



**SUBMISSION IN RESPONSE TO THE ACCC'S
CONSULTATION PAPER**

**IN RELATION TO THE AUSTRALIAN RAIL
TRACK CORPORATION'S PROPOSED
HUNTER VALLEY RAIL NETWORK ACCESS
UNDERTAKING**

25 October 2010

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Executive Summary and Introduction

1. Context

Coal & Allied Industries Limited (**C&A**) makes this submission in response to the Australian Competition and Consumer Commission's (**ACCC**) 16 September 2010 Consultation Paper inviting submissions on Australian Rail Track Corporation Limited's (**ARTC**) proposed 2010 Hunter Valley Coal Network Access Undertaking (the **Proposed HVAU**).

As the ACCC is aware, C&A has consistently sought to engage with ARTC, the ACCC and other industry stakeholders on the terms of ARTC's Proposed HVAU and proposed Indicative Access Holder Agreement (**Proposed IAHA**). In particular, since the ACCC's Draft Decision on 5 March 2010 in relation to ARTC's April 2009 application for a Hunter Valley Coal Network Access Undertaking (**2009 HVAU**)(the **Draft Decision**) and the subsequent withdrawal of ARTC's 2009 HVAU on 19 April 2010, C&A has devoted significant efforts to attempt to resolve with ARTC the remaining issues with previous versions of the HVAU and IAHA. These efforts have included C&A working with the Hunter Rail Access Task Force (**HRATF**) to achieve consensus on the following five key unresolved issues in an attempt to simplify the task of ARTC developing a revised set of arrangements:

- 1 Certainty of contracted volumes on the track;
- 2 ARTC accountability for delivering contracted volumes;
- 3 Incentives to align the interests of ARTC and Access Holders;
- 4 Contractual alignment through capacity management protocols; and
- 5 An efficient, cost reflective pricing approach.

C&A and the HRATF have both sought to raise these issues with ARTC for consideration and resolution. Unfortunately, despite these efforts, the Proposed HVAU (including the Proposed IAHA) submitted by ARTC reflects few of the substantive changes required to address these critical issues.

In addition, the Proposed HVAU is incomplete, as key components, including those related to incentive structures and transition arrangements, are yet to be lodged with the ACCC.

2. C&A's Position

ARTC's failure to address the issues raised previously lead C&A to conclude that it is unable to support ARTC's Proposed HVAU in its current form. C&A does not believe that the Proposed HVAU should be accepted by the ACCC having regard to the matters listed in s44ZZA(3) of the Trade Practices Act 1974 (Cth)(**TPA**). In particular, C&A considers that the Proposed HVAU:

- (a) does not sufficiently promote the economically efficient operation of, use of and investment in the Hunter Valley Rail Network or the Hunter Valley Coal Chain;
- (b) does not appropriately balance the interests of ARTC and Access Seekers; and

(c) as a result of the above, is not in the public interest.

C&A does not reach this conclusion lightly. As one of the largest coal producers in the Hunter Valley, C&A has already made significant, irrevocable take-or-pay commitments to port terminal capacity with both Port Waratah Coal Services Limited (**PWCS**) and Newcastle Coal Infrastructure Group Pty Limited (**NCIG**). These commitments, totalling several billion dollars, create an urgency to secure track access as quickly as possible. However, at the same time C&A also seeks to ensure that the terms of the Proposed HVAU and Proposed IAHA appropriately protect the interests of Access Holders, as C&A is likely to be subject to those terms for 10 years or longer.

3. Procedural Implications

C&A believes that ARTC's lodging of the Proposed HVAU at this stage in the negotiation and development of the undertaking is premature. As noted above, given that many critical issues have not been resolved and some components remain subject to completed drafting, C&A had hoped to have the opportunity to further negotiate these issues with ARTC before ARTC lodged the Proposed HVAU. C&A does not believe that it is in the best interests of ARTC and interested parties to have the timeframes under Part IIIA of the TPA commence when many critical issues remain unresolved and where C&A, the HRATF and other interested parties remained keen to engage with ARTC to attempt to resolve these issues before ARTC lodged the Proposed HVAU.

C&A considers that when ARTC lodges the remainder of its Proposed HVAU application, the ACCC should exercise its powers under s44ZZBD(1) of the TPA and invite public submissions on those aspects of ARTC's application as interested parties should be given the opportunity to make submissions on the complete Proposed HVAU. There must be appropriate recognition of the linkage amongst the elements of the Proposed HVAU; that is, the proposed incentive arrangements, which ARTC has indicated will be submitted later, must be considered in the context of other aspects of the Proposed HVAU, such as the pricing proposals.

C&A has concerns that the timing of a potential ACCC decision will prevent interested parties from having the opportunity to conduct a thorough review and prepare submissions following the lodging of the remainder of the Proposed HVAU by ARTC. Sufficient time should be made available to allow submissions to be made to the ACCC by interested parties once a complete Proposed HVAU is available for consideration.

As outlined by the ACCC in section 3.3 of its Consultation Paper, recent amendments to Part IIIA of the TPA provide that the ACCC may give an "amendment notice" in relation to an undertaking before accepting the undertaking. It is C&A's view, however, that the amendments that ARTC would need to make to address the unresolved issues with the Proposed HVAU and Proposed IAHA are well beyond the scope of what was intended to be addressed through the amendment notice process.

Looking forward in light of the above, there is a need for more extensive and effective interaction amongst ARTC, producers, rail providers and other stakeholders to develop a comprehensive new HVAU and IAHA that better balance the needs of all parties. C&A

continues to strongly support the principle of developing a track access undertaking within the Hunter Valley and sees it as having great importance to industry. As a result, it is critical that all interested parties, including ARTC, continue to work on reaching a solution as an industry. Importantly, C&A considers that, given the appropriate guidance by the ACCC, the majority of the remaining unresolved issues could be resolved in a timely manner.

4. Rationale

This submission outlines the rationale for C&A's conclusion that it cannot support the Proposed HVAU. In the sections which follow, C&A has identified a number of the unresolved issues and has also sought to respond to the matters specifically raised by the ACCC in its Consultation Paper. However, C&A has focussed this submission on the five key issues which the Proposed HVAU fails to address, and has also considered the appropriateness of the Rate of Return proposed by ARTC in light of these issues.

C&A has also sought to propose practical solutions to the key issues where possible. At this point C&A has not, in all instances, proposed detailed drafting to implement the revised proposals, but can provide drafting at a later stage if the ACCC wishes. C&A's proposals on the way forward from this point are discussed in the final section of this submission.

In C&A's view, to properly address the five key issues, the Proposed HVAU would need to provide:

- 1 Certainty of access to track Capacity, both in the transition to the new arrangements and in future through a clear framework for making further allocations of and investment in track Capacity;
- 2 Certainty that ARTC will be held accountable for Capacity Shortfalls it causes through a True-Up Test which is transparent, comprehensive and independent, including in relation to the determination of Network Path Capability (**NPC**) and appropriate inclusion of Tolerance;
- 3 Alignment of ARTC and Access Holder interests, through the development of a comprehensive set of incentives;
- 4 Alignment of contractual and operational elements along the Hunter Valley Coal Chain, particularly by ARTC playing a necessary and appropriate role in the development of a system for identifying and managing Capacity gains and losses; and
- 5 Pricing which promotes the economically efficient operation and use of track Capacity and sends appropriate signals to industry regarding efficient investment in above and below-rail Capacity, by reflecting the true cost of access.

5. The Five Key Issues

An outline of C&A's perspectives on each of the five key issues is set out below and discussed in depth in the relevant sections of this submission. The detailed sections of the submission also note the ACCC's comments on the relevant issues in its Draft Decision and ARTC's response to those comments.

5.1 Key Issue 1: Certainty of Capacity, both in terms of the transition to the HVAU and in the future, is the number one priority for Access Holders, to allow them to align their track Capacity with their investments in operations and their commitments at the port terminals

(a) Key Issue 1A: There is no transparency (or specific proposal) for the transition from the current arrangements to the initial allocation of Capacity under the Proposed HVAU

In order to provide transparency and certainty to Access Seekers, C&A considers it essential that ARTC develop appropriate transition arrangements from the New South Wales Rail Access Undertaking (*NSWRAU*) to the Proposed HVAU.

The importance of transparent and certain transition arrangements is particularly critical in this instance, as Hunter Valley coal producers have now been through two rounds of capacity nominations at PWCS, and NCIG has signed contracts for the first 53 mtpa of production. As a result, by the end of 2010, coal producers will have committed to a total of approximately 200mt of port terminal allocation on 10 year rolling take-or-pay contracts. These obligations represent more than \$10 billion in forward commitments. The transition arrangements must make it clear how Available Capacity and Additional Capacity will be allocated amongst Access Holders to align with their significant existing long term port commitments.

Despite C&A having previously emphasised the importance of transition arrangements to ARTC, ARTC has not provided any detail in the Proposed HVAU as to how ARTC plans to transition Access Seekers from the current arrangements under the NSWRAU to the new HVAU. Further, it is only in its Explanatory Guide to the Proposed HVAU (*Explanatory Guide*) that ARTC provides for the transition of its own regulatory arrangements.

C&A has suggested in this submission a process for nominating for and allocating track Capacity in a manner consistent with allocations at the port terminals, referred to in section 1b below. In the absence of any other proposed transition arrangements, this process could be extended to initial nominations and allocations to be made once an HVAU comes into effect.

(b) Key Issue 1B: The Proposed HVAU does not provide Access Holders with sufficient certainty that new track Capacity will be delivered as required by Access Holders

It is widely anticipated that Hunter Valley coal production is likely to continue growing into the foreseeable future, potentially to 250Mtpa of export and domestic production over the next five to seven years. Therefore, the process for allocating

and investing in Additional Capacity is an integral part of the Proposed HVAU and certainty that this can be achieved as and when it is needed is a key concern for Access Holders.

The investment framework in the Proposed HVAU falls short in terms of the processes for allocating and investing in new Capacity, the processes for ensuring users can fund expansions and the appropriate oversight and governance of the investment process. In this regard, C&A submits:

(i) Identification and allocation of Additional Capacity required

The process of identifying whether Additional Capacity is required to meet an Access Application is ill-defined, particularly in regards to when ARTC issues an Indicative Access Proposal and the point at which the Applicant enters into an Access Holder Agreement (**AHA**).

Section 3.13 of the Proposed HVAU, dealing with applications for mutually exclusive Access Rights, has been narrowed to only address applications for Available Capacity (providing ARTC with a great deal of discretion in these cases), but there is no discussion of how mutually exclusive applications for Additional Capacity will be handled (for example, it is not clear whether mutually exclusive applications for Additional Capacity will be resolved on a first come, first served basis, through a pro rata allocation or on the basis of which application maximises values to ARTC).

(ii) Funding of Additional Capacity

It is not clear when a decision is made as to who will fund a particular expansion (ARTC or the Access Holder), who has the first right to fund and who will ultimately pay for the expansion (for example, recovery through Access Charges). Moreover, it is uncertain whether these decisions will be made in time to ensure the Capacity is available when needed by the Access Holder.

C&A welcomes the inclusion in section 6.2(g) of the Proposed HVAU of principles for an equitable form of reconciliation where Additional Capacity is initially funded by a Capital Contribution. However, C&A considers that these principles should be clearly embodied in a pro forma Capital Contribution Deed between ARTC and the Applicant. This Deed would include all necessary commercial terms for the making of the Capital Contribution by the Applicant.

C&A considers that ARTC should be required to submit a draft Capital Contribution Deed to the ACCC for acceptance as part of an amended HVAU except if ARTC were to commit to funding or constructing any Additional Capacity required to meet any initial allocations, in which case, ARTC should be required to submit the deed within six months of the ACCC's acceptance of an HVAU.

(iii) **Certainty of delivery of Additional Capacity**

The Project Completion Conditions Precedent in the Train Path Schedule of the Proposed IAHA appear to give ARTC the opportunity to decline to fund a specific expansion required to deliver Base Path Usages (**BPUs**), even after the AHA is signed, raising a significant question about the real nature of ARTC's contractual commitment under the Proposed IAHA.

Although ARTC has somewhat restricted its ability to choose not to build Additional Capacity funded by an Applicant on the basis of ARTC's "legitimate business interests", the fact that the "legitimate business interests" test is retained in the Proposed HVAU means that ARTC's discretion to decide whether to build Applicant-funded Additional Capacity is still too broad. As a result, ARTC's commitment to build Additional Capacity even after funding has been arranged remains unclear. The arrangements by which Applicants can elect to fund Additional Capacity are particularly important to Applicants as user-funding is the only mechanism which ensures Applicants can obtain the track Capacity they need when ARTC is unable or unwilling to fund the construction of Additional Capacity.

Without certainty as to the delivery of Additional Capacity, Access Holders face the risk of potential delay in achieving the expansion of the NSW coal industry.

C&A believes that the shortcomings identified in the processes of nominating and allocating Capacity could be improved through a number of modifications to the Proposed HVAU, which C&A has described in its Proposed Solution to Key Issue 1B below (see sections 1.2 – 1.8 of the main body of this submission). The modifications which C&A has suggested are aligned to the capacity nomination and allocation arrangements developed at PWCS, a well recognised system which industry sees as being fair and transparent. C&A believes that ARTC adopting these arrangements would further promote contractual alignment along the Hunter Valley Coal Chain and leave ARTC no worse off than under the Proposed HVAU. These arrangements could apply equally to domestic coal and could also be adapted to consider other non-coal users of the Network.

5.2 Key Issue 2: ARTC should have greater accountability for delivering contracted volumes, through a transparent determination of Network Path Capability and inclusion of Tolerance in the calculation of take-or-pay rebate accruals in the True-Up Test

The True-Up Test is currently the only means of recompense for Access Holders in the event that ARTC fails to deliver the required Train Paths given the liability exclusions in the Proposed IAHA. It is therefore critical that the True-Up Test ensures that ARTC is held accountable for any Capacity Shortfalls that it causes. In this regard, C&A believes that:

(a) Transparency of elements in the True-Up Test

- (i) To be effective as an incentive for ARTC to run the Network efficiently, the True-Up Test must be transparent and independent, particularly in relation to the determination of NPC. A proper determination of NPC is fundamental to the appropriate determination of Capacity and the operation of the True-Up Test, since no TOP Rebates will be paid if NPC is overestimated.
- (ii) C&A believes the determination of NPC should align to the modelling done by the HVCCC, which is a more rigorous approach than currently proposed by ARTC.
- (iii) C&A also considers that ARTC should use the transparency contained in HVCCC publications as a guide for the level of transparency needed in its True-Up Test publications.

(b) Comprehensiveness of True-Up Test and inclusion of Tolerance

- (i) Tolerance is a key system-wide right; it provides the capability for Access Holders to shift the use of their allocated BPUs between Periods in order to accommodate the variability of the Hunter Valley Coal Chain.
- (ii) Access Holders will pay for Tolerance as part of the Access Charges. Given that Access Holders will be paying for Tolerance, it is only right that ARTC should be required to compensate Access Holders if it does not make Tolerance paths available and, as a result, an Access Holder fails to use all of their BPUs over the year.
- (iii) Tolerance was included as part of the True-Up Test calculation in ARTC's April 2009 IAHA; however, Tolerance is not included as part of the True-Up Test in Schedule 2 of the Proposed IAHA. As a result, the mechanics of the True-Up Test in the Proposed IAHA do not adequately compensate Access Holders if ARTC fails to make Tolerance paths available, nor do they provide an adequate incentive for ARTC to provide Tolerance paths to the industry.

C&A suggests in section 2.4 of the submission below modifications that can be made to the True-Up Test that leads to a workable solution, while retaining the best aspects of ARTC's proposal and also addressing the issues above.

C&A notes that ARTC has raised in its Explanatory Guide reasons why it considers that it would be inappropriate to include Tolerance in the True-Up Test. In sections 2.3 and 2.4 below, C&A has addressed each of these points. In summary, C&A is of the view that the matters raised by ARTC do not justify the position that Tolerance should not be included in the calculation of rebate accruals under the True-Up Test.

5.3 Key Issue 3: C&A supports the development of a package of incentives that provide upside for ARTC to align the interests of ARTC and Access Holders

Section 8.3 of the Proposed HVAU states that "Before acceptance of the Undertaking, ARTC will propose one or more incentive mechanisms". C&A would be prepared to

support the inclusion of an incentive mechanism, provided it is designed in a way that will effectively align the interests of ARTC and Access Holders and lead to gains in the throughput of the Hunter Valley Coal Chain as a whole. In particular, C&A:

- (a) would be prepared to support additional performance-linked revenue, linked to (for example) achievement of safety targets and/or non-capital intensive performance improvements; and
- (b) is supportive of providing ARTC with the opportunity to earn additional revenue for making ad hoc paths available, but subject to the arrangements being implemented in a way that protects Access Holders access to their BPU's and Tolerance entitlements.

As outlined above, C&A believes it is essential that interested parties should have the opportunity to review and make submissions on ARTC's proposed incentive mechanisms before the ACCC issues a Draft Decision or final Decision.

5.4 Key Issue 4: The Proposed HVAU could go further in promoting contractual alignment across the Hunter Valley Coal Chain, particularly through capacity management protocols

C&A considers that more can be done to improve the contractual and operational alignment of elements along the Hunter Valley Coal Chain to encourage optimal use of assets across the rail, track and terminal assets. C&A believes this can only be achieved with effective identification and management of Capacity gains and losses under an HVAU, so that parties are held accountable for any Capacity impacts that they cause and so that other Access Holders will not be impacted by their actions.

In C&A's view:

- (a) The five day period for Capacity Shortfall events currently proposed in clause 6 of the Proposed IAHA will, in practical terms, have the effect of providing ARTC with total discretion to allocate all likely shortfalls in track capacity, with no regard to either "at fault" or "affected producers", potentially leading to inequitable outcomes.
- (b) Although the scope of the proposed review of "policy and processes for identifying and allocating losses of Capacity" section 5.9 of the Proposed HVAU has been broadened from earlier drafts, C&A believes that such a review needs to take a coal-chain wide perspective, to ensure that gains in one area are not at the expense of losses in another part of the coal chain. Accordingly, the review should be co-ordinated by the Hunter Valley Coal Chain Coordinator (**HVCCC**), not ARTC, given the HVCCC's existing role of planning and co-ordinating the co-operative daily operation and long term capacity alignment of the Hunter Valley Coal Chain. However, it will be necessary for ARTC to constructively participate in this process and be willing to adopt the HVCCC's recommendations.
- (c) The approach outlined in clause 11.6 of the Proposed IAHA for addressing Network Capacity losses due to train cancellations has some shortcomings and could compromise contractual alignment.

As set out in sections 4.1 – 4.3 of C&A's detailed submissions, the changes to the Proposed HVAU and the Proposed IAHA necessary to address the shortcomings above are relatively straightforward. Specifically, C&A still sees considerable merit in pursuing the 'scheduled path' approach put forward previously by C&A and other Access Seekers.

5.5 Key Issue 5: It is critical that ARTC's pricing approach sends accurate signals about efficient investment in, operation of and use of the rail Network

Given the magnitude of the investment decisions to be made in the Hunter Valley Coal Chain in the immediate future, including an estimated additional \$2 billion of above and below-rail assets over the next five years, the pricing approach which ARTC adopts must ensure that this capital is spent appropriately in efficient infrastructure. C&A believes pricing must send accurate signals to operators and investors, allowing them to make decisions about how to invest in, operate and use the Network efficiently. In the interests of certainty for Access Holders this approach must be adopted sooner rather than later.

In particular, C&A submits that:

- (a) The approach to pricing track access amongst various Indicative and non-Indicative Services does not promote the economically efficient operation of, use of and investment in the Network as it is not based on actual use of Capacity and does not reflect the drivers of costs. For example, Trains which consume an equivalent Path Usage may pay a different price if they have different lengths, since pricing is currently set on a GTK-basis.
- (b) ARTC's proposal to develop "the indicative service which ARTC considers will deliver the optimum utilisation of Coal Chain Capacity" is flawed. ARTC should instead focus on determining the basis of pricing which most closely reflects the cost of providing Capacity. This approach will enable Access Holders (and their Hunter Valley Coal Chain Service Providers) to choose the most appropriate service for them, with full knowledge of what they will be charged and that this charge reflects the cost of the Capacity that service consumes.
- (c) In putting forward this approach, C&A is not seeking to penalise Access Holders for prior decisions made regarding existing assets. Rather, C&A proposes that the decision on how pricing will change must be made as soon as possible, as it is important to put in place pricing which will drive efficient investment as soon as possible, in order to influence future decisions and planning. To help Access Holders cope with the transition to cost-reflective pricing, C&A suggests that implementation of the efficient pricing structure can be gradual and made subject to appropriate "grandfathering" regimes.
- (d) ARTC has used as justification for the decision to maintain the current pricing approach a letter to the New South Wales Minerals Council (*NSWMC*), dated 6 May 2009, in which ARTC makes a commitment to "pricing parity" on a GTK basis. ARTC sent this letter after it had lodged its 2009 HVAU application with the ACCC. Such a commitment risks being considered misleading as it may imply that by giving such a commitment before the ACCC had accepted an HVAU, ARTC is somehow able to limit the ACCC's ability to determine a different pricing structure

that it regards as more appropriate. C&A believes that it would be inappropriate for the ACCC to give this commitment by ARTC any weight when having regard to the matters in s44ZZA(3) of the TPA. That is, this commitment should not limit the ACCC's consideration of what pricing approach should be implemented by ARTC under the Proposed HVAU. C&A believes that should this commitment limit the ACCC's consideration of what the pricing approach should be, it may set a dangerous precedent as other service providers may make similar commitments in the context of other access undertakings and also seek to limit the scope of the ACCC's consideration.

C&A believes that the appropriate pricing mechanism, to be implemented over time, would combine a variable maintenance-related expenditure recovered through a charge based on gross tonne kilometres (**GTK**)(as is proposed by ARTC), with a take-or-pay component of charges recovered on a “per train-kilometre” basis.

6. Risk versus Return

On balance, the level of risk proposed to be adopted by ARTC under the Proposed HVAU is not consistent with the proposed weighted average cost of capital (**WACC**) which ARTC has put forward. The structure of the Proposed HVAU results in ARTC wearing very little risk, for example:

- (a) ARTC's revenue cap means that ARTC is not exposed to volume variations (in constrained parts of the Network).
- (b) All Capital Expenditure must be vetted by the Rail Capacity Group (RCG) or the ACCC; once approved Capital Expenditures will be recovered through depreciation and return on capital allowances.
- (c) ARTC has limited liability for non-performance.
- (d) ARTC has a broad discretion as to whether to fund expansions.
- (e) ARTC's assets are mature with limited “stranding” risk – less so since coal producers have already signed approximately 200Mt of port terminal allocation on 10 year rolling contracts.

Further, section 4.7(c) of the Proposed HVAU provides that ARTC may propose a revised Rate of Return pending decisions made by the Australian Competition Tribunal or Federal Court in relation to other access disputes.

Given this, C&A supports the use of the WACC parameters proposed by the ACCC in its Draft Decision. If the five key issues outlined above were to be addressed and ARTC took on the associated additional commercial risks, then C&A may support the higher WACC proposed by ARTC.

7. A Way Forward

To facilitate the development of an HVAU that better addresses the matters in s44ZZA(3) of the TPA, C&A remains prepared to enter into extensive and in-depth discussions with ARTC and the ACCC.

C&A has previously sought to engage ARTC in discussions to reach agreement on an HVAU which balances the interests of all parties. Going forward, C&A believes that the only way to resolve outstanding issues collaboratively, and within a reasonable timeframe, is for ARTC and interested parties, including the HRATF, to continue discussions at a more extensive level. Such discussions would best be held following a clear statement from the ACCC on its concerns with the Proposed HVAU.

In this regard, C&A is aware that the HRATF has also sought to engage with ARTC in order to resolve the outstanding issues. C&A would support the ACCC's facilitation of further discussions between ARTC and interested parties that are appropriately framed and guided.

8. Additional materials

In addition to the seven sections of this submission, outlined above, C&A will shortly provide as Appendix 1 to this submission, versions of the Proposed HVAU and Proposed IAHA which include selected comments made by the ACCC in its Draft Decision and ARTC's responses to those comments from its submission dated 31 March 2010 and from its Explanatory Guide. C&A developed this reference document in the course of its assessment of the Proposed HVAU and Proposed IAHA and provides it on the basis that it may assist the ACCC to have a copy included in C&A's submission. C&A wishes to emphasise that the ACCC and ARTC comments included in these versions of the Proposed HVAU and Proposed IAHA are not intended to be complete. They are, however, intended to illustrate that a significant number of the ACCC's comments and recommendations in its Draft Decision have not been substantially accepted or addressed by ARTC in the Proposed HVAU or Proposed IAHA.

C&A will also shortly provide as Appendix 2 to this submission, a table of other comments and concerns it has in relation to the Proposed HVAU and Proposed IAHA.

9. Conclusion

C&A has a significant stake in the development of access arrangements that underpin the efficient operation of and investment in the Hunter Valley rail Network and the Hunter Valley Coal Chain more broadly. Although having an HVAU accepted by the ACCC is ultimately desirable for the industry, there are certain key issues which must be addressed before C&A can support ARTC's application. C&A does not wish to see the process of developing such arrangements continue any longer than absolutely necessary, as it impacts C&A's ability to make investments in a context of regulatory certainty and C&A's ability to align its major terminal commitments with track access rights. However, given that the Proposed HVAU and Proposed IAHA fail to address the five key issues previously

identified by C&A and the HRATF, C&A cannot support ARTC's application in its current form.

C&A would be happy to discuss any aspect of this submission with the ACCC in more detail, including how the process may move forward in a timely but effective manner.

1. Key Issue 1: Under the new Hunter Valley Capacity Framework Arrangements, Producers require greater certainty of contracted volumes on the track

Key Issue 1A: Producers require greater transparency in the initial allocation of tonnes on the track

1.1 There is no transparency (or specific proposal) for the transition from the current arrangements to the initial allocation of tonnes under the Proposed HVAU

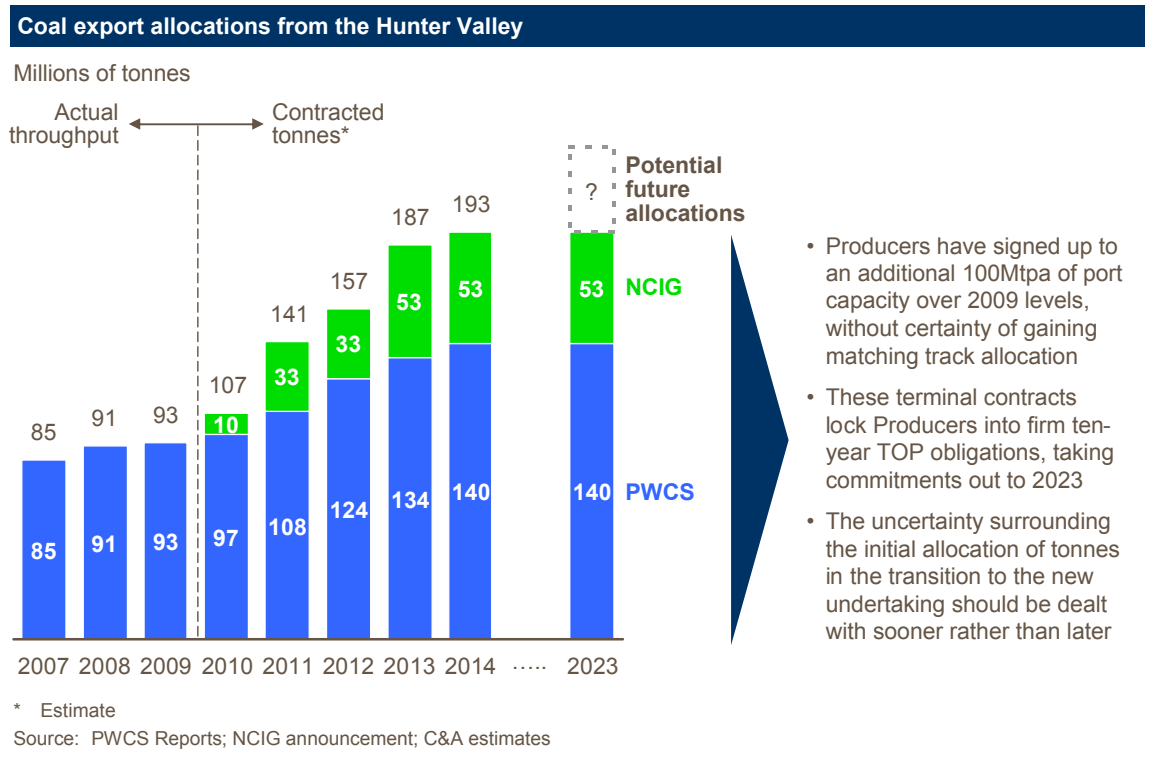
At section 2.17 of its Consultation Paper, the ACCC noted that in its Draft Decision it was of the preliminary view that there was a lack of clarity and certainty around how the 2009 HVAU was intended practically to operate. Importantly, the ACCC acknowledged concerns regarding the lack of transitional arrangements for the initial implementation of the 2009 HVAU.

In Appendix 5 to the Explanatory Guide to the Proposed HVAU, ARTC has set out a proposal for the transition of the annual compliance assessment function from the Independent Pricing and Regulatory Tribunal (*IPART*) under the New South Wales Rail Access Undertaking (*NSWRAU*), to the ACCC under the Proposed HVAU.

In the Proposed HVAU, however, ARTC has failed to provide any provisions which deal with transitional arrangements for Access Seekers. In order to provide transparency and certainty to Access Seekers, C&A considers it essential that ARTC develop appropriate transition arrangements from the NSWRAU to the Proposed HVAU. The background for C&A's position on this issue is as follows:

- (a) As set out in Exhibit A below, Hunter Valley coal producers have now been through two rounds of port nominations at PWCS and NCIG, such that by the end of 2010, coal producers will have committed to a total of approximately 200 Mtpa of port terminal allocation on 10 year rolling take-or-pay contracts. These obligations represent more than \$10 billion in forward commitments for port capacity;

EXHIBIT A



- (b) in order to produce sufficient coal to utilise their port entitlements, the Hunter Valley coal producers must make substantial additional investments in their coal mining operations;
- (c) it is anticipated that the Hunter Valley coal producers will seek contracts with ARTC for a quantity of track Capacity that corresponds with their port entitlements at some uncertain point between now and the time shortly after an HVAU is accepted by the ACCC. If track allocations do not match the contracted port allocations, the misalignment could result in inefficient investments in port and mine operations;
- (d) at section 2.17 of its Draft Decision, the ACCC noted the absence of transitional provisions and ultimately took the view that the processes and timeframes proposed in section 3 of the 2009 HVAU were inappropriate; and
- (e) C&A and the HRATF subsequently reinforced to ARTC the importance of transitional arrangements being included in the HVAU, and C&A presented a proposal of transitional arrangements for ARTC to consider,

As noted above, Appendix 5 of the Explanatory Guide to the Proposed HVAU includes a proposal for the transition of ARTC's **regulatory** arrangements, but there is no mention of any proposed transitional arrangements for **Access Seekers**. There is also no proposed protocol or other guidance on how ARTC anticipates making initial offerings of capacity to the Access Seekers, despite a very real possibility that acceptance of an HVAU could lead

to many or all Access Seekers moving promptly to submit potentially competing applications for access once an HVAU comes into effect.

Track is a critical link between the mines and the port that is controlled by a monopoly service provider. The lack of certainty around track access under the Proposed HVAU exacerbates the issues which result in other Hunter Valley Coal Chain Service Providers being forced to make very substantial infrastructure investments without knowing whether or how much capacity of that infrastructure will not be utilised if ARTC does not provide sufficient track Capacity. This crucial disjoint in the Hunter Valley Coal Chain has the potential to lead to misalignment that would not promote the economically efficient operation of, use of and investment in infrastructure consistent with s44AA(a) of the TPA.

One of ARTC's stated objectives in the Proposed HVAU is to "establish a workable, open, non-discriminatory, efficient and inclusive process for lodging and processing applications for Access Rights" (section 1.2(b) of the Proposed HVAU). If ARTC is to adhere to its stated objective, it is very important that ARTC clarify the process by which it will make allocations of initial capacity under an HVAU.

In the absence of any specific proposal by ARTC to clarify how it anticipates allocating initial Capacity, section 3.13 of the Proposed HVAU is the only provision of the Proposed HVAU that provides ARTC's methodology for allocating Capacity in circumstances where there is insufficient Capacity for all Applicants (and this only addresses the situation where Applicants have submitted mutually exclusive applications for **Available Capacity**). As discussed in section 1.7 below, section 3.13 of the Proposed HVAU proposes to allocate Access Rights for mutually exclusive applications based on ARTC's opinion of which Access Agreement would represent "the highest present value of future returns to ARTC after considering all risks associated with the Access Agreement." This is, at best, a discretionary methodology for allocating Capacity.

Given the concerns expressed above, this methodology (or lack thereof) provides no certainty that Applicants will receive track contracts that match their port contracts or domestic delivery commitments, or that allocations of track Capacity (whether Available Capacity or Additional Capacity) will be determined in a fair and transparent manner.

Transitional arrangements will be a crucial part of any HVAU, as they form a key part of the package that the industry will assess. They also ensure a smooth and orderly transition to the new arrangements. In the absence of transitional arrangements, the Proposed HVAU is, in C&A's view, incomplete and inappropriate.

Proposed Solution

C&A proposes an alternate framework for track nomination, investment and contracting (the **Framework**), described in section 1.B below. In the absence of any proposed transition arrangements, C&A suggests that the Framework could be extended to incorporate initial nominations and allocations to be made within a defined period of an HVAU coming into effect – say within three months of an HVAU being accepted.

As discussed in the annotations to the Framework set out in Exhibit C below, non-coal Access Seekers would nominate to the extent not already contracted and priority would continue to be preserved for passenger Trains.

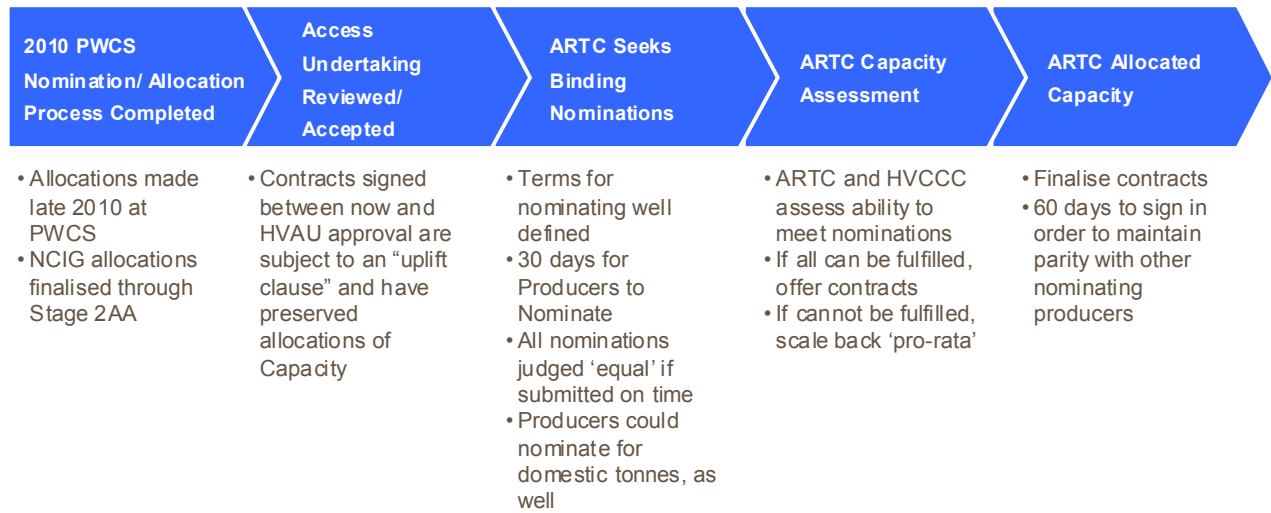
C&A envisages that the initial round of nominations would be made in accordance with the proposed Framework, essentially as the first, annual nomination for track Capacity. Although the proposed period for nominations, Capacity Analysis and contracting might be extended for the first time the Framework is implemented, the process would otherwise essentially be identical to the process that would be applied each subsequent year.

With regard to any access agreements that are entered into under the NSWRAU from now until an HVAU comes into force, C&A proposes that ARTC should seek to include in any access agreement an "uplift clause" that automatically varies key clauses of the access agreement to be consistent with an IAHA that is accepted by the ACCC. Although contractual terms related to allocations of Capacity should be preserved, the terms related to key matters such as Capacity management, rebates, liability and pricing should be subject to an automatic variation.

This methodology is consistent with the approach taken by ARTC in the 23 December 2009 draft IAHA that was circulated by ARTC to the industry, which contemplated the parties entering into the agreement before an HVAU was approved and which included an uplift clause (clause 19.1 of 23 December 2009 draft IAHA). C&A considers this approach appropriate given that ARTC has lodged an access undertaking application with the ACCC and, therefore, ARTC and Access Seekers should start planning towards the acceptance and implementation of an HVAU.

EXHIBIT B

Initial Allocation Process – Track Nomination, Investment and Contracting Process



Key Issue 1B: The Proposed HVAU does not provide Access Holders with sufficient certainty that Additional Capacity will be delivered as required by Access Holders

1.2 Introduction

In section 9.6.2.2 of its Draft Decision, the ACCC was of the view that the 2009 HVAU should include a clearly drafted provision that sets out ARTC's obligations in relation to the provision of Additional Capacity in a clear and transparent manner, including a specific consultation mechanism obliging ARTC to consult with the HVCCC.

The ACCC also considered at section 9.6.5 of its Draft Decision that a possible approach would be for the contractual terms between ARTC and Access Seekers/ Holders regarding the delivery of Additional Capacity to be subject to negotiation (and ultimately arbitration by the ACCC).

ARTC has responded to these concerns in section 6.2(a)(i) of the Proposed HVAU by setting out the criteria it will take into account in determining whether an Additional Capacity project is commercially viable. Should ARTC decide that the commercial viability criteria are not satisfied, the Applicant has certain rights to seek to fund the Additional Capacity itself by way of a Capital Contribution under section 6.2(b) of the Proposed HVAU. ARTC has made amendments to how Capital Contributions will be treated under sections 6.2(f) and 6.2(g) of the Proposed HVAU.

C&A welcomes the inclusion of the ability for Applicants to fund the construction of Additional Capacity in the absence of ARTC's willingness to do so. However, since such funding is the only effective means that Applicants have of ensuring that Additional Capacity becomes available, this mechanism must be robust and practical.

ARTC's decision to allow an Applicant to fund Additional Capacity is subject to ARTC determining that it does not "otherwise compromise ARTC's legitimate business interests" (section 6.2(a)(ii)(D)). In section 9.6.2.3 of its Draft Decision, the ACCC was of the view that the phrase "does not compromise ARTC's legitimate business interests" was unclear in its meaning and would benefit from further explanation. That is a view that C&A endorses.

In section 7.2.5 of its response to the ACCC's Draft Decision, ARTC stated that it did not consider it appropriate or necessary to define ARTC's legitimate business interests. ARTC has still not defined "legitimate business interests" in the Proposed HVAU.

As discussed below, C&A is supportive of certain changes, but overall the Additional Capacity provisions in the Proposed HVAU are inadequate and, therefore, inappropriate.

It is widely anticipated that Hunter Valley coal production is likely to continue growing into the foreseeable future, potentially to 250Mtpa over the next five to seven years. Therefore, the process for investing in and building new track Capacity is an integral part of the Proposed HVAU. Certainty that Additional Capacity can be delivered as and when it is needed is a key concern for Access Holders.

The investment framework in the Proposed HVAU falls short in providing answers to the following fundamental questions:

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- (a) What is the process for allocating, investing and entering into contracts for Capacity (both Available Capacity and Additional Capacity)?
 - (b) How can Access Seekers and Access Holders ensure that their track allocation matches their port entitlements or address domestic supply obligations over the long-term?
 - (c) Why is ARTC not contractually obligated to build Additional Capacity even after it enters into take-or-pay contracts that can only be fulfilled after that Additional Capacity is built?
 - (d) What is the process for ensuring Access Seekers and Access Holders can fund Expansions where ARTC is unwilling to do so and for having certainty that such Additional Capacity will be constructed by ARTC?

As discussed in Part 1.A above, if the terms of the Proposed HVAU were accepted by the ACCC, and C&A were to enter into an AHA in the form of the Proposed IAHA (or even a negotiated AHA), C&A would still lack sufficient certainty as to whether it would receive track allocation that matches its port entitlements.

Furthermore, even if ARTC were to enter into an AHA with C&A that nominally matches C&A's port entitlements, ARTC would have no contractual obligation to actually provide any Capacity that requires the construction of Additional Capacity (see discussion below). If ARTC were to decide not to provide that Additional Capacity, there would be little or no negative financial impact on ARTC, but it could have serious negative consequences for C&A (see discussion in Key Issue 3). Further, even if C&A agreed to **fund** the construction of Additional Capacity that C&A requires to match its port allocation, ARTC is still not unconditionally required to **construct** that Additional Capacity (discussed further below).

1.3 Access Seekers and Access Holders need certainty that if they are willing to fund the construction of Additional Capacity, that Capacity will be built

The need for certainty

ARTC's decision to allow the Applicant to fund Additional Capacity is subject to ARTC determining that it does not "otherwise compromise ARTC's legitimate business interests" (section 6.2(a)(ii)(D) of the Proposed HVAU). The ACCC's Draft Decision comments on this point and ARTC's response are discussed in section 1.2 above.

C&A acknowledges that, as a general principle, ARTC might not be expected to fund an expansion in all circumstances. In circumstances where Applicants are willing to fund an expansion, however, C&A believes ARTC should be unconditionally required to construct that Additional Capacity. In response to submissions previously made by coal producers, ARTC **rejected** a proposal that as an option of last resort, Applicants should be permitted to **fund and "step in" in order to build** Additional Capacity on ARTC's Network if ARTC refuses to fund or build that Additional Capacity.

By contrast, section 7.5.5(l) of QR Network's recently approved 2010 Access Undertaking includes, at the instigation of the Queensland Competition Authority (QCA), the right for a Funding User who believes that QR Network is unnecessarily delaying construction of an Extension, to refer the issue to the dispute resolution

process under which the QCA has the power to require QR Network to permit the Funding User to undertake the development. That is, the Funding User has the right to seek to construct the Extension itself.

As ARTC's refusal to build Additional Capacity could result in underutilised mine, above-rail and port assets, where ARTC is not willing to fund Additional Capacity, it is vital that Applicants have a clear right to provide that funding and certainty that the Additional Capacity will be built. Accordingly, C&A is not seeking that in the Hunter Valley Applicants have a right to build, but if ARTC wishes to reserve to itself the sole right to construct Additional Capacity, it must **unconditionally agree** to construct Additional Capacity when funded by an Applicant.

In section 6.2(a)(ii)(D) of the Proposed HVAU, ARTC has, when compared to the 2009 proposed HVAU, somewhat restricted its discretion to refuse to construct Additional Capacity funded by an Applicant. However, C&A considers that the fact that the "legitimate business interests" test is retained in the Proposed HVAU means that ARTC's discretion to decide whether to build Applicant-funded Additional Capacity is still too broad.

C&A believes that the question of "ARTC's legitimate business interests" should not be relevant for Applicant-funded Additional Capacity. In C&A's view, a more appropriate arrangement would require a fundamental change to the Proposed HVAU that gives Applicants a clear right to fund Additional Capacity when the technical feasibility of that Additional Capacity has been confirmed and an estimate of the cost of that Additional Capacity has been scoped (the 'point of commitment'). At the point of commitment, either ARTC makes a firm contractual commitment to fund and build that Additional Capacity, or, if ARTC declines, then the Applicant must have the right to fund that Additional Capacity. At the point of commitment, the Applicant should know what capital needs to be spent to deliver the Additional Capacity and whether and to what extent that Additional Capacity will be recovered through a socialisation of costs across all Access Holders in that Pricing Zone.

Once a project for Additional Capacity is committed with either ARTC or Applicant funding, ARTC must be required to build the Additional Capacity unless developments arise which result in either the RCG or the ACCC determining that the Additional Capacity no longer meets the legal, environmental, safety or technical requirements of the type referred to in sections 6.2(a)(ii)(A) and (B) of the Proposed HVAU.

The timing and process for the arrangement described above is part of the Framework proposed at the end of this section. The proposed Framework also considers, in its annotations, a range of other issues, including, a requirement for an Applicant knowing early in the process:

- (a) what capital needs to be spent to deliver the Additional Capacity; and
- (b) whether and to what extent it will be recovered through a socialisation of costs across all Access Holders in that Pricing Zone.

In the case of ARTC's assessment of whether it is prepared to fund Additional Capacity, C&A submits that to the extent ARTC must make a legitimate business interest

determination, or a commercial viability determination, these should be decisions that are made once, relatively early in the process, and should not be subject to change.

The RCG process

Under the RCG decision making process contemplated by section 6.4 of the Proposed HVAU, ARTC is not required to proceed with a project where the cost of Additional Capacity will lead to an increase in charges by more than 10% and that Capacity is not endorsed by a 70% RCG vote (or approved by the ACCC as per section 6.4(b)(viii) of the Proposed HVAU).

C&A considers that an inability to secure a 70% RCG endorsement should not veto the construction of the Additional Capacity if the Applicant is willing to fund the project on a "non-RAB" basis to the extent required to keep charge increases at 10%, that is, the Applicant would be willing to fund any increase above the 10% threshold without earning a Rate of Return on the amount funded in excess of the approved price increase level. However, the Applicant should know prior to committing to funding the amount it will be required to fund (the Capital Contribution) and whether it will earn a Rate of Return on that Capital Contribution.

Additional Capacity recommended by the HVCCC

C&A supports the concept of Additional Capacity being recommended by the HVCCC, particularly given the importance of addressing circumstances where Additional Capacity is required to service existing Capacity Entitlements (for example, to relieve congestion or provide additional Tolerance to assist with coordination of track and port entitlements). However, C&A has concerns with the following drafting in section 6.3 of the Proposed HVAU:

- (a) Section 6.3(b)(ii) of the Proposed HVAU requires that there be sufficient take or pay commitments contracted by applicable Access Holders to recover the new capital component of costs associated with the Additional Capacity over the economic life of the Additional Capacity. This criteria is unreasonable because the Proposed IAHA contemplates that Access Seekers will enter into 10 year contracts, but the economic life of most track infrastructure is longer than 10 years.
- (b) Section 6.3(b)(iii)(A) of the Proposed HVAU requires that the provision of the Additional Capacity be, in ARTC's opinion, commercially viable "having regard to the terms and conditions of the relevant Access Agreement". This is conceptually inconsistent with C&A's understanding of the circumstances where the Additional Capacity is an enhancement to improve service to existing Capacity Entitlements (that is, where no new AHAs for Additional Capacity Entitlements would arise from the construction of the HVCCC recommended Additional Capacity). For example, if the HVCCC recommends, and the RCG endorses, a track improvement investment project, the cost of that project would be included in the RAB, and this in turn would result in an increase in relevant Access Charges. As C&A understands, the Additional Capacity would not result in the terms and conditions of any existing AHAs being changed, so the requirement in section 6.3(b)(iii)(A) of the Proposed HVAU does not appear relevant or appropriate.

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- (c) In the event the HVCCC recommends an investment to provide Additional Capacity, but ARTC decides that the provision of the Additional Capacity is not commercially viable in accordance with the criteria listed in section 6.3(b)(iii) of the Proposed HVAU, it is important that the HVCCC-recommended investment proceed to implementation if one or more Access Holders agree to fund that track investment and the relevant project is endorsed by the RCG. In the way that the Proposed HVAU is currently drafted, this 'backstop' for ensuring HVCCC-recommended Additional Capacity is built if Access Holders are willing to fund the construction of that Additional Capacity does not exist.

1.4 The process for identifying whether Additional Capacity is required to fulfil an Access Application is ill-defined

In section 6.5.4 of its Draft Decision, the ACCC expressed the view that given the overall uncertainty as to how section 3 of the 2009 HVAU was intended practically to operate, the ACCC could not conclude that the processes and timeframes proposed in section 3 were appropriate. The ACCC considered that if ARTC were to provide greater clarity and certainty around the practical operation and implementation of the section, particularly in light of the current stage of contract negotiations between ARTC and Access Seekers, then the section may be more likely to be appropriate.

C&A considers that the drafting of sections 3, 5 and 6 of the Proposed HVAU, and the ambiguous overlap of these sections with the Conditions Precedent in the Proposed IAHA Train Path Schedule, remains unclear in the following key areas. These issues identified by the ACCC and others in relation to the 2009 HVAU have not been addressed by ARTC in the Proposed HVAU.

The Applicant has limited visibility as to whether any Additional Capacity is required to satisfy its application

When an Access Seeker applies for capacity, it simply requests a certain number of tonnes from the load point to the exit point – it does not specifically request access to a particular section of track, a particular passing loop, or other particular infrastructure. In most cases, a producer does not know whether it is applying for existing capacity or capacity for which Additional Capacity is required.

ARTC and the HVCCC, in conducting the Capacity Analysis under section 5.2 of the Proposed HVAU, are the only entities who have visibility as to whether the fulfilment of an Access Application by ARTC will require Additional Capacity, and whether the Capacity being sought by an Access Seeker has been or is in the process of being requested by other Access Seekers. Accordingly, C&A considers that the requirement in section 3.7(a)(iii) of the Proposed HVAU that an Applicant provide ARTC with information on any requirements for Additional Capacity is inappropriate. Even if an Access Seeker does have visibility that Additional Capacity may be required (eg, through the Corridor Capacity Strategy process), it should not be the role of the Access Seeker to identify that this is the case.

Similarly, Proposed HVAU clause 3.7(a)(ix)(B) requires that an Applicant include, as part of its request for Access Rights, any advice provided by the HVCCC on the impact of the

Access Rights sought on Coal Chain Capacity. As a threshold question, it is unclear how a request for Access Rights could have any impact on Coal Chain Capacity. Although a request for Access Rights could have an impact on the **allocation** of Coal Chain Capacity, it cannot impact the calculation of Coal Chain Capacity.

Moreover, it seems more logical to C&A for the HVCCC to conduct this impact assessment after the Access Application has been submitted, as only then would the HVCCC have full information to determine whether the Access Application impacts on Coal Chain Capacity, the operating requirements needed to deliver Coal Chain Capacity and on whether the Applicant has sufficient Network Exit Capability to enable the utilisation of the Coal Access Rights sought.

C&A recognises that, as a general principle, ARTC cannot be forced to fund an expansion. However, even if ARTC does not fund an expansion, the onus should remain on ARTC (not the Applicant) to determine the threshold question, in consultation with the HVCCC, of whether Additional Capacity is required. C&A considers that ARTC should have a greater obligation than is contemplated by the Proposed HVAU to accept the recommendations of the HVCCC.

Under the Proposed HVAU, the process and sequence of steps for the AHA contracting process are complex and unclear

Under the provisions of sections 3, 5 and 6 of the Proposed HVAU, the process and sequence of steps leading to the execution of an AHA (including obtaining the information required to submit an Application, conducting the Capacity Analysis, referring an Indicative Access Proposal to the HVCCC and negotiating the terms of an AHA) are confusing. For example, it is unclear whether ARTC will conduct its Capacity Analysis process with the HVCCC and other Hunter Valley Coal Chain Service Providers under section 3.6 of the Proposed HVAU before Access Seekers embark on the negotiation phase contemplated by sections 3.11 and 3.12 of the Proposed HVAU. C&A considers that it is counter-intuitive for an Applicant to be negotiating an AHA before ARTC and HVCCC have concluded their Capacity Analysis, and before the HVCCC has advised on how many Path Usages may be required.

C&A suggests that a more logical order for capacity analysis would be as follows:

- (a) Applicants nominate for Capacity (without specifying whether it is for Available Capacity or Additional Capacity) as part of an annual process in which all nominations are received and considered in a given period, ensuring fairness and transparency;
- (b) subsequently, ARTC and the HVCCC conduct a Capacity Analysis to determine whether the nominations can be satisfied and whether Additional Capacity is required;
- (c) ARTC issues Indicative Access Proposals; and then
- (d) ARTC and Applicants negotiate and execute AHAs based on the Indicative Access Proposals.

It is unclear at what point an AHA would actually be signed

Under the Proposed HVAU, it is unclear at what point an AHA would actually be signed, and in some cases, this results in a "chicken and egg" dilemma where certain information is required before an AHA is signed, but an AHA must be signed before certain information is known.

For example, in circumstances where the HVCCC recommends an investment to provide Additional Capacity, ARTC will not consent to the provision of the Additional Capacity unless it has sufficient take or pay commitments contracted to recover the cost of the Additional Capacity (see section 6.3(b)(ii) of the Proposed HVAU). However, Access Seekers might not have entered into contracts for that Additional Capacity, since ARTC is permitted, during the contract negotiation process, to withhold consent to the provision of Additional Capacity unless a number of factors are satisfied in ARTC's opinion (including the Additional Capacity being economically efficient and not compromising ARTC's legitimate business interests)(see section 6.2 of the Proposed HVAU). If ARTC declines to enter into contracts for Additional Capacity, the HVCCC recommendation of an investment in that Additional Capacity would not materialise, since there would not be contracts in place to support that Additional Capacity.

It is unclear whether the negotiation of an access proposal is put on hold while the Additional Capacity process contemplated under section 6.2 of the Proposed HVAU is being worked through

C&A accepts that ARTC requires some time to determine whether or not it is willing to fund and build Additional Capacity, but it seems inappropriate (for example) for the execution of an AHA which is based on both Available Capacity and Additional Capacity to be stalled until ARTC confirms its position on any Additional Capacity that may be required.

The Train Path Schedule of the Proposed IAHA suggests that an Applicant could enter into an AHA for two tranches of Path Usages. Tranche 1 consists of Capacity Entitlements (that is, Available Capacity that has been contractually allocated to the Applicant), and tranche 2 consists of Additional Capacity. The Path Usages that are listed in tranche 2 are subject to a number of conditions precedent that must be satisfied before that capacity becomes Capacity Entitlements.

C&A generally supports the methodology set out in the Train Path Schedule, but believes it is necessary to revise the processes described in clauses of the sections 3, 5 and 6 of the Proposed HVAU so that they are compatible with the form of contract contemplated by the Train Path Schedule. Tranches of Capacity are mentioned in the Train Path Schedule but are not described in the Proposed HVAU or the main body of the Proposed IAHA. The distinction between the two tranches of Capacity, however, determines the level of certainty which the Access Holder has in relation to its contractual right to that Capacity.

C&A proposes that the Train Path Schedule approach include an additional tranche of Path Usages to be included for Additional Capacity that ARTC has already committed to build. This additional category of Capacity is described in the proposed Framework below as "Pending Capacity".

Further limiting the number of negotiable terms of the Proposed IAHA

In section 6.5.1.2 of its Draft Decision, the ACCC was of the view that the 'Essential Elements' in the 2009 HVAU did not achieve their purpose of ensuring a consistent operating framework for Access Holders to ensure effective supply chain alignment outcomes as the 'Essential Elements' were 'non-exhaustive' and could have been excluded by agreement.

The ACCC subsequently noted in section 2.2 of its Consultation Paper that certain provisions of the Proposed IAHA should be 'Tier 1 (mandatory) provisions', that is, provisions which are to be consistent across all relevant access agreements to ensure workable alignment of the coal supply chain.

The Proposed HVAU contemplates that an Applicant could enter into either an indicative or a negotiated access agreement with all terms other than a list of Tier 1 mandatory provisions being negotiable.

C&A considers that this adds a layer of complexity to the contracting process and queries the extent to which a process of negotiation is realistic or appropriate. As ARTC is operating under a revenue cap, it would appear that ARTC would have little to gain by offering different terms (for example, as to liability) to different Access Seekers. Therefore, C&A queries whether ARTC will in practice be willing to extensively negotiate the terms of any particular AHA.

C&A suggests that only a limited number of clauses of the Proposed IAHA be negotiable, as narrowing the scope of negotiation would help expedite the contract negotiating process and assist with ensuring that the rights of Access Holders are on equal, aligned terms.

In regards to the proposed Tier 2 provisions, C&A believes that there is significant uncertainty as to how certain of those Tier 2 provisions could be negotiated by Applicants. For example, C&A considers that the provisions relating to Charges (point 6 of the Tier 2 provisions) must be the same across Access Holders. It is also unclear, for example, how Applicants could negotiate with ARTC in relation to ARTC's obligations under the NSW Lease, its Environment Licence or its passenger priority obligations. C&A intends to pursue the issue of negotiation of provisions of this type with ARTC and may lodge a further submission on this point at a later date.

Network Exit Capability

In section 6.5.5.2 of its Draft Decision, the ACCC was of the view that to the extent that information satisfying the Network Exit Capability requirement is required as part of an Application for Coal Access Rights under section 3.7 of the Proposed HVAU, it was unlikely to be necessary for ARTC to have the right to also require satisfaction of the Network Exit Capability requirement in section 3.4(d) of the Proposed HVAU.

ARTC has responded to these concerns in the Proposed HVAU by amending section 3.7 to make it clear that the advice provided to the HVCCC may cover whether the Applicant has sufficient Network Exit Capability to enable the use of Access Rights sought – and where this is the case, this information should be included in the Access Application.

The drafting in the Proposed HVAU suggests that an Applicant may be required to demonstrate that it has Network Exit Capability (or is in the process of negotiating for Network Exit Capability) at five different stages:

- (a) when submitting an application to request Access Rights under sections 3.7(a)(ix)(A) and (b) of the Proposed HVAU;
- (b) when negotiating Coal Access Rights under section 3.4(d) of the Proposed HVAU and continuing to negotiate Coal Access Rights under section 3.12(b)(vi) of the Proposed HVAU. During the negotiation phase, ARTC may require evidence to ARTC's satisfaction that Access Seeker has Network Exit Capability – this is a discretion, not an obligation;
- (c) when entering into an Proposed IAHA (see section 3.14(b)(i)(A) of the Proposed HVAU);
- (d) when ARTC is allocating Coal Access Rights under section 3.13(c) of the Proposed HVAU (although it is unclear whether this section only applies to mutually exclusive applications); and
- (e) as a condition precedent that must be satisfied before ARTC is obligated to make Path Usages available to Access Holder (see clause 4 of the Proposed IAHA Train Path Schedule).

Furthermore, section 3.14(b)(i) of the Proposed HVAU appears to offer Applicants a choice between three different forms of AHA, with differing requirements for demonstrating Network Exit Capability. The contract described in section 3.14(b)(i)(A) of the Proposed HVAU requires Network Exit Capability, but the contracts described in sections 3.14(b)(i)(B) and (C) of the Proposed HVAU do not appear to require Network Exit Capability. This suggests that ARTC is prepared to offer AHAs on terms that do not require Network Exit Capability, although it is unclear at what point the Applicant elects which of the three forms of contract it wishes to enter into.

C&A is of the view that ARTC should only allow an Applicant to enter into a contract for Capacity if it demonstrates that it has Network Exit Capability to match those Path Usages. Allowing Applicants to enter into contracts for Path Usages without first demonstrating that they have matching Network Exit Capability could result in over-contracting by some Access Holders. If Capacity is constrained, over-contracting by some Access Holders could mean that while some Access Holders have spare or surplus track Capacity, other Access Holders would have insufficient track Capacity to match their port allocations. Although this misalignment could be addressed by transfers of Capacity between Access Holders as and when these gaps occur, C&A believes it would be preferable to avoid the misalignment in the first place by only allowing Access Seekers to contract for Path Usages that corresponding to their Network Exit Capability.

1.5 The proposed Conditions Precedent for an AHA give ARTC the opportunity to decline to fund a specific expansion required to deliver BPU's, even after an AHA is signed, raising a significant question about the nature of ARTC's contractual commitment under an AHA

In section 9.6.5 of its Draft Decision, the ACCC was of the view that the conditions precedent in the IAHA, and in particular clause 6(a)(iv) of the Train Path Schedule (now clause 4.3(a)(iii) of the Proposed IAHA) provided too much discretion to ARTC to decide whether or not to finalise the building of Additional Capacity within a certain timeframe, and as a result, created significant uncertainty for Access Seekers and Access Holders.

The Proposed HVAU and Proposed IAHA include some marginal revisions to narrow the scope of ARTC's discretion in this regard. However, for the reasons discussed below, C&A is of the view that the revisions are inadequate to address the concern raised by the ACCC and reiterated by industry stakeholders.

Although C&A appreciates that ARTC must retain some discretion in the process for determining whether, when and how Additional Capacity is to be built, there must be some point at which ARTC is required to commit to building Additional Capacity that is the subject of a signed AHA. In the Proposed HVAU, there is no point at which ARTC is required to complete the projects that are necessary to provide the Capacity that an Access Holder has contracted for under the AHA. However, Access Holders **are committed**, from the point of signing an AHA, to pay for Additional Capacity on a take or pay basis once that Capacity becomes available. **Therefore, in practical terms, when an Applicant and ARTC enter an AHA, the AHA is only binding on the Applicant and not ARTC.**

Under the terms of the Proposed IAHA, where an Access Seeker and ARTC enter into an Access Agreement for Additional Capacity, the contract is, to the extent that particular Path Usages relate to track not yet built, only binding on the Access Seeker, and not on ARTC. This results from the lack of a firm commitment by ARTC to build the Capacity for which the Producer has contracted.

Specifically, clause 4.3(a)(iii) of the Train Path Schedule of the Proposed IAHA states that ARTC's obligation to first make available Path Usages is conditional upon:

In ARTC's reasonable opinion, the listed and new projects being commercially viable having regard to:

- (a) the terms and conditions of all the access agreements relevant to the listed and new projects; and
- (b) circumstances for ARTC to service and raise financing through debt and equity for the listed and new projects;
- (c) opportunity cost to ARTC given the relative risk and returns associated with the financing of the listed and new projects relative to other investment opportunities; and
- (d) net effect on ARTC's balance sheet, gearing ratios and any other debt covenants in existence at the time.

From the Access Holder's perspective, the key purpose of contracting future Capacity with ARTC under long-term access agreements is to provide security and certainty over that track Capacity. That will in turn, assist Access Holders to make investments at their mining operations and enter into take or pay commitments with other Hunter Valley Coal Chain Service Providers.

The current drafting of the Train Path Schedule allows ARTC to renege on its obligation to provide Path Usages where it decides, after signing an AHA, that the expansion is no longer commercially viable. Inclusion of this condition in the Train Path Schedule, therefore, does not provide Access Holders with sufficient certainty to make investments or other take or pay commitments.

That is, the "commercial viability" condition precedent in clause 4.3(a) of the Train Path Schedule gives ARTC an open-ended discretion as to whether or not it will construct the projects necessary to deliver Additional Capacity. Although the language of clause 4.3(a)(iii) of the Train Path Schedule has been modified so that it is consistent with the commercial viability factors referred to in section 6.2(a)(i)(A) of the Proposed HVAU, clause 4.3(a) of the Train Path Schedule exists independently of, and is not linked to, the commercial viability assessment which ARTC is required to make under section 6.2(a)(i)(A) of the Proposed HVAU in the negotiation process which precedes the execution of an AHA. As such, ARTC could form the view under section 6.2(a)(i)(A) of the Proposed HVAU that the provision of Additional Capacity is commercially viable and enter into AHAs on that basis. However, it could subsequently form a view that the relevant Capacity is not commercially viable and therefore choose not to proceed with its construction. In those circumstances, the Access Holder has no recourse against ARTC.

1.6 The Proposed HVAU, does not provide guidance as to when a decision is made who (the ARTC or Applicant) will fund a particular expansion therefore there is no certainty that the decision will be made in time to ensure the Capacity is available when needed by the Applicant

In section 9.6.6.4 of its Draft Decision, the ACCC recommended that the industry consultation process in section 6.4 of the Proposed HVAU should include (amongst other things):

- (a) specific timeframes within which obligations by ARTC and other parties must be satisfied;
- (b) a clear description of when ARTC will choose to adopt a modified consultation process for particular projects; and
- (c) further clarification around the information that should be included in the reports to be provided to the RCG as part of the consultation process.

ARTC has responded to these concerns in section 6.4(d)(ii)(E) of the Proposed HVAU by stating that the concept assessment report to be provided by ARTC to the RCG will include an assessment of the indicative timeframes for the development, to clarify that it is industry (via the RCG) that controls a project's timetable.

Further, ARTC has amended section 6.4(f)(ii) of the Proposed HVAU so that the project assessment report to be provided will incorporate a project schedule, including time

tolerances and project management plan under section 6.4(f)(ii)(E)(xi) setting out, among other things, project phases, milestones, deliverables. The RCG's endorsement of the project assessment report, which will be sought if ARTC wishes to proceed to project implementation, will include endorsement of the project schedule and these project phases, milestones and time tolerance.

Although the revisions introduced by ARTC are helpful developments to the RCG process, the ultimate question of whether Access Holders can be certain that capacity will be available when the Access Holders need that Capacity, remains unresolved.

As noted above, the right for Access Seekers to fund an expansion is, ultimately, the only assurance that expansions necessary to deliver requested Additional Capacity will be built. C&A recognises that ARTC might not be "forced" to invest in and expand its facilities. Given this, the process for Applicants funding expansions must be transparent, including the timing of key decisions. The decision-making processes in sections 3, 5 and 6 of the Proposed HVAU are not sufficiently transparent and several areas of concern are discussed below.

First, if the HVCCC recommends Additional Capacity under section 6.3 of the Proposed HVAU, it is unclear how this sits with the 'RCG' industry consultation process in section 6.4 of the Proposed HVAU, and how long the process is likely to take.

Similarly, the Proposed HVAU does not include any indication of how long ARTC's assessments under sections 6.2(a) and 6.3(b) of the Proposed HVAU may take, or how long the RCG processes (which respond to assessments and other information provided by ARTC) may take. Applicants could potentially wait for a very lengthy period of time – perhaps even years – before ARTC completes the various processes required to decide whether or not to proceed to fund a project to build Additional Capacity. However, in the meantime, Applicants will most likely have made substantial, binding investment commitments that rely on the availability of that Additional Capacity.

C&A considers that the following timeframes should apply to ARTC's assessments of Additional Capacity under sections 6.2(a) and 6.3(b) of the Proposed HVAU:

- (a) 6 months for assessments involving less than 10mtpa of Additional Capacity; and
- (b) 12 months for assessments involving more than 10mtpa of Additional Capacity.

The Proposed HVAU also does not specify the point at which the decision as to who will fund the construction of Additional Capacity is made. This is a critical juncture, however, given that the party that funds a project needs to know when it must arrange for financing and a range of internal approvals for a substantial investment in infrastructure. Also, if an Applicant needs to self-fund a project for Additional Capacity, it may bear a much higher charge for that Capacity than for an expansion funded by the ARTC and socialised amongst all Access Holders.

1.7 Section 3.13 of the Proposed HVAU, dealing with applications for mutually exclusive access rights, has been narrowed to only address applications for Available Capacity. However, ARTC retains a great deal of discretion in these cases and there remains no rules or detailed guidelines of how mutually exclusive applications for Additional Capacity will be handled

In section 13.10.7 of its Draft Decision, the ACCC was of the view that the operation of the mutually exclusive provisions should be clarified and be made more transparent.

ARTC has responded to these concerns by:

- (a) amending section 3.13(a) of the Proposed HVAU to clarify that section 3.13 applies to Available Capacity only; and
- (b) added subsection (e) to clarify the impact of the rights to annual renewal in clause 2.4 of the Train Path Schedule.

However, section 3.13(b) of the Proposed HVAU remains unchanged and continues to state that:

ARTC will allocate Access Rights to the Applicant who accepts an Access Agreement with ARTC which, in the opinion of ARTC, is most favourable to it.

C&A repeats its previous submissions that the process described in this clause does not ensure a transparent and equitable outcome for all Access Seekers that aligns with port terminal contracts.

As discussed in section 1.2 of Key Issue 1.A above, the lack of transparency which underlies section 3.13 of the Proposed HVAU highlights the need for transitional Capacity allocation provisions which are to apply upon an HVAU taking effect. If section 3.13 of the Proposed HVAU were to drive the way ARTC allocates initial allocations of Capacity, Applicants would have no certainty as to the process to be applied by ARTC in assessing those applications, which could represent a very sizeable level of throughput, perhaps 200Mtpa, or more. That would, C&A submits, be contradictory to the ARTC objective of establishing a "workable, open, non-discriminatory, efficient and inclusive process for lodging and processing applications for Access Rights", as stated in section 1.2(b) of the Proposed HVAU.

1.8 Conclusion

C&A believes that the shortcomings and concerns identified in this section and raised by ACCC in its Draft Decision could be improved through a number of modifications to the proposed arrangements for nominating for, assessing and contracting for Capacity.

Proposed Solution

In place of the approach provided for in the Proposed HVAU, C&A proposes a Nomination, Track Investment and Contracting Framework that addresses the concerns that are raised above. The proposed Framework is described in detail in Exhibit C at the end of this section of this submission with a diagrammatic flowchart with footnote annotations on the various steps of the flowchart. Following the annotations is a summary of the differences between the approach provided for in

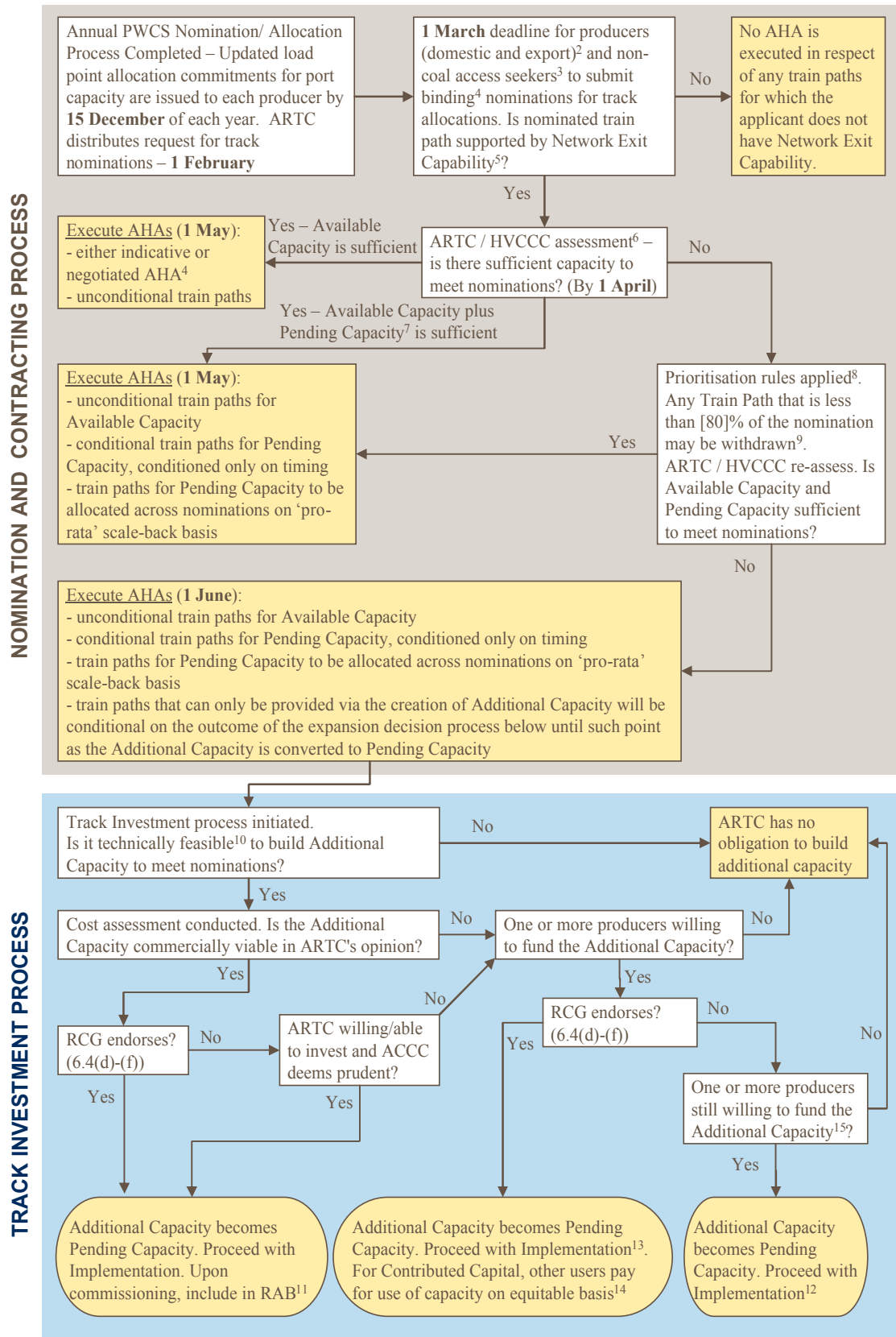
the Proposed HVAU and C&A's proposed Framework.

The proposed Framework includes the following principles:

- (a) Nominations for Capacity will be made on an annual basis, with all nominations for Path Usages to be submitted within the same month each year, shortly after PWCS port allocations have been confirmed. Non-coal Access Seekers would nominate to the extent not already contracted. ARTC and HVCCC would then conduct the Capacity Analysis to determine whether existing and planned Capacity is sufficient to meet the track nominations, and whether additional capacity is required. Priority would be preserved for passenger Trains.
- (b) The Capacity Analysis referred to in (a) above could be relatively quick, as it would build off the information and analysis in the Hunter Valley Corridor Capacity Strategy document, which would be prepared and circulated to the industry in advance of the Nominations process
- (c) After ARTC and HVCCC have completed the Capacity Analysis and issued Indicative Access Proposals with track allocations, Access Seekers enter into contracts for all allocated Path Usages, regardless of whether they are Path Usages for Capacity Entitlements, Additional Capacity, or a new category of Path Usages called Pending Capacity:
 - (i) Additional Capacity is identical to the Capacity that ARTC has labelled "Tranche 2" in the Train Path Schedule in the Proposed IAHA (that is, the Access Holder is contractually bound on a take or pay basis for that Capacity and ARTC's contractual obligation is subject to a range of conditions precedent). When the conditions precedent for Additional Capacity are satisfied and the project reaches the implementation phase, the Additional Capacity automatically converts into Pending Capacity.
 - (ii) Pending Capacity is Capacity for which ARTC is contractually bound to complete the construction of that Capacity. The only conditions precedent for Pending Capacity are those related to the timing of the completion of construction of that Capacity. When Pending Capacity is commissioned, that Capacity automatically converts into Capacity Entitlements.
 - (iii) Capacity Entitlements are identical to the Capacity that ARTC has labelled "Tranche 1" in the Train Path Schedule.
- (d) Once AHAs have been entered into by Access Holders, the track investment process is initiated. ARTC retains discretion throughout the track investment process, in a manner similar to that proposed in the Proposed HVAU. As explained in footnote 7 to the proposed Framework flowchart, there are several criteria that must be satisfied before Additional Capacity is converted into Pending Capacity. However, once Additional Capacity becomes Pending Capacity, ARTC is contractually bound to complete the construction of that Capacity.
- (e) HVCCC can recommend the construction of Additional Capacity at any time, whether in conjunction with or outside of the annual Nomination, Track Investment and Contracting Framework.

EXHIBIT C: Annual¹ ARTC Nomination, Track Investment and Contracting Framework

Process flowchart



Annotations to the Framework flowchart (the numbers below are cross-referenced in footnotes to the flowchart)

1. **Annual process** – C&A suggests that the capacity nomination and allocation arrangements developed at PWCS provide an excellent basis for developing fair, transparent transitional arrangements on the track and could be adapted to consider other non-coal users of the Network. The nomination and allocation process at PWCS is an annual process, through which producers submit binding nominations for capacity at the port. PWCS only allocates and enters into contracts for long-term capacity through this process and the PWCS terminal access protocol includes a detailed set of allocation rules regarding the timing for the annual nomination process, the renewal of existing allocations, the Capacity Analysis and the objective criteria by which allocation is prioritised in circumstances where nominations exceed available capacity.

A similar set of rules could be established for the nomination and allocation of track Capacity and C&A sees many advantages in coordinating the port and track capacity allocation and contracting processes, so that the track process follows shortly after the port allocations have been finalised. C&A offers the following suggestions:

- (a) Track allocation to be based on complete and accurate information – Insofar as previous requests by ARTC for non-binding Capacity nominations have resulted in insufficiently precise information – imprecise estimates of Capacity, as well as non-responses – and given the importance of having accurate estimates when conducting the Capacity Analysis, C&A acknowledges that ARTC would prefer accurate nominations with responses being received from all Access Holders and Access Seekers.
- (b) Annual PWCS allocations are issued no later than 15 December of each year. If ARTC were to conduct an annual nomination and allocation process, with binding nominations due 1 March of each year, the nominations would be accurate as they would necessarily be based on the confirmed port allocations. Furthermore, all Access Holders and Access Seekers would need to ensure their nominations are submitted by the due date to be considered and this would give ARTC the ability to assess Capacity based on the actual aggregate nominations all on the table at the same time. ARTC could ensure it has nominations from all Access Holders and Access Seekers by deeming any Access Holder or Access Seeker who did not submit a nomination by 1 March as having nominated for no Path Usages.
- (c) The contracting process contemplated in the Proposed HVAU allows Applicants to approach ARTC for a contract at any time, so ARTC would need to assess each contract request on an ad hoc basis as and when an application is submitted. As C&A understands it, this is essentially a "first come, best dressed" approach which could result in substantial "gaming" by Applicants to try to secure more binding Capacity Entitlements for themselves and leave other Applicants with non-binding Additional Capacity. From a contractual alignment perspective, it is imperative that ARTC be able to assess all Access Applications in a coordinated manner, based on accurate information about each applicant's Network Exit Capability.

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- (d) Coordinated HVCCC capacity assessment – The PWCS capacity assessment involves modelling conducted by the HVCCC and ARTC proposes that the HVCCC be involved in the Capacity Analysis in section 5.2 of the Proposed HVAU as well. C&A understands that it would be a simpler, and more harmonious coal chain capacity planning exercise if the track and port nomination and contracting processes were coordinated.

As discussed in Key Issue 1.A of this submission, this framework could be adapted to be a workable process for the transition to an HVAU and the initial allocation of Capacity by ARTC.

C&A is of the view that conducting an annual track nomination process, with coal export Access Holders being required to demonstrate the outcome of their port allocations as Network Exit Capability, and with binding nominations, would provide ARTC with a better platform for obtaining realistic, accurate nominations from Access Holders and Access Seekers.

From the perspective of achieving contractual alignment, an annual track nomination process that follows shortly after PWCS port allocations are issued, would provide a level of certainty that is lacking from the process provided for in the Proposed HVAU of ad-hoc contracting and Capacity Analysis as and when Applicants approach ARTC to negotiate an AHA. Without comprehensive, accurate nominations, there are necessary limits to ARTC's ability to conduct a meaningful Capacity Analysis. Further, without a firm Network Exit Capability requirement – that is, one that precludes an Applicant from obtaining Capacity Entitlements without demonstrating Network Exit Capability – , it is also difficult to understand how ARTC can have a meaningful understanding of how much Capacity on the Network is actually required in order to satisfy the Access Application (see note 4 below).

2. **Domestic coal** – C&A believes the track Capacity for domestic coal exit points can also be appropriately nominated for and allocated on an annual basis. To the extent that an Applicant wishes to secure track Capacity outside of the annual process, ARTC could enter into short term contracts (of less than one year) to provide Capacity until the subsequent annual nomination process, when the Applicant could nominate in the usual manner for a long-term Capacity Entitlements.
3. **Non-coal traffic** – Non-coal Applicants would nominate to the extent not already contracted and priority would be preserved, at all times, for passenger Trains. If it is not appropriate to include passenger Trains or other non-coal traffic in the annual process, this can be accommodated.
4. **Binding nominations for tonnage** – Nominations would be binding as to tonnage, to the extent that nominated capacity can be met with Available Capacity or Pending Capacity. Please refer to discussion at part 1.4 of this submission regarding limiting the number of negotiable terms of the Proposed IAHA. If producers are to be allowed to negotiate an AHA, then the following steps apply:
 - (a) Producers who wish to do so may negotiate the terms of their AHA prior to the submission of nominations.

(b) Producers who wish to do so may negotiate alternative terms after they have nominated, but if negotiations fail to reach an agreement within 30 days of the Indicative Access Proposal being issued by ARTC, the indicative AHA would set the terms for the nomination.

5. **Network Exit Capability** – C&A's suggested framework would adopt the same definition of Network Exit Capability as in the Proposed HVAU, but would contain the following stricter, more clearly defined application of the Network Exit Capability requirement:

(a) An Applicant must demonstrate at the time a nomination is submitted for Path Usages that it has Network Exit Capability for those Path Usages. Any nominated Path Usages that do not have Network Exit Capability will be non-compliant nominations and those Path Usages will not be included in the Train Path Schedule issued by ARTC for that Applicant (that is, no contract for Path Usages with no Network Exit Capability).

(b) The timing of the proposed track nomination process would mean that producers nominate for track Capacity shortly after they know how much capacity they have been allocated at PWCS. With the coordinated, annual process, ARTC would know exactly how much port allocation each Applicant has, and ARTC would be in a position to prevent an Applicant from over-contracting for track Capacity.

For actual train planning and scheduling throughout the year, an Applicant must not be allocated a Path Usage unless it has actual Network Exit Capability.

6. **ARTC/HVCCC Capacity Analysis** – The Capacity Analysis would be made in consultation with the HVCCC, as in section 5.2 of the Proposed HVAU, but with the benefit of having all track nominations available to assess at the same time and full information on recently confirmed port allocations.

7. **Additional Capacity, Pending Capacity and Capacity Entitlements** – Under the Proposed HVAU and Proposed IAHA, when an Applicant executes an AHA, it receives a Train Path Schedule with a schedule of Path Usages for each load point. The Path Usages that will use Available Capacity are listed in the Train Path Schedule without any Project Completion Conditions Precedent. By contrast, the Path Usages that will use Additional Capacity are listed in the Train Path Schedule with the Project Completion Conditions Precedent. The Project Completion Conditions Precedent are only satisfied if ARTC is of the opinion that the project is commercially viable having regard to a range of discretionary criteria (see discussion at part 1.5 of this submission).

As C&A understands, Additional Capacity is Capacity that is either under construction, planned (for example, as part of the Hunter Valley Corridor Strategy), or otherwise contemplated by ARTC. Available Capacity is existing Capacity that has not already been allocated to another Access Holder as Capacity Entitlements. Available Capacity becomes a Capacity Entitlement when an AHA for that Available Capacity is executed.

C&A proposes that all contracts for Train Paths be entered into at the same time, as part of an annual nomination and contracting process, regardless of whether they are Train Paths for Capacity Entitlements, Additional Capacity, or a new category of Train Paths called Pending Capacity:

Additional Capacity is identical to the Capacity that ARTC has labelled "Tranche 2" (that is, the Access Holder is contractually bound on a take or pay basis for that Capacity once it is commissioned and ARTC's contractual obligation is subject to a range of conditions precedent). When the conditions precedent for Additional Capacity are satisfied, the Additional Capacity automatically converts into Pending Capacity.

Pending Capacity is Capacity for which ARTC is contractually bound to complete the construction of that Capacity. The only conditions precedent for Pending Capacity are those related to the timing of the completion of construction of that Capacity. When Pending Capacity is commissioned, that Capacity automatically converts into Capacity Entitlements. Pending Capacity would include, for example, the Newdell Junction Upgrade.

Capacity Entitlements are identical to the Capacity that ARTC has labelled "Tranche 1" in the Train Path Schedule. There are no conditions precedent for Capacity Entitlements.

When Capacity is in an idea/planning phase, it is Additional Capacity. When Additional Capacity becomes confirmed under the 'endorsement' processes provided for in the HVAU, that Additional Capacity automatically converts into Pending Capacity. When Pending Capacity is commissioned, it automatically becomes Available Capacity (if no Access Holder has been granted that Capacity), or Capacity Entitlement (if that Capacity has already been granted to an Access Holder under an AHA).

Additional Capacity →	Pending Capacity →	Available Capacity (if no contracts) or Capacity Entitlements (if contracts)
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ARTC has indicated that it is reluctant to be contractually bound to deliver on all Capacity that is contemplated by ARTC or sought by Applicants. However, PWCS **is obligated** to expand port capacity to meet producers' capacity nominations, no matter how high those nominations might be and regardless of whether it is commercially viable for PWCS to expand. While C&A does not **propose** that ARTC be compelled to construct Additional Capacity in the same manner as PWCS' unqualified obligation to expand, C&A considers it inappropriate for ARTC to have no binding obligation to build Additional Capacity in circumstances where the RCG has already endorsed the implementation of Capacity which ARTC has assessed and proposed and which is backed by long-term take or pay contracts, or in circumstances where an Applicant has agreed to fund Additional Capacity based on an implementation plan and budget agreed with ARTC.

Accordingly, C&A suggests limiting the scope of Pending Capacity to include only Capacity that meets the following criteria:

- (a) The Additional Capacity is commercially viable in ARTC's opinion, and has been endorsed by the RCG;
- (b) The Additional Capacity is commercially viable in ARTC's opinion, and has been approved by the ACCC;
- (c) One or more Applicants are willing to fund the Additional Capacity and the Additional Capacity has been endorsed by the RCG; or

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- (d) One or more Applicants are willing to fund the Additional Capacity and the RCG has not endorsed the Additional Capacity, but the Applicants would be willing to fund any increase above the 10% threshold without earning a Rate of Return on the amount funded in excess of the approved price increase level.
8. **Withdrawal** - After the prioritisation rules are applied, ARTC issues Indicative Access Proposals and informs all Applicants whose allocated Path Usages are less than 80% of the Capacity nomination. Those Applicants may withdraw the nomination for that Path Usage by written notice to ARTC within an appropriately confined period – for example, two weeks. If an Applicant does not withdraw the nomination within two weeks, the nomination is binding on the Applicant. The percentage of the Path Usage that can be met with Available Capacity or Pending Capacity will be categorised accordingly on the Train Path Schedule. The balance of the Path Usage will be categorised as Additional Capacity.
9. **Technical feasibility** – C&A acknowledges that it is appropriate for ARTC to make a decision as to the technical feasibility of Additional Capacity, as contemplated by section 6.4(a)(ii)(A) of the Proposed HVAU. However, in the event that ARTC determines that Additional Capacity is not technically feasible, C&A considers that the Applicant should have the opportunity to seek a review of that decision that would bind ARTC, for example, by an independent expert.
10. **Conversion of Additional Capacity to Pending Capacity for ARTC commercially viable capacity** - Project implementation is to be conducted in accordance with section 6.4(g) of the Proposed HVAU, except, if a situation arises under section 6.4(g)(iii)(C)(vi) of the Proposed HVAU, where an independent expert determines that a variation is not Prudent or the variation to the project schedule is not reasonable, ARTC may not cease implementation. Rather, ARTC would be required to complete implementation, with all non-Prudent costs excluded from the RAB.
11. **Conversion of Additional Capacity to Pending Capacity for Applicant-funded Capacity that is endorsed by the RCG** - Project implementation is to be conducted in accordance with section 6.4(g) of the Proposed HVAU and funded by Applicants. If a situation arises under section 6.4(g)(iii)(F)(vi) of the Proposed HVAU where an independent expert determines that a variation is not Prudent or the variation to the project schedule is not reasonable, ARTC may not cease implementation. Rather, ARTC would be required to complete implementation, with all non-Prudent costs paid for by ARTC. No implementation costs will be included in the RAB, but see note 13.
12. **Conversion of Additional Capacity to Pending Capacity for Applicant funded Capacity that is not endorsed by the RCG** - Project implementation is to be conducted in a manner similar to section 6.4(g) of the Proposed HVAU and funded by Applicants, except endorsements are to be made by the funding Applicant rather than the RCG. If a situation arises under section 6.4(g)(iii)(F)(vi) of the Proposed HVAU where an independent expert determines that a variation is not Prudent or the variation to the project schedule is not reasonable, ARTC may not cease implementation. Rather, ARTC would be required to complete implementation, with all non-Prudent costs paid for by ARTC.

In those circumstances, no implementation costs will be included in the RAB.

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13. **Equitable reconciliation** – C&A welcomes the inclusion in section 6.2(g) of the Proposed HVAU of principles for an equitable form of reconciliation where Additional Capacity is initially funded by a Capital Contribution. However, C&A considers that these principles should be clearly embodied in a pro forma Capital Contribution Deed between ARTC and the Applicant. This Deed would include all necessary commercial terms for the making of the Capital Contribution by the Applicant.

C&A considers that ARTC should be required to submit a draft Capital Contribution Deed to the ACCC for acceptance as part of an amended HVAU except if all initial nominations are covered by Existing or Pending Capacity, in which case, ARTC should be required to submit the deed within six months of the ACCC's acceptance of an HVAU.

14. **Cost of Additional Capacity** - Where the cost of Additional Capacity will lead to an increase in charges by more than 10% and that Capacity is not endorsed by a 70% RCG vote (or approved by the ACCC under section 6.4(b)(viii) of the Proposed HVAU), The portion of the costs which would lead to charges increasing by 10% should (provided there is 50% RCG endorsement) be included in the RAB, with Applicants(s) being able to fund the balance of the costs on a "non RAB" basis. That is, an inability to secure 70% RCG endorsement should not veto the Additional Capacity if user(s) are willing the fund the project on a "non RAB" basis to the extent required to keep charge increases at 10%

If ARTC agrees to assume this implementation risk described in notes 10 – 12 above, C&A would be willing to support a higher WACC, as discussed in section 6 of this submission.

C&A considers that all steps should not exceed a period of:

- (a) 6 months for assessments involving less than 10mtpa of Additional Capacity; and
- (b) 12 months for assessments involving more than 10mtpa of Additional Capacity.

1.9 Other certainty issues

Greater clarity around definition of Extensions required

As the ACCC noted in section 2.1 of its Consultation Paper, section 2.1(c) of the Proposed HVAU provides that the undertaking does not apply to Extensions. The ACCC also noted that the definition of 'Network' refers to a description of railway lines specified in Schedule B, but excluding the maps of those lines annexed to the Schedule. The annexure nonetheless states that the Network forming part of the lease may change over time, but not so as to be inconsistent with Schedule B. Submissions from interested parties expressed confusion over what is and is not covered by the HVAU, and the ACCC further noted that it should not be difficult for ARTC to clearly define the Network proposed to be covered by the HVAU, and that the convoluted approach described above creates significant uncertainty that is unlikely to be appropriate.

In response, ARTC revised the Network description in Schedule B and proposed changes to section 6.1 to clarify the scope of a 'connection'.

However, the definition of Network continues to leave room for uncertainty as to what track is included within the Network. For example, it remains unclear whether an additional line or passing loop that is built next to an existing part of the Network would constitute an "Extension" to the Network that falls outside the scope of the Proposed HVAU.

Changes over time to Proposed HVAU which are automatically incorporated into the HVAU leads to greater uncertainty for Access Holders

As the ACCC has noted in section 2.16 of its Consultation Paper, clause 19.1 of the Proposed IAHA relates to the incorporation into an executed access agreement of changes to that may occur over time to the HVAU. The clause provides that any change to a Tier 1 (mandatory) provision will be automatically incorporated into the agreement, and that where there is a change to the indicative access agreement that is inconsistent with the executed access agreement, the parties will negotiate in good faith to modify the executed agreement, with recourse to the dispute resolution provisions in the executed agreement if necessary.

As discussed in the Proposed Solution to Key Issue 1A, C&A supports the approach taken by ARTC in the 23 December 2009 draft AHA, which contemplated the parties entering into an AHA before an HVAU was accepted by the ACCC and which included an uplift clause that automatically varied key clauses of the AHA to be consistent with an IAHA that is accepted by the ACCC. Stakeholders have a reasonable idea of what amendments might be introduced through the uplift clause and can assess their positions on the basis of certain assumptions.

By contrast, an open-ended obligation to accept any new terms that may arise from a new or varied access undertaking being accepted by the ACCC at some undetermined point in the future creates too much uncertainty for Access Holders. Accordingly, C&A believes that the scope of clause 19.1 of the Proposed IAHA is inappropriate and should be deleted.

2. Key Issue 2: ARTC should have greater accountability for delivering contracted volumes

2.1 Overview of the TOP Rebate as determined by the periodic True-Up Test and Annual Reconciliation process

In section 13.11.3.6 of its Draft Decision, the ACCC considered that the 2009 IAHA did not provide a sufficiently clear definition of the “Network Path Capability” and “Tolerance Cap” components of the True-Up Test. The ACCC considered that ARTC needed to provide details of the calculation methodology for both these terms to provide additional transparency and clarity for Access Holders.

In response to the ACCC's Draft Decision, ARTC has made various revisions to clauses 3.1 to 3.5 of the Proposed IAHA and to the Train Path Schedule attached to the Proposed IAHA. ARTC has:

- (a) amended the definition of Tolerance in clause 3.1;
- (b) added to clause 3.3 of the Proposed IAHA a methodology for the determination of the Monthly Tolerance Cap (**MTC**); and
- (c) amended the definition of NPC in clause 2.2 of Schedule 2 of the Proposed IAHA.

C&A notes that under section 4.10(b) of the Proposed HVAU and clause 2.4 of Schedule 2 of the Proposed IAHA, the only recourse for Access Holders if ARTC does not make Path Usages available is a take or pay (**TOP**) Rebate, as determined through the periodic True-Up Test and Annual Reconciliation process. Accordingly, C&A sees it as imperative that the TOP Rebate and Annual Reconciliation process are calculated and conducted appropriately.

Under the Proposed IAHA, the True-Up Test is a two stage process which involves:

- (a) first, the determination of whether ARTC has made available the Path Usages it has contracted to provide; and,
- (b) secondly, if there has been a System Availability Shortfall, the allocation of rebate accruals to Access Holders who do not receive their BPU's in that Period.

An Access Holder will only receive a TOP Rebate payment if at the end of the year they have not used all of their annual contracted BPU's, as determined through the Annual Reconciliation process in clause 5.4 of the Proposed IAHA.

Overall, C&A believes that the concept of a TOP Rebate will act as an appropriate incentive for ARTC to not underperform or over-contract; however, there are significant shortcomings in the proposed TOP Rebate calculation which must be addressed to ensure ARTC is held appropriately liable for any losses it has caused. **Importantly, the True-Up Test must be transparent, comprehensive and be subject to independent audit by a third party.**

Since the original draft AHA submitted on 29 April 2009, there have been a number of iterations of the True-Up Test. As noted above, some variations have been made to clarify the definition and determination of the MTC and NPC components of the True-Up Test.

However, C&A's view is that the Proposed IAHA still does not go far enough to make these terms clear.

In addition, the mechanism by which the TOP Rebate accruals are determined for Access Holders has been altered, most notably by removing Tolerance from the TOP Rebate calculation such that ARTC is no longer held accountable for not providing system-wide Tolerance.

On balance, the changes have resulted in a decrease to the total rebate accrual ARTC is liable for given the same level of shortfall. These issues are further explained in the following sections.

2.2 Determination of NPC and other key components of the periodic True-Up Test

Calculating the NPC is the critical first step of the True-Up Test. It is important that the NPC accurately and transparently represents the useable capacity of the Network, since it is directly used to determine whether there has been a System Availability Shortfall (**SAS**).

If the NPC is overstated, it is unlikely that a SAS will ever be identified, even if some Producers were unable to use all of their BPU's. C&A's view is that this would lead to undesirable outcomes, that is:

- (a) There will be no recourse for Producers if paths are not made available by ARTC, since no TOP rebates will be accrued if no shortfall is recognised; and,
- (b) ARTC could over-contract without risk of being held liable for a TOP rebate.

The Proposed IAHA outlines a definition of NPC based on Functional Coal Paths, that is, a path that is capable of being used by a Coal Train. The definition stipulates that the track-related System Assumptions (for example, train lengths, speeds, axle loads and section run times) will be considered in the calculation, as well as any other measure of Network performance which ARTC reasonably considers will have an impact on Network Capacity. In addition, the NPC is determined at a single point on the Network for each Pricing Zone.

C&A submits that there are other factors beyond track-related System Assumptions which determine whether a path is actually useable for a Coal Train, since a 'useable' Train Path requires both an available load point at the mine and dump slot at the terminal. C&A's view is that ARTC should more explicitly recognise other System Assumptions which impact on the usability of the Train Path in determining NPC (for example, System Assumptions related to Access Holder load points and dump stations at the terminals). Alternatively, the reference to "forecast system losses – other parties" in paragraph (e) of the definition of Total Path Usages Required (**TPR**) in section 2.2 of Schedule 2 of the Proposed IAHA could explicitly state that the value will be based in part on System Assumptions related to interface losses between track and terminal.

In terms of the methodology for determining NPC, ARTC has proposed basing the Capacity of a Pricing Zone on a static, single point estimate. C&A requests that ARTC make available to industry its Capacity modelling as soon as practicable so that an informed assessment of the appropriateness of the methodology can be made. C&A notes that there is an example set of True-Up Test rebate accrual calculations in the Explanatory

Guide to the Proposed HVAU, but it does not include an example of how NPC will be calculated at a particular point on the track.

C&A has concerns that the single point approach is not appropriate as the Capacity at that point cannot remain representative over time. For instance, ARTC states in section 5.12.4 of its Explanatory Guide that "Whittingham Junction is representative of the available capacity in Pricing Zone 1 for the majority of traffic taking into account the proportion using each part of the Pricing Zone and capacity at various points". However, these conditions are only applicable as of the date the Proposed IAHA was lodged with the ACCC and will likely require adjustment as additional investments are made or demands on Capacity change. For this reason, C&A does not see it as appropriate that a specific point should be locked into a ten year contract without any mechanism for adjusting the point of estimate from time to time as the Hunter Valley Coal Chain evolves.

ARTC has also stated at section 5.12.4 of the Explanatory Guide that the approach it proposes for calculating NPC is "consistent with capacity reporting undertaken by the HVCCC". It is C&A's understanding that although the HVCCC **reports** Capacity at various points along the Hunter Valley Rail Network, Capacity **modelling** is done on an entirely different basis. In determining track Capacity, the HVCCC looks at the Capacity across individual track sections (approximately 14 sections in total) covering the entire track Network and considers estimated demand at each load point based on coal producer production forecasts, to determine an overall system Capacity.

C&A's view is that the ARTC's determination of NPC should reflect the HVCCC's methodology. The modelling method used by the HVCCC is more in line with the alternative approach presented by ARTC in section 5.12.4 of its Explanatory Guide, that is, an "average" Capacity approach, where the Capacity at junctions across the Pricing Zone is considered and weighted by the traffic at those points.

In the same section, however, ARTC argues against "average" Capacity over the proposed single point method. C&A notes the following ARTC comments in relation to the average Capacity proposal and responds as follows:

- (a) "Such an approach would involve complex judgements as to how planned capacity losses (for example, planned maintenance outages or system losses) should be allocated..."

C&A notes that the definition of NPC does not consider the impact of planned capacity losses as these are taken into account in the build up of TPR (that is, in the "actual maintenance requirement", the "actual ARTC system losses" and the "lesser of actual versus forecast other party system losses" terms). Hence, C&A queries why this is relevant to the determination of NPC.

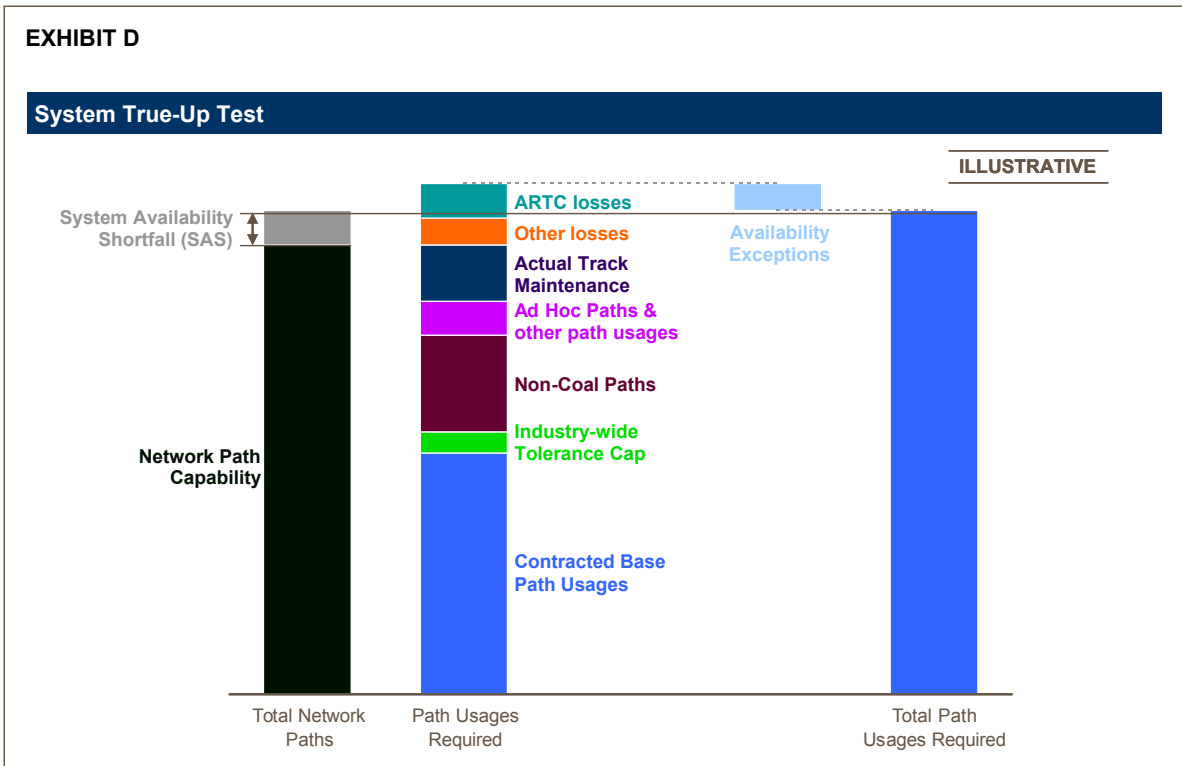
- (b) "... and the adoption of arbitrary assumptions given the multiplicity of sources and sinks for coal traffic."

C&A's view is that ARTC can adopt the approach taken by the HVCCC and use its knowledge of which track contracts are in place and other production forecasts to ascertain the likely demand profile on the Hunter Valley rail Network.

Regarding the components which contribute to the calculation of the TPR (see clause 2.2 of Schedule 2 of the Proposed IAHA), it is still not clear to C&A where the information needed to determine these values will be sourced from. C&A's view is that the HVCCC should be explicitly stated as the source for information on system losses, actual track maintenance and other factors which are typically modelled and measured by the HVCCC.

In particular, the source of information on non-Coal Train Paths will need to be made clear. C&A has concerns that the treatment of these Train Paths may not be appropriate. ARTC states in section 5.12.5 of its Explanatory Guide that the number of Services scheduled for non-Coal Trains is determined prior to the commencement of the relevant month and this will be incorporated into the True-Up Test on a coal path-equivalent basis. It is possible, however, that an actual non-coal service that month could consume more coal paths than originally considered, due to delays or slow-running of the relevant Train. It is not clear how this scenario will be dealt with under the Proposed IAHA, for example, whether it will be by an ex-post adjustment of the non-coal Path Usages item or by incorporating the lost Path Usages into ARTC losses.

In addition, C&A notes that the diagrammatic depiction of the True-Up Test contained in clause 2.1(b) of Schedule 2 of the Proposed IAHA is inconsistent with the written details of the True-Up Test in clause 2.2 of Schedule 2 of the Proposed IAHA. In particular, TPR in the diagram is made up of all the components listed in clause 2.2, but Availability Exceptions have not been deducted as they should be. A more accurate depiction is demonstrated in Exhibit D below.



Proposed Solution

Regarding the determination of Network Path Capability, C&A proposes that:

- (a) ARTC acknowledge other System Assumptions which impact the useability of track for Coal Trains, as provided by the HVCCC, in the definition of NPC contained in section 2.3 of Schedule 2 of the Proposed IAHA.
- (b) ARTC bases the determination of NPC according to the projected demand for each load point (as indicated by the signed track contracts), as is consistent with HVCCC annual capacity modelling methodologies.
- (c) ARTC be required to apply the recommendations of the HVCCC in determining NPC.

Regarding the components of Total Path Usages Required, C&A proposes that:

- (a) The definitions of components making up TPR outlined in Section 2.2 of Schedule 2 of the Proposed IAHA be extended to explicitly state the sources of information relied upon to provide the information required.
- (b) The definition of non-Coal Train Paths in the same section be expanded to include details on how the equivalent coal paths for a given non-coal service will be determined.

Finally, C&A recommends that, for greater clarity, the depiction of the System True-Up Test in section 2.1 of Schedule 2 of the Proposed IAHA be updated to reflect the actual wording of section 2.2 of Schedule 2 of the Proposed IAHA.

2.3 The critical role of Tolerance

In section 2.13 of its Consultation Paper, the ACCC has sought views on whether the True-Up Test appropriately accounts for Tolerance.

By way of threshold comment, C&A acknowledges that Tolerance is provided on a system-wide basis to serve as a flexibility mechanism for Access Holders to draw on as and when needed to manage use of coal access rights between Periods. C&A understands that Tolerance is a means of smoothing the use of BPU's across Periods and that it is not an entitlement to additional paths above contracted BPU's over the year; rather, it is only a right to the time-shifting of BPU's from one Period to another.

In this regard, Tolerance is critical for the effective operation of the Hunter Valley Coal Chain for the following reasons:

- (a) Providing Tolerance is necessary given the different bases for recording allocation usage across components of the Hunter Valley Coal Chain – that is, coal is railed over the course of a week for a vessel joining the queue at a specific time. As a result, a vessel arriving at the end of a month to use that month's allocation will always load coal hauled by Trains which run at the beginning of the following month, given a reasonable queue length.

-
- (b) Tolerance allowance on the track promotes alignment across the Hunter Valley Coal Chain by matching tolerance provided in port terminal contracts – Access Holders are entitled to a certain level of tolerance at the port terminal to maximise allocation usage between months. That is, Producers can bring forward capacity usage at the port terminal if the remaining allocation in a month is insufficient to fill a vessel.
 - (c) Tolerance enables Access Holders to manage capacity issues which may emerge in the Hunter Valley Coal Chain. For example, Tolerance can be used to deal with times when the vessel queue exceeds ideal levels, or there is misalignment in the sculpting of allocation across the track and terminal.

It is also important to note that Access Holders ultimately pay for the flexibility granted by Tolerance, since the cost of capacity built to accommodate Tolerance is embedded in the Access Charges. In this regard, ARTC states in section 5.2.1 of its Explanatory Guide that the level of the Target Monthly Tolerance Cap (**TMTC**) will reflect the amount of Capacity that the industry is prepared to build in order to have a sufficient level of flexibility, up to a maximum of 10% over a year.

Appropriate checks on setting of TMTC

In clause 1.1 of the Proposed IAHA, 'TMTC' is defined as

the Target Monthly Tolerance Cap for each Pricing Zone, being the lesser of:

- (a) the percentage of overall Capacity commissioned and available for use in the Pricing Zone, reasonably determined by ARTC as the target monthly tolerance cap following consultation with the RCG, as specified in the Hunter Valley corridor capacity strategy for that Contract Year; and
- (b) ten per cent of the overall Capacity commissioned and available for use in the Pricing Zone;

C&A is concerned that the definition of "TMTC" currently gives ARTC the discretion to set the TMTC at any level, although not greater than 10%, only having regard to consultations with the RCG (but not requiring RCG approval). C&A notes that it is possible for ARTC to set the TMTC at a level that is less than the industry's requirements (even to a zero level) which would impact on the flexibility needed in the Coal Chain. Therefore, C&A believes it is appropriate to set a minimum TMTC, and require ARTC to seek approval from the RCG in order to set the TMTC below this level.

Proposed Solution

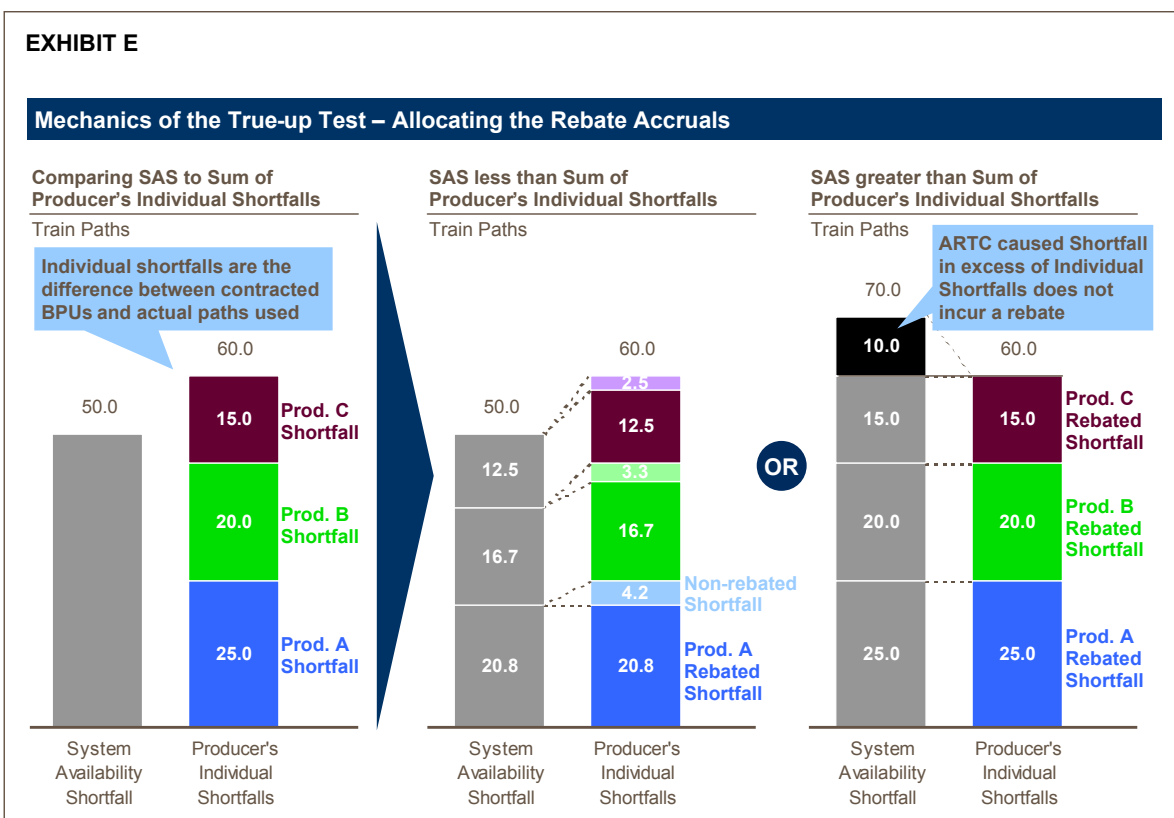
C&A proposes that the definition of TMTC be amended to include a minimum level of TMTC and a requirement that any decisions to set TMTC below this level must be approved by the RCG.

2.4 Issues with the proposed accrued System Period Rebate

ARTC recognises that providing the Monthly Tolerance Cap within a Pricing Zone is a commitment by it to all Access Holders as a group rather than to individual Access Holders.

ARTC has stated in section 5.12.3 of its Explanatory Guide that “its performance against this commitment is measured under the True-Up Test”.

However, C&A notes that although Tolerance is considered in the first stage of the True-Up Test, where the Capacity Shortfall is determined, it has been removed from the second stage of the True-Up Test, that is, in the allocation of TOP Rebate accruals. The result is that Access Holders may not receive any rebate accrual for Tolerance paths not provided, since the current mechanism for allocating rebates limits the accrual to Capacity Shortfalls which impact the use of BPUs only (see Exhibit E below).



The fundamental issue with the True-Up Test in its current form is that ARTC is not always held liable for the entire Capacity Shortfall it causes, as illustrated by the example in Exhibit E above.

C&A believes that the True-Up Test should be comprehensive and, as a result, the industry should be able to accrue rebates if ARTC fails to provide Tolerance paths, since Tolerance is an entitlement of the industry as a whole.

The secondary issue is how this rebate accrual should be allocated amongst Access Holders. Since Access Holders pay for Tolerance through their Access Charges, on a pro-rata basis, C&A believes it stands to reason that any rebate accrual for unused Tolerance paths should be allocated according to the same principle.

In section 5.12.3 of its Explanatory Guide, ARTC noted that one producer submitted to ARTC that an Access Holder should be entitled to a TOP Rebate under the True-Up Test if it did not receive its contracted Tolerance, or as an alternative, its share of the MTC.

ARTC expressed its view that this submission "fundamentally misconstrued" the purpose of the Tolerance provided under the Proposed IAHA and the nature of ARTC's commitment. ARTC then makes a number of arguments as to why it is inappropriate for an Access Holder to accrue a rebate for not receiving Tolerance.

C&A makes the following points in response to those arguments:

- (a) "The purpose of Tolerance is not to enable each and every Access Holder to use its 'fair share' each month."

C&A agrees that within a month it is not likely that all Access Holders will wish to **use** Tolerance paths. However, **all** Access Holders **do pay** for Tolerance to be made available every month, since the cost of providing Tolerance is included in Access Charges. Industry chooses to pay for this Tolerance so that required flexibility is available if and when it is needed. Although the nature of Tolerance as it is used in practice is distinct from how it is paid for, the fact that Access Holders do pay for Tolerance means that Tolerance paths which are not made available should attract a rebate accrual in line with the way industry pays for Tolerance.

- (b) "Where there is no rebate applicable to Tolerance paths... ARTC will be incentivised to ensure that an Access Holder who requires BPU will receive the BPU ahead of another Access Holder... seeking to use Tolerance."

C&A agrees that Access Holders should receive BPUs before Tolerance paths and that ARTC should be incentivised to provide BPUs ahead of Tolerance paths. However, C&A believes that this can be achieved if rebate accruals for BPU shortfalls are allocated before accruals for Tolerance. Moreover, Access Holders who do not receive their BPUs in a given month are more likely to fall short of their Annual Contracted BPUs and therefore receive an actual TOP Rebate payment following the Annual Reconciliation process. Consequently, there is still an incentive for ARTC to provide BPUs before Tolerance.

- (c) "The availability of Tolerance to any particular Access Holder is subject to the MTC available to the system"

C&A agrees that the level of available MTC and actual consumption of the MTC will first need to be considered before determining whether any Access Holders should receive a rebate accrual due to a shortfall. For example, one Access Holder may consume 50% of the Tolerance cap, while the remaining 50% is unavailable due to shortfall. In this case, only rebate accruals equivalent to the remaining 50% of the MTC will be allocated amongst Access Holders. It should be noted that this may not be how the Tolerance paths would have been **used** in practice, but it does align with how they are **paid for**.

- (d) "ARTC should not have to rebate TOP where Tolerance is not used – the TOP charge is determined as a monthly average of the ACP and has no relationship with either BPUs or Tolerance paths"

It is important to note first that the periodic True-Up Test results in rebate **accruals** and ARTC will only be liable for a TOP Rebate **payment** if at the end of the year an Access Holder has not received all of their Annual Contracted Path Usages.

Secondly, C&A's view is that the failure to provide Tolerance in a given month could impact an Access Holder's ability to achieve their annual BPU's, and this should be recognised through a rebate accrual. For example, if a vessel was scheduled to arrive in a certain month but its arrival was delayed into the following month and an Access Holder could not use Tolerance in that month due to an ARTC Capacity Shortfall, the Access Holder could potentially lose port terminal allocation for that month as it would be unable to haul coal to the port terminal for all of its vessels. In this case, the Access Holder is unlikely to reach their Annual Contracted Path Usages.

- (e) "It is much more likely that Tolerance is not used due to reasons other than ARTC not making the path available"

C&A's view is that regardless of whether or not an Access Holder may or may not have wanted to use a Tolerance path, since a shortfall in Tolerance represents a level of flexibility paid for but not provided by ARTC, a liability should be accrued.

- (f) "There is no conceptual justification or mechanism for allocating MTC between Access Holders"

C&A submits that any imperfections in the allocation of rebate accruals related to Tolerance should not relieve ARTC of its obligation to pay TOP Rebates for not making Capacity available. It should again be noted that Access Holders share the cost of maintaining flexibility in the Network through higher TOP charges in order to fund the additional "peaking" capacity required for Tolerance paths. Based on this concept, allocating rebate accruals for Tolerance shortfalls pro-rata to the TOP charges paid by Access Holders is appropriate and justified.

Finally, by not including Tolerance in the True-Up Test, ARTC could retain revenue from Train Paths it does not supply. Considering the example set out in Exhibit F below, where as Access Holder has an allocation of 200 BPU's every month:

- (a) In November, one of the Access Holder's ships arrives late at the port so it decides to only use 190 BPU's in that month and make up the difference in the following month by using 210 BPU's in December; however, the required Tolerance paths needed in December cannot be made available at the fault of ARTC.
- (b) Since the Access Holder has used their BPU's in December, they are not entitled to accrue a rebate, despite ARTC causing a System Availability Shortfall in that Period.
- (c) At the end of the year, the Access Holder has used fewer paths than it has contracted for, but it cannot receive a TOP Rebate payment since it has not accrued any rebates throughout the year by virtue of the current application of the True-Up Test. As a result, ARTC effectively earns revenue for more paths than it has provided.

EXHIBIT F

The need for Tolerance in determining rebate accruals – Worked Example

	Jan	Feb	...	Oct	Nov	Dec	Total Year
Actual Path Usages	200	200	...	200	190	200	2390
Base Paths for which Producer paid TOP charges	200	200	...	200	200	200	2400
Paths paid for but not used	-	-	...	-	10	-	10
System Availability Shortfall	-	-	...	-	-	20	-
True-Up Test TOP Rebate	-	-	...	-	-	-	-

Month of shortfall: No rebate given since Producer used their BPU, despite an ARTC shortfall in delivering tolerance paths

ARTC receives revenue for all 2,400 paths contracted, despite not supplying the 10 tolerance paths the Producer needed to meet their annual contracted BPU

Proposed Solution

Appropriate inclusion of Tolerance

In light of C&A's comments above, C&A proposes that Tolerance be reintroduced into the calculation of the rebate accruals for the periodic True-Up test with the following changes:

- (a) First and foremost, if a System Availability Shortfall is determined for the Period in question, rebate accruals corresponding to Access Holders' individual shortfalls from Base Path Usages for each Train Path (that is, System Period Rebates) should be allocated, through the mechanism drafted by ARTC in the Proposed HVAU (section 2.4, Schedule 2, of the Proposed IAHA).
- (b) In the case where the System Availability Shortfall is greater than the sum of Access Holders' individual shortfalls, a Tolerance-related rebate accrual for the remaining shortfall is distributed to Access Holders who have not reached their limit of Tolerance in that Period (i.e., 10% or 13 paths). Tolerance-related rebate accruals (that is, System Period Tolerance Rebates) are distributed to Access Holders within the tested Pricing Zone, not based on specific Train Paths, since Tolerance within an Access Holder's allowance can be used on any Train Path within a Pricing Zone.
- (c) The System Period Tolerance Rebate for each eligible Access Holder is determined by the following formulae, which applies across all of their contracted paths in the Zone:
 - (i) If the System Availability Shortfall in a given Period is greater than the sum of Access Holders' individual shortfalls then:

$$\text{System Tolerance Path Shortfall (STPS)} = \text{SAS} - \sum(\text{AH}_1 \text{ IS}, \text{AH}_n \text{ IS})$$

Where:

- (A) SAS is the System Availability Shortfall; and,
 - (B) $AH_i IS$ is an Access Holder's Individual Shortfall, i.e., contracted Base Path Usages for the period less Actual Path Usages.
- (ii) An Access Holder is eligible to accrue a System Period Tolerance Rebate for the tested Pricing Zone unless the Access Holders actual usage of Tolerance across all paths in that Pricing Zone is equal to or greater than:
- Relevant Period Tolerance Cap (PTC) x AH BPU / Total BPU of relevant AHs

Where:

- (A) AH BPU is the Access Holder's Base Path Usages; and,
 - (B) 'Relevant AHs' are Access Holders which contract based on the relevant Period (i.e., Monthly or Quarterly)
- (iii) If eligible, an Access Holder accrues a System Period Tolerance Rebate equal to:

$STPS \times (AH TA - AH ATPU) / (\text{Relevant PTC} - \sum(AH_1 ATPU, \dots, AH_n ATPU))$

Where:

- (A) AH ATPU is the Access Holder's actual path usages in the Period counted towards the System Tolerance Cap;
 - (B) $\sum(AH_1 ATPU, \dots, AH_n ATPU)$ is the sum of all eligible Access Holders' actual path usages in the Period counted towards the System Tolerance Cap; and,
 - (C) AH TA is the Access Holder's Tolerance Allowance which equals:
 $(\text{Relevant PTC} - \text{Tolerance used by all ineligible AHs}) \times AH BPU / \text{Total BPU of all eligible AHs}$
- (d) As contemplated by ARTC in the draft AHA dated 7 December 2009, the proportion of the Monthly Tolerance Cap (MTC) used in the calculation of rebate accruals for monthly versus quarterly Access Holders can be determined on a pro-rata basis.
- (e) If at the end of the Contract Year an Access Holder does not receive their Annual Contracted BPUs, then, following the Annual Reconciliation process outlined in Section 5.4 of the IAHA, any System Period Rebate can be used to determine TOP Rebates to Access Holders for unused or unrebated Annual Contracted Base Path Usages of a particular Train Path, that is:
- (i) If for a Train Path the sum of:
 - (A) an Access Holder's Actual Path Usages (AH APU) used in the Contract Year, including Ad Hoc Path Usages; and

-
- (B) an Access Holder's rebated path usages for individual shortfalls from Base Path Usages,

is less than their Annual Contracted Path Usages (ACP) for that Train Path, and the Access Holder has accrued System Period Tolerance Rebates, then the Access Holder is entitled to an additional TOP Rebate payment.

- (ii) The TOP Rebate payment is equal to the lesser of:

(A) TOP price x (ACP – AH APU – rebated AH BPU)

(B) TOP price x (Sum of unused System Period Tolerance Rebates accrued through Contract Year).

2.5 Independence of True-Up Test

Given the importance of the True-Up Test as the only recourse for Access Holders should ARTC not make Train Paths available, C&A's view is that the test should be audited by an independent third party. In discussions with industry, ARTC has made mention of an independent audit of both the True-Up Test and the Annual Reconciliation process; however, Access Holders will have no assurance that this audit will take place unless a provision is included in the Proposed IAHA which requires ARTC to do so. Moreover, any obligation on ARTC to engage in an audit must be on the basis that the auditor is truly independent and that the process will be overseen by the HVCCC.

Proposed Solution

C&A proposes that provisions be included in Section 5.4 and Schedule 2 of the Proposed IAHA requiring the Annual Reconciliation process and True-Up test respectively to be subject to a mandatory audit by an independent third party, as decided by the RCG, with the whole process overseen by the HVCCC.

2.6 Other issues with the True-Up Test

Path Usages and TOP Rebate accrual

C&A recognises that an Access Holder may accrue a rebate for unused Path Usages regardless of whether or not there was the intention to use those paths. C&A suggests that in determining an Access Holder's individual shortfall, ARTC should consider whether the Access Holder has:

- (a) sought to trade allocation by placing a request on the Capacity Trading System (CTS) Clearing House;
- (b) voluntarily relinquished allocation at the port terminal; or,
- (c) had allocation quarantined at the port terminal.

It should be noted that under clause 2.5(a) of Schedule 2 of the Proposed IAHA, ARTC does contemplate making an Access Holder ineligible to accrue a rebate if its total Path Usages are greater than its BPU's less any Path Usages not made available under the Network Exit Capability and No Valid Operator Nomination provisions. C&A's view is that this consideration should be extended to the calculation of rebate accruals since an Access Holder may have a right to accrue a rebate under clause 2.5(a) of Schedule 2, but still have been unable to use **all** of the difference between its BPU's and Actual Path Usages, for example, due to lack of port terminal allocation.

Traded Path Usages

In addition, C&A notes an issue with the treatment of traded Path Usages. A Path Usage which has been traded is deemed to have been used by the originating Access Holder and counts towards its BPU's and, conversely, the Path Usage is not recognised to have been used by the new Access Holder who actually consumes the Path Usage. However, it is possible that a Path Usage could be traded and then not used due to a Capacity Shortfall caused by ARTC. In this case, it should be recognised that the Path Usage was not consumed, rather than assuming a Path Usage is used once it is traded, so that the originating Access Holder is still entitled to accrue a rebate for the Path Usage not made available. The trading Access Holder can then manage any refunds for trades which lead to inequitable outcomes through the terms of its agreement.

Proposed Solution

C&A proposes that the definition of an Access Holder's individual shortfall used to determine accrued System Period Rebate as outlined in Section 2.4 of Schedule 2 of the Proposed IAHA be altered to include consideration for:

- (a) Path Usages which would not have been made available under the Network Exit Capability clause (clause 3.14 of the Proposed IAHA); and,
- (b) Path Usages which the Access Holder attempted to trade by placing a request on the Hunter Valley Capacity Trading System (CTS) Clearing House, but did not then trade.

C&A also proposes that clause 16.5 (a) of the Proposed IAHA regarding treatment of traded Path Usages be altered so that a traded Path Usage is only deemed to be utilised by the Former Access Holder once it has been physically utilised by the New Access Holder.

2.7 Sufficiency of overall liability regime

In section 7.4.4.2 of its Draft Decision, the ACCC made the following three points with respect to ARTC's liability regime:

- (a) First, the ACCC was of the view that definition of "consequential loss" was too broad and that it was inappropriate for ARTC to exclude liability for direct losses. The ACCC's preliminary view was that the definition of "consequential loss" should be limited to indirect losses.

In section 5.4.5 of its response to the ACCC's Draft Decision, ARTC stated that it did not propose to limit the definition of 'consequential loss' any further. ARTC has not amended the definition of 'consequential loss' in the Proposed IAHA.

- (b) Secondly, the ACCC was of the preliminary view that the liability release in the 2009 IAHA was unlikely to be appropriate as it effectively released ARTC from liability for performance of its obligations under the 2009 IAHA. The ACCC noted that this unreasonably favoured ARTC and did not adequately recognise the interests of Access Seekers. The ACCC considered that a more balanced approach to liability would be more appropriate.

In section 5.4.3 of its response to the ACCC's Draft Decision, ARTC stated that it amended the mutual release in the December IAHA to exclude liability for fraud or wilful misconduct and that it did not propose to amend the release further to exclude liability for either negligence or breach of contract.

- (c) Thirdly, the ACCC noted that the amended maximum cap of the lesser of \$2 million and the amount of TOP charges may be too low to provide the correct incentives for ARTC to meet its obligations. The ACCC stated that in particular, depending on the amount of an Access Holder's TOP Charges, the amendment may have the effect of further limiting ARTC's liability when compared to the initial provision.

In section 5.4.4 of its response to the ACCC's Draft Decision, ARTC refused to increase its liability cap, but did propose to amend the liability cap to provide that it will increase annually in line with CPI increases.

C&A submits the following in relation to ARTC's proposed liability and indemnity regime:

- (a) C&A supports the ACCC's view that ARTC's proposed definition of "consequential loss" is overly broad and open-ended and should not, at least, incorporate matters which would usually be regarded as direct losses relating to property damage, personal injury or death.

Proposed Solution

C&A proposes that the definition of Consequential Loss in the IAHA be revised so that it is a limited definition rather than an inclusive one, and so that it has a carve-out for property damage, etc., that is consistent with the definition of Consequential Loss in the Proposed Operator Sub-Agreement.

"Consequential Loss means:

- (a) *any Liability which does not flow naturally from the relevant breach of this agreement, even if that Liability may reasonably be supposed to have been in the contemplation of both parties as a probable result of the breach at the time they entered into this agreement;*
- (b) *loss of profits, loss of business opportunity, loss of production, loss of revenue, loss of use, loss of contract, loss of goodwill, damage to goods being transported on the Services, any port or shipping/demurrage costs or fees, damages or penalties payable under the Access Holder's customer contracts (whether direct or indirect); and*

(c) *any other economic, special or consequential Liabilities; but does not include property damage or losses arising from third party claims in respect of property damage, personal injury, nervous shock or death;"*

(b) As there are potential future ARTC-caused problems which are not within the scope of the TOP Rebate determination, Access Holders should have the right to seek equitable relief from ARTC as a part of the overall liability regime. As the Proposed IAHA is currently drafted, the failure by ARTC to provide a Train Path does not constitute a default under the Proposed IAHA, even if ARTC deliberately, or even maliciously, fails to make a Train Path available in circumstances where the Proposed IAHA clearly require it to do so. Therefore, equitable relief is a necessary remedy to attempt to ensure ARTC's compliance with the Proposed IAHA and the Proposed IAHA should explicitly recognise that Access Holders have a right to equitable relief.

Proposed Solution

In proposing the revision to the Proposed IAHA outlined below, C&A understands and accepts that ARTC's monetary liability for failure to provide Train Paths is limited to a TOP Rebate. The drafting below seeks to provide Access Holders with the right to seek equitable relief (not monetary damages) for breaches (for example, failure to provide information to the HVCCC) and for failure to provide Train Paths in circumstances where ARTC can and should, but does not provide Train Paths.

5.4(f) Subject to clause 14.3(c), ~~It~~ the sole monetary remedy of the Access Holder for the failure by ARTC to make available a Path Usage or a Train Path for any reason is a TOP Rebate under clause 5.4(c) ~~and any such failure does not constitute a default under this agreement.~~

13(a) Except for an entitlement to a TOP Rebate under clause 5.4, the Access Holder releases ARTC from any Claims it may have, or Liability incurred by the Access Holder, however arising (including under this agreement, in tort including negligence, or for breach of any statutory duty), relating to:

- (i) Incidents;
- (ii) a Path Usage or any part of a Train Path not being made available (except, when arising as a result of a breach of this agreement) or an Operator's Train is not delivered on time to its ultimate or intermediate destination in accordance with the Daily Train Plan;
- (iii) the use of, or failure to use, Path Usages by the Operator under the Operator Sub-Agreement;
- (iv) an Operator complying with the terms of its Operator Sub-Agreement, including complying with Instructions and directions from ARTC; or
- (v) any breach by an Operator of the Operator Sub-Agreement as endorsed by the Access Holder; ~~or~~

~~(vi) any breach of this agreement which directly or indirectly causes ARTC to fail to make a Path Usage or Train Path available to the Access Holder (including clauses 4, 8 and 9),~~

14.3 Mediation, [equitable relief and general rights](#)

...

(c) Nothing in this clause ~~14.3 or clause 14.1(d)~~ prohibits a party from seeking ~~appropriate injunctive equitable~~ relief. [The Access Holder may seek any injunction, order for specific performance, declaration, or other equitable remedy and enforce any such remedy against ARTC relating to:](#)

[\(i\) any breach or anticipated breach by ARTC under this document; or](#)

[\(ii\) without limiting paragraph \(i\), any failure or anticipated failure to make available a Path Usage or a Train Path where such failure would be contrary to the terms of this agreement.](#)

[ARTC acknowledges that rights to use Path Usages in each Allocation Period are a unique asset for which it is not possible to readily obtain a replacement.](#)

The reference to clause 14.1(d) should be deleted from clause 14.3(c) because circumstances where an injunction or specific performance are appropriate are likely to be circumstances where time is critical and it will therefore be inappropriate for the aggrieved party to go through the 14 day negotiation process contemplated by clause 14.2.

C&A has also deleted the word "appropriate" from clause 14.3(c) as it is the court that should decide whether the relief sought is appropriate.

The revision to clause 13(a)(ii) and the deletion of clause 13(a)(vi) of the Proposed IAHA are not meant to change the scope of what constitutes a breach for which ARTC is liable. Rather, the changes are merely to make it possible for the Access Holder to seek the (discretionary) remedy of specific performance in the event of an ARTC breach. For example, if there is an extreme event leading to an extended Capacity Shortfall triggering clause 6.3, for which affected load points should bear an equitable pro-rata share of Capacity Shortfall, but ARTC decides to give ALL constrained capacity to one preferred producer, even though it would be practicable to provide capacity to several affected producers, C&A would want to be able to seek specific performance to obtain some Path Usages.

- (c) C&A considers that ARTC's proposed monetary cap of \$2 million for losses that are not consequential losses, or are not otherwise excluded by ARTC, is inappropriately low. C&A believes that a liability cap linked solely to TOP charges is appropriate, as originally set out by ARTC in clause 13.3 of the 23 April 2009 version of the IAHA, which provided a cap of a year's TOP charges. However, C&A could be satisfied with a lower level of TOP charges, for example, 50% of the Access Holder's annual TOP charges (uncapped).

If, instead, the ACCC considers a specific monetary amount as being the appropriate cap, C&A believes that this amount should be indexed not by CPI, but by the annual percentage increase in the TOP charges. For example, if an Access Holder's TOP charges are increased by 25%, then there should be a 25% increase to ARTC's liability cap.

3. Key Issue 3: C&A supports the development of a package of incentives that provide upside for ARTC to align the interests of ARTC and Access Holders

3.1 Introduction

Section 8.3 of the Proposed HVAU states that "Before acceptance of the Undertaking, ARTC will propose one or more incentive mechanisms". C&A considers that when ARTC lodges its proposed incentive mechanism the ACCC should exercise its powers under s44ZZBD(1) of the TPA and invite public submissions on ARTC's proposal as interested parties should be given the opportunity to make submissions on the complete Proposed HVAU. There must be appropriate recognition of the linkage amongst the elements of the Proposed HVAU; that is, the proposed incentive arrangements must be considered in the context of other aspects of the Proposed HVAU, such as the pricing proposal.

In this regard C&A is of the view that the development of a set of incentives that would better align the interests of ARTC and Access Holders is a priority for the industry. A carefully developed incentives scheme could provide significant gains for the Hunter Valley Coal Chain as a whole. In particular, ARTC must have potential to earn upside in order to be adequately incentivised to improve network performance and to optimise the use of available capacity.

C&A notes that there is scope for the Proposed HVAU and Proposed IAHA to provide ARTC with incentives which are either:

- (a) Output-based: to increase throughput;
- (b) Cost-based: to reduce operating costs and, therefore, prices; or,
- (c) Performance-based: to improve other aspects of network management and operations (for example, safety).

It is C&A's view that the alignment of Hunter Valley Coal Chain interests would best be achieved through an incentive to increase output and a performance-based incentive determined by ARTC achieving safety targets. C&A places less importance on an incentive to reduce ARTC's costs. The reasons for these opinions are outlined in the following sections of this submission.

In developing an incentive mechanism, it will be necessary for ARTC to set an appropriate base level of Network Capacity and performance against which improvements can objectively be measured. The baseline output must be no less than the contracted track Capacity and the baseline performance level must be no less than ARTC's performance in the previous year. C&A believes it would be appropriate for this baseline to be proposed by ARTC in consultation with the HVCCC and subject to the approval of the RCG.

3.2 Existing incentives in the Proposed HVAU

In the absence of a more complete incentives scheme, the only motivation for ARTC to provide Train Paths to Access Holders is through to the True-Up Test and Annual Reconciliation process, which relates only to the provision of BPUs as contracted by

ARTC. This process is an asymmetrical incentive in that it does not provide for any upside in the case of improved performance by ARTC and only acts to penalise ARTC where it provides insufficient Train Path Usages. There is no mechanism in the Proposed HVAU or Proposed IAHA whereby any improvement in performance by ARTC, especially an improvement that does not require capital, will result in any gains for ARTC.

The asymmetric nature of the True-Up Test provides ARTC with an incentive to under-contract so that the contracted BPU's are readily achievable. In addition, ARTC is not incentivised to provide ad hoc paths, as providing ad hoc paths increases the risk of ARTC failing the True-Up Test while not providing ARTC with any gain because ARTC operates under a revenue cap. C&A believes that developing incentives which have the potential for positive outcomes for ARTC will be critical in promoting the optimisation of track output.

3.3 Incentives rewarding increased track output

It is in the best interests of the Hunter Valley Coal Chain to maximise throughput on the Network. It is more appropriate to link incentives to actual output (as opposed to performance-based measures), as this results in a form of "benefit sharing" between Access Holders, who would benefit from the increased throughput, and ARTC who could benefit through a right to retain revenue above the revenue cap in instances where it is able to supply additional Path Usages. Typically, these additional Path Usages would be offered to Access Holders in the form of ad hoc paths.

In providing ARTC with an incentive to make ad hoc paths available, C&A believes it is important to ensure that each Access Holder's right to both BPU's and Tolerance is protected. Ad hoc paths should only be offered where the Period's BPU's, as well as any demand for Tolerance Path Usages, can be met by ARTC. The revised True-Up Test C&A proposes in section 2.4 below would act to extend the current protection of an Access Holder's right to BPU's to include ARTC's commitment to provide Tolerance. Under this revised True-Up Test, ARTC's incentive to provide ad hoc paths should, therefore, not adversely impact the contractual rights of Access Holders.

3.4 Incentives rewarding reduced operating costs

It may be argued that the efficient operation of the Hunter Valley Coal Chain requires ARTC to operate under the lowest possible costs. In fact, ARTC already has an incentive to reduce operating costs to efficient levels under section 4.4 of the Proposed HVAU.

However, C&A believes that an overemphasis on incentivising cost reduction could threaten the security of track Capacity supply, potentially at great cost to Access Holders through reduced throughput. The risk that excessive cost reduction could result in the required Path Usages being unavailable (for example, as a result of poor maintenance) is a sufficient reason to ensure that cost reduction is not a substantial part of an incentive package for ARTC.

3.5 Incentives rewarding improved performance

There are several aspects of performance that could form the basis of an incentive. C&A considers that, in general, where ARTC improves its performance in any aspect of Network management, it would be likely that this will result in an increase in Network output. For

example, an improvement in communications would facilitate the efficient operation of the Network, resulting in more Path Usages being available. Therefore, if an output-based incentive is introduced, as is contemplated in section 3.3 and preferred by C&A, then additional performance-based incentives would be duplicative.

As an exception, C&A believes that the safe operation of the Network is a critical concern for the whole Hunter Valley Coal Chain and, therefore, C&A supports the implementation of a safety-based incentive mechanism. While improvements in safety might in some cases be evident in terms of increased Network output (for example, eliminating instances of fatal accidents may reduce track outages), less drastic improvements in safety might not especially impact throughput.

To specifically reward safety performance, any improvements compared to a baseline safety level could be rewarded with an increased Rate of Return. C&A proposes that an appropriate safety metric would be the standard metrics Lost-Time Injury Frequency Rate (**LTIFR**) and All Injury Frequency Rate (**AIFR**), however other comparable measures might also be acceptable. ARTC's safety performance should be benchmarked against other heavy-haul rail systems in Australia, including the Western Australia iron ore rail networks run by Rio Tinto, BHP Billiton and Fortescue Metals Group, and the Queensland coal rail network operated by QR Network. In this way, any improvement in ARTC's safety performance could be taken in the context of any improvements seen across heavy-haul rail networks in general. Further, any safety standard set in an incentive package should be subject to review and approval by the RCG.

Proposed Solutions

C&A proposes that the incentive package to be developed by ARTC includes:

- (a) an incentive linked to output, allowing revenue to be earned above the revenue cap for additional Path Usages provided; and
- (b) an incentive linked to safety performance on the Network, measured by LTIFR, AIFR and perhaps other comparable measures, and benchmarked against other heavy-haul rail systems operating in Australia as reviewed by the RCG.

4. Key Issue 4: The Proposed HVAU could go further in promoting contractual alignment across the Hunter Valley Coal Chain, particularly through Capacity management protocols

4.1 The allocation of shortfall provisions in the Proposed HVAU and Proposed IAHA leave ARTC with too much discretion and having no regard to at fault Access Holders

In section 8.5.3.2 of its Draft Decision, the ACCC expressed the view that ARTC's position in relation to the operation of the Capacity Shortfall provisions should be set out in any revised version of the HVAU and the IAHA in greater detail. Furthermore, in section 8.5.3.4 of its Draft Decision, the ACCC considered that it was unclear why ARTC had included an ability to simply "take into account" its contractual obligations to Access Holders and was of the preliminary view that ARTC should amend the 2009 HVAU so that the rationale for the flexibility and objective to be followed by this provision is clear and certain.

ARTC has responded to these concerns by noting in Appendix 1 to its Explanatory Guide that subsection 5.5(a)(ii) of the Proposed HVAU has been amended to make it clear that ARTC's objective is to ensure the Network is efficiently utilised during the period of the short term temporary shortfall and that with this objective in mind, ARTC has a discretion to allocate the remaining Capacity as it sees fit, but taking into account ARTC's contractual obligations.

ARTC has also made certain amendments to the Capacity Shortfall provisions in sections 5.4 – 5.7 of the Proposed HVAU and clause 6 of the Proposed IAHA. The principal amendment made is to reduce the "short-term shortfall" period from seven days or less to five days or less.

C&A considers that while the Capacity Shortfall provisions in the Proposed HVAU and Proposed IAHA have been improved, they will not sufficiently promote the economically efficient operation of ARTC's Network or appropriately take account of the interests of Access Holders for the following reasons:

- (a) It is not clear how ARTC will identify Capacity Shortfalls under clause 6.1. Without ARTC providing transparency over this process there is scope for ARTC to claim that there is no issue with available track capacity, only with Access Holders' ability to use that capacity. In such a situation Access Holders would not be in a position to test ARTC's claim. Nor is ARTC's decision subject to review.
- (b) It is not clear when ARTC will test for Capacity Shortfalls under clause 6.1.
- (c) The Capacity Shortfall provisions grant ARTC too much discretion. C&A believes that there are very few events that would result in a Capacity Shortfall of greater than five days. Consequently, ARTC will have discretion to allocate losses for almost all events that result in a Capacity Shortfall. To put this into perspective, a Capacity Shortfall lasting for five days would result in approximately 1.4Mt of lost throughput, which is worth approximately \$70 million in lost profits for the industry.

That is, ARTC would have the discretion to allocate up to \$70m of losses amongst Access Holders, an amount more than the annual TOP charges paid by any one Access Holder.

- (d) Under clause 6.2(b) of the draft IAHA lodged by ARTC dated 23 December 2009 (**23 December IAHA**), when allocating capacity ARTC was required to take into account the impact on the efficient utilisation of "Capacity and Coal Chain Capacity". However, under the Proposed HVAU and Proposed IAHA ARTC has removed the requirement to take into account the impact on Coal Chain Capacity and is instead only required to take into account the impact on its Network. In its Explanatory Guide, ARTC has not explained its reasons for removing this requirement. In the absence of a reasonable explanation, C&A considers the removal of this requirement as inappropriate. If ARTC is not required to take into account Coal Chain Capacity when exercising its discretion in allocating Capacity, there is real potential for misalignment along the Coal Chain.
- (e) ARTC is not expressly required to seek to minimise the number of affected Access Holders when exercising its discretion. Further, for events leading to a Capacity Shortfall of greater than five days, ARTC is obliged to allocate Capacity in accordance with the principle that contracted path usages from unaffected load points will not be reduced (see section 5.6(a)(ii) of the Proposed HVAU and clause 6.3(a)(ii) of the Proposed IAHA). However, no such principle exists in relation to Capacity Shortfalls of less than five days, which, as described above, C&A believes will constitute almost all Capacity Shortfalls. C&A considers that there is a consequent risk that ARTC will exercise its discretion to reduce contracted path usages from unaffected load points for events lasting less than five days.
- (f) The inter-play of the Capacity Shortfall provisions in clause 6 with the cancellation of services provisions in clause 11.6 is unclear.
- (g) As the shortfall and compression provisions in the Draft Undertaking and PWCS Terminal Access Protocol are not aligned, the treatment of capacity shortfalls by ARTC does not appropriately balance the interests of the various producers and ARTC. The proposed arrangements mean that producers will be subject to two different sets of provisions which may prove problematic in practice.
- (h) The language in section 5.5(a)(ii) of the Proposed HVAU and section 6.2(a)(ii) of the Proposed IAHA is inconsistent. This appears simply to be a transposition error in that section 5.5(a)(ii) of the Proposed HVAU has not been updated to reflect the amendments to clause 6.2(a)(ii) of the Proposed IAHA, which has now (appropriately) been amended to remove the reference to 'minimising the number of Access Holders affected'.

Proposed Solutions

Corresponding to C&A's comments above, C&A proposes that:

- (a) ARTC be required to publish as soon as practicable, but in any event within two weeks, the basis on which it has identified a Capacity Shortfall and should be

required to do so within a month of the event. By doing so, Access Holders will be able to better understand how ARTC identifies a Capacity Shortfall.

- (b) ARTC be under a positive obligation to continually monitor and report available Capacity to HVCCC – it is not enough for ARTC to inform others only after it identifies that there is likely to be a shortfall. This obligation can be included as a further provision in section 5.4 of the Proposed HVAU and clause 6.1 of the Proposed IAHA.
- (c) ARTC only be able to allocate Capacity at its discretion for events leading to Capacity Shortfalls of less than two days rather than five days.
- (d) The obligation on ARTC to take into account the impact on Coal Chain Capacity when allocating Capacity be reinserted such that ARTC is obliged to ensure, as far as is practicable, that the Network is efficiently used and the overall impact on Coal Chain Capacity throughput is minimised. As ARTC is already required to consult with the HVCCC when it identifies a Capacity Shortfall, ARTC could easily request the HVCCC's recommendation for allocating Capacity in a way that takes into account the impact on Coal Chain Capacity.
- (e) Clause 5.5(a)(ii) of the Proposed HVAU and clause 6.2(a)(ii) of the Proposed IAHA be amended so that ARTC is obliged to allocate Capacity in accordance with the principle that contracted path usages from unaffected load points will not be reduced.
- (f) ARTC act on the HVCCC's recommendation as to what an "affected load point" is. If ARTC fails to act on a recommendation, it should (in accordance with our general proposal in this regard set out in section 4.2 below) publish to the industry the reasons for not doing so.
- (g) The inter-play of the Capacity Shortfall provisions in clause 6 with clause 11.6 (or any other improved "at fault" regime which is implemented) be made clearer. That is, clause 11.6 (or any other "fault"-based capacity allocation provisions which form part of the HVAU or IAHA – see our submissions below) must be applied, where applicable, before clause 6.
- (h) The language of clause 3.14(a) of the Proposed IAHA be amended so that ARTC 'must not' make Path Usages available where the Access Holder does not have sufficient Network Exit Capability.
- (i) Section 5.5(a)(ii) of the Proposed HVAU be made consistent with clause 6.2(a)(ii) of the Proposed IAHA.

4.2 The train cancellation provisions in clause 11.6 of the Proposed IAHA are inadequate and may lead to inequitable allocation of losses

The proposed scheduling cap approach

As the ACCC notes in its Consultation Paper, clause 11.6 of the Proposed IAHA allows ARTC, in certain circumstances, to remove Path Usages from an Access Holder where the

Access Holder has cancelled services or has caused the cancellation of services intended to be used by another Access Holder.

As ARTC correctly notes in section 5.9.1 of its Explanatory Guide, certain producers, including C&A, submitted a proposal to ARTC aimed at capping the number of Path Usages an Access Holder could schedule each Month and quarantining the impact of excessive cancellations to the responsible Access Holder. This approach involved:

- (a) setting a scheduling cap for each Access Holder based on their required BPU's and standard allowance for cancellations;
- (b) monitoring train cancellations and identifying the party responsible; and
- (c) allocating the cancellation to the responsible party and thereby consuming that Access Holder's overall scheduling cap if they are deemed responsible.

As the Explanatory Guide describes, ARTC rejected this proposal. One reason that ARTC has given for rejecting this proposal is that it would have been "administratively complex".

ARTC has instead attempted to address producer concerns by strengthening the provisions in clause 11.6 and proposing a review process under section 5.9 of the Proposed HVAU.

C&A is concerned that by rejecting the proposed scheduling cap approach because ARTC regards it as "administratively complex", ARTC is not sufficiently taking into account the interests of Access Seekers, Access Holders and the public interest by agreeing to implement an approach which C&A considers will better ensure the efficient use of the Network.

Proposed Solution

C&A proposes that as the Government-owned Corporation responsible for the management of the Hunter Valley Coal Rail Network, ARTC be required to make more effort to improve the efficiency of the Network and Coal Chain. It would, in C&A's view, be readily possible for ARTC to:

- (a) establish internal administrative procedures to oversee a scheduling cap approach, with appropriate enhancements of ARTC's internal systems and additions to ARTC's staff (and with the relevant expenses to be recovered through the charges which are to apply under the Proposed HVAU);
- (b) agree to introduce a scheduling cap approach which would have a similar intent to clause 11.6 in the Proposed HVAU, provided that robust, HVCCC-administered delay accounting procedures to allocate fault appropriately exist to support a scheduling cap approach; and,
- (c) remove clause 11.6 from the Proposed HVAU as it would be superseded by the scheduling cap approach.

Clause 11.6 of the Proposed IAHA

While C&A maintains that the scheduling cap approach is a more effective solution than provisions in clause 11.6 of the Proposed IAHA, it recognises that the amendments made

to clause 11.6 are an attempt by ARTC to include some form of accountability for the Access Holder's use of the Network. C&A welcomes this as a step in the right direction.

However, C&A believes that clause 11.6 of the Proposed IAHA can only be viewed as an interim solution until the review contemplated under section 5.9 of the Proposed HVAU can be conducted and implemented. C&A considers that the appropriate outcome of the review in section 5.9 of the Proposed HVAU will be the introduction of the scheduling cap approach.

Further, C&A has a number of concerns regarding the practical implementation of clause 11.6 as currently drafted in the Proposed IAHA, including that:

- (a) An Access Holder may potentially have Path Usages removed from it twice. That is, if the cancellation causes a Capacity Shortfall and ARTC, through the application of clause 6 of the Proposed IAHA, removes Path Usage allocation from the Access Holder in that Month, the at fault Access Holder may then have Path Usages removed again in the following Month under clause 11.6.
- (b) Similarly, if an Access Holder causes a Capacity Shortfall due to excessive cancellations and ARTC, through the application of clause 6, removes Path Usage allocation from another Access Holder, clause 11.6 would be used to remove Path Usages from the at fault Access Holder, but it does not provide for any form of reimbursement or compensation for Access Holders who have been affected by the cancellations.
- (c) Further to (b), clause 11.6 is insufficient in facilitating efficiency or alignment in the subsequent Period to the cancellation as the availability of the removed paths to affected Access Holders in the subsequent Period will not assist them unless they can secure matching port capacity. As such, clause 11.6 may be no more than a punitive measure which, by removing paths from the "at fault" Access Holder without delivering additional usable paths to other Access Holders, leads to a reduction in overall Coal Chain efficiency and throughput.
- (d) Punishing an Access Holder for excessive cancellations by removing Path Usages in the subsequent Period does not protect the capacity entitlements of other Access Holders in the Period in which the excessive cancellations occurred.
- (e) The provisions in clause 11.6 are unclear in their operation as they do not explicitly recognise section 5.9 of the Proposed HVAU and the potential for the review contemplated in section 5.9 to affect the ongoing operation of clause 11.6.

C&A supports the development and implementation of procedures which uphold performance accountability and equitably allocate Capacity Shortfalls on the Network. In this regard, C&A considers that clause 11.6 would more appropriately take into consideration the interests of Access Holders if it sought to more equitably allocate Capacity Shortfalls. ARTC's failure to provide adequate provisions to deal with Capacity Shortfalls may have broader public interest considerations as the provisions may result in ARTC not sufficiently promoting the economically efficient operation and use of its Network.

Proposed Solutions

C&A proposes that:

- (a) In order to increase the certainty and transparency of the operation clause 11.6, clause 11.6(e) be amended so that, in addition to providing its written reasons for not removing BPUs to the HVCCC, ARTC is also required to publish its reasons on its website, or consent to the HVCCC distributing ARTC's reasons to its members.
- (b) Clause 11.6 be amended to consider any application of clause 6 of the Proposed IAHA that may have occurred in the Period where the cancellation caused the loss in Capacity, to ensure the Access Holder deemed responsible is not penalised twice.
- (c) C&A acknowledges ARTC's comments in its Explanatory Guide that there is not necessarily a "direct linear relationship" between the number of cancellations and the number of paths available on the Network. However, in the event that ARTC removes Path Usages from an at fault Access Holder, ARTC should be required to use its best endeavours to make additional paths available to affected Access Holders to the extent possible by offering available Path Usages to industry on an ad hoc basis (thereby facilitating alignment and the efficient use of the Hunter Valley Coal Chain). Accordingly, C&A considers that clause 11.6 be amended so that affected Access Holders receive compensation in the form of first rights to ad hoc Path Usages from ARTC which may become available after removing Path Usages from the at fault Access Holder, to the extent possible.
- (d) To better facilitate Hunter Valley Coal Chain efficiency and alignment, ARTC should be required to consult with the HVCCC and other Hunter Valley Coal Chain Service Providers to assess the impact of any removed Path Usages on the other contractual arrangements of the at fault and affected Access Holders.
- (e) Clause 11.6 be amended to state that it will operate subject to outcome of the review contemplated by section 5.9 of the Proposed HVAU. If the result of that review is the introduction of a system that renders clause 11.6 redundant or results in required changes to clause 11.6, then ARTC be requested to review or accordingly amend clause 11.6 in each executed AHA.

4.3 The proposed review of the Capacity management process in section 5.9 of the Proposed HVAU should be broadened to take a Coal Chain-wide perspective and give the HVCCC the responsibility for conducting the review

In section 4.17 of its Explanatory Guide, ARTC has noted producers' proposals that a scheduling cap, and measures aimed at "quarantining" the impact of cancellations on the responsible Access Holder, be introduced in the Proposed HVAU.

In response, ARTC has stated in section 5.9 of the Proposed HVAU that it proposes to, within 12 months of the commencement of the Proposed HVAU, undertake a review of the policy and processes for identifying and allocating losses of Capacity caused by Access Holders and their Operators and potential incentive mechanisms to minimise such losses

where they have a material impact on Capacity or Coal Chain Capacity or the Capacity entitlements of Access Holders.

C&A welcomes the inclusion of a review, however, C&A considers that the nature of the proposed review falls short of what is desirable for the following reasons:

- (a) The proposed review of "policy and process for the cancellation of scheduled Services" is too narrow and may preclude other effective whole-of-coal-chain Capacity management mechanisms from being implemented.
- (b) The proposed review of ARTC's approach to cancelled services under clause 5.9 of the HVAU is only a **review**, which ARTC could conduct and subsequently ignore if **ARTC** determines that the proposal meets the criteria set out in section 5.9(c). Accordingly, the review process provides no comfort to Access Holders that ARTC will genuinely address the critical issue of individual Access Holder performance accountability.

C&A considers that, unless amended in accordance with the proposed solutions below, the proposed review in section 5.9 of the HVAU will not sufficiently promote the economically efficient operation of ARTC's Network and will not adequately protect the public interest or the interest of Access Holders.

Proposed Solutions

Corresponding to C&A's comments above, C&A proposes that:

- (a) A more appropriate review would be a comprehensive review of performance accountability/capacity management across the entire Coal Chain to which all stakeholders – Access Holders and Hunter Valley Coal Chain Service Providers – can contribute and which is responsible for identifying and designing solutions to maximise the efficiency of the Coal Chain for the benefit of all stakeholders. The review should be coordinated by the HVCCC as the appropriate oversight body for the entire Coal Chain and with significant input from ARTC, other Hunter Valley Coal Chain Service Providers and Access Holders. The provisions for such a review would be outside the scope of the Proposed HVAU and would need to be implemented at an "industry" level. The HVCCC would necessarily be the appropriate body to frame the provisions of the review.
- (b) ARTC would give effect to the review by seeking to have the HVAU varied under the TPA in accordance with any HVCCC recommendations. To the extent that ARTC (having been involved in the HVCCC review) does not agree with any of the HVCCC recommendations, it should be relieved from its obligation to apply to have the HVAU varied only if it can establish to the satisfaction of the ACCC that the recommendations do not satisfy criteria of the type set out in sections 5.9(c)(ii)(A) and (B) of the HVAU. That is, C&A considers it appropriate that the ACCC, rather than ARTC, should act as the 'umpire' in determining whether it is inappropriate for ARTC to seek to implement recommendations made by the HVCCC on this key Coal-Chain-wide issue. The ACCC would be given the power to perform this function under s44ZZA(6A) of the TPA.

4.4 Tier 1 provisions – appropriate dispute resolution process

As the ACCC has noted in section 2.2 of its Explanatory Guide, ARTC has included in section 3.14 of the Proposed HVAU recognition that certain provisions of the IAHA should be "Tier 1 (mandatory) provisions" that are to be consistent across all relevant AHAs to attempt to ensure workable alignment of the Hunter Valley Coal Chain.

In its section 6.5.2.1 of its Draft Decision, the ACCC expressed the preliminary view that provisions relating to the management of Capacity on the Network should:

- (a) be included in the HVAU itself and mirrored in AHAs in order to ensure consistent application of Capacity management protocols across the Network; and
- (b) specify that disputes in relation to the mirrored Capacity management provisions are to be dealt with under the dispute resolution and arbitration provisions in the HVAU to maintain the effectiveness of the aligned approach.

In response, ARTC proposed in sections 1.2.3 and 4.1.6 of its response to the ACCC's Draft Decision, to clearly identify in Schedule A to the HVAU "Tier 1 mandatory provisions" which are non-negotiable and necessary to ensure alignment between Access Holders. As these provisions will appear in Access Holder Agreements, ARTC proposed that the dispute resolution provisions in clause 14 of the Proposed IAHA apply.

While ARTC stated in section 4.2.2 of its response to the ACCC's Draft Decision that it understood that the ACCC's primary concern in including the Tier 1 mandatory provisions in the HVAU was to ensure a consistent interpretation of the provisions in order to avoid the risk of misalignment, ARTC considered that the risk of conflicting interpretations was very low.

In these circumstances, ARTC did not consider it necessary for the ACCC to be involved in arbitrating a dispute specific to an Access Holder which may have no implications beyond that individual Access Holder (see section 4.2.2 of ARTC's response to the ACCC's Draft Decision).

Instead, ARTC proposed in section 4.2.2 of its response to the ACCC's Draft Decision, that it be under an obligation to inform the ACCC if a dispute arises in relation to Tier 1 provisions under an AHA which ARTC reasonably considers could have a broader adverse impact on Coal Chain alignment. If so, ARTC would facilitate, to the extent it is possible, the ACCC making submissions on the issue before an expert or court.

In section 2.2 of its Consultation Paper, the ACCC has sought views on whether ARTC's approach is appropriate, particularly whether it is likely to promote alignment across the supply chain, and whether the provisions identified as mandatory are appropriate, including whether certain provisions should be included or excluded.

C&A believes that, as the Tier 1 mandatory provisions represent the most important provisions in the Proposed IAHA, disputes in relation to these provisions should be resolved under the dispute resolution process that is best suited to the parties' needs. C&A considers that the dispute resolution provisions under the Proposed HVAU are preferable to those in Proposed IAHA for the following reasons:

-
- (a) arbitration is likely to be quicker and cheaper than court proceedings and C&A believes that it is in the interests of both parties to the dispute to have the dispute resolved as soon as practicable;
 - (b) the ACCC is the most appropriate body to adjudicate any access dispute given:
 - (i) it is the body that will approve an HVAU and IAHA (if it chooses to do so) and is, therefore, more familiar with these documents than a court;
 - (ii) the role of the ACCC in an arbitration also gives the ACCC greater opportunity to monitor:
 - (A) ARTC's compliance with the implemented HVAU and any Access Holder agreement; and
 - (B) whether the HVAU is "working", which will be relevant to the review of the HVAU provided for in section 2.3(b) of the Proposed HVAU; and
 - (iii) that ACCC arbitration should result in a greater chance of consistency of interpretation of the Tier 1 provisions which would minimise the risk of misalignment; and
 - (c) the arbitration provisions in section 3.15(c) of the Proposed HVAU coupled with the ACCC arbitration procedure in Division 3 Subdivision D of Pt IIIA of the TPA:
 - (i) provide for the ACCC not being bound by technicalities, legal forms or rules of evidence (s44ZF(1)(a) of the TPA);
 - (ii) place a positive obligation on the ACCC to proceed as quickly as is possible and consistent with a fair and proper assessment of the matter (section 3.15(c)(ii)(D)(i) of the Proposed HVAU and s44ZF(1)(b) of the TPA);
 - (iii) allow the ACCC to determine the periods that are reasonably necessary for the fair and adequate presentation of the respective cases of the parties and require that the cases be presented within those periods (s44ZF(2) of the TPA);
 - (iv) in addition to (ii) and (iii) above, allow the ACCC to do all such things as are necessary or expedient for a speedy hearing and determination of the access dispute (s44ZG(1)(f) of the TPA);
 - (v) require the ACCC to present its determination in a draft form to the parties and hear argument from the parties before making a final determination. No such opportunity will be afforded the parties under court proceedings (section 3.15(c)(ii)(D)(v) of the Proposed HVAU);
 - (vi) allow persons to apply to the ACCC to join as parties to an arbitration if certain "interest" criteria are met. C&A believes the opportunity that third parties have to join an arbitration under these provisions is clearly preferable to ARTC's proposal that it be under an obligation to inform the ACCC if a dispute arises in relation to Tier 1 provisions which ARTC reasonably considers could have a broader adverse impact on Coal Chain

alignment and that ARTC would facilitate, to the extent it is possible, the ACCC making submissions. C&A considers that this proposal:

- (A) is not binding on ARTC as it is currently provided for in either the Proposed HVAU or IAHA;
- (B) provides ARTC with too much discretion as to when it will invite the ACCC to become involved in a dispute;
- (C) is unclear, as what would constitute a 'broader adverse impact' on Coal Chain alignment is open to interpretation;
- (D) does not allow for the joining or involvement of other interested parties apart from the ACCC; and
- (E) limits the involvement of the ACCC to making submissions facilitated 'to the extent it is possible' by ARTC and so may not result in any ACCC submissions being made despite ARTC informing the ACCC of the dispute.

C&A is, therefore, of the view that ARTC's approach is inappropriate as the interests of Access Holders, Access Seekers, the public and ARTC will be better served by having the most important terms of an Access Holder agreement being subject to the Proposed HVAU arbitration process that is conducted by the most appropriate body in the circumstances and is quicker, cheaper and allows for greater involvement by the parties and interested person in the process than the court proceedings provided for in the Proposed IAHA.

Proposed Solution

C&A supports the ACCC's preliminary view that the provisions relating to the management of capacity on the Hunter Valley network should be included in the HVAU and dealt with under the arbitration provisions in section 3.15 of the Proposed HVAU.

4.5 ARTC should not deviate from agreed System Assumptions once published in the System Assumptions document

In section 11.2.4 of its Draft Decision, the ACCC noted that the principle regarding System Assumptions is an important aspect of the Guiding Principles for contractual alignment and that the principle should be reflected in the HVAU in order to facilitate alignment. The ACCC also expressed the view that while ARTC should not be bound by System Assumptions dictated by another organisation, if it was involved in the development of System Assumptions and the preparation of the System Assumptions Document, there should be no reason why ARTC could not comply with those Assumptions.

ARTC's response to the ACCC's Draft Decision was that it was critical that ARTC was not forced into accepting and applying track related System Assumptions which it does not agree with. ARTC has repeated this response in section 4.16 of its Explanatory Guide. ARTC stated that the definition of System Assumptions in both the Proposed HVAU and

the Proposed IAHA protects ARTC from being forced into accepting and applying System Assumptions which it does not agree with.

C&A accepts that ARTC should not be bound to determine the available amount of network capacity based on System Assumptions dictated by another organisation. However, as is the case with PWCS, ARTC will have the ability to advise the HVCCC of the System Assumptions that should be used with regard to track services.

Since the potential consequence of using misaligned System Assumptions across the Coal Chain could be extremely severe (as it has been at the Dalrymple Bay Coal Terminal), C&A does not consider section 5.1(b) is appropriate as it only requires ARTC to 'have regard' to the System Assumptions in carrying out Capacity Analysis. If ARTC is not bound by the System Assumptions provided by ARTC itself and reflected in the System Assumptions Document, there is a risk that the potential misalignment will not promote the economically efficient operation of the Network, which in turn, will not protect the interests of Access Holders and the public interest.

C&A also notes that ARTC has recognised the System Assumptions in the performance measurement and incentives in Schedule D of the Proposed HVAU. However, C&A queries the effectiveness of this recognition on ARTC's performance if ARTC is not bound by these System Assumptions.

Proposed Solutions

C&A proposes that:

- (a) ARTC be bound to provide System Assumptions to the HVCCC for the purposes of developing the System Assumptions Document and participate in the development of a System Assumptions Document as reasonably required by the HVCCC;
- (b) the definition of 'System Assumptions' be amended to state that to the extent that the System Assumptions Document reflects the Assumptions provided by ARTC, ARTC should be bound to accept those System Assumptions; and
- (c) the definition of 'System Assumptions' be amended to delete the word 'including' in reference to track related assumptions and instead, in the interests of certainty, provide an exhaustive list of track related assumptions that are not otherwise dealt with in the System Assumptions Document.

4.6 The process of consulting with the HVCCC should be clarified and ARTC should provide clear explanations if rejecting the HVCCC's proposals

In several areas of its Draft Decision, the ACCC recommended that ARTC's obligation to consult with the HVCCC in relation to a number of matters should be expanded on to set out the processes ARTC will follow when consulting with the HVCCC regarding any impact on the efficient utilisation of Coal Chain Capacity, including specific timeframes and the specific nature of ARTC's obligations during and in relation to the consultation.

For example, in section 8.5.3.5 of its Draft Decision, the ACCC recommended that the HVAU should include a mechanism that requires ARTC to consult with the HVCCC where there is to be a reduction in access holder's below rail access rights as a result of the capacity shortfall provisions being utilised in order to attempt to minimise any losses in supply chain efficiency.

As ARTC summarises in section 4.3.1 of its Explanatory Guide, it has included in Schedule F of the Proposed HVAU a set of principles that it will use its best endeavours to follow when consulting with the HVCCC. ARTC lists these principles in the Explanatory Guide, however, ARTC fails to mention that ARTC will (under the wording of Schedule F as currently proposed) ultimately **not** be obliged to following the HVCCC's recommendations or advice in relation to any matter. Further, Access Holders will have no recourse for any decision that ARTC makes that is not in accordance with HVCCC recommendations or advice.

Given the HVCCC's role as an independent integrated body (including representatives from all producers and Hunter Valley Coal Chain Service Providers, including ARTC) and that ARTC is a regulated, but not producer-owned, participant in the Coal Chain, C&A considers that ARTC should be under greater obligation than it currently proposes in the Proposed HVAU to accept the recommendations and advice of the HVCCC.

In its Explanatory Guide ARTC refers to how the HRATF sought a general requirement that, in addition to providing reasons to the HVCCC as to why ARTC did not follow the HVCCC's views, ARTC should also provide written reasons to affected Access Holders.

ARTC has rejected this suggestion because of:

- (a) the additional administrative burden it would place on ARTC;
- (b) the need to deal with specific confidentiality requirements; and
- (c) the apparent inconsistency between this suggested requirement and the purported need to have a central coordinating body for the purposes of consultation in the first place.

C&A considers each of ARTC's reasons for its rejection of the HRATF's suggestion as inadequate:

- (a) as the Government-owned Corporation responsible for the management of the Hunter Valley Coal Rail Network, ARTC should be required to undertake administrative tasks that ensure there is a sufficient level of transparency in relation to its reasons for disagreeing with the HVCCC's recommendations and advice;
- (b) any specific confidentiality requirements should not outweigh the need for transparency and form such a barrier that ARTC should not be required to provide its reasons to affected Access Holders (within the bounds of steps taken to protect confidential and sensitive information); and
- (c) any perceived inconsistency does in fact not exist, but even if it did, should not outweigh the need for transparency.

Consequently, C&A considers that unless ARTC amends the HVCCC consultation process so that it is also required to provide its reasons to affected Access Holders, the process will

be inappropriate as it does not sufficiently take into account the interests of Access Holders in obtaining transparency as to ARTC's reasons for disagreeing with the HVCCC's recommendations or advice.

Proposed Solutions

C&A proposes that:

- (a) ARTC be bound to accept the HVCCC's recommendations or advice in relation to the following matters:
 - (i) determining/confirming NPC on the basis of information provided by ARTC;
 - (ii) determining/confirming who are "affected producers" for the purposes of clause 6;
 - (iii) determining when Path Usages are not to be made available under clause 3.14 of the IAHA for lack of Network Exit Capability; and
 - (iv) specifying the non-rail parameters to be applied in determining the efficient Train configuration;
- (b) for those matters not listed above, in all instances where ARTC disagrees with the recommendations or advice it receives from the HVCCC, ARTC be required to publish on its website detailed reasons for its rejection within one week of its rejection; and
- (c) in the alternative to (b), ARTC be required to provide the HVCCC with its reasons as to why ARTC did not follow the HVCCC's recommendations and allow the HVCCC to distribute those reasons to HVCCC members. C&A has approached the HVCCC with this proposed solution and the HVCCC has indicated its willingness to participate.

4.7 Non-compliant services

As recognised by ARTC in section 5.8 of its Explanatory Guide, some producers expressed a concern that the 2009 IAHA did not allow them to temporarily or permanently run Trains which did not accord with the Service Assumptions agreed for a Train Path at the commencement of the relevant Access Holder agreement.

ARTC has responded to these concerns in clause 11.5 of the Proposed IAHA by providing for a temporary use of a Non-Compliant Service or a permanent change to the Service Assumptions if certain conditions are met.

Subject to the comments below, C&A considers the general approach of allowing the operation of Non-Compliant Services in certain circumstances under clause 11.5 of the Proposed IAHA to be appropriate.

C&A does not consider it appropriate for ARTC to retain a residual ability to withhold its consent under clauses 11.5(a) and (c) if the Access Holder has satisfied the relevant criteria in those clauses. That is, if an Access Holder has satisfied the relevant criteria, then there should be no other circumstances in which ARTC should be able to reasonably withhold its consent (as currently provided in the drafting of clauses 11.5(a) and (c)).

In addition, C&A does not consider appropriate the criteria in clause 11.5(c)(iii), that is, "the variation of the Service Assumptions does not lead to a reduction in TOP Charges that would otherwise be payable". As a result of this criterion, ARTC may withhold its consent in circumstances where an Access Holder wishes to use smaller Trains than previously, as under the GTK pricing methodology, the change to smaller Trains will result in a reduction in TOP Charges.

C&A considers this criterion as inappropriate as it unreasonably limits the flexibility of Access Holders to change Train sizes in response to changing circumstances. The criterion also provides another example of the inappropriateness of the GTK pricing methodology.

Proposed Solutions

C&A proposes that:

- (a) clauses 11.5(a) and (c) be amended so that ARTC is deemed to have provided its consent to the operation of a Non-Compliant Service if an Access Holder has satisfied the relevant criteria in clauses 11.5(a) and 11.5(c);
- (b) if ARTC has envisaged other circumstances in which it may reasonably withhold its consent under clauses 11.5(a) and (c), that these be circumstances be listed as additional criteria for the Access Holder to satisfy; and
- (c) clause 11.5(c)(iii) be removed.

4.8 Assignment, trading and novation provisions

As the ACCC has noted in section 2.15 of its Consultation Paper, ARTC has made various changes to clause 16 of the Proposed IAHA, which relates to the assignment, trading and novation of access agreement, or of rights granted under the agreement.

Clause 16.1

Clause 16.1(a) of the Proposed IAHA deems the Access Holder to have given its consent to ARTC's assignment or novation of the agreement, its interest in the subject matter of the agreement or any right under the agreement in certain circumstances.

ARTC notes in section 5.10 of its Explanatory Guide that the ACCC considered in its Draft Decision that the Access Holder should be able to terminate the Access Holder agreement if the NSW Lease ends or if ARTC loses its right to grant access to the Network. ARTC's response was that such a right was not appropriate as clause 21.4 of the NSW Lease provides that:

ARTC agrees to include within all ARTC Agreements a right for the Lessor or its nominee, if it so elects, to take an assignment or require the novation of the applicable ARTC Agreement at the expiration or earlier termination of this Deed, at no cost to the Lessor and without the need for the consent of any party to the ARTC Agreements.

In light of ARTC's obligations under clause 21.4 of the NSW Lease, C&A considers that the novation or assignment of the whole of an Access Holder agreement without the consent of the Access Holder would be appropriate in those circumstances covered by the NSW Lease.

C&A also considers that unless ARTC is assigning or novating an Access Holder agreement under the requirements of the NSW Lease, ARTC should be required to seek the consent of Access Holders before novating or assigning the agreement.

Further, in clause 16.1(a) of the Proposed IAHA, ARTC has also sought the right to assign or novate "its interest in the subject matter of the agreement or any right under the agreement". There is (based on the information provided by ARTC) no obligation on ARTC under clause 21.4 of the NSW Lease to impose a right for ARTC to assign or novate an interest or right under the agreement without the Access Holder's consent. Consequently, C&A does not consider that assignment or novation without the consent of the Access Holder in these circumstances would be appropriate.

C&A also agrees with the ACCC's comments in section 7.4.11.8 of its Draft Decision, that more specificity in relation to the liability of the parties in the event of assignments would add a degree of certainty to these provisions. ARTC has maintained its position that such specificity is unnecessary. C&A considers that it would be in the interests of both parties to have a greater degree of certainty in relation to these provisions and, therefore, considers that the provisions are currently inappropriate.

Proposed Solution

C&A proposes that:

- (a) clause 16.1(a) be amended to provide ARTC with the right to assign or novate the **whole** of the Access Holder agreement only; and
- (b) clause 16 be amended to include more specificity in relation to the liability of the parties in the event of assignments or novations. If the ACCC agrees with C&A's proposal, C&A would be pleased to draft appropriate liability provisions for public consultation.

Clause 16.2

In section 7.4.11.8 of its Draft Decision, the ACCC considered that a more balanced approach in clauses 16.1 and 16.2 of the IAHA would be reasonable. Further, in section 8.5.7.3 of its Draft Decision, the ACCC noted that ARTC is not under an obligation to act reasonably in relation to requests by Access Holders for consent to assign, trade or novate their rights under the 2009 IAHA other than in clauses 16.3 and 16.4. The ACCC recommended that clause 16.2 be amended accordingly.

In section 5.11.7 of its response to the ACCC's Draft Decision, ARTC proposed to amend clause 16.2 of the IAHA to introduce a reasonableness criterion into ARTC's "prior written consent". However, as described in section 5.11.2 of its Explanatory Guide, ARTC no longer considers it appropriate to make this change as:

-
- (a) most types of transfers will be dealt with under clauses 16.3 and 16.4 and under these provisions ARTC is required to consent to such transfers provided certain conditions are met; and
 - (b) ARTC should retain discretion not to consent to an assignment or novation under clause 16.2 as terms of the AHA with a particular applicant may reflect the individual circumstances of the applicant and ARTC should not be required to extend those terms to an assignee who may not be in the same circumstances.

C&A does not consider ARTC's explanation for its changed stance to be reasonable for the following reasons:

- (a) while most types of transfers may be dealt with under clauses 16.3 and 16.4, those that are not should not be subject to different consent criteria without ARTC providing appropriate reasons;
- (b) the reason given by ARTC for retaining its discretion under clause 16.2 is not appropriate. C&A considers that it would be reasonable for ARTC to withhold its consent to an assignment of an AHA to an assignee that had significantly different circumstances to the existing Access Holder; and
- (c) ARTC fails to explain why an Access Holder is under an obligation not to withhold its consent unreasonably in clause 16.1, but ARTC should not be under the same obligation under clause 16.2. C&A cannot see any difference in these clauses that justifies ARTC's position.

Accordingly, C&A does not consider clause 16.2 to be appropriate as it does not appropriately balance the interests of ARTC and Access Holders.

Proposed Solution

C&A proposes that clause 16.2 be amended to mirror clause 16.1 by adding the words "which will not be unreasonably withheld" at the end of the clause.

Clause 16.4

In section 8.5.7.2 of its Draft Decision, the ACCC stated that it understood that a Capacity Trading System was in operation (as of early 2010), and considered that ARTC should be in a position to assess how this System interacted with the HVAU and the system for temporary trade of capacity as contemplated by clause 16.4(a) and (b) of the 24 December IAHA. In particular, the ACCC considered that ARTC could devise an aligning Network trading system (as contemplated by clause 16.4(a) and (b) of the 24 December IAHA) for inclusion in a revised HVAU and thereby avoid any complications that may arise if ARTC sought a variation to an accepted undertaking to incorporate such a trading system.

In section 1.2.5 of its response to the ACCC Draft Decision, ARTC proposed to amend clause 16.4 – 16.8 of the 2009 IAHA to:

- (a) affirm ARTC's commitment for Access Holders to use the CTS Clearing House to find counterparties for a trade of Network Capacity;

-
- (b) provide that ARTC will consider the HVCCC's recommendation in good faith and ARTC will inform the HVCCC whether it approves or rejects a trade (in accordance with the rules and timeframes set out in the IAHA);
 - (c) provide that ARTC will inform the HVCCC of its decision within the timeframes provided for in the CTS. ;
 - (d) provide that ARTC will conduct a review by 31 December 2011 of the appropriate time period for ARTC to inform the HVCCC of its decision to approve or reject trades and ARTC will seek the views of the HVCCC of the appropriate time period and will consider the HVCCC's views in good faith; and
 - (e) given the amendments proposed above, remove the commitment in clause 16.4(a) and (b) contained in the December version of the IAHA for ARTC to develop a further temporary trading system and the automatic uplift of such a provision into the AHA.

ARTC has made these proposed amendments in the Proposed IAHA. C&A considers these amendments as being appropriate.

However, clause 16.4(a)(iv) of the Proposed IAHA states that:

the Former Access Holder and New Access Holder each warrant that the Trade will not adversely impact Coal Chain Capacity and agree that ARTC is entitled to rely, and is under no obligation to review the accuracy of, this warranty.

C&A does not consider that it is appropriate for Access Holders to be required to provide the warranties referred to in this clause. Access Holders are not in a position to provide this information and, in any case, the CTS process already determines what impact the Trade will have on Coal Chain Capacity.

In addition, under clause 16.4(a) Access Holders are only permitted to trade without ARTC's consent when the conditions listed in clauses 16.4(a)(i) – (viii) are satisfied. These conditions appear aimed at ensuring that the Trade will not adversely impact on Coal Chain Capacity. C&A is of the view that once trading parties have satisfied these conditions (except for the condition in clause 16.4(a)(iv)), the warranties required to be given under clause 16.4(a)(iv) are unnecessary and, therefore, inappropriate.

In relation to Trades that do require ARTC's consent, under clause 16.4(d)(iii), ARTC must inform the HVCCC of its decision within two weeks of ARTC being notified of the Trade. C&A considers that two weeks is an unreasonably long time for ARTC to consider a Trade and will reduce the efficacy of the Coal Chain from an Access Holder's perspective and result in an inappropriate level of uncertainty for Access Holders who are seeking to Trade Path Usages.

C&A acknowledges that under clause 16.8 of the Proposed IAHA, ARTC will, by 31 December 2011, conduct a review of the appropriate time for ARTC to inform the ACCC of its decision to approve or reject trades. However, C&A considers that as the Capacity Trading System (**CTS**) at the Port of Newcastle has been in operation since 1 January 2010, ARTC should already have all of the information it needs to conduct its review.

Proposed Solution

C&A proposes that:

- (a) Clause 16.4(a)(iv) be deleted.
- (b) If clause 16.4(a)(iv) is not deleted, clause 16.4 should be amended so that ARTC has no recourse against the trading parties for the warranties provided by them.
- (c) The Proposed HVAU adopts the CTS Clearing House timeframes for trades.
- (d) If the amendment to clause 16.4(d)(iii) is made, clause 16.8 be removed.
- (e) If the amendment to clause 16.4(d)(iii) is not made, clause 16.8 be amended so that ARTC is required to conduct the review by 30 June 2011.
- (f) If the amendment to clause 16.4(d)(iii) is not made, clause 16.8 be amended so that ARTC is required to publish on its website its reasons for reducing or maintaining the two week decision period.

5. Key Issue 5: It is critical that ARTC's pricing approach sends accurate signals about efficient operation of, use of and investment in the Network

5.1 Introduction

In section 13.2.6 of its Draft Decision, the ACCC stated:

The ACCC considers that a gtkm measure to allocate fixed costs may not reflect the time taken for a train journey nor the amount of track capacity consumed by that journey...

[W]hile the ACCC considers that ARTC's use of gtkm based pricing is likely to be appropriate in the short term provided an effective trading regime is in place and ARTC can reconfigure Train Paths, the ACCC considers that in the longer term price signals to run efficient Trains are necessary.

The ACCC went on to express its preliminary view that:

- (a) ARTC should be required to submit an efficient train configuration to the ACCC for effective consultation with access seekers within three to four years of the commencement of the HVAU;
- (b) the consultation process should be set out clearly in the HVAU;
- (c) the ACCC should have the ability to arbitrate disputes if agreement cannot be reached between the parties on what is efficient; and
- (d) a pricing system based on the efficient train configuration must become effective within four to five years from the Commencement Date of the HVAU and must apply to all coal services in operation on the Network irrespective of when the access contracts were entered into.

In response to the ACCC's Draft Decision, ARTC has set out in section 4.16 of the Proposed HVAU the steps it will take to determine the Indicative Service which it considers will deliver optimum utilisation of Coal Chain Capacity. Under section 4.16, ARTC is required to consult with industry in determining the proposed characteristics of the Indicative Service, obtain the ACCC's approval of the Indicative Service and, in doing so, submit to the ACCC the proposed characteristics and charges for the Indicative Service.

In each of its submissions to the ACCC in relation to ARTC's April 2009 HVAU, C&A has stated that the pricing approach adopted in any approved HVAU should reflect the actual consumption of Capacity in order to accurately send signals about efficient use of the Network. C&A remains strongly of the view that the current approach of pricing track access amongst various Indicative and non-Indicative Services, and solely on a GTK basis, does not promote the economically efficient operation of, use of and investment in the Network under s44ZZAA(a) of the TPA.

C&A understands that congestion on the Network is a significant cause of lost Capacity in the Hunter Valley Coal Chain. Under GTK pricing, Access Holders would not be deterred from using smaller, less efficient Trains, thereby adding more Trains to the Network than may otherwise be the case. For example, using two 4,000 tonne Trains to rail 8,000

tonnes of coal consumes twice as much capacity as using one 8,000 tonne Train, and further contributes to congestion. Under a GTK-based pricing regime, however, the Access Charge for railing 8,000 tonnes of coal would be almost the same under either option.

C&A considers that ARTC's proposal to first "determine the Indicative Service which it considers will deliver the optimum utilisation of Coal Chain Capacity" and then determine pricing on this basis, is flawed. The inherent cost of consuming rail Network Capacity is a key input to determining the "efficient train size", together with the distance of the mines from the port, infrastructure costs and a range of other factors specific to individual mines or Access Holders.

C&A believes that rather than focusing on determining the "efficient train configuration" and pricing this as an Indicative Service, ARTC should move to a basis of pricing which most closely signals the cost of providing Capacity; this will enable Access Holders (and their Hunter Valley Coal Chain Service Providers) to make investment decisions across the Hunter Valley Coal Chain knowing they are doing so on an efficient, sustainable basis. Moreover, pricing based on any approach which is not reflective of actual Capacity consumed inherently creates cross-subsidies and, as a result, distorts pricing signals.

Further, C&A considers that the justification for the continued use of GTK pricing is unclear. In section 13.2.6 of its Draft Decision, the ACCC stated that

Given that ARTC has indicated it is not yet in a position to determine an efficient Train configuration and this seems reasonable given the uncertainty around mining and port investment, the ACCC considers that maintaining the status quo is, at least in the short term, likely to be appropriate.

As stated in its 31 March 2010 submission, C&A queries why ARTC would need three to four years to submit what it thinks is an efficient Train configuration. C&A believes that ARTC should be in a position to make this determination now, or at least in a much shorter timeframe than in three to four years time, as matters are unlikely to change significantly over this time.

To be clear, C&A believes the challenge is not to "determine the efficient Train configuration", but rather to determine and implement the appropriate cost-reflective pricing mechanism for access to the rail Network. Once this is in place, Access Holders and their above-rail providers will make their own decisions as to the most efficient Train configuration to suit their specific situation, based on the track Capacity they consume, distance from the terminal and other factors. This is discussed further in the following sections.

5.2 Pricing to reflect actual costs

C&A believes that the appropriate pricing mechanism will see variable maintenance-related expenditure recovered through a charge based on GTKs (as is currently proposed by ARTC), and the take-or-pay component of charges recovered on a "per train-kilometre" basis, that is, on a path basis.

C&A understands that pricing on a "per train-kilometre" or "train-path" basis is the most commonly used pricing mechanism in Europe and the United States. As demonstrated in

Exhibit G below, many rail systems across Europe and the United States use path-based pricing as an element of their pricing arrangements.

EXHIBIT G

International charge structure comparison

Country/Region	Charge Basis
Proposed NSW Sept 2010 ARTC HVAU (coal services)	\$/GTK
Proposed NSW Sept 2010 ARTC HVAU (non-coal services)	\$/GTK, \$/km flagfall, \$/hr excess network occupancy component
2008 ARTC Interstate Access Undertaking	\$/GTK, \$/km flagfall, \$/hr excess network occupancy component
Germany	\$/train-km
Denmark	\$/train-km varied by main line or other
France	\$/train-km
Switzerland	\$/train-km and \$/GTK; junction charge plus contribution margin
Austria	\$/train-km and \$/GTK
Italy	\$/train-km, varied by time of day, track quality and rolling stock
Netherlands	\$/train-km
USA	\$/train plus a flat charge

Source: Adapted from the BTRE Report "Rail Infrastructure Pricing: Principles and Practice" (2003)

HV Rail Network continues to price on a GTK basis for coal services only...

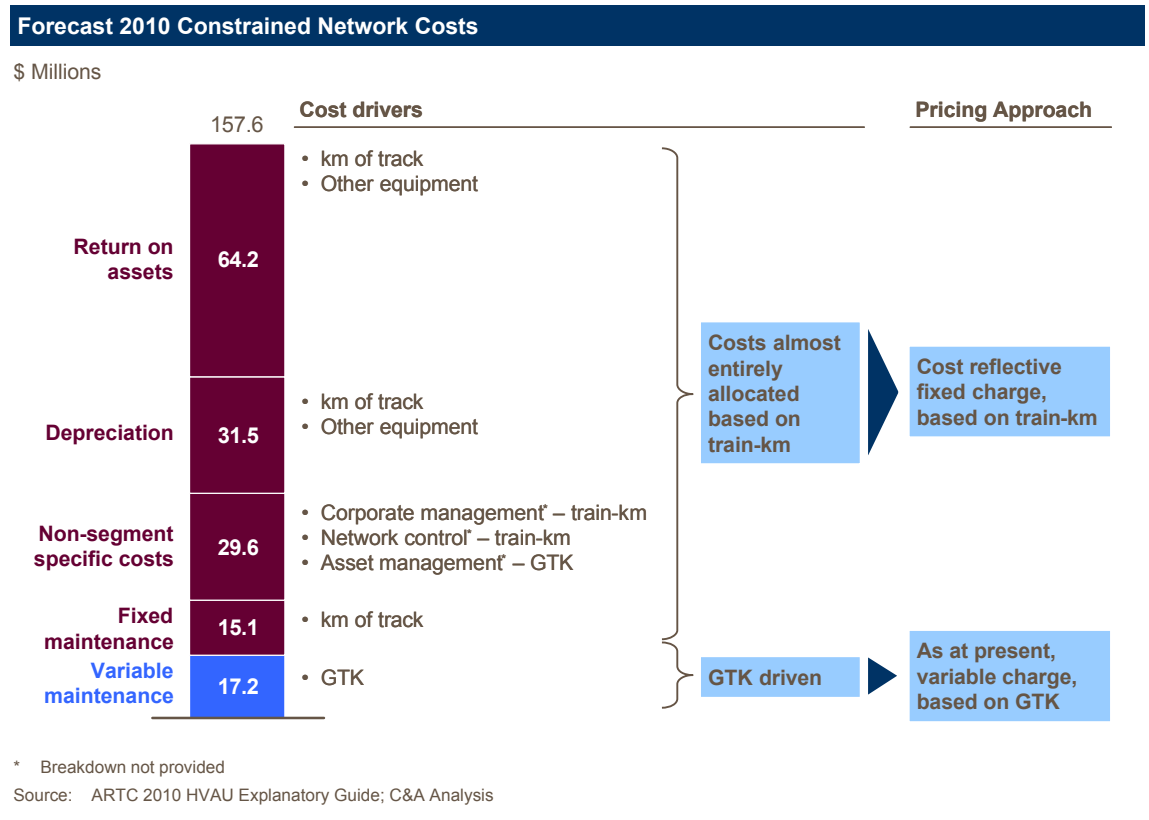
...while international TOP charges are commonly based on path equivalents

In fact, given that most rail network costs are driven by network kilometres, not weight, many rail systems do not have any weight-based component in their pricing, choosing to use the single, simpler measure of train-kilometres as the indicator for capacity consumed.

Similarly, ARTC itself proposes that non-coal services in the Hunter Valley be charged on a GTK-basis for variable costs only, with other costs recovered using a \$/train-km approach. ARTC has not provided any justification as to why Access Charges for coal services should be charged on a different basis to non-coal services. In addition, C&A notes that ARTC's own Interstate Access Undertaking uses a charge basis of \$/GTK for the variable component only, with \$/km for the flagfall and \$/hr for an excess network occupancy component.

Moreover, path-based pricing is aligned to ARTC's own approach to allocating costs across its Network as set out in clause 4.5(a)(iii) of the Proposed HVAU. Exhibit H below shows that only approximately 10% of ARTC's cost base is variable to GTKs, while the rest is linked mainly to track kilometres. Hence, cost-reflective pricing would charge for these costs based on Train Path kilometres.

EXHIBIT H



5.3 Pricing to signal efficient investment

In section 13.2.6 of its Draft Decision, the ACCC made the comment that:

The ACCC also notes that assuming ARTC has sufficient capacity for all producers expected rail needs, the argument about the use of gtkms is really one about cost allocation and how common fixed costs should be allocated between different access seekers.

C&A believes that there is a risk that this line of reasoning may not adequately consider the prospect that ARTC will need to invest in significant new track assets over the next few years, and therefore, that it is important to send accurate signals about the cost of track Capacity in order to ensure that the appropriate investments are made. C&A understands that there have recently been congestion-caused losses of Capacity, calling into question any assumption that there is currently sufficient Capacity on the Network. Looking past the current Network limitations, ARTC’s Corridor Capacity Strategy indicates that significant expansions will be needed in the next few years to meet growth (see Exhibit J in section 5.4 below).

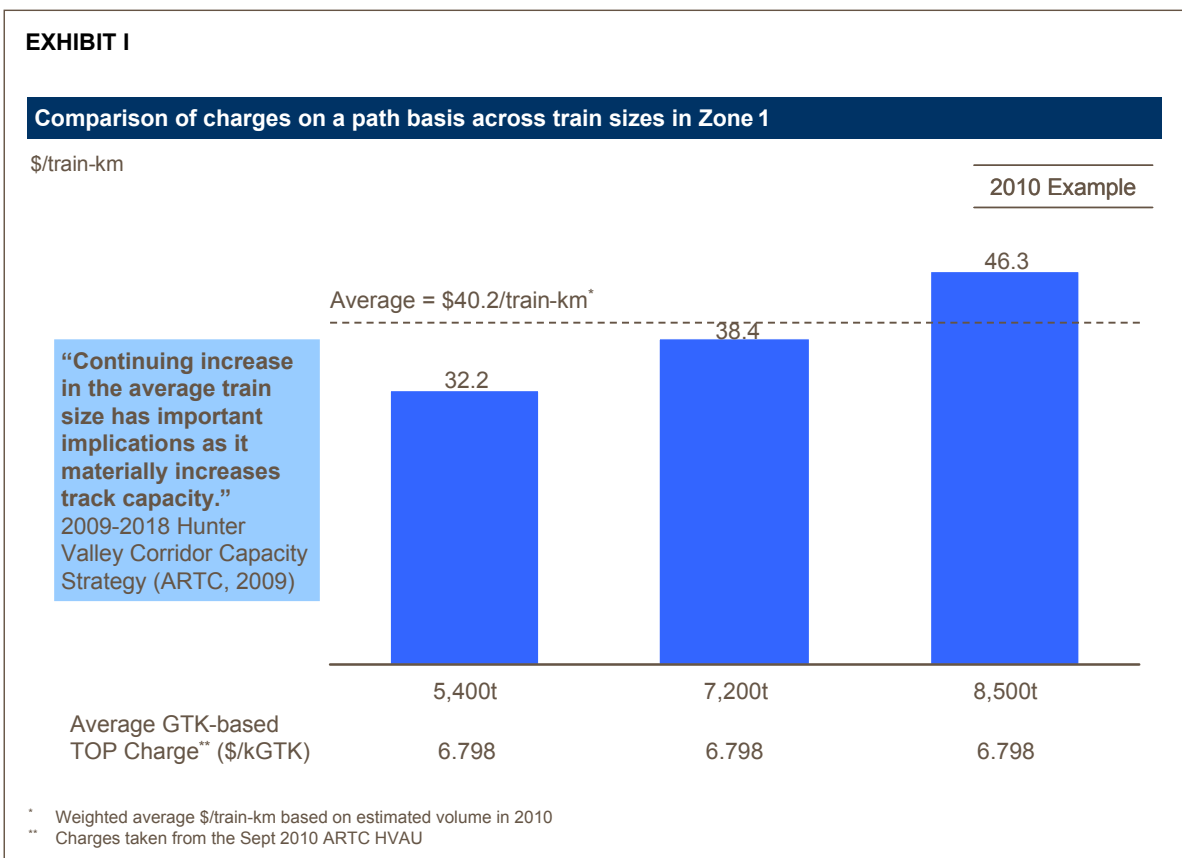
Major investment decisions are already being made in relation to expansions of the Network, particularly on the Gunnedah line. For example, currently under consideration is the potential duplication of the existing track in that region, which has been reported to be the preferred option of Pricing Zone 3 coal producers. C&A is concerned that duplication of the existing track, without upgrading the track to handle services greater than 5,400 tonnes

of Capacity, could result in more Train Paths being consumed in Pricing Zone 1 by Pricing Zone 3 Access Holders, than if those Access Holders were able to use larger Trains.

This could, in turn, add to the congestion problem already identified by the HVCCC or could lead to the need for more investment in Pricing Zone 1. Under the current pricing regime, consuming the additional Train Paths needed to run these Trains comes at no higher price, despite the additional cost to Capacity. Conversely, under cost-reflective pricing, prices would reflect the actual Capacity consumed and investment decisions would be made on that basis, therefore leading to efficient outcomes.

Pricing on a GTK basis, rather than on actual consumption of Capacity, introduces inherent cross-subsidies which distort signals regarding investment in an efficient train size for specific Access Holders. In the Proposed HVAU, the take-or-pay component of each Interim Indicative Service charge (in \$/GTK) is identical within each Pricing Zone. As demonstrated in Exhibit I below, this leads to a large variation on how train sizes are priced for the Train Paths they consume, that is, when based on train kilometres.

ARTC's proposed "pricing parity" approach (on a GTK basis) means that larger Trains are effectively cross-subsidising smaller Trains, discouraging investment in larger train sizes. The result of distorting pricing in this way is reduced Hunter Valley Coal Chain throughput since, as ARTC itself recognises, "continuing increase in the average train size has important implications as it materially increases track capacity" (see ARTC, 2009-2018 Hunter Valley Corridor Capacity Strategy Consultation Document, June 2009, page 6).



Distortions in pricing signals on the Network could be exacerbated in the case of non-Indicative Services through charge differentiation. The arrangements outlined in Section 4.14 of the Proposed HVAU allow ARTC excessive scope for charge differentiation.

The list of factors to be considered by ARTC in determining any charge differentiation is expansive, essentially allowing ARTC to consider anything in formulating Charges for non-Indicative services. There is no framework surrounding the relative importance of each factor and how each one will be used in formulating Charges.

Further, there is no assessment of the reasonableness of Charges, which means that ARTC could charge for services above that which would be observed in a competitive market from a service provider acting in an efficient manner. It is important to note that charge differentiation would not be required if pricing was set based on Train Paths; in this case all charges would inherently reflect consumption of Capacity.

5.4 Moving to Train Path-based, cost-reflective pricing

On 6 May 2009, ARTC sent a letter to the New South Wales Minerals Council (**NSWMC**) outlining a commitment to maintain "pricing parity" (on a GTK basis) between the two primary services operating in Pricing Zones 1 and 2, that is, the 74 wagon and 91 wagon Trains. This commitment was proposed to apply for "a period not less than five years".

In section 13.2.6 of its Draft Decision, the ACCC also referred to this letter and the pricing commitment that ARTC had made. In section 4.1.4 of its response to the ACCC's Draft Decision, ARTC stated that:

As the ACCC is aware, ARTC has committed to maintain pricing parity between the two primary types of Service currently operating in the Hunter Valley for a period of five years from 2009. This means that even if the efficient train configuration (Indicative Service) comes into effect before January 2015, pricing parity between the two current services would remain.

C&A considers that it was inappropriate for ARTC to make such a commitment **after** it had lodged its 2009 HVAU application with the ACCC. To the extent that this "commitment" suggests that ARTC is somehow able to limit the ACCC's ability to determine a different pricing structure that it regards as more appropriate, such a commitment may risk being misleading.

C&A believes that it would be inappropriate for the ACCC to give this commitment by ARTC any weight when having regard to the matters in s44ZZA(3) of the TPA. That is, this commitment should not limit the ACCC's consideration of what pricing approach would:

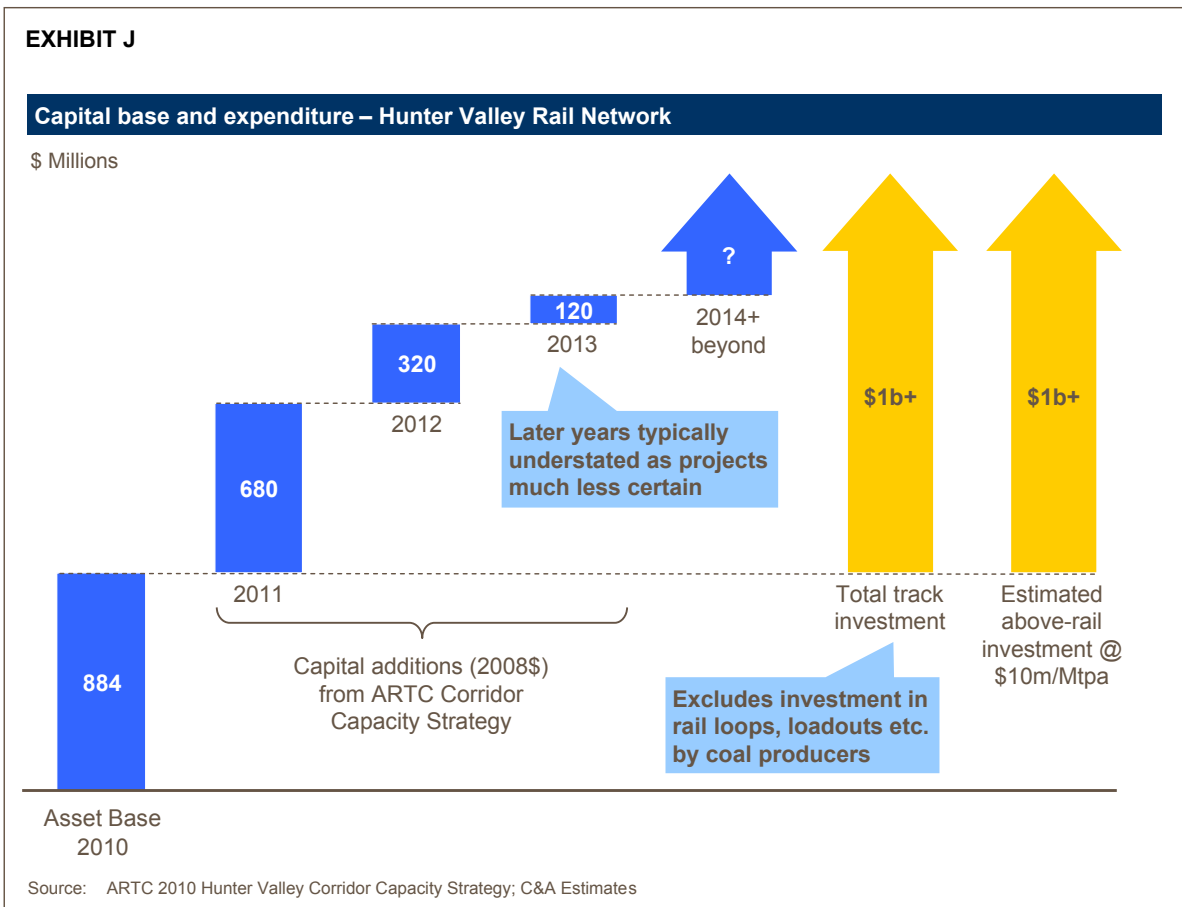
- (a) most appropriately promote the economically efficient operation of, use of and investment in the Network under s44ZZAA(a) of the TPA; and
- (b) be consistent with the pricing principles specified in s44ZZCA of the TPA.

C&A also considers that should this commitment limit the ACCC's consideration of what the pricing approach should be, it may set a dangerous precedent as other service providers may make similar commitments in the context of other access undertakings and also seek to limit the scope of the ACCC's consideration.

Further, C&A notes that ARTC's letter does not mention 5,400 tonne services; it refers only to the two primary services operating in Pricing Zones 1 and 2, that is, the 74 wagon and 91 wagon Trains. C&A queries, therefore, why the "commitment" to pricing parity has now been extended to all Train types under the Proposed HVAU.

In addition, and as discussed above, a decision on the appropriate pricing approach should be made as soon as possible, certainly much more quickly than the suggested four years, to assist Access Holders and haulage companies with their future investment decisions. With the expected growth of terminal capacity, the industry is poised to make billions of dollars of investments in above and below-rail capital expenditure. Accordingly, **now** is the time for ARTC to provide the certainty of cost-reflective pricing (see Exhibit J below).

Finally, it should be noted that even the specified "format" for publishing Indicative Access Charges in section 4.13(c) of the Proposed HVAU requires that the Charges be specified on a \$/GTK basis, which would appear to limit the flexibility for future change.



To help Access Holders manage and plan for the transition to cost-reflective pricing, C&A suggests that implementation of the efficient pricing structure can be gradual and made subject to appropriate "grandfathering" regimes. However, the decision on how pricing will change must be made as soon as possible, since deferring any decision for potentially longer than four years only compounds investment risks in the meantime.

If, contrary to the views expressed by C&A in this submission, a review was to be based on efficient train configurations, C&A considers that the HVCCC would be the most appropriate body to conduct the review. While ARTC is best positioned to provide input on track-related matters, the HVCCC is better placed to consider what the efficient train configuration may be from a whole-of-coal chain perspective. However, C&A reiterates that it would be more useful to first conduct a review of (or decide upon) the efficient pricing mechanism, rather than the efficient Train configurations.

Proposed Solutions

C&A proposes that:

- (a) Section 4.16 of the Proposed HVAU be amended to provide for the determination of future pricing structures rather than the determination of the "efficient train configuration". The new pricing structure should accurately reflect the use of track Capacity and the drivers of cost involved in maintaining the Network. Where such a pricing structure is in place, Access Holders will be incentivised to invest in efficient assets and will pay an appropriate price for the Capacity that they use.
- (b) If an appropriate pricing structure has been developed that reflects the use of track Capacity and the costs of operating the Network (as proposed above), clause 4.14(a) of the Proposed HVAU (relating to charge differentiation for Coal Access Rights) be deleted.
- (c) Section 4.16 of the Proposed HVAU should be further amended to reduce to 18 months the timeframe in which the review to determine the appropriate pricing structure be conducted.
- (d) To alleviate the impact of a change in pricing structure on Access Holders, a grandfathering period for the implementation of the new pricing structures be included in the Proposed HVAU. For example, initially a portion of the charges could reflect the new pricing structure with the remainder representing the existing structure. Then, over the following five years, there would be an increase in that proportion until the cost is determined entirely by the new pricing structure.
- (e) Section 4.13(c) of the Proposed HVAU be amended to provide for indicative prices described in terms of \$/capacity unit, where the initial "capacity unit" might be GTK.

6. On balance, the risks borne by ARTC under the Proposed HVAU are not consistent with ARTC's proposed Rate of Return

Currently, ARTC bears very little risk under the Proposed HVAU. Therefore, the Rate of Return to which ARTC is entitled should be commensurately low unless ARTC is willing to accept more risk for which it could earn a higher Rate of Return

6.1 Risks under the Proposed HVAU

In section 2.3 of its Consultation Paper, the ACCC notes that in its Draft Decision it was of the preliminary view that ARTC's proposed overall Rate of Return was not appropriate. The ACCC considered that the key features of the 2009 HVAU (including the use of the loss capitalisation model, the revenue cap pricing regime, the use of long term take or pay contracts, the use of shorter asset lives to determine regulatory depreciation) had the effect of reducing both the commercial and regulatory risk faced by ARTC and, therefore, that the Rate of Return proposed by ARTC was too high.

C&A believes that, on balance, ARTC would be exposed to very little risk under the Proposed HVAU due to the following mitigating factors:

- (a) Investment risk: All capital expenditure is vetted by either the RCG or the ACCC. Furthermore, ARTC retains the discretion as to whether it will fund an expansion, and prudent capital expenditure is reflected in the RAB.
- (b) Volume risk: In the constrained Network (Pricing Zones 1 and Zone 2), the revenue cap applies such that ARTC is not exposed to volume risk, unless volumes drop to such a degree that prices cannot be raised to the remaining customers without threatening their viability. In the unconstrained Network (Pricing Zone 3), a loss capitalisation model applies, allowing ARTC to recover revenue in future periods. Thus, ARTC's exposure to volume risk is minimal.
- (c) Asset stranding risk: Access Holders are already exposed to large long-term take-or-pay commitments at the port terminals, thus reducing ARTC's risk of asset stranding. C&A recognises the argument that the port terminals may themselves be subject to stranding risk, thus reducing the "comfort" that the rail owner might take from the existing port terminal contracts. However, C&A believes that this argument fails to recognise that both of the port terminals are producer-owned, making it even more difficult for the users of those port terminals to "strand" the assets, as they will likely have ongoing financial commitments in any event. By the end of 2010, the commitments at the port terminals total around 200Mt on 10 year rolling contracts, which is significantly more capacity than can be currently delivered by the track. Moreover, under section 3 of the Proposed HVAU, ARTC can refuse to provide Coal Access Rights to an Applicant who cannot demonstrate Network Exit Capability, further mitigating ARTC's risk of stranding.
- (d) Performance risk: Under the Proposed HVAU, ARTC carries minimal liability for underperformance. As outlined above in section 2, the only recourse for ARTC not delivering contracted paths remains the True-Up test and Annual Reconciliation

process, where a rebate of TOP charges may be applicable. Furthermore, the current structure and mechanics of the True-Up Test offer little assurance that rebates will actually be paid.

C&A can foresee that addressing the five key issues of the Proposed HVAU as outlined in the above sections of this submission might expose ARTC to some additional risk. In particular, increased risk might be associated with:

- (a) A commitment by ARTC to build expansions where a party is willing to fund the investment (ARTC, or a Producer) and the expansion is deemed to be prudent. This would be associated with a narrowed definition of the 'legitimate business interests' under which ARTC may refuse to build an expansion.
- (b) ARTC accepting liability where expansion project costs exceed budget, where risk might be borne by ARTC via the exclusion of excess costs from the RAB.
- (c) The specific requirement for ARTC to deliver "Pending Capacity" such that contracted BPUs will be made available, and forcing expansions to proceed once an investment decision has been made.
- (d) Adjustment of the True-Up Test such that TOP Rebate accruals consider system Tolerance as well as BPUs, placing an increased obligation on ARTC to make Tolerance paths available to industry.
- (e) ARTC accepting an increased role for the HVCCC in assessing Capacity and NPC, as well as the use of an independent auditor to conduct the monthly True-Up Test and Annual Reconciliation processes.

It is critical to carefully determine the WACC that will set ARTC's Rate of Return on its investments. On one hand, ARTC needs to be sufficiently rewarded for the risk that it bears in managing and investing in track assets. On the other, given that Access Seekers and Access Holders are obliged to make use of ARTC's service, the WACC must not be unjustifiably high.

6.2 The Proposed HVAU WACC

As noted in section 2.3 of its Consultation Paper, the ACCC formed the preliminary view in section 12.7 of its Draft Decision that certain input parameters into the WACC calculation were not appropriate. In particular, the ACCC considered that ARTC's proposed cost of debt methodology, asset beta, market risk premium, the gearing ratio and value of gamma were not appropriate.

In response to the ACCC's Draft Decision, ARTC proposed changes to address the concerns raised by the ACCC with respect to certain input parameters, and has outlined its proposed changes in Appendix 3 to the Explanatory Guide. The following parameters, however, remain inconsistent with the recommendations put forward by the ACCC in its Draft Decision (see Exhibit K below):

- (a) Asset beta;
- (b) Market risk premium; and
- (c) Imputation factor (Gamma).

EXHIBIT K

Issues with 2009 HVAU WACC parameters and proposed changes by ARTC in 2010 HVAU

Parameter	ACCC's Issue in 2010 Draft Decision	ARTC Changes in 2010 HVAU	
Risk free rate	Risk free rate should not include a 'convenience yield' to adjust for a 'flight to quality' for CGS	Convenience yield was removed as an adjustment to the risk free rate	✓
Cost of debt	Calculation methodology is not appropriate for current market conditions	Used ACCC's recommended method of extrapolation based on shorter maturity yields	✓
Debt issuance costs	Debt issuance costs should be 0.095%, not 0.125%	Used ACCC's recommended figure of 0.095%	✓
Asset beta	Asset beta should lie between 0.4 (based on utility firms) and 0.5 (based on beta estimate for QR in 2005)	Asset beta is still 0.55, the average of the 2009 HVAU upper and lower bounds	✗
Market risk premium (MRP)	MRP should be 6%, to reflect stable market conditions	MRP is still 6.5%, the average of the 2009 HVAU upper and lower bounds	✗
Capital structure	Capital structure should be 50% debt and equity, as other comparables have lower leverage	Gearing is 52.5% debt, 47.5% equity, average of 2009 HVAU upper and lower bounds	✓
Gamma	Should lie between 0.57 and 0.74 based on empirical studies	Used gamma of 0.5	✗

Source: ACCC March 2010 Draft Decision; ARTC 2010 HVAU Explanatory Guide

Asset Beta

In section 12.7.12 of its Draft Decision, the ACCC noted that during the term of the 2009 HVAU, ARTC's revenues were generally protected by the revenue cap/floor regime, take-or-pay arrangements for the duration of the contracts and the loss capitalisation model.

The ACCC also stated that beyond the term of the 2009 HVAU, ARTC's stranding risk would not be excessive due to the:

- (a) strong medium to long term demand for thermal coal;
- (b) complementary sunk investment in ports and mines by the mining companies;
- (c) capital expenditure approval process for the Hunter Valley Coal Network;
- (d) ability to earn excess returns through the loss capitalisation model for the recovery of previous Periods' return deficits; and,
- (e) conservative approach to estimating asset lives.

For these reasons the ACCC suggested that an asset beta of 0.5 was appropriate to account for any residual stranding risk that may exist. The ACCC also recognised that previous regulatory decisions have used asset beta values of 0.4 to 0.5 for rail businesses largely serving bulk commodity traffic. For example, decisions made by IPART and the Queensland Competition Authority (**QCA**) for comparable rail networks were respectively 0.4 for the Hunter Valley Coal Network and, more recently, 0.45 for QR Coal. While ARTC has proposed an asset beta of 0.55 in the Proposed HVAU, C&A does not think it is likely

that ARTC will bear more stranding risk than comparable rail businesses due to the above mechanisms to protect revenue and transfer risk to Access Holders.

Market Risk Premium

ARTC's 2009 HVAU proposed that a Market Risk Premium (**MRP**) of 6-7% would be appropriate. In that submission, ARTC argued that historical analyses tended to indicate MRP values well in excess of the 6% that has usually been adopted by regulators. Furthermore, the global financial crisis had caused some instability in capital markets, which ARTC highlighted as providing further evidence that a higher MRP, of around 7%, was likely to be appropriate. This opinion was derived from advice provided by Synergies Economic Consulting in April 2009.

In the Draft Decision to the 2009 HVAU, the ACCC reiterated its belief that a MRP of 6% would better reflect both recent regulatory decisions and the considerably improved market conditions following the Global Financial Crisis.

ARTC has accepted that the "worst of the financial crisis is past", as stated in Appendix 3 of the Explanatory Guide to the Proposed HVAU (Section 3, p. 20), but maintains the view that the financial outlook remains uncertain and hence proposes to include a MRP of 6.5%.

C&A queries the use of 6.5% as the MRP as it is still inconsistent with the rationale posed by the ACCC in its 2009 Draft Decision and cases of regulatory precedent.

Imputation Factor (Gamma)

In section 12.7.16 of its Draft Decision, the ACCC considered that ARTC's proposed gamma value of zero was unlikely to be inappropriate. The ACCC considered that the assumption that the marginal investor is foreign was not theoretically valid for determining the value of imputation credits and that, given the results of empirical studies, the most appropriate value for gamma should lie between 0.57 and 0.74. In response, ARTC has adopted a gamma value of 0.5 in the Proposed HVAU.

C&A supports the ACCC's theoretical reasoning for its recommended range for gamma and suggests that ARTC adopt a gamma value of at least 0.57.

Effect on WACC

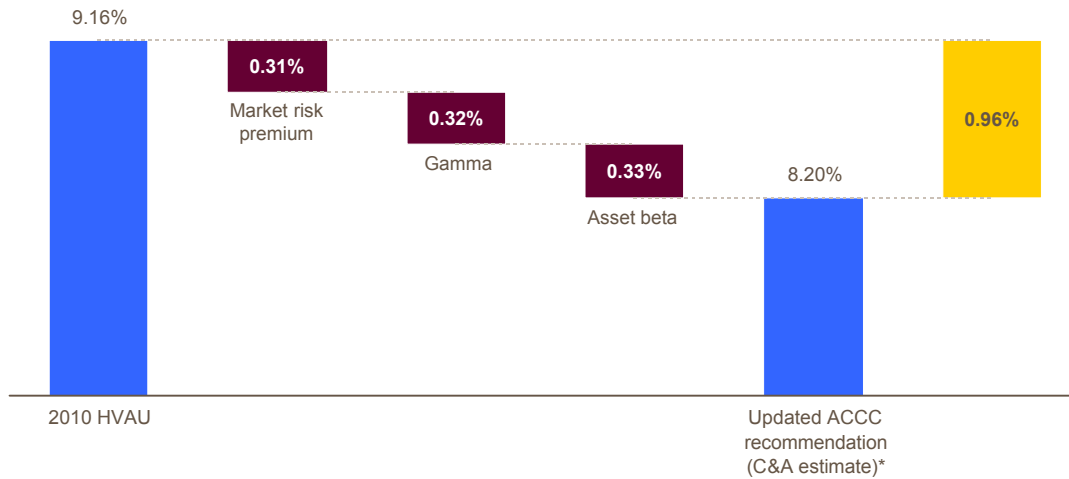
In the Proposed HVAU, ARTC proposes a real pre-tax WACC of 9.16% (see Exhibit K above). This is significantly higher than the WACC proposed in section 12.7.18 of the ACCC's Draft Decision of 7.00% (although this value does not reflect changed market conditions).

Based on current market conditions, C&A has estimated an updated WACC using the ACCC's suggested gamma, asset beta and methodology for determining debt risk premium. The resulting WACC still differs significantly from the ARTC's proposal, as outlined below.

Comparing the impact of market risk premium, gamma and asset beta (as proposed in the ACCC's Draft Decision and adjusted for current market conditions) to ARTC's proposed input parameters (see Appendix 3 of the Explanatory Guide), the difference in WACC is approximately 100 basis points (see Exhibit L below).

EXHIBIT L

The effect of individual WACC parameters on pre-tax WACC



* WACC calculated using AER precedent for gamma (0.65) and debt risk premium (3.42%). Note: this figure is different compared to the 2010 HVAU Explanatory Guide updated ACCC recommended WACC of 7.73%, which is due to the methodology used to calculate debt risk premium

Source: ACCC March 2010 Draft Decision; ARTC 2010 HVAU Explanatory Guide; C&A Estimates

Proposed Solution

Given that under the Proposed HVAU ARTC is exposed to relatively low risk, C&A considers that ACCC's WACC recommendation is more appropriate than ARTC's proposal.

6.3 Potential for ARTC to include a higher WACC

On balance, under the Proposed HVAU, the level of risk to be adopted by ARTC is not consistent with ARTC's current proposed WACC.

Given this, C&A supports the use of the WACC parameters proposed by the ACCC in its Draft Decision. However, if the five key issues outlined above were to be addressed and ARTC takes on the associated additional commercial risks, then C&A may support the higher WACC proposed by ARTC.

7. The way forward

C&A has a significant interest in seeing the terms of access being quickly resolved. As one of the largest coal producers in the Hunter Valley, C&A has considerable take-or-pay commitments at the PWCS and NCIG port terminals extending at least through to 2023 (but with evergreen renewal rights), and therefore wishes to secure track access rights as soon as it appropriately can.

Despite the concerns raised throughout this submission, C&A is firmly of the view that resolutions to the five key issues can be found in a timely manner if ARTC and interested parties effectively engage with each other. To recap, this collaborative process should lead to the development of a revised HVAU that better balances the interests of ARTC and potential access seekers by:

- (a) Providing Applicants with certainty of access to current and future track Capacity;
- (b) Ensuring that ARTC is fully accountable for any failure to deliver the required number of Train Paths;
- (c) Including a comprehensive set of incentives to align the interests of ARTC and Access Holders;
- (d) Protecting the contractual rights of each party by implementing a system for identifying, assigning responsibility for, and managing Capacity gains and losses; and
- (e) Encouraging the economically efficient operation of, use of and investment in the Network and by sending appropriate signals to industry about the cost of Capacity through a pricing strategy that is cost-reflective.

Within this submission, C&A has proposed a number of solutions to address each of the five key concerns for potential access seekers, and these could form a starting point for further consultation with industry.

C&A considers that the required engagement would also be facilitated by the ACCC issuing a statement that outlines its concerns with the Proposed HVAU and Proposed IAHA. This statement would ensure that further discussions between ARTC and interested parties are appropriately framed and guided.

In conclusion, C&A encourages ARTC and other interested parties to continue to engage with each other. C&A believes that it is in the best interests of all parties to have an appropriate HVAU implemented and that such an outcome can be readily achieved. C&A, for its part, would be prepared to commit the time and resources required to make such a collaborative process work.