incremental Capital Cost applies only to *Segments in Pricing Zone 1*). HRATF members from Pricing Zone 3 do not have any objection to this approach.
12.	*Is it appropriate that Pricing Zone 3 Access Holders traversing Pricing Zone 1 meet their Variable Maintenance Costs and Incremental Capital Costs?*	Yes – while producers within HRATF may have differing individual views, the HRATF supports the proposed approach to allocation of Pricing Zone 1 costs (and in particular Incremental Capital Costs) as between Constrained Customers and PZ3 Customers, because it forms part of a package of changes that are acceptable.
13.	*Is the introduction of two Constrained Networks appropriate?*	HRATF recognises that, at present, two Ceilings are necessary while a loss capitalisation balance remains in place in respect of Pricing Zone 3. HRATF does not express a view about whether the dual ceiling approach is appropriate or desirable longer term, after the PZ3 loss capitalisation balance has been repaid. However, ARTC has indicated that this is unlikely to occur before the end of the current regulatory period, so HRATF consider that this is more appropriately a matter considered and addressed in the context of the next HVAU. The current loss capitalisation arrangements are also the primary reason, HRATF understands, why the reconciliation of PZ3 customers' share of PZ1 costs occurs outside the ceiling. This adds complexity to the process and, as part of a future regulatory reset, there may be value in re-visiting whether a more streamlined approach could be used.
14.	*Is the rationale and purpose for creating two Ceiling Limits for*	See response to 12 and 13 above.

	Question	Response / reference
	two Constrained Networks clear?	
15.	*Is it clear how the two Ceiling Limits will practically operate?*	The practical material (pack) included with the Explanatory Guide provides an illustration of how the process for undertaking the annual compliance process in respect of both Ceilings (and the reconciliation of PZ3/PZ1 costs and revenues) is intended to operate. As noted above, at page 5 (Incremental Cost – dual ceiling), given the complexity of the process, the operation of the framework should be kept under review during the 2018 Annual Compliance process to ensure that it operates as expected.
16.	*Is it appropriate to determine the Ceiling Limits on a Train Path basis?*	HRATF understands that, as a practical matter, the Ceiling Limits under the HVAU have been determined within the tariff model on the basis of the cost of Segments used by individual Access Holders under the 2011 HVAU – consistent with the combinatorial approach. While the drafting in clause 4.3 has been amended to refer to Train Paths rather than Access Holders, this is not understood as intended to change the approach adopted. The cost which comprises each Ceiling is still based on the Economic Cost of *Segments* comprising each of the Pricing Zones. In that sense, the Ceiling Limit is a cost construct that continues to apply to Segments (i.e. there are not separate Ceilings for each Train Path). While Ceilings are a cost construct, Train Paths as used in clause 4.3 are a revenue construct (i.e. *the "Access revenue from any Train Path … must not exceed*"). We understand that the amended drafting is therefore only intended to more accurately reflect how the reconciliation of revenues (from Train Paths) matches with costs (Segment Ceilings) occurs. On that basis, the HRATF does not object to the amendments.
17.	*Are there any concerns relating to RCG endorsement of a capital cost where RCG approves the capital cost but does not agree with ARTC's proportions and allocation methods for Incremental Capital Costs.*	Yes. As noted above at page 4-5 (Incremental Capital Costs – approach to cost allocation and approval by RCG), HRATF considers it appropriate that the RCG should be required to endorse any cost allocation methods proposed by ARTC for new projects or capital expenditure. This is consistent with the fact that such cost allocation decisions do not materially affect ARTC (i.e. they do not change overall cost recovery), but they may have a significant impact on different producers – given the different cost recovery models for Fixed and Incremental Capital Cost. The current drafting does not provide sufficient assurance to HRATF that: (a) ARTC will always seek RCG endorsement of cost allocation decisions (clause 9.2(a)(iii)); and (b) the process will provide sufficient time and opportunity to the RCG to consider these issue (e.g. clause 9.2 refers only to "at

	Question	Response / reference
		the appropriate stage in the consultation process" and no firm process or timing is set out for this in either the HVAU or the Explanatory Guide). HRATF had hoped that the Explanatory Guide would provide more assurance around how the RCG would be involved, but it largely fails to do so. While HRATF does not consider that this issue is sufficient to warrant a rejection of the Variation by the ACCC – members would look to the ACCC to ensure that it monitors the involvement of RCG (as well as the timing and quality of consultation undertaken) when consider capital expenditure approval.
18.	*Is the distinction between section 9.2(a)(ii) and section 9.2(a)(iii) on proportions and allocation methods for Incremental Capital Costs and Fixed Costs and the role of ARTC and the RCG clear?*	HRATF considers that the distinction between provision of <u>information</u> concerning proposed cost allocation (clause 9.2(a)(ii)) and seeking <u>endorsement</u> from the RCG (clause 9.2(a)(iii)) is suitably clear in the drafting. See response to item 17 for HRATF concerns with the operation of this process.
19.	*Is the role of the ACCC for assessing decisions relating to the proportion and allocation methods for Project costs or other Capital Expenditure clear?*	The role of the ACCC in relation to approval of cost allocation decisions is not well expressed in the HVAU. However, HRATF understands that this is implicit in the right for ARTC to seek ACCC endorsement of any project expenditure that is not otherwise endorsed by the RCG, under clause 9.2(i). Again, as for the HRATF's role, it is disappointing that the only means by which cost allocation decisions can be changed in these circumstances is for the ACCC to refuse to endorse the project entirely, due to the cost allocation decisions made by ARTC. Given the ambiguity, HRATF consider that there would be benefit in the ACCC clearly indicating in its decision the approach which it intends to take to overseeing cost allocation decisions, as part of the capital approval process. In particular, HRATF notes that it should not be assumed that where the RCG has endorsed capital projects for the purpose of the Annual Compliance process, that it has also endorsed the cost allocation approach proposed by ARTC (bearing in mind that ARTC is not required to seek endorsement for its approach to cost allocation).
20.	*Is the proposed basis for TOP and non-TOP Charges appropriate?*	With the exception of one member, HRATF endorses the approach proposed by ARTC to recovering Incremental Capital Costs through TOP Charges.

	Question	Response / reference
21.	*Does the proposed structure of charges provide sufficient incentive for the efficient use of the Network.*	Yes – see discussion above at page 4 (Incremental Cost – allocation based on Contracted tonnage). With the exception of one member, HRATF considers that the approach proposed by ARTC best balances and promotes incentives for (a) capital investment; and (b) use of the HVCN. In terms of <u>*use*</u> of the network, HRATF submits that the incentive for use is primarily driven by the volumes that are able to be produced and exported using existing (i.e. 'sunk') investment in mine site and supply chain infrastructure. This contrasts with <u>*investment*</u> incentives. Here, there is a real risk that a misalignment of network charges will lead to poor capital planning decisions. Decisions about future investment in the network are closely aligned with how the costs of that investment will be recovered. Linking capital cost recovery (both Fixed Costs and Incremental Capital Costs) to contracted volumes provides a strong incentive for producers that drive expansion of the HVCN to be incentivised to then continue to support that capacity through take or pay commitments (and associated use of that capacity). There is a considerable risk of 'free riding' if producers can trigger capital costs on the basis that they are not required to pay for the capital cost of that capacity in the future unless it is used. For these reasons, HRATF (other than one member) recognises that the recovery of capital costs on the basis of contracted volumes is the policy position that most appropriately reflects the objective of incentivising both efficient use of, and investment in, infrastructure.
22.	*Does Train KM reflect how Fixed Costs are incurred?*	As noted at pages 3-4 (Path Based Pricing), HRATF accepts the move to path based pricing (including Train KM for Fixed Costs) as part of the overall package of changes proposed in the Variation.
23.	*Does Gtkm reflect how Variable Maintenance Costs and Incremental Capital Costs are incurred?*	As noted at pages 3-4 (Path Based Pricing), HRATF accepts the move to path based pricing (including Gtkm for Variable Maintenance Costs and Incremental Capital Costs) as part of the overall package of changes proposed in the Variation.
24.	*Is it clear which activities are considered to be a. Incremental Capital Costs; b. Variable Maintenance Costs; and c. Fixed Costs?*	No. HRATF is aware that this work was undertaken to a reasonable degree of detail in late 2016/early 2017 as part of the aborted attempt to develop an opex efficiency scheme. However, the material associated with that process has never been incorporated more fully into the HVAU. Moreover, since the 2013 Compliance Assessment (and associated WIK report), ARTC has included its own detailed engineering assessment as part of its compliance assessment submission. This provides a degree of insight into the approach being adopted by ARTC to the allocation of

	Question	Response / reference
		maintenance, capex and projects as between Fixed Costs and Incremental Capital Costs. HRATF see this as an area which can be further and better developed as part of the next reset.
25.	*Are the proposed configurations in the Services Envelope appropriate?*	HRATF has no objection to the technical configurations in the Services Envelope. This endorsement is on a confirmation by ARTC that the Services Envelop has been defined to capture the configurations of all contracted train services currently operating in the Hunter Valley.
26.	*Is the introduction of the Services Envelope dependent on a portion of TOP Charges being levied on a Train KM basis?*	With the exception of one member, HRATF view the introduction of path based pricing as part of a package, together with: • the shift to Contracted volumes as the basis for allocating TOP and Non-TOP amounts; and • a change in the approach originally proposed by ARTC to the allocation of Incremental Capital Cost from Contracted TKM to Contracted Gktm. HRATF understands that this shift has been made to respond to concerns expressed by the ACCC. We understand that the ACCC's question is directed towards the second of these changes. Based on presentations provided to the HRATF by ARTC in 2017, we understand that moving from contracted TKM to Gtkm for the purpose of recovering TOP ICC charges should not materially adversely impact any individual producer or group of producers – this appears to be shown by the very small variances at pages 17-19 of the pack at Appendix 1 to the Explanatory Guide. Provided this understanding is correct, then the change in the proportion of TOP associated with the move from Contracted TKM to Gtkm (for Incremental Capital Cost) should not be controversial and is not objectionable. Again, however, given the complexity of this issue (and reliance upon high level illustrations in the Explanatory Guide) – HRATF would welcome the ACCC testing that the change does not materially impact the share of TOP which are levied as between producers relative to the position today.
27.	*Is the proposed approach to determining Access Charges for coal customers whose train configurations fall outside of the Services Envelope appropriate?*	The approach to assessing Access Charges for services outside the Services Envelope appears to substantially adopt the test previously applied by ARTC where services were different to Indicative Services. HRATF is also conscious of the limitations on differentiation provided by clause 4.16. For these reasons, HRATF are comfortable with the approach proposed by ARTC. Nonetheless, the approach to non-standard services and Access Charges should be kept under review as path based pricing is

	Question	Response / reference
		implemented to ensure that unfair or discriminatory outcomes do not arise as between services within the Services Envelope and those that are not.
28.	*Are the proposed changes to the basis for determining RCG membership and voting entitlements appropriate?*	The HRATF does not have a common or shared view as to whether a move from contracted Gtkm to contracted TKM is appropriate for the purpose of RCG. However, in understanding the materiality of this issue, ARTC have indicated to the HRATF that: • there is only a marginal change in individual voting rights with the move from contract Gtkm to contract TKM, with no individual Access Holder group changing by more than +/- 1% in any zone; and • the change to TKM does not provide any one producer a greater balance of the voting majority or ability to endorse or obstruct projects. We would welcome the ACCC testing this is the case and confirming the ARTC view. Assuming that this is the case, we do not consider that it is a material issue that ought to impact upon the appropriateness of the Variation.
29.	*What would be the effect of changing the basis of determining RCG membership and voting entitlements from Contracted Gtkm to Contracted Coal KM?*	See response to question 28.
30.	*Is the proposed change to the basis for RCG endorsement thresholds appropriate?*	See response to question 28.
31.	*What would be the effect of changing the basis for RCG endorsement thresholds from contracted Gtkm to Contracted Coal KM?*	See response to question 28 above.

	Question	Response / reference
32.	*Are there any concerns with other changes in the Proposed Variation that have not been addressed in this consultation paper?*	None.
33.	*Are there any other issues in the HVAU that have not been addressed in the Proposed Variation?*	As noted above, at page 6 (Final Observations), there are a range of issues that had previously been considered as part of the earlier reset process in 2016-17 that have not been incorporated here. However, ARTC has limited its changes to those strictly necessary to meet the requirements of clause 2.3. HRATF do not consider that these other matters need to be further debated or delay approval of this Variation, but the process does highlight, once again, the inadequacy of the current HVAU approval process and the need for a more concrete regulatory process to close out issues through the ACCC. The complexity (and lack of clarity) around elements of the new cost allocation process would also present a potential risk for industry in the event of any privatisation of ARTC. This is another reason why an overhaul of the regulatory framework (including the HVAU) would be necessary as part of any future privatisation.