# AUSTRALIAN RAIL TRACK CORPORATION LTD

# APPLICATION TO VARY THE 2011 HUNTER VALLEY COAL NETWORK ACCESS UNDERTAKING (HVAU) TO PROVIDE FOR THE ADOPTION OF THE FINAL INDICATIVE SERVICES AND CHARGES IN ACCORDANCE WITH SECTION 4.18(B)

# ARTC RESPONSE TO ACCC POSITION PAPER

**August 2014**

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# 1 KEY ISSUES RAISED IN THE ACCC POSITION PAPER

ARTC submitted an application (**Application**) to vary the Hunter Valley Coal Network Access Undertaking (**HVAU**) to incorporate the Final Indicative Services in accordance with Section 4.18 of the HVAU on 31 January 2014.

Following the release of a Consultation Paper on 18 February 2014 (**Consultation Paper**) and subsequent receipt of stakeholder submissions, the ACCC released a Position Paper on 1 August 2014 (**Position Paper**). Since its application, ARTC has also responded to 2 information requests from the ACCC primarily in relation to the provision and explanation of financial modelling supporting the Application.

The Position Paper incorporates the ACCC's preliminary views in relation to the Application set out in 3 areas as follows:

1. Final Indicative Services (**FIS**);
2. Final Indicative Access Charges (**FIAC**); and
3. Drafting Amendments.

Table 1 below sets out what ARTC considers to be the key areas of concern raised by the ACCC in the Position Paper. ARTC has provided its response in relation to these areas of concern at sections 2, 3 and 4 of this response.

**Table 1: Key areas of concern raised in the Position Paper**

| Section | Area of concern | ACCC's preliminary view |
|---|---|---|
| **4.2.5** | **Selection of FIS** | The ACCC seeks comment on whether adopting a shorter term view is likely to be problematic for investments and the economic life of those investments |
| | **New HVAU** | It will be up to ARTC to propose the terms of the replacement undertaking and the nature of the Indicative Services at that time. |
| **5.1.1.4** | **GTK pricing unit** | Retaining gtkm as the pricing unit is likely to be appropriate for the current assessment. |
| **5.1.3.4** | **Non-TOP component of charges** | The ACCC seeks comments on the train configurations and assumptions used by ARTC in its calculation of the differentiation factors relating to variable maintenance in the non-TOP component of charges. |
| **5.1.4.4** | **TOP component of charges** | |
| | **Transparency** | The ACCC has presented additional information in relation to the detailed calculation of differentiation factors and FIAC at Appendix A of the Position Paper |
| | **Infrastructure constraints** | ARTC has the flexibility to set access charges higher or lower than the charges for the Indicative Services based upon its consideration of the various factors in section 4.15, which includes consideration of logistical impacts and impacts on other services operating on the network and the relative consumption of capacity (for example). The ACCC encourages ARTC and its customers to work together in these instances to determine appropriate charges. ARTC is also required to publish these charges on its website to ensure transparency amongst industry participants. The HVAU allows producers to raise a dispute about prices, which the ACCC may be called upon to arbitrate. |
| | **Fixed Maintenance** | The ACCC seeks comments on the train configurations and assumptions used by ARTC in its calculation of the differentiation factors relating to fixed maintenance in the TOP component of |

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|---|---|---|
| | | charges.<br><br>It is important to note that the ACCC assesses the efficiency of ARTC's operating costs (including maintenance) as part of the annual compliance assessment process that occurs at the end of each calendar year to ensure that ARTC receives no more revenue than to cover prudent and efficient costs (including a return on investment commensurate with the risks). As such, the ACCC has not assessed ARTC's forecast operating costs as part of its assessment of the Proposed Variation as that will occur during the annual compliance assessment process. |
| | **Network Capacity** | The ACCC seeks comments on the assumptions used by ARTC in its calculation of the differentiation factors relating to fixed maintenance in the TOP component of charges. |
| | **Coal Chain Capacity** | There might be limitations around using the HVCCC model to reflect consumption of Coal Chain Capacity when determining access charges.<br><br>For example, the Scenario 3 results of the HVCCC model adopted by ARTC assume that all the trains have the same configuration.<br><br>Inherent in the modelling for Coal Chain Capacity appears to be considerations of axle load, train length and payload. The ACCC notes that these are also considerations in the Network Capacity and Maintenance differentiation factors. As such, the ACCC questions whether there may potentially be some overlap between the differentiation factors.<br><br>The ACCC seeks comments on the methodology used by ARTC in its calculation of the differentiation factors relating to Coal Chain Capacity in the TOP component of charges.<br><br>The ACCC seeks comments on the use of the HVCCC modelling in the calculation of the differentiation factors relating to Coal Chain Capacity in the TOP component of charges. |
| | **Weightings** | The ACCC is of the view that ARTC needs to provide further information regarding its underpinning assumption for weightings given to each of the differentiation factors before it is able to form a view as to their reasonableness. The ACCC will be sending a request to ARTC for further information on this matter.<br><br>The ACCC seeks comment on the weightings applied to the differentiation factors by ARTC in its calculation of the TOP component of charges in light of the additional information presented in the Position Paper. |
| | **Pricing approach** | The ACCC is of the view that ARTC should consult with stakeholders prior to making any changes to its methodology so as to ensure open and transparent pricing practices.<br><br>The ACCC is of the view that there may be some benefit in ARTC giving consideration to whether there may be less complex approaches that still achieve the same objective as well as supporting more transparent methodologies. |
| **5.2.4** | **Transparency for pricing for non-Indicative Services** | The ACCC encourages ARTC to continue to work with industry as to the nature and level of information that may be provided to industry on an ongoing basis so as to provide sufficient transparency. |
| **6.3** | **Drafting Changes** | The ACCC's preliminary view is that ARTC' should clarify that the section 4.20 process does not apply to the Final Indicative Access Charges in the year 'immediately following' the ACCC's acceptance of the Proposed Variation.<br><br>The ACCC considers that ARTC needs to provide further clarification of how Sections 4.15 and 4.17 are intended to operate in relation to Initial Services.<br><br>The ACCC also notes the proposed amendments to subsection 4.10(a)(iii) of HVAU in which ARTC has removed reference to the Interim Access Charges. The ACCC understands that if the proposed changes come into effect on 1 January 2015, the section 4.10 would require ARTC to submit annual compliance documentation for the 2014 calendar year by 30 April 2015. As the Interim Access Charges continue to apply during the 2014 calendar year, the ACCC's preliminary view is that this reference should not be deleted. |

# 2 ARTC RESPONSE – FINAL INDICATIVE SERVICE (FIS)

## 2.1 Stakeholder Consultation

ARTC notes that the ACCC considers that ARTC has complied with the requirements of the HVAU for its consultation with industry in relation to the proposed characteristics of the FIS and in relation to the gtkm pricing unit.

ARTC also notes that the ACCC is of the view that it would have been appropriate for ARTC to have provided industry with feedback on the issues coming out of the consultation on the 'aspirational' train configurations and its proposed approach prior to submitting the Application to the ACCC. In response to this view, ARTC sought during the FIS development to undertake reasonable consultation with stakeholders in accordance with section 4.18(b)(i). ARTC also had regard to submissions arising out of this consultation in developing the proposed characteristics of the FIS in accordance with section 4.18(b)(ii). Section 4.18 does not prescribe the exact nature and extent of consultation that should be undertaken and as such ARTC must decide what is reasonable in the circumstances. Whilst more consultation with stakeholders is always considered desirable, it must be weighed up against other considerations including time and cost impacts for both ARTC and the industry. ARTC provided stakeholders and the ACCC with advice as to how it would consult with stakeholders very early in the development.

In relation to consultation late in the development process referred to in the Position Paper, ARTC decided not to re-engage with industry after having received submissions to its consultation document. It considered this decision reasonable having regard to the following circumstances at the time:

1. Although not explicitly required under section 4.18(b)(i), ARTC considered that the release of a consultation document and opportunity to make submissions had some merit, despite this being in addition to around 12 months of earlier engagement with the industry in relation to the development of the FIS.

2. The last submission from industry was received by ARTC on 2 December 2013, only 16 business days before the date that the Application was required to be submitted to the ACCC. At the time, ARTC had not secured an extension for submission from the ACCC (one month extension secured 13 December 2013).

3. ARTC had not formulated its position in relation to the Application until some time after this. ARTC advised the ACCC of its position at a meeting on 19 December 2013. As such, ARTC considered that there was insufficient opportunity to engage further with the industry ahead of the revised due date for submission of the Application, in addition to the significant effort required to develop its Application incorporating the changed position.

4. ARTC's changed position reflected the views held by a fairly wide cross-section of industry stakeholders in any event.

5. Industry would become aware of the changed position within several weeks of it becoming crystallised when the Application was submitted to the ACCC in any event, and would have a further opportunity to submit views via the ACCC's public consultation.

## 2.2 HVCCC Consultation

ARTC notes that the ACCC is of the view that ARTC's consultation with the HVCCC has complied with the requirements set out in the HVAU.

## 2.3 HVCCC Modelling and the proposed FIS

ARTC notes that the ACCC is of the view that ARTC has undertaken the modelling with the HVCCC within the scope of the HVAU.

ARTC notes that the ACCC is of the view that the proposed FIS at least signals to users the train configuration(s) that currently contribute to achieving efficient utilisation of capacity in the Hunter Valley and are therefore likely to be appropriate having regard to the objects of Part IIIA set out in section 44A of the Competition and Consumer Act 2010 (**Act**).

In relation to some specific matter raised by the ACCC in the Position Paper, ARTC provides the following responses.

### 2.3.1 Time Horizon

ARTC notes that the ACCC has sought further comment from industry on whether adopting a shorter term view for the FIS is likely to be problematic in relation to investments and the economic life of those investments.

In submissions made in response to the Consultation Paper, where industry has had an opportunity to comment on this matter, ARTC notes that whilst not all stakeholders supported the proposed characteristics of the FIS for various reasons, there was generally some support for the shorter term view taken by ARTC. This is not altogether surprising to ARTC given the shorter term view was taken in response to views expressed in submissions to ARTC's earlier consultation document in 2013.

ARTC is not aware of any changed circumstances that may cause this position to change.

Nevertheless, the need to develop an aspirational or long term view of what might represent efficient operations in the future does have some merit. Achievement of that long term outcome is likely to require significant development across the coal chain and to varying extents, where some parts of the coal chain are now further developed than others. As such, the operation of certain elements of the coal chain at more efficient levels may be achievable for some parts of the coal chain before others. This can create the problems identified by ARTC in the Application where some efficient elements may operate alongside inefficient elements, and together may result in adverse rather than improved coal chain efficiency.

ARTC understands that having and encouraging a more efficient coal chain was a driving force behind the industry and ACCC seeking certain provisions in the HVAU intended to promote this. ARTC did not oppose to this objective.

Having said that, ARTC is not convinced that mandating processes intended to achieve efficient industry outcomes in regulatory arrangements is always the best approach. In this case, the development of a longer term aspirational target and offering access for that target in the short term (as is provided under section 4.18 of the HVAU) may result in adverse short term effects. This was not anticipated at the time of development and finalisation of the HVAU where expectations as to the outcome were uncertain without significant further development of available HVCCC modelling.

Nevertheless, ARTC supports, in principle, the objective behind developing an aspirational view of an efficient Hunter Valley coal chain that can inform the operational and commercial decisions of all coal chain participants. ARTC considers that such a view can and should be developed cooperatively by all coal chain participants and having regard to the requirements of all of those participants. ARTC believes that this type of thinking is behind the establishment of the HVCCC and its predecessor.

Mandating such a process via a regulatory instrument applicable to only one component of the coal chain may not necessarily be the most effective way of achieving a desirable outcome.

To this end, ARTC would consider participating in, and even leading, a cooperative industry based approach to the development of an aspirational view of an efficient Hunter Valley coal chain. Such a view would serve to inform all industry participants, including ARTC, in making its decisions around pricing and the attendant incentives under any future regulatory arrangements.

### 2.3.2 Future FIS Determination

ARTC notes that the ACCC has indicated that it will be up to ARTC to propose the terms of a replacement undertaking and the nature of Indicative Services at that time.

At this time, ARTC is yet to develop a position in relation to the continuing development of Indicative Services over time. ARTC considers that more thought needs to be undertaken by the industry in relation to this ongoing development. As has become apparent during this consultation there are some practical implications arising from the development of aspirational service configurations and attendant pricing incentives, whilst offering access to such long term aspirational services in the shorter term.

As stated above, ARTC considers that the development of an aspirational view of the Hunter Valley coal chain and its elements can and should be undertaken cooperatively by all coal chain participants, through an industry based approach and having regard to the requirements of all of those participants. This would serve to inform ARTC in the development of any future regulatory arrangements.

ARTC believes that this type of thinking is behind the establishment of the HVCCC and its predecessor.

# 3 ARTC RESPONSE – FINAL INDICATIVE ACCESS CHARGES (FIAC)

## 3.1 GTK as a pricing unit

ARTC notes that the ACCC considers that, whilst there may be other pricing units that could be used, there does not appear to be a sufficient basis to change to an alternative pricing unit at the current time, and that retaining gtkm as the pricing unit is likely to be appropriate for the current assessment.

ARTC also notes that stakeholders are, in general, more comfortable with the use of gtkm as a pricing unit in view of more recent developments under the HVAU that have served to better inform stakeholders of the application of gtkm as the pricing unit.

ARTC will continue to assess the appropriateness of pricing options in the Hunter Valley as circumstances change in terms of the prevailing costs and benefits and endeavouring to seek a reasonable balance between interests of all parties involved. Nevertheless ARTC regards simplicity in the presentation and application of pricing on its network very highly.

## 3.2 Structure of the FIAC

ARTC notes the ACCC's preliminary view that the proposed structure of the FIAC (non-TOP/TOP components) meets the requirements of 4.11(a) of the HVAU, deemed appropriate at the time of approval of the HVAU.

## 3.3 Non-TOP component of the FIAC

ARTC notes that the ACCC considers that ARTC's proposal to use average speed and axle load in the calculation of the non-TOP access charges appears reasonable for the current assessment and the proposed non-TOP access charges are likely to be appropriate.

ARTC notes that the ACCC raised a stakeholder (Idemitsu) query as to why the 82 wagon 30TAL service in Pricing Zone 1 had a differentiation factor of more than one. ARTC presumes that the additional information provided by the ACCC at Appendix A to the Position paper would satisfactorily inform Idemitsu in this regard. The primary reason for the differentiation factor being slightly higher than 1 is the service assumption of a slightly higher wagon tare for the 82 wagon service reflecting the average of the different wagon types expected to be used in this configuration, which manifests in a slightly higher average axle load for the 82 wagon configuration when empty.

ARTC notes that the ACCC has indicated that it is important to note it assesses the efficiency of ARTC's operating costs as part of the annual compliance process at the end of each calendar year and that it has not assessed ARTC's forecast operating costs as part of its assessment of the Application.

It is not clear to ARTC whether this advice was provided by the ACCC in response to Idemitsu's query above. Given that the reason for the higher differentiation factor as raised by Idemitsu was largely as a result of an assumption in relation to the characteristics of the 82 wagon configuration and not as a result of any cost consideration, ARTC is unclear as to the relevance of the ACCC's response.

In any event, where such advice is provided in the context of an assessment of charges and differentiation ahead of a calendar year, there would seem to be a suggestion that the ACCC may seek to alter charges and differentiation as a result of its end of year compliance assessment. This may be problematic where pricing in a particular year is fixed under access agreements for that year once it has been published (following the applicable opportunity for Access Holders to notify a dispute under the HVAU).

ARTC notes that the ACCC has sought further comment from stakeholders on the train configurations and assumptions used by ARTC in its calculation of the differentiation factors relating to variable maintenance in the non-TOP component of charges.

The train configurations used by ARTC in its calculations are those contracted by Access Holders. The assumptions underpinning ARTC's approach and calculations were first advised to the industry in 2008 in order to provide transparency to the industry as to how it might differentiate coal pricing under the HVAU and have applied consistently by ARTC since 2012 following the Initial Indicative Service (**IIS**) variation public consultation. Whilst ARTC would welcome advice on any more recent developments in the field of track maintenance cost causality, ARTC's approach has been developed based on ARTC substantial experience and expertise in this area.

## 3.4 TOP component of the FIAC

### 3.4.1 Transparency of calculation of the FIAC

ARTC notes that the ACCC is of the view that stakeholders need to be given sufficient information to enable them to fully consider and provide comment on the assumptions, methodology and outputs [of the calculation of TOP charges]. The ACCC presented additional information in this regard throughout the Position Paper and further substantial detail was provided at Appendix A to the Position Paper. ARTC further notes that the additional information provided by the ACCC was in response stakeholders concerns regarding the lack of sufficient detail being provided by ARTC in its public documentation.

The ACCC also provided further information in relation to the ACCC's process regarding ARTC's claims for confidentiality at section 2.5 of the Position Paper, where the ACCC indicated that it had sought ARTC consent to provide additional information in the Position Paper, including Appendix A.

ARTC wishes to confirm that whilst the ACCC sought ARTC's consent in relation to additional information provided, this consent was only sought in relation to the detail at Appendix A, and only Appendix A was provided to ARTC for its review.

Further, Appendix A contains some information that ARTC did not provide its consent to publish, and expressed its confidentiality concerns to the ACCC. This relates to certain data[1] provided at Tables 11 and 12 of Appendix A, where the ACCC advised ARTC informally that it would publish this data based on its own legal advice.

In formulating the Application, including the supporting documentation, ARTC sought to at least provide detail in relation to the development of the FIAC in public documents that was consistent with that provided during public consultation on the Initial Indicative Access Charges (**IIAC**) in 2012. At that time, the ACCC's decision[2] was that the level of transparency during that consultation including the additional information provided by ARTC was sufficient[3] also having regard to the level of transparency provided under other provisions of the HVAU.

Specifically ARTC proposed as part of the IIS variation application a set of guiding principles that it would use to determine the IIAC, Interim Access Charges and Charges for non-Indicative Services during the Initial Period and Interim Period. These principles were intended to increase pricing transparency and certainty to a level that the ACCC considered was appropriate. These principles were reproduced as an attachment to the supporting documentation provided with this Application and ARTC advised in that supporting document that it intended to apply these guiding principles (as applicable) in determining Indicative Access Charges and Charges for other Services following approval of the FIS and until 30 June 2016 in order to maintain the existing level of pricing transparency and certainty[4].

The HVAU also provides for:

- cost and volume information to underpin annual pricing negotiation and future access pricing for 10 years;
- publishing of all pricing for Indicative and non-Indicative Coal Access Rights, providing a basis to enable an Access Holder to obtain a reasonable indication to Access Holders as to the likely direction and magnitude of differentiation in relation to any other Coal Train configurations to assist investment and efficiency decision making;
- an initial estimate of Charges for Access Rights associated with Access Application to be included in the Indicative Access Proposal; and

[1] Wagon tare in relation to specific train configurations.

[2] ACCC, Decision in relation to Australian Rail Track Corporation's Hunter Valley Rail Network Access Undertaking – Initial Indicative Service variation, 17 October 2012.

[3] Op. Cit. p41. '*The ACCC considers that the information provided by ARTC in its supporting documentation, combined with the suite of prices to be published under section 2.6(b)(iv) of the June 2011 HVAU, should provide sufficient pricing transparency to industry.*'

[4] ARTC Application to vary the HVAU to provide for the adoption of the FIS and FIAC in accordance with section 4.18(b) of the HVAU – Supporting Documentation, January 2014, p26.

- the right to dispute pricing during an access negotiation or annually.

Further, in the ACCC's decision, the ACCC '*considered that access seekers should have sufficient information to be able to calculate, with a reasonable degree of certainty, the likely direction and estimated magnitude of pricing relativities between various services.*'[5]

On this basis, ARTC considered that it was reasonable for it to align to the level of transparency to that provided in public documents in 2012, and have an expectation that this would again be sufficient.

ARTC notes the comments made by some stakeholders in submissions to the Consultation Paper in relation to seeking greater transparency. In relation to those comments included by the ACCC in the Position Paper, ARTC notes:

- Comments made by HVEC seemed to be specifically related to the HVCCC modelling for the FIS, not in relation to ARTC's modelling of TOP charges.

- Where comments made by Idemitsu relate to enabling comparisons with access charges for existing Indicative Services being beneficial to access holders to properly understand the proposed pricing, ARTC considers that where existing Indicative Services (IIS) were also Final Indicative Services such comparisons could be made. Comparisons in relation to existing Indicative Services that would be non-Indicative Services following approval of this Application (and in 2015) could be made at the appropriate time in accordance with the HVAU. Where comments made by Idemitsu relate to providing the necessary transparency between the weightings for the TOP and non-TOP components of charges, ARTC considers that such a query could be addressed by a more direct response. As Idemitsu has indicated the weightings used are the same as those used for the development of the IIAC and the basis for those weighting was made transparent in public documents arising from that consultation.

- Whilst not stated in the Position Paper, comments made by Asciano relate specifically to non-Indicative Services, whereas the ACCC's preliminary position and additional information provided relates to transparency in relation to the FIAC.

- Comments made by Coal & Allied reflect the general position in relation to pricing transparency that has been taken by Coal & Allied in both the IIS public consultation and earlier consultation during development of the HVAU. In the absence of additional supporting evidence or argument from Coal & Allied in its submission, ARTC would have thought that this position was addressed in the ACCC's decision arising from the IIS public consultation.

Based on the above, it is not clear to ARTC as to nature of any additional evidence or arguments that may have lead the ACCC to come to a view that the provision of the level of detail in relation to the detailed calculation of the FIAC, in addition to that provided in ARTC's public documents, aligned to the level of transparency that arose during public consultation on the IIS, was now necessary.

[5] Op. Cit. p39.

ARTC notes that section 4.18(a) of the HVAU provides that:

'*ARTC will develop, in consultation with the HVCCC, the proposed characteristics of the indicative services which ARTC considers will deliver the optimum utilisation of Coal Chain Capacity, given certain System Assumptions ("Final Indicative Services"). The intention is that this process will be a more robust modelling exercise than that used for selecting the Initial Indicative Services and will include scenarios under which System Assumptions are also varied in addition to the Coal Train configurations.*'

It may be that undertaking a more robust modelling exercise may warrant a greater level of transparency. However section 4.18(a) only relates to the development of the FIS. There is no requirement for more robust modelling in relation to the development of differentiation factors and the FIAC. Indeed the approach adopted by ARTC in this regard largely mirrored that adopted for the development of the IIAC, other than the use of more robust Coal Chain Capacity modelling advice from the HVCCC.

The development and finalisation of the HVAU between 2008 and 2011 resulted from substantial public consultation undertaken by ARTC and the ACCC in relation to pricing formulation and transparency as well as many other aspects of the HVAU. In the end, the HVAU approved by the ACCC resulted from a negotiated outcome between ARTC and key stakeholders that was intended to represent a balance of interests between the parties. This overall balance would have included a position in relation to pricing transparency at the time.

In the interests of certainty intended to be afforded by an access undertaking, ARTC does not consider that the balance achieved through the HVAU development process and negotiated outcome should be altered during the HVAU term in a piecemeal fashion (that is, in relation to single aspects, such as pricing transparency) without the support of both stakeholders and ARTC. ARTC believes that such matters are better addressed during formulation of a subsequent access undertaking, when all aspects of the arrangement are re-opened for development, consultation and negotiation).

In its decision in relation to the IIS variation, ARTC notes that the ACCC has taken a similar view in relation to the grandfathering provisions under the HVAU as follows:

'*The ACCC considers that subsection 4.15(a)(iii) forms part of the overall 'package' of terms which were negotiated by ARTC and coal industry stakeholders and subsequently incorporated into the June 2011 HVAU. In its decision to accept the June 2011 HVAU the ACCC noted statements made by ARTC in its letter of 6 May 2009, including that it was committing to maintain pricing parity between the two key existing train types operating in the Hunter Valley for not less than five years. The ACCC took the view that while the 6 May 2009 letter should not limit its consideration of the appropriate pricing approach under the HVAU, it was appropriate for the HVAU to incorporate grandfathering arrangements to ensure that those parties that had invested in good faith on the basis of ARTC's statement have sufficient time to adjust to the new arrangements, once determined.*

*The ACCC does not intend to reopen its decision to accept the balance of terms and conditions contained in the June 2011 HVAU in its assessment of this variation by removing or extending the scope of the grandfathering provisions in subsection 4.15(a)(iii).'* [6]

The ACCC has re-iterated this view at section 5.3.1 of the Position Paper.

It has been ARTC's intention to maintain its existing approach to information disclosure to the regulator and stakeholders (as had been practised under the NSWRAU) to be highly transparent with the regulator to enable the regulator to make determinations that would result in the industry having a great deal of confidence in the outcome of those determinations. In effect, the regulator would act on a similar basis to an external auditor auditing the accounts of a company provided to it in accordance with a set of rules (the regulatory instrument) and publish its assurance for shareholders (stakeholders). Schedule G of the HVAU (largely carried over from rules under the NSWRAU) was intended to support this approach.

ARTC considers that Appendix A as provided by the ACCC effectively extracts all of the essential numbers and formulae provided in confidential price differentiation and financial modelling provided by ARTC to the ACCC. Appendix A will, in ARTC's view, provide stakeholders with the information substantively needed to enable development of what amounts to a 'pricing calculator'.

Apart from creating a perception in industry that Charges for coal operations in the Hunter Valley can be determined through calculation, which ARTC believes is inconsistent with the pricing flexibility inherent in the Pricing Principles in the HVAU (and ARTC believes is needed in the Hunter Valley), this will restrict ARTC's ability to effectively negotiate pricing.

Further, the guiding principles for developing coal access pricing approved as part of the IIS variation and used over the last two years provide for some flexibility in pricing whilst, along with other elements of the HVAU, providing transparency to users.

Therefore, it is ARTC's view that the publishing of Appendix A by the ACCC is inappropriate having regard to:

- the extent of pricing transparency previously considered to be sufficient by the ACCC in decisions on the HVAU and on the IIS variation, and having regard to negotiated outcomes and/or stakeholder views, at those times;
- what would seem to be, to ARTC, a lack of substantive and relevant new views and arguments by stakeholders put forward in submissions to the Consultation Paper as described above to support another change in position;

[6] p 42.

- the current approach in relation to information disclosure and regulatory practice underpinning the HVAU and earlier applicable regulatory instruments; and
- the constraints that may arise on future pricing negotiations, and pricing flexibility in the Hunter Valley by creating a perception of, and framework for, formula driven pricing outcomes.

### 3.4.2 Infrastructure Constraints

ARTC notes:

- Concerns from stakeholders relating to infrastructure constraints existing in Pricing Zone 3 and on parts of the rail network not managed by ARTC (such as user infrastructure and the TfNSW network) that, at this time, prevent certain users from operating the longest proposed FIS in Pricing Zone 1 (96 wagon). Such configurations may be shorter FIS or non-FIS configurations, where some price differentiation may apply.
- The ACCC has indicated that charges should be cost reflective and, as such, will send pricing signals that efficient utilisation of the Hunter Valley Coal Network will be promoted by the use of longer more efficient trains. PZ3 constraints are reflected in the FIAC offering little flexibility where differentials are approved by the ACCC, including HVCCC modelling outcomes.
- The ACCC has acknowledged that there may be instances where non-FIS may not necessarily impact on the efficiency or capacity of the rail network in practice.
- For non-FIS, ARTC has some discretion as to what charges apply taking into account a range of factors that are set out in section 4.15 of the HVAU.

The ACCC has indicated a preference for prices to be cost reflective, and that this sends desirable pricing signals. The ACCC has indicated that there may be room to consider whether there are circumstances where a non-FIS may not impact on the efficiency or capacity of the rail network. On the other hand, the ACCC acknowledges ARTC's discretion under section 4.15 of the HVAU which may contemplate differentiation that is not solely focussed on cost.

Firstly, ARTC considers that there is some uncertainty as to the extent of discretion it may have under section 4.15 of the HVAU, based on the ACCC's position above.

ARTC has proposed to determine Indicative Access Charges and Charges for other Services following approval of the FIS and until 30 June 2016 in order to maintain the existing level of pricing transparency and certainty. These principles, consistent with section 4.15 of the HVAU and previously sought by the ACCC, permit some pricing discretion which can be based on cost based on non-cost based considerations.

Further, ARTC considers that the creation of a perception of, and framework for, formula driven pricing outcomes will hamper ARTC's ability to use discretion in pricing decisions to the extent that it now can. ARTC fears that publishing charges that do not conform with the industry's or an Access Holder's expectations in relation to differentials and incentives, and which are more likely to result from formula driven outcomes, may create a more confrontational environment.

To this end, ARTC seeks further guidance from the ACCC in relation to the extent of any discretion that ARTC may have under section 4.15 of the HVAU (and the proposed guiding principles) that may be impacted by the ACCC's position above and the perception of, and framework for, formula driven pricing outcomes that may now exist going forward.

In relation to instances where non-FIS may not necessarily impact on the efficiency or capacity of the rail network in practice, ARTC presumes that the ACCC is primarily referring to instances where non-FIS may only use a small part of the network, may only relate to a relatively small amount of coal haulage, or may operate only where capacity exists (opportunity).

Given the integrated nature of coal chain capacity planning and the treatment of train paths for planning, ARTC considers that irrespective of the extent of the network that may be used, or the extent of volume carried:

- From a Capacity perspective, a non-FIS is likely to consume a train path in PZ1, in any event. The pricing differential in relation to Capacity arises from an ability to operate a longer heavier train on that path however long the path is or often it is used.

- From a Coal Chain Capacity perspective, the carriage of a tonne of coal on a non-FIS is likely to consume more Coal Chain Capacity than the carriage of a tonne of coal on an FIS.

- Where coal is only carried on an opportunity basis (i.e. where there is a spare capacity in the port queue):

    - This may require very detailed coal chain modelling and may be specific to the circumstances each time the non-FIS is operated in order to confirm the impact on Coal Chain Capacity;

    - Any outcome and resulting pricing impact would be dependent on a range of variables specific to circumstances at a particular time, whereas the price operated would need to apply over a period of time (annually) and a range of circumstances.

In such circumstances, the ability to utilise discretion in pricing differentials, where such discretion may need to be justified in a cost based and formulaic framework will be difficult to implement.

Further, in relation to using some discretion to deal with non-FIS services, it is necessary to be mindful of the incentives that may be created. Where the price for a particular non-FIS results from the circumstances described above (small volumes, small part of network, opportunity utilisation), the price ultimately attached to that non-FIS, published and therefore offered to other users of that non-FIS may be such that it creates adverse incentives by attracting users of more efficient trains to using the less efficient non-FIS.

For example the user of a more efficient and more highly used configuration (User A) may have a Capacity or Coal Chain Capacity differentiation factor incorporated in the charge reflecting that higher utilisation. The same factor for a less efficient and less utilised non-FIS (utilised by User B) may be smaller or zero as acknowledged by the ACCC above, manifesting in a lower charge. Where this occurs, the lower charge may attract User A to use the less efficient service.

Where this occurs, it could be argued that the resulting higher utilisation by User A of the less efficient non-FIS will cause the Capacity or Coal Chain Capacity differentiation factor to increase, which may mitigate the incentive, but will also increase the charge for User B.

This highlights an issue associated with developing a charge that is specific to a certain circumstance such as volume, part of network or opportunity.

### 3.4.3 Fixed Maintenance

ARTC notes that the ACCC has sought further comment from stakeholders on the train configurations and assumptions used by ARTC in its calculation of the differentiation factors relating to fixed maintenance in the TOP component of charges.

The train configurations used by ARTC in its calculations are those contracted by Access Holders. The assumptions underpinning ARTC's approach and calculations were first advised to the industry in 2008 in order to provide transparency to the industry as to how it might differentiate coal pricing under the HVAU and have applied consistently by ARTC since 2012 following the IIS variation public consultation. Whilst ARTC would welcome advice on any more recent developments in the field of track maintenance cost causality, ARTC's approach has been developed based on ARTC substantial experience and expertise in this area.

As indicated in section 3.3 of this response, ARTC seeks further clarification from the ACCC in relation to impact of the outcomes of the ACCC's compliance assessment on charges and differentiation applicable in a previous calendar year.

### 3.4.4 Network Capacity

ARTC notes the ACCC's view that the extent to which the rail network is the key constraint on the overall coal supply chain should be a key consideration in the appropriateness of the weightings that ARTC applies to each of the differentiation factors. ARTC presumes from this that the ACCC is suggesting that applying a higher weighting to the Capacity differentiation factor (compared to other differentiation factors such as Coal Chain Capacity) than might otherwise be the case might be appropriate.

Whilst ARTC does not object to this position in principle, ARTC would logically infer from this position that the weighting may change over time with the extent that the rail network is the key constraint on overall coal chain capacity. ARTC would also logically infer that where Coal Chain Capacity was the constraint (rather than the rail network) then the extent to which Coal Chain Capacity is the key constraint should be a key consideration in the appropriateness of the weightings that ARTC applies to each of the differentiation factors, and applying a higher weighting to the Coal Chain Capacity differentiation factor (compared to other differentiation factors such as Capacity) than might otherwise be the case might be appropriate.

### 3.4.5 Coal Chain Capacity

ARTC notes the ACCC's preliminary view that the HVCCC modelling is appropriate to select the FIS characteristics, but there might be some limitations around using the model to reflect consumption of Coal Chain Capacity when determining charges.

Limitations of HVCCC modelling

The ACCC has indicated that the modelling undertaken by the HVCCC evaluates the effect of all access seekers utilising a particular train configuration compared to all access seekers using the FIS configuration rather than the impact of one access seeker using a particular train configuration amongst other access seekers using the FIS configuration.

ARTC understands that this characteristic of the modelling may to some extent constrain the effectiveness of the model for determining price differentials.

ARTC notes that section 4.18(a) of the HVAU does not require ARTC to utilise or base any price differentiation relating to Coal Chain Capacity on HVCCC modelling. Section 4.15(a)(i) of the HVAU requires ARTC, in formulating its prices for non-FIS, to reflect the commercial impact on ARTC's business of the relative consumption of Capacity and Coal Chain Capacity compared to FIS and the logistical impact on ARTC's business of the relative reduction in Capacity and relative reduction in Coal Chain Capacity compared to FIS.

This requirement to mandate the incorporation of differentials in pricing reflective of Coal Chain Capacity impacts was sought by the industry during final negotiation of the HVAU with industry in 2011. The HVAU is not prescriptive as to how such differentials should be determined or incorporated.

During these negotiations ARTC expressed its concerns that it may not be the best party to deal with coal chain impacts as it did not have expertise or modelling in this area.

As the HVAU cannot place obligations on parties other than ARTC, such as the HVCCC, ARTC was not in a position to consult with the HVCCC, and the HVCCC was not required to participate in such consultation, in relation to matters other than that required to determine the FIS. Additional activity relies on the availability, goodwill and cooperation on the part of the HVCCC.

As such, and given that ARTC does not have the expertise nor models to undertake its own assessment of the impact on Coal Chain Capacity of different train configurations, ARTC sought to inform itself in the regard through the modelling that the HVCCC had provided.

This is consistent with the approach adopted in relation to the IIS development.

ARTC expects that to develop detailed price differentials that reflected specific coal train configurations, the relative utilisation of coal train configurations, whether considered from a two coal train configuration simulation or perhaps a more realistic multi-train simulation would require substantial modelling and analysis to be undertaken, and may not be achievable with existing HVCCC modelling.

ARTC would welcome this body of work being undertaken, presumably by the HVCCC, so as to become better informed in relation to these specific Coal Chain Capacity impacts.

In the absence of this information, and given that ARTC does not have the expertise or models to undertake its own assessment of the impact on Coal Chain Capacity of different train configurations (nor does it believe it to be efficient for it to acquire the necessary expertise and modelling given the existence of the HVCCC), ARTC sought to inform itself in this regard as best as possible through the modelling that the HVCCC had provided as part of the FIS.

This is consistent with the approach adopted in relation to the IIS development.

ARTC would intuitively expect that the impact on Coal Chain Capacity of modelling a mix of train types would be similar to that which might be expected when considering Capacity in itself, where:

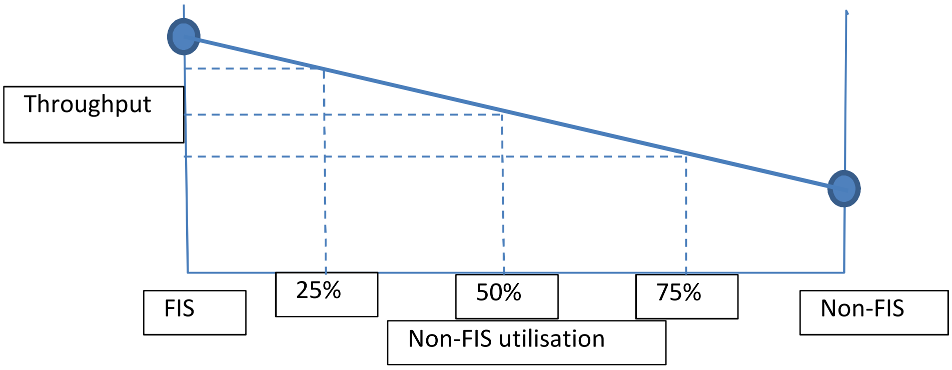
- due to the deleterious effect that interactions between trains with different operating parameters would have on network throughput for a given network, the throughput of any mix of different trains is likely to be less than where homogenous trains are operated; and

- where the mix is heavily biased towards one type of train the impact of throughput of another infrequent train operation is likely to be less than that where there is an even mix of different trains.

It may be that similar characteristics result in other parts of the coal chain such as trains and ports.

Whilst ARTC is unable to support this through detail Coal Chain Capacity modelling, it is ARTC's current view following consideration of the HVCCC advice that has been provided that the Coal Chain Capacity impact of introducing a different coal train configuration to a network utilising only the FIS configuration may not deviate too far from a linear pattern as indicated in Figure 1 below.

**Figure 1: Recognising relative mix of train configurations**




This view is consistent with the intuition described above and with the view expressed by the ACCC at page 48 of the Position Paper in relation to non-FIS in certain circumstances.

This view may be useful in guiding ARTC's pricing decisions in relation to non-FIS in certain circumstances notwithstanding the concerns expressed at section 3.4.2 of this response.

In any event this constraint on the effectiveness of the available HVCCC modelling to determine Coal Chain Capacity differentials for coal train configurations was a matter considered by ARTC in determining the appropriateness of the proposed weighting used to determine price differentials (refer section 3.4.6 below).

<u>Overlap between differentiation factors</u>

The ACCC has indicated that Coal Chain Capacity modelling undertaken by the HVCCC appears to consider axle load, train length and payload, and that these are considerations in the Network Capacity and Maintenance differentiation factors. As such, the ACCC has questioned whether there may potentially be some overlap between differentiation factors.

ARTC recognises that a coal train configuration operating at a higher axle load and a longer train length would normally carry a higher payload and operate at a higher gross mass.

Gross mass is not a substantial driver of Capacity on the Network, where an assumption that all train configurations consume the same Capacity is made. The use of gross mass (loaded and empty) only applies to convert a single charge for a path to a $/000GTK price.

ARTC understands that payload is a key driver in the HVCCC modelling used to determine Coal Chain Capacity differentials.

Nevertheless, ARTC considers that these elements of a coal train configuration are considered with respect to the Maintenance, Capacity and Coal Chain Capacity components of the non-TOP and TOP charge (as applicable) independently.

Further, the impact of these elements on each pricing component is different. For example utilisation of a higher axle load configuration would normally result in a negative Maintenance impact (leading to a higher price) but a positive Coal Chain Capacity differential (where it results in a higher payload). Similarly a shorter train configuration with a lower payload and gross mass is like to result in a larger price differential for the Capacity component than for the Coal Chain Capacity component, where a shorter train configuration may result in less consumption of port capacity and shorter cycle time.

These different impacts are explicitly recognised in the guiding principles incorporated in the approved IIS variation and utilised since and proposed to be used until expiry of the HVAU as part of this Application.

The differential in relation to each pricing component applies to a separate part of ARTC cost base and the weighting of the different components of the charge serves to balance the different impacts of the characteristics of the coal train configuration on each component. This would seem reasonable to ARTC and would mitigate overlap to a large extent.

### 3.4.6 Weighting of differentiation factors

More detailed analysis and justification for the weightings used for Capacity and Coal Chain Capacity

ARTC notes that the ACCC expects that ARTC would be able to provide more detailed analysis and justification for the weightings that have been applied to Capacity and Coal Chain Capacity. The proposed weighting is 50%/50% which results in a weighting of Coal Chain Capacity impact in the overall TOP charge as described at Table 2 below. The differences between Pricing Zones largely results from the different proportion of maintenance cost as opposed to Economic Cost forecast in each Pricing Zone.

**Table 2: Relative Coal Chain Capacity weightings**

| Pricing Zone | Coal Chain Capacity weighting |
|---|---|
| 1 | 44.25% |
| 2 | 41.17% |
| 3 | 44.67% |

As indicated in section 3.4.5 of this response, section 4.18(a) of the HVAU does not require ARTC to utilise or base any price differentiation relating to Coal Chain Capacity on HVCCC modelling. However, the requirement to incorporate differentials in pricing reflective of Coal Chain Capacity is mandated at section 4.15 of the HVAU, and was sought by the industry during final negotiation of the HVAU with industry in 2011. The HVAU is not prescriptive as to how such differentials should be determined or incorporated.

As stated above, ARTC expressed its concerns that it may not be the best party to deal with coal chain impacts as it did not have expertise or modelling in this area. ARTC also expressed concerns throughout the consultation that Coal Chain Capacity was not a direct driver of ARTC's costs in providing access to the Network. It may be considered as an indirect driver of costs in the broader context of costs across all other Hunter Valley Coal Chain participants.

ARTC recognises that Coal Chain Capacity impacts are a consideration in capacity investment decisions through the RCG process and in the development of the Hunter Valley corridor capacity strategy.

This would lend support to maintenance and Capacity considerations being the key drivers of ARTC cost of providing access to the Network. Without the above mandate, it is likely that ARTC would differentiate charges for coal train configurations large based on these two considerations.

As such, ARTC would normally be inclined towards a lower or minimal weighting for Coal Chain Capacity, in view of the fact the mandate under section 4.15 is not prescriptive as to the extent that pricing differential should be reflective of Coal Chain Capacity impacts.

ARTC considers that this is consistent with the ACCC's view that charges should accurately reflect the cost of service provision as is stated throughout the Position Paper.

Having said this, on the Constrained Network, ARTC recovers Economic Cost through application of the Ceiling Revenue Limit and the operation of unders and overs accounting. As such, ARTC can afford to be somewhat indifferent to the mechanism for recovering Economic Cost (pricing) which would primarily serve to 'slice up the pie' only. This is the main reason why ARTC in the 2011 negotiations conceded to the above mandate required by the industry primarily to drive towards more efficient consumption of Coal Chain Capacity.

As such, the extent to which Coal Chain Capacity impacts are reflected in price differentiation may be driven more-so by the outwardly focussed consideration of delivering appropriate incentives rather than the inwardly focussed consideration of cost recovery and allocation.

However, adopting such a focus results in decision making around weightings of price components that is more likely to be based on qualitative considerations such as balancing industry views and the size of differentials against broader industry costs.

The more detailed analysis and justification that is sought by the ACCC is more appropriate to determining the relativity of the variable v fixed maintenance weightings and maintenance v capacity weightings as these are largely based on cost considerations.

For the reasons above, the relativity of the Capacity v Coal Chain Capacity weightings however are not underpinned by detailed mechanical or numerical analysis and justification.

Nevertheless, in recognition that the relativity of Capacity v Coal Chain Capacity can have a fairly significant impact on resulting TOP charge differentials between different coal chain configurations, the determination of a 50%/50% relativity as proposed by ARTC did involve a number of qualitative considerations as described below.

1. ARTC has sought to give due consideration (as it did in the IIS development) to the importance placed by industry and the ACCC on providing pricing incentives across the coal chain (including the rail network) that encourage efficient utilisation of Coal Chain Capacity. This objective was strongly promoted by industry during the HVAU development. For this objective to be properly implemented, similar incentives should exist in pricing across all coal chain infrastructure providers.

   Nevertheless, in its initial IIS variation proposal, ARTC proposed a relativity between Capacity and Coal Chain Capacity weighting of 1/3rd to 2/3rd to recognise the importance placed by industry and the ACCC on providing pricing incentives across the coal chain (including the rail network) that encourage efficient utilisation of Coal Chain Capacity.

   '*ARTC recognises the importance placed by the coal industry on efficient utilisation of Coal Chain Capacity. To this end ARTC proposes to weight Coal Chain Capacity considerations 2/3rds and Capacity consideration 1/3rd.*'[7]

   In that development, ARTC was open in declaring that its proposal was made on somewhat arbitrary grounds.

   In its response to the ACCC's Position Paper in that development ARTC stated:

   '*ARTC has made it clear in supporting documents that the weighting afforded to Coal Chain Capacity impacts has been set somewhat arbitrarily, and to recognise the importance placed by the industry, and supported by the ACCC in the Position Paper, on recognising Coal Chain Capacity consumption in below-rail pricing. Generally, Coal Chain Capacity differentials account for around 50% of overall pricing differentials.*'[8]

   In that response ARTC also sought the views of industry in relation to the proposed Coal Chain Capacity weighting.

   '*ARTC is not aware of any concerns raised, or information provided, in stakeholder submissions as to the appropriateness of the weighting it has afforded to Coal Chain Capacity differentials. ARTC would welcome any further views on this.*'[9]

   At the time, ARTC did not detect or receive any further views in relation to the Coal Chain Capacity submission subsequently from stakeholders other than Coal & Allied, which argued for the use of the Capacity differential as a proxy

[7] ARTC Application to vary the 2011 HVAU to provide for the adoption of the IIS and IIAC in accordance with section 4.17(c)(ii) – Supporting Documentation, 1 December 2011, p45.

[8] p 24.

[9] p 25.

for Coal Chain Capacity differential (that is a 0% Coal Chain Capacity weighting) in view of the constraints of the HVCCC modelling at the time. This view would have resulted in much larger differentials and would have supported a broader Coal & Allied position seeking larger differentials.

Following further consultation with the ACCC at the time, ARTC adjusted the Coal Chain Capacity weighting to 50/50 in order to address Coal & Allied's concerns and balance this against ARTC position that it did not wish to overstate differentials in what amounted to an interim arrangements without robust and proper modelling to support those differentials.

2. The FIS development is intended to be a 'more robust modelling exercise than that used for selecting the IIS including scenarios under which System Assumptions are also varied in addition to the Coal Train configurations'.

   ARTC considers that whilst the HVCCC modelling used for the FIS development still had some limitations (as pointed out by the ACCC in the Position Paper) it still represented a more robust exercise that removed many of the limitations perceived by stakeholders (including Coal & Allied) during the IIS development.

   On this basis, ARTC considered that the basis for reducing the Coal Chain Capacity weighting from 2/3rds to 50% was not as strong and could provide a basis for increasing the weighting above 50% to align to the initial IIS proposal.

3. On the other hand, ARTC also recognised limitations still existed in relation to the HVCCC modelling, particularly where it is utilised for determining pricing differentials. This has been recognised by the ACCC in the Position Paper.

4. The longest FIS in predominant Pricing Zones 1 and 2 is the same configuration as the longer IIS in those Zones.

5. On this basis, ARTC saw no compelling reason to move away from the 50/50 weighting adopted for the IIS development.

6. Further, recognition that the relativity of Capacity v Coal Chain Capacity can have a fairly significant impact on resulting TOP charge differentials between different coal chain configurations would also leads to the realisation that the selection of the weighting will play a significant role in determining the extent to which the competitive position in which some stakeholders in the short term will benefit from the FIS/FIAC development and some stakeholders will lose.

   In some cases, ARTC recognises that infrastructure constraints create this short term outcome. This is also recognised by the ACCC in the Position Paper.

   Given that the selection of a weighting is not based heavily on cost considerations, ARTC saw a 50/50 weighting as a reasonable balance between these positions given that the Capacity component fully aligns differentiation with consumption of Capacity and cost.

7. In making this proposal, ARTC would have expected that most stakeholders would have considered the impact of commercial outcomes of the FIS

development on their businesses, with the beneficiaries seeking to maximise the benefit and the others seeking to minimise the impact of the development.

ARTC has sought to be reasonable in its consideration of the extent to which Coal Chain Capacity impacts should be reflected in pricing differentials in the circumstances and given that there was no prescription (which is not surprising given the different commercial interests of stakeholders art the time).

ARTC would be happy to consider any constructive views expressed by stakeholders as to the determination of a weighting of Coal Chain Capacity that is based on more robust analysis and justification, bearing in mind that any movement away from 50/50 is likely to be criticised by some stakeholders and applauded by others, and no outcome is likely to be widely supported by stakeholders.

Having said this, ARTC would also be willing to consider a linkage between the Capacity v Coal Chain Capacity weightings and the extent to which to which the rail network or the coal chain is the key constraint on the overall coal supply chain throughput. This could result in determining movements in either direction around the 50/50 weighting to reflect the relative importance of incentives around the utilisation of Capacity or Coal Chain Capacity depending on prevailing circumstances. ARTC would be happy to consider any widely held stakeholder views in this regard.

### 3.4.7 Pricing Approach

#### 3.4.7.1 Changes to methodology

ARTC has indicated that the approach may change over time should better information become available or new factors come into play. The guiding principles accepted by the ACCC as part of the IIS variation (and committed to as applicable by ARTC until the expiry of the HVAU in this Application) provide ARTC with limited flexibility in its pricing development as follows:

- any reasonable adjustments to reflect practical considerations;
- may consider other factors as contemplated at Section 4.15 including any variation to the terms and conditions incorporated in the Indicative Access Holder Agreement or Indicative Operator Sub-Agreement relevant to the Charge; and
- may alter the assumptions, methodologies or adjustments described above, but only where there is a reasonable basis for doing so.

ARTC will consult with stakeholders prior to making any changes to its methodology that are not reasonably within the bounds of the Pricing Guidelines. Such a change may require a variation to the HVAU in any event.

To the extent that any changes are within the reasonable bounds of the Pricing Guidelines ARTC will inform stakeholders in annual pricing advice under s4.20 to ensure openness and transparency. Access Holders may dispute if they consider changes fall outside the reasonable bounds of the Pricing Guidelines.

#### 3.4.7.2 Complexity of Approach

ARTC notes that the ACCC considers that there may be some benefit in ARTC giving consideration to whether there may be less complex approaches that still achieve the same objective as well as supporting more transparent methodologies.

ARTC does not consider the methodology proposed to differentiate pricing to be very complex.

As indicated earlier maintenance and Capacity are ARTC's two key cost drivers and the industry has sought to mandate reflection of Coal Chain Capacity impacts in price differentials. As such at least 3 components of pricing are necessary. In addition the non-TOP and TOP component of charges is required under the HVAU and ARTC believes that this has general industry support. This requires separate treatment of variable and fixed maintenance cost under the HVAU. As such, each charge is underpinned by six separate considerations as a minimum.

In the Application ARTC has provided what was previously considered to be a reasonable amount of transparency around the methodology use in the case of determining differentiation factors for each component. The ACCC has now provided substantially more detail in the consultation, which should make methodologies clear and transparent.

This leaves the complexity and transparency around the HVCCC modelling. ARTC understands that could be inevitably complex and 'black box'-like. ARTC encourages industry stakeholders to seek greater transparency and understanding of modelling used by the HVCCC.

As part of the development of any new undertaking, ARTC will consider the costs and benefits of alternative pricing methodologies. Simplicity of pricing has always been one objective, but ARTC recognises that the tendency to use access pricing to meet a range of other legitimate objectives works against simplicity.

### 3.4.8 Transparency of pricing for non-FIS

ARTC notes that the ACCC considers that the legitimate business interests of ARTC in retaining a certain level of discretion regarding the prices it sets must be balanced against the interests of access seekers in having charges that are sufficiently transparent, and that the guiding principles proposed by ARTC, and the existing HVAU requirements, appear to provide a degree of transparency.

ARTC also notes that it is the ACCC's view that it remains appropriate for ARTC to retain a certain level of discretion regarding prices for non-Indicative Services.

As stated earlier in this response, ARTC has proposed to continue to utilise the guiding principles provided as part of the supporting document to the Application as applicable for the remainder of the Term of the HVAU in order to maintain the existing level of pricing transparency and certainty. Since the approval of the IIS variation, ARTC has negotiated and finalised access charges with Access Holders for 2013 and 2014 without controversy or dispute.

Under the HVAU, additional measures intended to increase transparency in pricing include:

- cost and volume information to underpin annual pricing negotiation and future access pricing for 10 years;
- publishing of all pricing for Indicative and non-Indicative Coal Access Rights, providing a basis to enable an Access Holder to obtain a reasonable indication to Access Holders as to the likely direction and magnitude of differentiation in relation to any other Coal Train configurations to assist investment and efficiency decision making;
- an initial estimate of Charges for Access Rights associated with Access Application to be included in the Indicative Access Proposal; and
- the right to dispute pricing during an access negotiation or annually.

ARTC has during the development of the HVAU and subsequent reviews sought to achieve and maintain a balance between the users' need for pricing transparency and its own need for some discretion in setting charges. This is consistent with the overall objectives of the HVAU that also seek an appropriate balance.

It should be noted that the reference at section 1.2(c) of the HVAU to 'use transparent and detailed methodologies, principles and processes for determining Access revenue limits, terms and conditions' specifically revenue to 'Access revenue limits' and not pricing. This specific reference was intended as the Access revenue limits are critical under the HVAU floor and ceiling tests in ensuring there is no cross-subsidisation between users and ARTC does not collect excessive revenue. The specific reference was not intended to extend to determination of charges where some discretion and flexibility was considered important as was the case under prior regulatory arrangements in the Hunter Valley. ARTC sought to make this clear in supporting documents and during earlier consultation with the industry and the ACCC.

ARTC has already expressed its concerns at section 3.4.1 of this response in relation to the level of information provided publicly as part of this consultation on future pricing negotiation and ARTC's discretion in this regard.

ARTC would expect that users will always seek greater transparency and detail in relation to the determination of charges, and notes that the ACCC has again recognised concerns in the regard in stakeholder submissions. ARTC noted similar broad concerns during HVAU development and during consultation on the IIS variation. It is ARTC's view that the existing level of transparency, primarily ARTC's commitment to utilise the guiding principles and to publish all pricing delivers sufficient transparency to users for the purpose of business planning and results in a reasonable balance of interests. As has been the case in the past, ARTC would be happy to further assist stakeholders in the development of new business proposals.

Other than broad concerns raised, ARTC has been unable to identify in stakeholder submissions any detailed evidence as to why the existing level of transparency is not sufficient to meet their planning needs.

### 3.4.9 Grandfathering arrangements

ARTC notes that the ACCC does not consider it appropriate to extend the scope of the grandfathering provisions in section 4.15(a)(iii) of the HVAU as part of the FIS variation.

ARTC also notes that the ACCC Decision on the IIS variation recognised that subsection 4.15(a)(iii) formed part of the overall 'package' of terms which were negotiated by ARTC and the coal industry stakeholders and subsequently incorporated in the HVAU, and that it was not appropriate to re-open its decision to accept the balance of terms and conditions contained in the HVAU in its assessment of the IIS variation by removing or extending the scope of the grandfathering provisions.

# 4 ARTC RESPONSE – DRAFTING AMENDMENTS

## 4.1 Section 4.20 application to FIAC

ARTC notes the ACCC's preliminary view the ARTC proposed amendments to section 4.18(a)(i) may not reflect the position that section 4.20 does not apply in relation to the FIAC approved by the ACCC to apply in the year immediately following the ACCC's acceptance of the FIS variation.

To clarify, ARTC proposes the following alternative amendments at section 4.18 of the HVAU.

**Table 3: Proposed alternative amendments to section 4.18 of the HVAU**

| | |
|---|---|
| **4.18(a)(i)** | the characteristics ~~proposed under section 4.18(b) as the Final~~ of the Indicative Services and~~,~~ the Indicative Access Charges applicable to the Indicative Services ("**Indicative Access Charges**") to apply in the year immediately following the date the ACCC approves the variation of the Undertaking for the adoption of the Indicative Service. To avoid doubt, the annual process for the finalisation of Indicative Access Charges under **section 4.20** will not apply to the Indicative Access Charges approved by the ACCC; |
| **4.18(c)** | Indicative Access Charges will be subject to annual review in accordance with **section 4.14,** except for Indicative Access Charges approved by the ACCC as part of the variation for the Undertaking for the adoption of the Indicative Service. Subject to **section 4.20**, for each calendar year, ARTC will, using reasonable endeavours and having regard to available information, determine:<br><br>(i) Indicative Access Charges applicable to the Indicative Services; and<br><br>(ii)Charges for other Services associated with Coal Access Rights, including Initial Services during the Initial Period and Charges for other non-Indicative Services. |

## 4.2 Clarity of treatment of Initial Services

ARTC notes that the ACCC requires further clarification as to the operation of section 4.17 and section 4.15 of the HVAU specifically as they apply to services that ARTC has proposed as Initial Services (Initial Indicative Services until approval of the Application) until 30 June 2016.

ARTC sought to clarify the operation of these sections of the HVAU at Section 4 of the Application as follows:

'*Initial Services that have the characteristics set out in section 4.17(d) (previously Initial Indicative Services) to apply during an extended Initial Period ending on 30 June 2016. Initial Services have been retained as a transitional arrangement ahead of the take up of the Indicative Services. Initial Services are no longer Indicative*

*Services for the purpose of section 4.15 of the HVAU as they no longer represent the most efficient consumption of coal chain capacity (other than the characteristics of the Initial Service 1 in Pricing Zone 1 and 2 that ARTC has proposed to be the Indicative Service in those Pricing Zones as set out in Table 1). To recognise the existing predominant utilisation of Initial Services on the Network, Charges will continue to be determined under section 4.15 and reviewed in accordance with section 4.20 of the HVAU.'*[10]

In relation to the operation of sections 4.17, 4.20 and 4.15 of the proposed HVAU as they apply to the Initial Services until the end of the Initial Period, ARTC provides the following further clarification:

1. Relevant proposed amendments to section 4.17 are intended to extend the concept and specification of the 'Initial Indicative Service' beyond the approval of the FIS and until expiry of the HVAU. That is, for the purposes of developing and finalising Charges for the 2015 and 2016 calendar years. It should be noted that the proposed longest FIS in Pricing Zones 1 and 2 is the same as the approved longest IIS in those Pricing Zones. As such, the practical application for the 'Initial Indicative Services' beyond approval of the FIS will relate to Initial Indicative Service 2 in Pricing Zone 1 and Initial Indicative Service 1 in Pricing Zone 3 (82 wagon 25 TAL configuration). ARTC has proposed to do this because it considers it likely that take up of FIS will be gradual over this period and, there will still be a significant proportion of the 82 wagon 25 TAL services in operation.

   This treatment is almost identical to that afforded to the Interim Indicative Service configurations under the IIS variation (these were relabelled Interim Services under that variation until approval if the FIS variation), and for the same reasons.

2. The Initial indicative Services have been proposed to be renamed Initial Services following approval of the FIS variation and until 30 June 2016. This is because under section 4.15 of the HVAU, ARTC is required to:

   a. reflect the commercial impact on ARTC's business of the relative consumption of Capacity and Coal Chain Capacity compared to Indicative Services and the logistical impact on ARTC's business of the relative reduction in Capacity and relative reduction in Coal Chain Capacity compared to Indicative Services

   b. have regard to Indicative Access Charges for Indicative Services in formulating Charges for non-Indicative Services (section 4.15(a)(ii)(A).

   These requirements are intended to set the Indicative Service and Indicative Access Charges as the 'benchmark' against which other Charges will be set, where such services represent most efficient use of resources.

[10] Application, Section 4, p 11.

Services with the characteristics of the Initial Indicative Services (82 wagon 25TAL services) and which are not proposed to be a Final Indicative Service, will no longer represent most efficient use of resources (rather the FIS will). Accordingly, ARTC has proposed to rename these services to Initial Services so as to make it clear that these services will not act as indicative services after approval of the FIS but will be subject to differentiation based on the FIS as the benchmark similar to other non-Indicative Services.

This treatment is also almost identical to that afforded to the Interim Indicative Service configurations under the IIS variation (these were relabelled Interim Services under that variation until approval if the FIS variation), and for the same reasons.

ARTC proposes, under the Final Indicative Service variation, to adopt the existing longest IIS in Pricing Zones 1 and 2 as the longest FIS in Pricing Zones 1 and 2. If the ACCC is of the view that this proposal is causing some confusion (i.e. the longest FIS and longest Initial Services in Pricing Zones 1 and 2 will be the same), then ARTC could consider removing this configuration as an Initial Service under section 4.17(c) to clarify that the only Initial Service after approval of the FIS variation will be the 82 wagon 25TAL service.

3. Following approval of the FIS, the 82 wagon 25TAL Initial Service will no longer represent the benchmark for differentiation under section 4.15. Nevertheless, as stated above, ARTC expects that there will still be a significant proportion of the 82 wagon 25 TAL services in operation following approval of the FIS until 30 June 2016.

   The process for finalising charges under section 4.20 has to date been applied not just for Indicative Services (being the most efficient) but also for commonly used non-Indicative Service configurations. This can be seen in the treatment of Interim Services under section 4.20(h) of the approved IIS variation, which were also expected to be commonly used for a period after the IIS variation was approved. ARTC proposes to adopt this approach for the Initial Service until 30 June 2016.

   ARTC considers that it is appropriate to include commonly used configurations under the section 4.20 process to ensure charges in relation to commonly used services are finalised expeditiously and that any disputes are resolved on an industry wide basis. The dispute resolution process for non-Indicative Services under section 4.15 are stayed until all disputes under section 4.20 are finalised. If section 4.20 did not apply to Initial Services and a subsequent dispute under section 4.15 resulted in a requirement to adjust pricing for an Initial Service (being a commonly used non-Indicative Service configuration), this will have implications for the already finalised Indicative Access Charges and increase uncertainty for the industry. If all section 4.15 disputes only related to uncommon non-Indicative Service configurations, then any significant implication for Indicative Access Charges are unlikely.

   As such, for the purpose of finalising charges under section 4.20 **only**, ARTC has proposed that the section 4.20 process should apply to Initial Service configurations until 30 June 2016. In this way, Access Holders operating Initial

Service configurations during this period will have the same right of dispute as those operating the Indicative Services (FIS).

ARTC hopes that this further clarifies the treatment in the proposed Initial Services following approval of the FIS variation and until 30 June 2016.

## 4.3 2014 Annual Compliance

ARTC notes the ACCC's preliminary view that the reference to Interim Access Charges in section 4.10(a)(iii) of the HVAU should be re-instated.

To address the ACCC's concern in this regard, ARTC proposes to re-instate the reference to Interim Access Charges in section 4.10(a) but, for clarity, proposes to limit its application to the end of the Regulatory Transition Period (or 31 December 2014) as follows:

**Table 4: Proposed alternative amendments to section 4.10(a) of the HVAU**

| | |
|---|---|
| **4.10(a)** | ARTC will submit to the ACCC by 30 April each year in respect of the previous calendar year:<br><br>(i) documentation detailing roll-forward of the RAB and the RAB Floor Limit, and comparisons between RAB and RAB Floor Limit;<br><br>(ii) where documentation in (i) above demonstrates that RAB is at or below RAB Floor Limit, documentation detailing calculations relevant to reconciliation of Access revenue with the applicable Ceiling Limit and calculation of any allocation of the total unders and overs amount; and<br><br>**(iii)** where documentation in (i) above demonstrates that RAB is above RAB Floor Limit in Pricing Zone 3, documentation demonstrating that Indicative Access Charges, Initial Access Charges during the Initial Period or Interim Access Charges during the Regulatory Transition Period, as applicable, satisfies the requirements in section 4.3(b). |