



AUSTRALIAN RAIL TRACK CORPORATION LTD

Ref No:

18 October 2010

Mr Anthony Wing
General Manager
Transport & General Pricing
GPO Box 520
Melbourne VIC 3001

AUSTRALIAN RAIL TRACK CORPORATION LTD ARTC HUNTER VALLEY COAL NETWORK ACCESS UNDERTAKING RESPONSE TO ACCC CONSULTATION PAPER

ARTC wishes to make the following short response in relation to the consultation paper released by the ACCC in relation to ARTC's Hunter Valley Coal Network Access Undertaking ("2010 HVAU") on 16 September 2010.

Please note that ARTC provided as part of the 2010 HVAU application to the ACCC in September, extensive supporting documents including an Explanatory Guide that detailed ARTC's explanations and positions in relation to most matters raised by the ACCC in the consultation paper. As such, ARTC's comments below relate merely to matters of further clarification and additional issues identified from its review of the consultation paper.

Treatment of Asset Disposals in RAB Roll Forward

The ACCC has sought views on

'Whether it is appropriate for asset disposals in the RAB roll forward equation to be accounted for at written down value.'

ARTC is not aware of this issue having been raised during previous development of the 2010 HVAU. ARTC understands that the write-down of assets disposed of as a result of asset replacement and/or enhancement is consistent with standard accounting practice. The treatment proposed by ARTC is consistent with current

practice in relation to RAB roll forward under the NSW Rail Access Undertaking (NSWRAU). Consistent with current practice, it is ARTC's intention to identify, in relation to any capital project, those RAB assets that would be removed as a result of the capital project. The written-down value of those assets (recorded in the regulatory asset base in the year of removal) is removed from the regulatory asset base and expensed in that year (offset by any proceeds received where the assets are sold by ARTC). On the constrained network, the written-down value that has been expensed is recovered through the ceiling test.

The identification and valuation of asset disposals in relation to any capital project, including industry endorsement for regulatory purposes, is currently part of the capital expenditure consultation process required under the NSWRAU, and will continue under the 2010 HVAU as part of the prescribed Rail Capacity Group consultation process.

Performance Measurement and Incentives

The ACCC has sought views on:

'If parties consider it appropriate for the proposed 2010 HVAU to include a performance incentive scheme for ARTC, they are requested to outline what that scheme should or could comprise.'

In the 2010 HVAU ARTC has proposed (at section 8.2) to comply with performance incentive schemes as yet to be prescribed. ARTC has advised that it will propose incentive mechanisms to the ACCC before acceptance of the 2010 HVAU.

The development of incentive mechanisms is largely in response to a concern expressed by the ACCC in the Draft Decision on the April 2009 HVAU¹ in relation to the application of the system-wide true up test (**TUT**) proposed in the April 2009 HVAU that sought to rebate take or pay charges to access holders where ARTC failed to deliver system capacity on a monthly or quarterly basis, and access holders did not utilise their base entitlement to path usages in that month or quarter. Specifically, the ACCC expressed concern as to the negative and asymmetric nature of the test and the absence of balancing mechanisms to positively incentivise ARTC to invest in, and maximise utilisation of, the Hunter Valley coal network.

'... the ACCC considers that it would be highly desirable for ARTC to be able to over recover revenue if ARTC was able to facilitate more path usages in a given period than the forecast of system capacity. However, the ACCC notes that a purely ex post assessment regime relying on penalties for under performance [system wide true up

¹ ARTC Hunter Valley Access Undertaking submitted for ACCC consideration in April 2009.

test], while arguably not as desirable as a regime with positive performance incentives, could still be appropriate as long as the ex post assessment was clear and transparent and created reasonable efficiency incentives.²

and, in considering the question,

'Does the true-up test in its current form provide the incentive for ARTC to facilitate efficient investment and use of the rail infrastructure?'

"... the ACCC also notes that the test may give ARTC an incentive to under contract as it is purely negative asymmetric in terms of expected cash flows to ARTC. In addition, the tighter the test is formulated, the greater the negative expected cash flows from the test would be and the greater the potential incentive to under contract capacity would be. As such, a highly segmented true up test may result in ARTC facing incentives that will not result in it efficiently operating its Network.³

As such, to align with the nature of the concerns raised by the ACCC, ARTC has focussed on mechanisms that focus on providing incentive for ARTC to manage access in a way that benefits the business of network users.

ARTC, the ACCC has additionally discussed with the ACCC the benefits of incorporating a mechanism that encourages ARTC to seek to continually improve productivity.

Since the Draft Decision, ARTC has consulted further with stakeholders and the ACCC in these matters. Specifically, ARTC proposed some options to address the ACCC concerns to the ACCC and/or stakeholders, including:

- a mechanism to positively incentivise ARTC to make capacity, in excess of that contracted and available to users, balancing the negative incentives in this regard arising under the TUT;
- a mechanism to incentivise ARTC to improve productivity by enabling ARTC to capture any benefits for delivering services at costs below pre-agreed benchmarks; and
- permitting ARTC to earn an increment on the regulated return, where it matched agreed benchmarks in relation to Key Performance Indicators.

² ACCC Draft Decision, p 29.

³ ACCC Draft Decision, p 677.

While stakeholders have not responded formally to these options, ARTC detected some acceptance of the need to have such mechanisms and the broad nature of the some of the mechanisms proposed.

In addition, stakeholders also sought some consideration of mechanisms that reward ARTC for:

- non-capital intensive performance – especially those that grow capacity; and
- achievement of safety targets.⁴

ARTC is preparing a paper providing further discussion in relation to positive incentive mechanisms in each of these aspects of ARTC service, and a proposed mechanism in each case. It is ARTC's intention to release this discussion paper to stakeholders in order to obtain views, and subsequently inform ARTC in the development of mechanisms that may be incorporated in the 2010 HVAU. ARTC considers that it is important to allow time to develop and consult on appropriate mechanisms and, as such, intends to provide a formal proposal to the ACCC in 2011.

Other Matters - Measures for non-coal access

In the consultation paper, the ACCC has stated:

'ARTC has proposed amendments to section 3.14 that state that non-coal users will be offered access to the Network under the terms and conditions of the Indicative Interstate Access Agreement, amended to take into account the particular circumstances of the Hunter Valley as reasonably determined by ARTC ...'

This statement is consistent with the ARTC's proposal expressed in its response to the Draft Decision on the April 2009 HVAU. However, following subsequent discussions with the ACCC on the matter, ARTC agreed to further clarify and improve certainty for non coal users by specifically prescribing those aspects of the Indicative Interstate Access Agreement that would vary to address the particular circumstances of the Hunter Valley. Amendments along these lines have been made to the 2010 HVAU.

The relevant section of the 2010 HVAU (3.14) now states that state that non-coal users will be offered access to the Network under the terms and conditions of the Indicative Interstate Access Agreement, amended to:

- (i) define the network covered by the Access Agreement as the Network subject to this undertaking; and

⁴ Rio Tinto meeting with ARTC, 6 August 2010.

- (ii) incorporate those provisions identified as Tier 1 (mandatory) Non Coal Provisions in Schedule A:2,

ARTC considers that these amendments now made in the 2010 HVAU substantially increase certainty in relation to the terms and conditions available to non coal users.

ARTC assumes that the ACCC has sought views in relation to a previous ARTC proposal, rather than the 2010 HVAU.

For further information regarding the preparation of this submission, could you please contact myself, (08) 82174314 (Ph), 08 82174578 (Fax), or sormsby@artc.com.au (Email), or Mr. Glenn Edwards, (08) 82174292 (Ph), (08) 82174578 (Fax), or gedwards@artc.com.au (Email).

Yours sincerely



Simon Ormsby
General Manager Commercial