

Hunter Valley Coal Network Access Undertaking
2017 Annual Compliance Assessment

ATTACHMENT 2: Capital Consultation

Submission To

Australian Competition & Consumer Commission

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ARTC

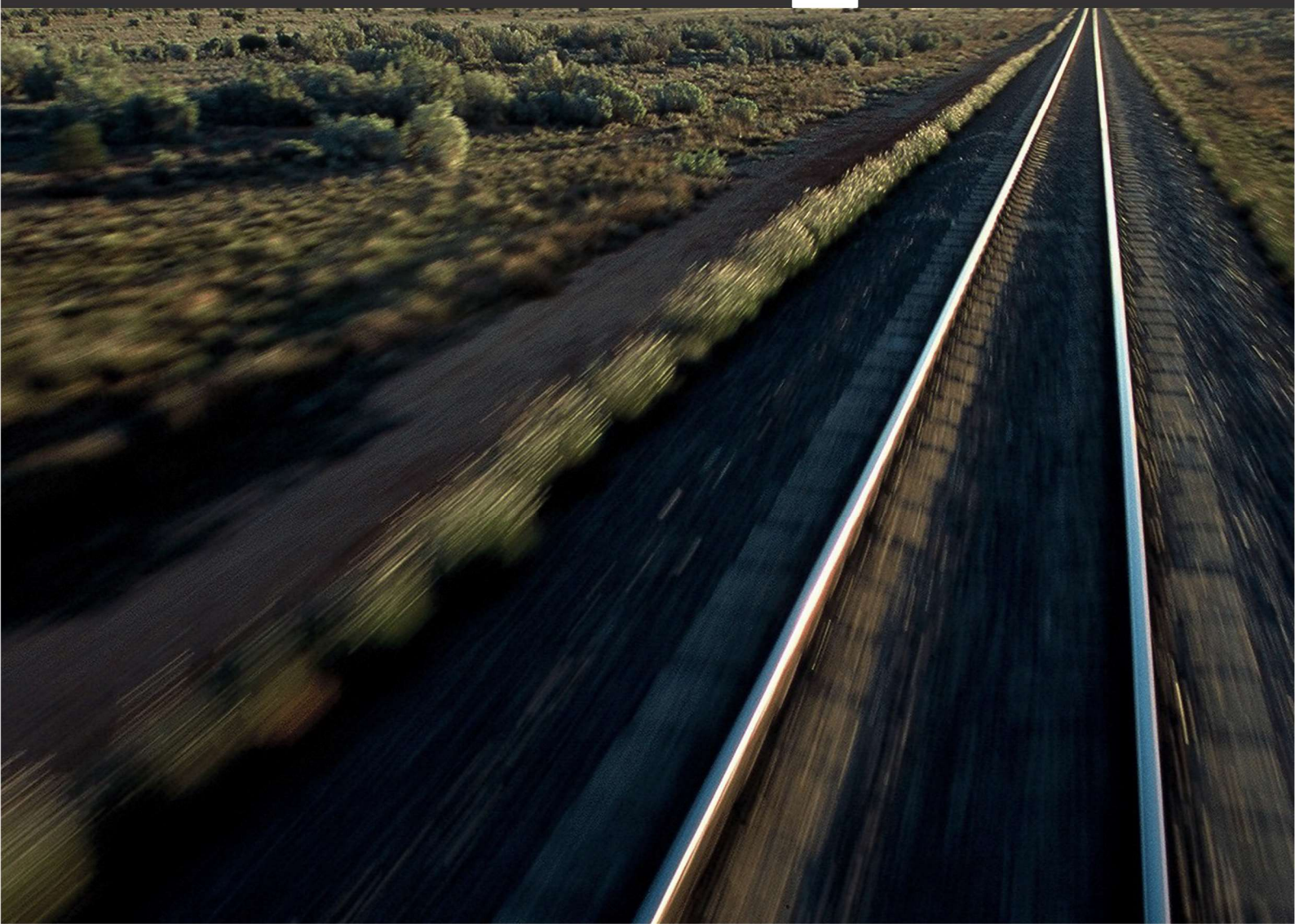


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1. INTRODUCTION

As part of its obligations under the Hunter Valley Coal Network Access Undertaking as varied on 29 June 2017 (**HVAU**), Australian Rail Track Corporation (**ARTC**) is required to engage in consultation with relevant stakeholders with regard to the capital expenditure program for the Hunter Valley rail network. This document forms Attachment 2 to ARTC's 2017 Compliance Submission and is provided to the ACCC for the purpose of demonstrating the consultation undertaken during the 2017 compliance period in support of the capital expenditure program including:

- a detailed description of the capital consultation process undertaken in 2017 and an explanation of how it met the requirements of the HVAU; and
- evidence of Access Holders' endorsement of proposed capital expenditure.

The name, address, contact details (including email address) of relevant stakeholders has been included as Appendix F to ARTC's 2017 Compliance Submission.

2. CAPITAL CONSULTATION PROCESS

2.1 Compliance Scope

Under HVAU section 9.2, ARTC is obliged to convene and conduct regular monthly meetings of the Rail Capacity Group (**RCG**). The RCG is a regular industry forum to ensure Access Holders, prospective Access Holders and other industry stakeholders are provided relevant input to identify, prioritise and evaluate future network investments and refine the capital works programme.

To achieve this objective, ARTC has a consultation process that incorporates the following:

- ARTC's planning approach, including the trade-off between routine maintenance and major periodic maintenance and capital expenditure;
- identification of the proposed capital investment needs for the forthcoming year and forecast capital expenditure for the following 10 years;
- explanation of the inputs to and outcomes of the evaluation undertaken for the proposed capital expenditure for the forthcoming year;
- assessment of the impact of the proposed capital expenditure on the Regulatory Asset Base (RAB);
- identification of the projects that will be funded or partly funded by capital contributions; and
- establishment of a process for Access Holders' input.

2.2 Industry Approach To Capital Consultation

2.2.1 Overview

Since taking responsibility for the NSW Hunter Valley Network in September 2004, ARTC has maintained its approach to consult all industry stakeholders with an interest in the movement of coal on the Hunter Valley rail network. ARTC has made an increasingly concerted effort to provide stakeholders with a comprehensive understanding of its overall strategy for the Network and an opportunity for input into the capital program.

For 2017, the primary document detailing the forecast demand for the Network and ARTC's proposed capital program to provide the required capacity to meet that demand is the 2016 Hunter Valley Corridor Capacity Strategy document and the 2017 update which was released for consultation in December 2017 and published in its final form in March 2018 (refer to Attachment CAP1.1 and Attachment CAP1.2).¹ This consultative process, which includes discussion at the RCG and feedback from stakeholders, continues to provide ARTC with significant insight and understanding of stakeholders' expectations of the rail infrastructure.

With the focus from industry now on optimising existing network infrastructure, the consultative process for capital expenditure on the Network is principally facilitated through the RCG. The RCG is attended by rail operators, coal producers, the Hunter Valley Coal Chain Coordinator (**HVCCC**) and more recently the terminal operators which allows for discussion on Coal Chain alignment aspects of ARTC's operational and capital activities.

Industry endorsement is necessary before ARTC will proceed with project implementation. Formal endorsement for the value of the project to be added to the asset base occurs through the RCG.

This consultation process is designed to provide maximum opportunity to work with Access Holders to identify and prioritise network investment and to refine capital work programs.

2.2.2 Rail Capacity Group

The RCG formally comprises a senior representative from the larger coal producers (i.e. Glencore, Coal & Allied, Yancoal, Whitehaven and Idemitsu) and one representative from the producers with lower network contracted demand (currently Hunter Valley Energy Coal). In addition to these members with voting rights, there are representatives from HVCCC and rail operators hauling coal on the Network (Aurizon, Freightliner, Pacific National and SSR). ARTC has also encouraged the attendance of other Access Holders and the terminal operators as guests. ARTC's Group Executive Hunter Valley chairs the forum. ARTC is also represented by personnel from Assets, Customer Service and Operations.

The RCG meets each month and has a standing agenda that covers:

- asset replacement and corridor capital works on the Network;
- major capital investment on the Network; and
- operational and strategic items relating to network operations, asset management and possession planning.

¹ Also available as a download from the ARTC website at <https://www.artc.com.au/uploads/ARTC-2016-25-Hunter-Valley-Corridor-Capacity-Strategy-Final-Oct-2016.pdf> and <https://www.artc.com.au/uploads/2017-HVCCS-Final.pdf>

The RCG also considers industry volume forecasts over a 10 year horizon and beyond to inform the Hunter Valley Corridor Capacity Strategy.

The RCG deals with the detail of investment proposals. ARTC provides detailed project submissions to the RCG for their review and input. Expenditure of a corridor capital nature is presented for review and approved annually by the RCG in advance of the work being undertaken. Endorsement for corridor capital is generally on the basis of the total package or works, recognising that the nature of the programme is subject to a greater degree of variation at the individual project level compared to major projects where the scope tends to be more predictable. Some corridor capital projects may also be presented to the RCG on an individual basis due to emerging circumstances, timing considerations or the complexity of a particular project.

ARTC utilises its internal governance processes and delegations to manage variability at an individual project level. This includes allowing underspends from approved budgets at a project by project level to be utilised to fund overspends on approved budgets at a project by project level, with variances reported to the RCG. This internal variation process has been communicated to the RCG.

ARTC provided quarterly updates to the RCG on the progress and cost of the corridor capital package including details of significant variations to scope and cost. The consultation documents provided to the RCG in this regard during 2017 form confidential Attachments CAP2.1, CAP2.2, CAP2.3 and CAP2.4 to this document.

ARTC uses a professional and standardised approach for classification of maintenance and capital expenditures. ARTC uses internal definitions and classifications of routine corrective and reactive maintenance (**RCRM**), major periodic maintenance (**MPM**) and capital expenditure, which is made clear to the RCG. However, when there is not a clear treatment, the issue is brought to the RCG for consultation and guidance.

There has been no change to ARTC's capitalisation policy.

2.2.3 HVCCC

Where a project will change the infrastructure on the Network, ARTC undertakes a process review of effects on network capacity and consults with the HVCCC on options to understand, mitigate or reduce the impact on the Coal Chain wherever relevant.

The HVCCC is an independent legal entity whose membership includes all current Hunter Valley coal chain producers as well as service providers. ARTC is a member of the HVCCC. The HVCCC's mission is to plan and co-ordinate the co-operative daily operation and long term capacity alignment of the Hunter Valley Coal Chain.

The HVCCC plays a consultation role in this process through modelling the capacity impacts resulting from infrastructure changes and other network capacity development initiatives on the Hunter Valley Coal Chain.

2.3 Hunter Valley Corridor Capacity Strategy Development

2.3.1 ARTC Approach

The development of the 2017 Hunter Valley Coal Corridor Capacity Strategy involved:

- assessment of the capacity of the existing Hunter Valley rail network for transporting export coal to the Newcastle ports and domestic coal to Hunter Valley power stations;
- updating demand forecasts by obtaining revised industry forecasts and views;
- comparing the available capacity with anticipated demand, to identify existing and future likely constraints;
- reviewing the options previously proposed to address these constraints;
- where necessary, the development of additional or refined options; and
- the selection of preferred actions to address each of the identified constraints.

2.3.2 Strategy Development

ARTC has continued to review and develop changes where necessary to the Hunter Valley Corridor Capacity Strategy.

ARTC continually refreshes its understanding of customer expectations of ARTC and the network, through regular discussions throughout the year. For 2017, the timing for release of the Corridor Capacity Strategy document was deferred to ensure the best possible understanding of forecast volumes given the growth being foreshadowed from the outer regions of the Network and to align with the timing of volume forecasts under the HVAU. ARTC sourced forecast information from all coal producers and domestic customers, prospective customers and presented the aggregate profile for review to the RCG. Subsequent to this, further detailed discussions took place with Zone 2 and Zone 3 Customers to understand what was a 'more likely' volume scenario (compared with the peak prospective volumes) to allow for targeted analysis of capacity options for forward years.

ARTC amends the annual strategy document to reflect updated information relating to changes in contracted capacity and forecast customer demand profiles along with the identification of projects required to fulfil the projected demand. The Corridor Capacity Strategy document also outlines the major changes to key assumptions from the previous version. For the 2017 update, the assumption change to reflect actual train running performance in the capacity calculations was explained

ARTC formally briefed stakeholders prior to publication of a Draft Strategy in December 2017. Stakeholders were provided an opportunity to provide feedback on the Draft Strategy. Follow-up discussions or responses were subsequently provided to individual respondents and a final version of the Hunter Valley Corridor Capacity Strategy was published in March 2018.

The strategy has given the Coal Chain increased certainty with the capacity pathways, timeline for delivery of the projects along with updated projected costs and as such offers options to resolve constraints and understand how coal producers can better manage their proposed course of action to increase coal throughput.

ARTC will continue to monitor and review the strategy to ensure proposals for infrastructure change are developed ahead of demand.

2.4 Project Consultation

2.4.1 Project Consultation Process

ARTC undertakes a comprehensive capital consultation process for all capital projects through the RCG. There are generally three categories of capital projects:

- major capital capacity projects;
- major asset renewal projects; and
- corridor capital (also referred to as minor capital) projects.

The major capital capacity projects are those designed to enhance capacity, that introduce significant technological change, add operational flexibility or otherwise form part of the Hunter Valley Corridor Capacity Strategy described in section 2.3 above, while the other projects are classified as either asset replacement or asset enhancement projects.

For major capital projects, consultation and endorsement is generally performed in stages to ensure that stakeholders are progressively informed before final endorsement for implementation is sought. The RCG is provided with detailed analysis of key elements of each project stage and all major projects sign off endorsements include details of:

- project aim;
- timing – start / finish;
- benefits and deliverables (e.g. capacity improvement, operational performance improvement, safety, cost savings);
- diagrams / document references;
- cost and contingency to RAB and loss on disposal where applicable; and
- endorsement signatory.

For the major asset renewal or replacement projects, a submission detailing the projects objectives, options, financial and risk management aspects is provided for review and endorsement by the RCG. This endorsement process is often iterative, and ARTC works closely with the industry in providing all necessary information for evaluation.

For the corridor capital projects, the programme of smaller projects is typically submitted collectively for consultation and endorsement to the RCG. Customers are also directly engaged in the proposed corridor capital programme in advance of it being submitted to the RCG for endorsement.

2.4.2 Project Endorsement

Confidential Attachment CAP3 to this document shows the details for all projects (major and corridor capital) which are being included in the RAB or expensed for the 2017 calendar year.

There was one major/capacity project that continued through the RCG endorsement process in 2017. In early 2017, the RCG endorsed progression of ARTC's Network Control Optimisation (ANCO) project into detailed design and subsequent implementation. This followed completion of the feasibility project phase and substantial industry engagement on the long term ANCO road map to transform service delivery and network capability to enable improved overall supply chain maturity and efficiency.

Expensed projects are projects previously endorsed by the RCG which, due to changes in the demand profile or other circumstances, will not proceed in the foreseeable future. Typically this relates to projects on which initial planning work has been carried out but the project has not proceeded to actual construction, though it may be the case that preliminary works have been carried out. The amount expensed represents the value of work in progress up to the point at which the project was suspended. For the 2017 compliance period, no projects were expensed.

Many capital projects result in the disposal of existing assets. ARTC is not able to provide the exact disposal values for capital projects prior to completion of the disposal process for consideration by the RCG, as the prospective values of any offset to the disposal value for equipment to be replaced is often not known accurately beforehand.

In some instances, new projects or variations to previously endorsed values have not been expressly endorsed or reviewed by the RCG. This can occur for a variety of reasons, including:

- the necessity to address a previously unknown issue, e.g. a critical defect is identified during testing/inspection that cannot be delayed to allow for the normal work planning process and endorsement to occur;
- an opportunity to carry out work arises out of sequence from the forward program that would result in a more efficient and lower cost than if the work is carried out as programmed. For example, where it is necessary to carry out unplanned remedial work due to an incident, it may be expedient to perform work on an adjacent site that was programmed for some future period;
- the scope of a planned task was found to be insufficient and it would be inefficient to pause the project to wait for formal endorsement from the RCG; and
- the cost of the variation is not sufficiently material to seek endorsement.

In each case, such variations are only approved by ARTC management in accordance with internal delegations where it can be demonstrated that the additional cost will not cause ARTC to exceed the overall RCG endorsed corridor capital works value for the period.

ARTC has provided to the ACCC, on a confidential basis, copies of the endorsements relating to 2017 capital expenditure provided by RCG members as a separate Attachment 3 to the 2017 Compliance Submission.

2.4.3 Capital Expenditure in 2017

During 2017, post-commissioning costs of \$2.1m were incurred on a number of major capital projects previously commissioned and added to the asset base (see Appendix A for more detail).

There was no interest during construction added to the asset base during 2017.

Corridor capital of \$47.3m was commissioned during 2017.

Disposals (i.e. reductions to the asset base) were \$8.1m.

A summary of the net additions to the asset base is set out in Table 1. Details for the amounts are set out in the 2017 Compliance Submission.

Table 1: Net Capital Expenditure Added To Network Asset Base In 2017

	\$
Major Projects Commissioned	-
Post Commissioning Costs	2,087,243
Total Major Project Capital	2,087,243
Interest During Construction	-
Corridor Capital	47,290,905
Total Capital Added To Asset Base	49,378,149
Disposals Removed From Asset Base	(8,138,432)
Net Capital Added To Asset Base	41,239,717

Further detail of major capital expenditure is provided in Appendix A. Confidential Attachment CAP3 to this document provides detail by project for both major project and corridor capital. Detail relating to disposals is set out in Appendix D and interest during construction in Appendix E of ARTC's 2017 Compliance Submission.

2.5 Compliance with the HVAU

ARTC considers that the consultation undertaken as described in sections 2.2 to 2.4 provides comprehensive evidence that ARTC has complied with the relevant requirements of the HVAU.

ARTC has worked closely with Access Holders, train and terminal operators and the HVCCC in identifying and prioritising network investments and refining capital works programs. Through this extensive consultation process, stakeholders have provided input into the major capital enhancement projects that form part of the Hunter Valley Corridor Capacity Strategy. This strategy document identifies the proposed capital investment needs for the forthcoming year and includes forecasts of capital expenditure for the following 10 years.

ARTC also provides clarity in relation to projects which are intended to be partly or fully funded by capital contributions. There were no such projects in 2017.

3. CONCLUSION

The consultation activities that ARTC has engaged in has revolved around obtaining a comprehensive understanding of coal mine development proposals, both new mines and expansion projects, and their timing of development where increased capacity is required on the Hunter Valley network. This information is reviewed against other industry information and ARTC seeks confirmation, where applicable, that its priority of project delivery matches other Coal Chain capacity deliverables.

During 2017, ARTC has found the level of co-operation and advice provided by coal producers, rail operators, and other service providers to be both informative and constructive in all aspects of managing and progressing with investment options. In particular, ARTC believes it has well developed working relationships with the Coal Chain as a whole and looks forward to these continuing.

ARTC is committed to the ongoing consultation described in this document and looks forward to a continued delivery of optimal rail network solutions in the Hunter Valley Coal Network.

Appendix A Major Project Capital Added To Asset Base 2017

Table A1: Newly Commissioned Projects \$

Project	Description	RCG Endorsed Value \$	Cost \$	IDC \$	Total Cost Added to RAB 2017 \$
Nil			-	-	-

Table A2: Post Commissioning Costs \$

Project Code	Description	RCG Endorsed Value \$	Cost Previously Added to RAB \$	Total Cost Added to RAB 2017 \$	Cumulative Cost Added to RAB \$
Pricing Zone 1					
5255	Maitland to Minimbah Third Road (Farley to Branxton)	362,800,000	185,873,534	34,697	185,908,231
5255	Maitland to Minimbah Third Road (Branxton to Whittingham)		169,560,952	15,062	169,576,014
6387	Hexham Relief Roads Stage 1	162,439,954	121,772,648	257,293	122,029,941
8667	Kooragang Arrival Roads Stage 2 Phase 6	36,579,867	28,262,127	1,785,192	30,047,318
Sub-Total		561,819,821	505,469,261	2,092,243	507,561,504
Pricing Zone 3					
5256	Scone Reconfiguration	8,622,392	7,979,712	(5,000)	7,974,712
Total Post Commissioning Cost		570,442,213	513,448,973	2,087,243	515,536,216