Australian Competition & Consumer Commission

Position Paper

Australian Rail Track Corporation's compliance with the financial model in the Hunter Valley Coal Network Access Undertaking for January – December 2013

26 November 2014

Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

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Glossary

Capitalised terms used in this paper and not listed in this glossary are terms as defined in section 14.1 of the Hunter Valley Coal Network Access Undertaking, which is available on the ACCC's website.

2012 Compliance Period	Calendar year from 1 January 2012 to 31 December 2012
2013 Compliance Period	Calendar year from 1 January 2013 to 31 December 2013
Asciano	Asciano Ltd
ACCC	Australian Competition and Consumer Commission
Anglo American	Anglo American Metallurgical Coal Pty Ltd
ARTC	Australian Rail Track Corporation
BDO	BDO (SA) Pty Ltd
BHP	BHP Billiton Limited
CCA	*Competition and Consumer Act 2010* (Cth)
Glencore	Glencore Coal Assets Australia Pty Ltd
gtkm	gross tonne kilometres
HVCCC	Hunter Valley Coal Chain Coordinator
HVAU	Hunter Valley Coal Network Access Undertaking
Idemitsu	Idemitsu Australia Resources Pty Ltd
IPART	NSW Independent Pricing and Regulatory Tribunal
NSWRAU	NSW Rail Access Undertaking
Peabody	Peabody Australia Mining Pty Ltd
PWCS	Port Waratah Coal Services Limited
RAB	Regulatory Asset Base
RCG	Rail Capacity Group
Rio Tinto	Rio Tinto Coal Australia Pty Ltd
TUT	True-Up Test
Vale	Vale Australia Pty Ltd
Whitehaven	Whitehaven Coal Ltd

Summary

The Australian Rail Track Corporation (**ARTC**) submitted documentation to the ACCC in May 2014 in order to demonstrate its compliance with the Hunter Valley Coal Network Access Undertaking (**HVAU**) financial model for the period 1 January 2013 to 31 December 2013 (**2013 Compliance Period**) (**ARTC's 2013 Compliance Submission**).

The ACCC has not yet made a determination on ARTC's compliance for the 2013 Compliance Period. The ACCC has identified a number of issues relating to ARTC's compliance that it would like further input from stakeholders on before making a decision. Such issues include the prudency and efficiency of ARTC's costs and the reconciliation of revenues received with applicable ceiling revenue limits. Stakeholders are invited to review the issues set out in this Position Paper and provide a submission to the ACCC by 21 January 2015.

Overview of the annual compliance assessment

ARTC is required to annually submit documentation to the ACCC for the purpose of an assessment of its compliance with the financial model set out in section 4 of the HVAU. As part of this assessment, the HVAU provides for the ACCC to determine whether ARTC has incurred prudent and efficient expenditure, rolled forward the regulatory value of its assets and reconciled revenues received with the applicable ceiling revenue limits (which are based on economic costs) in accordance with the HVAU. This reconciliation process ultimately ensures that ARTC receives no more revenue than is necessary to cover its economic costs by requiring ARTC to pay a refund to its customers where it has recovered more than its economic costs in a calendar year while also allowing ARTC to seek further revenue from its customers where it has recovered less than its economic costs.

ACCC's preliminary assessment for the 2013 Compliance Period

ARTC submitted that 'loss capitalisation' continued to apply in Pricing Zone 3 with cumulative losses of $8.80 million as at the end of the 2013 Compliance Period.[1] ARTC also submitted that its Economic Cost for the Constrained Network for the 2013 Compliance Period was $297.5 million and that, as it had only received $277.9 million in revenue for the Constrained Network, it had a $19.60 million shortfall in revenue.[2] ARTC proposed to recover this shortfall from Constrained Coal Customers.[3]

The ACCC previously consulted with stakeholders on ARTC's 2013 Compliance Submission by issuing a Consultation Paper in June 2014. The ACCC also separately consulted with stakeholders on ARTC's revenue allocation and reconciliations with applicable ceiling revenue limits by issuing a Discussion Paper in May 2014. Giving consideration to the submissions received in these prior consultations, the ACCC has identified the prudency of capital expenditure, efficiency of operating expenditure and revenue allocation and reconciliation as the key issues for the 2013 Compliance Period.

Capital expenditure

ARTC sought to roll forward into its regulatory value of assets net capital expenditure of $155.2 million (which ARTC would then earn a rate of return and recover depreciation of and informs the calculation of the ceiling revenue limits). The ACCC has identified some further

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1 For Pricing Zone 3 only, the HVAU allows 'loss capitalisation'. Until such time as ARTC is able to recover the Economic Cost of Pricing Zone 3, ARTC is allowed to capitalise revenue shortfalls into the regulatory value of its assets for Pricing Zone 3 to allow for recovery in future periods. Cumulative losses capitalised as at the end of the 2013 Compliance Period include capitalised losses from 2011, 2012 and 2013.

2 Constrained Network is defined in section 14.5 of the HVAU. In general terms, the Constrained Network currently comprises the majority of rail Segments in Pricing Zone 1 and 2 where there is enough volume to enable ARTC to recover its economic costs

3 Constrained Coal Customer is defined in section 14.5 of the HVAU. A Constrained Coal Customer is essentially a coal producer that originates in the Constrained Network.

evidentiary requirements for ARTC to demonstrate the prudency of its net capital expenditure amount. For example, there are instances where ARTC has not provided evidence of endorsement of capital expenditure by the Rail Capacity Group (**RCG**) as is required under the HVAU for that capital expenditure to be treated as 'prudent'.[4] However, the ACCC is of the preliminary view that, subject to ARTC providing that additional information, then the submitted net capital expenditure amount is likely to be appropriate.

Operating expenditure

ARTC submitted that operating expenditure (which informs the calculation of the ceiling revenue limits) for the Constrained Network was $102.72 million and for Pricing Zone 3 was $17.28 million. The ACCC considers that ARTC has not sufficiently substantiated the efficiency of its operating expenditure and has identified some further information that would assist the ACCC to form a view on the submitted operating expenditure amount. For example, while ARTC provided some explanation of variations in expenditure amounts from what it had forecast and notified to the RCG, ARTC has not provided detail on the associated dollar amounts, which has made it difficult for the ACCC to undertake any assessment. The ACCC also notes that ARTC sought to expense concept assessment project costs of approximately $8.97 million in the Constrained Network (included in $102.72 million noted above), which ARTC stated was advised to the RCG with no objections. In principle the ACCC does not oppose ARTC's approach, particularly as the HVAU appears to allow for it, however the ACCC considers it appropriate to ensure that all stakeholders have an opportunity to comment in the overall context of the annual compliance assessment.[5]

Revenue reconciliation

In relation to revenue allocation and reconciliation, the ACCC notes that ARTC has calculated the ceiling revenue limits for Pricing Zone 1 and 2 Access Holders by excluding only the Direct Costs (i.e. efficient variable maintenance expenditure) of Access Holders originating in Pricing Zone 3 as opposed to the incremental costs.[6] The ACCC's preliminary view is that the approach taken by ARTC may overestimate the ceiling revenue limits for Pricing Zone 1 and 2 Access Holders such that it could result in an over-recovery in revenue from those Access Holders and represents a cross-subsidy to Pricing Zone 3 Access Holders. The ACCC considers that ARTC's approach is likely to be inconsistent with the calculation of the ceiling revenue limits for Pricing Zone 1 and 2 Access Holders set out in subsection 4.3(a) of the HVAU. The ACCC recognises that identifying the difference between the Direct Costs and incremental costs of Pricing Zone 3 Access Holders in Pricing Zone 1 is likely to be contentious and is therefore encouraging industry to discuss and negotiate an appropriate resolution.

Seeking stakeholders' views for the 2013 Compliance Period

The ACCC is now calling for submissions from stakeholders on its preliminary views. Parties are welcome to comment on any aspect of this Position Paper, although the ACCC has outlined some specific questions in chapter 2. Parties are encouraged to respond giving consideration to ARTC's compliance with the financial model set out in section 4 of the HVAU.

Submissions are due by 21 January 2015. Details on how to make a submission are outlined in chapter 1 of this Position Paper.

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4 The RCG is a representative group made up of a range of stakeholders, including Access Holders and above-rail operators and the Hunter Valley Coal Chain Coordinator (HVCCC) (in a non-voting capacity). Subsection 4.10(d)(iii) of the HVAU explicitly provides that, if capital expenditure has been endorsed by the RCG in accordance with the consultation obligations set out in section 9 of the HVAU then the ACCC will accept that capital expenditure as prudent.

5 Section 8.2 of the HVAU allows for concept assessment costs to be treated as prudent and included in the regulatory value of assets or expensed in the year incurred.

6 The incremental costs of Pricing Zone 3 Access Holders in Pricing Zone 1 will, at the very least, include Direct Costs plus any capital expenditure projects that were commissioned to increase the capacity of Pricing Zone 1 solely to accommodate the increase in volumes from Pricing Zone 3.

1 Introduction

ARTC is a Commonwealth Government-owned corporation that was established in 1998 and provides a single point of contact for parties seeking to run trains on the National Interstate Rail Network across Australia and the Hunter Valley Coal Network in NSW. ARTC is vertically separated, providing ‘below-rail’ services (such as the rail track infrastructure) but not ‘above-rail’ services (such as haulage). The National Interstate Rail Network and the Hunter Valley Coal Network are currently subject to two separate access undertakings that were accepted by the ACCC in 2008 and 2011 respectively.

The Hunter Valley Coal Network is predominantly used to transport coal from mines in the Hunter Valley region in NSW to the Port of Newcastle for export and to transport coal to domestic customers, such as power stations. The network is also used by non-coal traffic, including general and bulk freight services (such as grain) and passenger services.

The Hunter Valley Coal Network was previously subject to the NSW Rail Access Undertaking (the **NSWRAU**) administered by the NSW Independent Pricing and Regulatory Tribunal (**IPART**). However, access to the Hunter Valley Coal Network has been regulated through the HVAU since the ACCC accepted the access undertaking in June 2011. The HVAU applies for an initial five year period and is due to expire in June 2016. The ACCC expects that the assessment of any replacement undertaking proposed by ARTC would commence before the expiry of the existing HVAU.

The remainder of this chapter provides information on the HVAU financial model that regulates ARTC’s revenues as well as the annual compliance assessment that the ACCC conducts to ensure ARTC’s compliance with the HVAU financial model. An outline of the process for the current assessment, including prior and current consultation, is also provided.

1.1 HVAU financial model

Section 4 of the HVAU regulates the amount of revenue that ARTC is entitled to receive for the Hunter Valley Coal Network by implementing revenue floor and ceiling limits.

Section 4.2 of the HVAU sets out the floor revenue limits, which links the minimum revenue that ARTC is required to receive to Direct Cost and Incremental Cost:

> (a) Access revenue from every Access Holder must at least meet the Direct Cost imposed by that Access Holder.
>
> (b) For each Segment or group of Segments, Access revenue from Access Holders should, as an objective, meet the Incremental Cost of those Segments (“Floor Limit”).

The term Direct Cost is defined in the HVAU as efficient maintenance expenditure, while the term Incremental Cost is defined as all costs that could be avoided in the medium term if a Segment was removed from the Network.[7]

Section 4.3 of the HVAU sets out the ceiling revenue limits, which caps the maximum amount of revenue that ARTC is entitled to receive at Economic Cost:

> (a) In relation to Segments identified as forming part of Pricing Zone 1 and 2 in Schedule E, Access revenue from any Access Holder, or group of Access Holders must not exceed the Economic Cost of those Segments which are required on a standalone basis for the Access Holder or group of Access Holders (“Ceiling Limit”)
>
> (b) In relation to Segments identified as forming part of Pricing Zone 3 in Schedule E, the Access revenue from any Access Holder, or group of Access Holders must not exceed the Ceiling Limit

7 All capitalised terms are defined in section 14.1 of the HVAU.

where the RAB for those Segments is equal to, or falls below, the RAB Floor Limit for those Segments at the end of the calendar year (t - 1).

The term Economic Cost is defined in section 4.5 of the HVAU. It is essentially calculated using a 'building block model' and incorporates allowances for return on assets, return of assets (depreciation) and efficient operating expenditure. The calculation of Economic Cost, therefore, also requires a regulatory value of assets. The regulatory value of assets is rolled forward each year to account for depreciation and prudent capital expenditure.

Reconciliation of revenues received with ceiling revenue limits, which are calculated based on the Economic Cost of providing services, is applied differently for the various parts of the Network while certain circumstances exist:

- For the Constrained Network[8], the HVAU applies an 'unders and overs' accounting framework that enables ARTC to recover the Economic Cost of providing services in each compliance period. If ARTC's revenue for the Constrained Network is less than Economic Cost in a compliance period, then ARTC is entitled to recover the 'under' from Constrained Coal Customers[9]. Conversely, if ARTC's revenue exceeds Economic Cost, then ARTC is required to refund the 'over' to Constrained Coal Customers.

- For Pricing Zone 3 only, the HVAU allows 'loss capitalisation'[10]. Until such time as ARTC is able to recover the Economic Cost of Pricing Zone 3, ARTC is allowed to capitalise revenue shortfalls into the Pricing Zone 3 regulatory value of assets for recovery in future periods. Once ARTC is able to recover the Economic Cost of Pricing Zone 3 (including the losses capitalised from previous years), then Pricing Zone 3 becomes part of the Constrained Network and the 'unders and overs' accounting framework as per the previous point takes effect.

1.2 ACCC annual compliance assessment

Section 4.10 of the HVAU provides for the ACCC to conduct an annual assessment to determine whether ARTC has complied with the HVAU financial model for the compliance period. In particular, the ACCC is required to determine whether:

- ARTC has undertaken prudent capital expenditure and incurred efficient operating expenditure in accordance with the requirements set out in the HVAU;

- ARTC has rolled forward the regulatory value of assets in accordance with the HVAU;

- Pricing Zone 3 forms part of the Constrained Network or whether 'loss capitalisation' continues to apply for that pricing zone as allowed for under the HVAU; and

- ARTC has reconciled revenues with the applicable revenue floor and ceiling limits and determined the allocation of any 'unders or overs' to Constrained Coal Customers in accordance with the HVAU.

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8 The Constrained Network is defined in section 14.5 of the HVAU as the group of Segments within the Network bounded by the mine loading points and the Newcastle port where access revenue on those Segments is likely to reach or exceed Economic Cost for those Segments on a standalone basis. The Constrained Network currently comprises the majority of the Network in Pricing Zones 1 and 2 where ARTC is expected to be able to recover its Economic Cost.

9 A Constrained Coal Customer is defined in section 14.5 of the HVAU as an Access Holder: (a) who holds Coal Access Rights under a current written access agreement with ARTC; and (b) who paid ARTC for access to the Constrained Network and such payments, other than for Direct Costs, formed part of the annual coal access revenue for the Constrained Group of Mines.

10 Loss capitalisation applies to Pricing Zone 3 because there is currently relatively lower demand for rail services due to the start-up nature of coal mines in the region and, therefore, ARTC is not currently expected to recover its Economic Cost. During the development of the HVAU, ARTC proposed the loss capitalisation model as a way to encourage investment in new assets where there was limited initial demand.

1.3 Previous consultations

ARTC provided its 2013 Compliance Submission to the ACCC in May 2014 in order to demonstrate its compliance with the HVAU financial model for the 2013 Compliance Period. The ACCC has previously issued a Consultation Paper on ARTC's 2013 Compliance Submission. The ACCC has also issued separate Discussion Paper relating to ARTC's revenue allocation and reconciliation with applicable ceiling revenue limits, which is relevant to the ACCC's consideration of ARTC's 2013 Compliance Submission. Details on these papers and submissions received from stakeholders are provided below.

1.3.1 Consultation Paper on ARTC's annual compliance submission

The ACCC published a Consultation Paper on 16 June 2014.[11] In that paper, the ACCC invited comments from interested parties on the documentation that ARTC provided to the ACCC on 21 May 2014 to demonstrate its compliance with the HVAU financial model for the 2013 Compliance Period. The ACCC received submissions from the following:

- Asciano Ltd (**Asciano**);
- Glencore Coal Assets Australia Pty Ltd (**Glencore**);
- Hunter Valley Energy Coal Pty Ltd, a subsidiary of BHP Billiton Limited (**BHP**); and
- Rio Tinto Coal Australia Pty Ltd (**Rio Tinto**).

The ACCC notes that submissions did not include substantive comments on ARTC's 2013 Compliance Submission and the issues identified in the ACCC's Consultation Paper. Rather, submissions called for the ACCC to postpone the annual compliance assessment for the 2013 Compliance Period until the review of ARTC's revenue reconciliation had been completed.

1.3.2 Discussion Paper on ARTC's Revenue Reconciliation

The ACCC released a Discussion Paper on ARTC's revenue allocation practices on 29 May 2014, inviting comments from interested parties on ARTC's approach to revenue reconciliation under the HVAU.[12] The ACCC received submissions from the following:

- Anglo American Metallurgical Coal Pty Ltd (**Anglo American**);
- ARTC;
- BHP;
- Coal & Allied Industries Limited, a subsidiary of Rio Tinto Coal Australia (**Rio Tinto**);
- Glencore;
- Idemitsu Australia Resources Pty Ltd (**Idemitsu**);
- Peabody Australia Mining Pty Ltd (**Peabody**);

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[11] The ACCC's Consultation Paper and submissions received can be accessed at: http://www.accc.gov.au/regulated-infrastructure/rail/annual-compliance-assessment-2013/consultation-paper

[12] The ACCC's Discussion Paper and submissions received can be accessed at: http://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/revenue-allocation-review/discussion-paper

- Vale Australia Pty Ltd (**Vale**); and
- Whitehaven Coal Ltd (**Whitehaven**).

A summary of the submissions is included in section 2 of this Position Paper.

1.4 Consultation on this Position Paper

As highlighted above, the submissions received as part of the prior consultations did not provide substantive comments on the content of ARTC's 2013 Compliance Submission but raised complex issues in relation to ARTC's revenue allocation practices. Given the complexity and significance of the issues, the ACCC considers that further input from ARTC and industry is required before it is able to make a determination on ARTC's compliance with the HVAU financial model for the 2013 Compliance Period.

Accordingly, the ACCC has conducted a preliminary assessment of ARTC's compliance for the 2013 Compliance Period, taking into account the views expressed during the prior consultations outlined above, and is now seeking submissions from the interested parties on the preliminary views outlined in chapter 2 of this Position Paper by 21 January 2015.

1.4.1 Making a submission

Submissions should be addressed to:

Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne Vic 3001
Email: transport@accc.gov.au

Submissions are due by **21 January 2015**.

1.4.2 Confidentiality

The ACCC strongly encourages public submissions. Unless a submission, or part of a submission, is marked confidential, it will be published on the ACCC's website and may be made available to any person or organisation upon request.

Sections of submissions that are claimed to be confidential should be clearly identified. The ACCC will consider each claim of confidentiality on a case by case basis. If the ACCC refuses a request for confidentiality, the submitting party will be given the opportunity to withdraw the submission in whole or in part.

For further information about the collection, use and disclosure of information provided to the ACCC, please refer to the ACCC publication '*Australian Competition and Consumer Commission / Australian Energy Regulator Information Policy – the collection, use and disclosure of information*' available on the ACCC's website.

1.4.3 Further information

ARTC's submission in relation to the 2013 Compliance Period and other relevant information, such as the currently accepted HVAU, are available on the ACCC's website at the following location:[13]

[13] www.accc.gov.au and follow the links to 'Regulated infrastructure' -> 'Rail' -> 'ARTC Hunter Valley Access Undertaking'

http://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking

Public submissions received during the current process will also be published at this location.

If you have any queries about any matters raised in this document, please contact:

Renée Coles
Infrastructure & Transport – Access & Pricing Branch
Infrastructure Regulation Division
Phone: +61 3 9290 6921
Email: renee.coles@accc.gov.au

2 Key issues

This chapter sets out the ACCC's preliminary views and invites comments from stakeholders on the following key issues relating to ARTC's 2013 Compliance Submission:

- prudency of capital expenditure (section 2.1);
- efficiency of operating expenditure (section 2.2);
- reconciliation of revenue with the applicable floor and ceiling limits (section 2.3); and
- True-Up Test results (section 2.4).

As set out in chapter 1 of this paper, the ACCC has previously issued a Consultation Paper on ARTC's annual compliance submission for the 2013 Compliance Period and a separate Discussion Paper relating to ARTC's approach to revenue reconciliation under the HVAU. These documents provide additional background information that is relevant to the current assessment and are available on the ACCC's website.[14]

Further, Appendix A of this paper outlines ARTC's calculations for the 2013 Compliance Period for the following:

- roll forward of the regulatory value of assets;
- determination of whether 'loss capitalisation' applies for Pricing Zone 3; and
- reconciliation of revenues received with the ceiling limit.

2.1 Prudency of capital expenditure

Subsections 4.4(a) and (b) of the HVAU define net capital expenditure as capital additions, plus interest costs incurred during construction, less the written down value of any disposals.

Importantly, the HVAU requires that, for capital expenditure to be included in the regulatory value of assets, it must be incurred on a 'prudent' basis. Subsection 4.10(d)(iii) of the HVAU explicitly provides that, if capital expenditure has been endorsed by the Rail Capacity Group (**RCG**) in accordance with the consultation obligations set out in section 9 of the HVAU, then the ACCC will accept that capital expenditure as prudent. The RCG is a representative group made up of a range of stakeholders, including Access Holders and above-rail operators and the Hunter Valley Coal Chain Coordinator (**HVCCC**) (in a non-voting capacity).

The HVAU also provides that interest costs incurred during construction up until 1 July in the calendar year that the asset was commissioned and determined by reference to the appropriate rate of return as well as interest costs and disposals incurred on a prudent basis.[15]

2.1.1 ARTC's Compliance Submission

In its 2013 Compliance Submission, ARTC sought to roll forward into its regulatory value of assets net capital expenditure of $155 187 320, broken down as set out in table 2.1 below.

[14] See section 1.3 of this Position Paper for further detail.

[15] See section 4.4 of the HVAU.

Table 2.1: Net capital expenditure for the 2013 Compliance Period[16]

Value	2012 ($)	2013 ($)
Major capital expenditure	444 487 652	126 898 239
Minor capital expenditure	39 567 969	29 039 480
Interest during construction	43 839 220	5 421 587
Disposals	- 8 490 116	- 6 171 987
Net capital expenditure	**519 404 725**	**155 187 320**

Details of the major and minor capital expenditure have not been reproduced in this Position Paper as they are numerous and are outlined in detail in Appendix B and also Attachment 2 of ARTC's 2013 Compliance Submission. Although, the ACCC notes that ARTC advised that $77 779 116 of the major capital expenditure amount related to projects commissioned during the 2013 Compliance Period, while the remaining amount of $49 119 123 was for post-commissioning works associated with major capital projects from prior periods.[17]

ARTC submitted interest during construction amounts associated with three projects as outlined in table 2.2 below.

Table 2.2: Interest during construction for the 2013 Compliance Period[18]

Project detail	Interest during construction ($)
Drayton Junction Upgrade (Pricing Zone 1)	2 107 504
KCT Bypass Road Realignment (Pricing Zone 1)	84 715
Bylong Loop Extension (Pricing Zone 2)	3 229 368
Total	**5 421 587**

ARTC advised that, for assets ascribed a regulatory asset value under the NSWRAU, the net loss on disposal was based on the written down value from the Booz Allen Hamilton DORC database less any recovery on disposal (either through an adjustment to inventory or recovery as scrap sales).[19] On this basis, ARTC submitted net loss on disposals as outlined in table 2.3 below.

16 ARTC's 2013 Compliance Submission, p. 11.
17 ARTC's 2013 Compliance Submission – Attachment 2 – Capital Consultation Document, p. 14.
18 ARTC's 2013 Compliance Submission, pp. 11, 35.
19 ARTC's 2013 Compliance Submission, p. 16.

Table 2.3: Net loss on disposals for the 2013 Compliance Period[20]

Activity / project detail	Net loss on disposal ($)
Minor Capital Works program (Pricing Zone 1)	2 485 785
Minor Capital Works program (Pricing Zone 2)	1 264 074
Minor Capital Works program (Pricing Zone 3)	1 722 120
Drayton Junction Upgrade (Pricing Zone 1)	464 214
KCT Departure Road No. 3 (Pricing Zone 1)	30 419
KCT Bypass Road Realignment (Pricing Zone 1)	99 172
Bylong Loop Extension (Pricing Zone 2)	106 203
Total	**6 171 987**

ARTC also confidentially provided to the ACCC evidence of RCG endorsement of capital expenditure amounts and provided details and calculations of interest during construction and disposals in its confidential financial model.

2.1.2 Stakeholder comments

Asciano submitted that it is satisfied that ARTC's capital expenditure in the 2013 compliance period was prudent. However, Asciano noted that there should be a stronger focus by ARTC on capital expenditure designed to address track congestion in the Hunter Valley.[21]

2.1.3 ACCC's preliminary assessment

The ACCC's preliminary assessment of the prudency of net capital expenditure has been arranged under four key issues: major capital expenditure additions, minor capital expenditure additions, interest during construction and disposals.

Major capital expenditure additions

The ACCC has reviewed the confidential documents provided by ARTC as evidence of RCG endorsement for major capital expenditure additions. The ACCC is satisfied that ARTC has shown evidence of RCG endorsement for $126 860 489 to be rolled into the regulatory value of assets for the 2013 Compliance Period. However, the ACCC has been unable to confirm RCG endorsement for one project, being the Aerosol (Murrumbo) Valley Loop for which ARTC has sought to roll $37 750 of post-commissioning costs into the regulatory value of assets.

The ACCC has sought additional information from ARTC to confirm RCG endorsement for the Aerosol (Murrumbo) Valley Loop project. Subject to this evidence being provided by ARTC, the ACCC's preliminary view is that the major capital expenditure amount of $126 898 239 that ARTC has sought to roll forward into the regulatory value of assets for the 2013 Compliance Period is likely to be prudent.

Minor capital expenditure additions

Based on the information provided in ARTC's 2013 Compliance Submission and also the confidential documents provided by ARTC, the ACCC has been unable to reconcile the amounts and scope of minor capital expenditure that ARTC has sought to roll forward into the

20 ARTC's 2013 Compliance Submission – Appendix C, p. 32.
21 Asciano, *Submission to the ACCC's Consultation Paper on ARTC's annual compliance*, 15 July 2014, p. 1.

regulatory value of assets with that endorsed by the RCG. In addition, the ACCC notes ARTC's advice that:

> In the April 2014 RCG meeting, a report detailing variations in minor capital projects between January 2013 and June 2014 was tabled before the members. The RCG was appreciative of the update for variances within the minor capital programme and acknowledged the additional transparency this update provided. No queries were raised, nor did the RCG seek any further clarification or explanation of the variances within the programme. This report has been included in confidential Attachment 3.[22]

The ACCC considers that this report will likely have been useful for stakeholders by providing additional transparency about ARTC's ongoing minor capital expenditure program and would inform the ACCC's assessment of the prudency of that expenditure. However, the ACCC was not provided with a copy of this report as advised by ARTC.

The ACCC has sought additional information from ARTC to confirm RCG endorsement, including obtaining a copy of the report to RCG members outlining the variations in expenditure, before forming a view on the prudency of the minor capital expenditure amount of $29 039 480 that ARTC has sought to roll into the regulatory value of assets for the 2013 Compliance Period.

Interest during construction

ARTC has sought to roll forward total interest during construction of $5 421 587 into the regulatory value of assets for the 2013 Compliance Period. The ACCC has reviewed ARTC's calculations for interest during construction and confirms that the calculations have been undertaken in accordance with the methodology prescribed under the HVAU.

Subject to no concerns being raised by stakeholders in relation to the projects and associated interest during construction, the ACCC's preliminary view is that the interest during construction amount submitted by ARTC is likely to be appropriate.

Disposals

ARTC has sought to include total net loss on disposals of $6 171 987 for the 2013 Compliance Period. The ACCC notes that, as shown in table 2.3 above, the majority of net loss on disposals related to rerailing or rail replacement activities as part of ARTC's minor capital expenditure works program. In most of these instances, ARTC has advised that assets were disposed as scrap with some proceeds received as outlined in Appendix C of ARTC's 2013 Compliance Submission while in some instances assets were transferred to inventory stockpiles.

In relation to the disposals associated with the major capital expenditure projects highlighted in table 2.3, the ACCC notes that ARTC has advised that some of the amounts were transferred to inventory. It is the ACCC's understanding that ARTC is to reduce the regulatory value of assets by the total value of disposals (i.e. that any amount received from sale or value of an asset is transferred to inventory does not remain in the regulatory value of assets for ARTC to earn a rate of return on). In Appendices C, D and E of ARTC's 2013 Compliance Submission, however, the ACCC notes that it is not clear whether the regulatory value of assets has been reduced by the total value of disposals or only the net loss on disposals amount.

Subject to no concerns being raised by stakeholders in relation to the projects and associated disposals, the ACCC's preliminary view is that the net loss on disposals amount submitted by ARTC is likely to be appropriate. However, the ACCC has sought further clarification from ARTC on how the proceeds from the sale of assets and/or transfer to inventory stockpiles have been incorporated into ARTC's confidential financial model to ensure that the amounts have indeed been appropriately removed from the regulatory value of assets.

[22] ARTC's 2013 Compliance Submission, p. 15.

Questions for comment on prudency of capital expenditure

- Does industry have comments on any aspect of ARTC's capital expenditure additions, interest during construction or disposals amounts for the 2013 Compliance Period?

2.2 Efficiency of operating expenditure

Subsection 4.10(e) of the HVAU provides for the ACCC to assess the efficiency of the ARTC's operating expenditure. Efficient costs and operating expenditure in turn informs the determination of Economic Cost and the maximum amount of revenue that ARTC is entitled to receive.

Section 2(c) of Schedule G of the HVAU requires ARTC to submit a detailed breakdown of the Economic Costs for the review period into standard operating cost line items, return and depreciation, as well as provide comparative values from the previous review period.

2.2.1 ARTC's Compliance Submission

In its 2013 Compliance Submission, ARTC reported total operating expenditure of $102.72 million for the Constrained Network[23] and $17.28 million for Pricing Zone 3[24].

A breakdown of the operating expenditure for the Constrained Network for the 2013 Compliance Period, which is used in the calculation of the Ceiling Limit, is outlined in table 2.4 below. Figures for the 2012 Compliance Period have also been included in the table for comparative purposes.

Table 2.4: Operating expenditure for the Constrained Network for the 2012 and 2013 Compliance Period[25]

Operating expenditure	2012 ($)	2013 ($)
Variable maintenance costs	27 146 024	28 788 509
Fixed maintenance costs	23 815 480	29 062 214
Shared maintenance	18 267 400	15 928 827
Expensed project costs	1 500 000	8 968 856
Network control	9 301 493	9 270 241
Corporate overheads	12 308 617	10 704 396
Total operating expenditure	**92 339 014**	**102 723 043**

ARTC submitted that the overall cost of maintenance expenditure in the 2013 Compliance Period was largely in alignment with expenditure in 2012, but that it was significantly lower than the forecasted amount advised to Access Holders in late 2012.[26] ARTC specifically noted that:

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23 ARTC's 2013 Compliance Submission, p. 19.
24 ARTC's 2013 Compliance Submission, p. 9.
25 ARTC's 2013 Compliance Submission, p. 19.

> The scope of maintenance tasks envisaged at the time of preparing the 2013 price setting advice to Access Holders was unable to be delivered and hence resulted in a reduced maintenance expenditure of $18.4M or 24% compared to previous forecasts.[27]

ARTC noted that the reason for the reduced scope of maintenance activities was largely due to the bulk of cyclic ballast cleaning in Pricing Zone 1 and 2 being deferred due to unavailability of track possession and track resources.[28]

In relation to expensed project costs, ARTC submitted that:

> An unexpected cost in fixed maintenance of $8.97M arose through the expensing of projects associated with the PWCS Terminal 4 (T4) expansion. A suite of projects were endorsed by the RCG prior to 2013 to enable the rail track capacity to match the additional capacity provided by T4. For each project, RCG endorsement is required to proceed to the next stage. For the T4 projects, the RCG did not endorse project advancement due to the deferral of the T4 project by PWCS and the capital spent was sought to be expensed in 2013.
>
> The expensed projects and the associated costs were discussed with the access holders during quarterly access holder meetings in November 2013 and February 2014. In addition, a consolidated list of expensed projects was provided to the RCG in March 2014 to add further transparency. This information paper did not seek endorsement but provided advice that in accordance with the previously endorsed project phases, projects were being expensed. No objections were raised by the RCG to the expensing of these projects in 2013.[29]

ARTC submitted that shared maintenance expenditure decreased by $2.34 million or 13 per cent from 2012. ARTC advised that this was due to a change in its cost allocation approach to directly identifying provisioning centre costs with the relevant pricing zones rather than allocating by gross tonne kilometres (**gtk**) for each pricing zone.[30]

ARTC submitted that network control costs for the 2013 Compliance Period was $9.27 million, which was similar to the level of network control costs approved by the ACCC for the 2012 Compliance Period.[31]

Finally, ARTC submitted that corporate overhead costs for the 2013 Compliance Period decreased by $1.6 million from 2012. ARTC advised that this decrease was due to:

> The increase in the share of Interstate non-coal train kilometres of the total ARTC network train kilometres when compared with the Constrained Coal train kilometres resulting in a reduction in costs allocated to the Constrained Network. In addition, a restructure within ARTC saw the Technical Services division being absorbed by other business divisions and so relevant associated Technical Services cost could be directly identified with specific corridors rather than being allocated as a system wide cost and allocated to the Hunter Valley corridor on a Train Kilometre basis.[32]

A breakdown of the operating expenditure for Pricing Zone 3 in the 2013 Compliance Period is outlined in table 2.5 below. Figures for the 2012 Compliance Period have also been included in the table for comparative purposes.

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26 ARTC's 2013 Compliance Submission, p. 21.
27 ARTC's 2013 Compliance Submission, p. 21.
28 ARTC's 2013 Compliance Submission, p. 21.
29 ARTC's 2013 Compliance Submission, p. 21.
30 ARTC's 2013 Compliance Submission, p. 21.
31 ARTC's 2013 Compliance Submission, p. 21.
32 ARTC's 2013 Compliance Submission, p. 21.

Table 2.5: Operating expenditure for Pricing Zone 3 for the 2012 and 2013 Compliance Period[33]

Operating expenditure	2012 ($)	2013 ($)
Variable maintenance costs	3 030 986	4 939 967
Fixed maintenance costs	5 340 695	7 920 060
Asset management overheads	1 370 891	1 401 442
Network control	1 480 915	1 667 840
Corporate overheads	1 233 135	1 348 027
Total operating expenditure	**12 420 623**	**17 277 336**

ARTC did not provide any further detail on operating expenditure for Pricing Zone 3 in its submission for the 2013 Compliance Period, with all of ARTC's commentary focused on the expenditure for the Constrained Network as outlined in table 2.4 above.

2.2.2 Stakeholder comments

Asciano submitted that deferred prudent maintenance expenditure should be undertaken in the next period to ensure that track quality is maintained. Asciano also expressed concern at the lack of an incentive scheme for ARTC to ensure that operating costs, maintenance and corporate costs are incurred at an efficient level. Asciano believes that ARTC should focus stronger on finalising and implementing an incentive scheme.[34]

2.2.3 ACCC's preliminary assessment

The ACCC's preliminary assessment of ARTC's operating expenditure has been arranged under four key components:

- maintenance costs (such as major periodical maintenance and reactive corrective routine maintenance);
- expensed project costs;
- network control costs (such as labour and materials associated with train control, signalling and operations) and corporate overheads (such as labour and materials associated with head office functions, including human resources, legal, finance etc); and
- other matters (such as performance incentives).

Maintenance costs

ARTC submitted that it incurred $73.8 million in maintenance costs for the Constrained Network for the 2013 Compliance Period, which compares to $69.2 million for the 2012 Compliance Period. Excluding unexpected expensed project costs (discussed below), maintenance costs made up approximately 78.7 per cent and 76.2 per cent of the total operating expenditure for the Constrained Network in 2013 and 2012 respectively. Accordingly,

33 ARTC's 2013 Compliance Submission, p. 8.

34 Asciano, *Submission to the ACCC's Consultation Paper on ARTC's annual compliance*, 15 July 2014, p. 2.

the ACCC notes that ARTC's maintenance expenditure for the Constrained Network is largely in line with the previous period.

For Pricing Zone 3, maintenance costs increased from $8.37 million for the 2012 Compliance Period to $12.86 million for the 2013 Compliance Period—making up approximately 67.4 per cent and 74.4 per cent of total operating expenditure for Pricing Zone 3 in 2012 and 2013 respectively.

For the 2012 Compliance Period, the ACCC assessed the efficiency of ARTC's maintenance costs by conducting a trend analysis of expenditure amounts and by making comparisons against available benchmarks. As part of that assessment, the ACCC requested historical and forecast expenditure amounts for the top six maintenance activities, which accounted for over half of the total maintenance costs. The ACCC noted that the additional confidential information submitted by ARTC in response to requests from the ACCC provided useful context to the cyclical nature of rail maintenance programs and would assist in informing future annual compliance assessment.

For the 2013 Compliance Period, the ACCC had expected that ARTC would provide similar supporting information for its maintenance costs as was ultimately provided for the previous period. In particular, the ACCC had expected that ARTC would in the first instance provide a breakdown of its six major maintenance activities across pricing zones and provide explanation of the variance from forecasted amounts as had been advised in the 2012 Compliance Period. The ACCC notes that, while ARTC provided some commentary – such as that it had deferred ballast cleaning from 2013 to 2014 – ARTC did not provide information on the deferred ballast cleaning expenditure amount nor any further breakdown that could assist the ACCC in its assessment. The ACCC's view is that more detailed information is necessary to enable a more robust analysis of ARTC's maintenance expenditure.

The ACCC has requested additional information from ARTC on its maintenance costs during the 2013 Compliance Period and will consider this information before forming a view on the efficiency of its operating expenditure. The type of information requested is similar to the information requested and ultimately provided for the 2012 Compliance Period.

Expensed project costs

ARTC submitted that an unexpected cost of $8.97 million arose in the 2013 Compliance Period as a result of the expensing of projects associated with the Port Waratah Coal Services (**PWCS**) Terminal (T4) expansion. ARTC has sought to include these expenses as part of the operating expenditure for the Constrained Network for the 2013 Compliance Period. In recent meetings, some stakeholders raised questions with the ACCC regarding ARTC's expensing of costs for rail track capacity expansion projects.

Based on the commentary in ARTC's 2013 Compliance Submission, the ACCC understands that ARTC had previously received RCG endorsement to conduct 'Concept Assessment' for a suite of projects that were intended to increase track capacity to support the additional capacity provided by T4. However, the RCG did not endorse advancement of the projects beyond this initial phase as a result of a decision by PWCS to defer the T4 expansion project.[35]

The ACCC notes that, ordinarily, capital expenditure endorsed by the RCG would be rolled into the regulatory value of assets following completion and commissioning of the asset, allowing ARTC to earn an ongoing return on capital (see section 2.1 of this document). In this particular instance, however, the projects are not being proceeded with (at least not in the foreseeable future) and ARTC has sought to include the associated capital expenditure to date as an expense item for the Constrained Network for the 2013 Compliance Period. Doing so enables ARTC to recover the associated costs in the current period, but not receive an ongoing return on the capital.

35 ARTC's 2013 Compliance Submission, p. 21.

ARTC submitted that its approach was discussed with Access Holders, who were provided with a list of expensed projects via the RCG consultation process. ARTC noted that no objections were raised by Access Holders in relation to the expensing of projects in the 2013 Compliance Period, although it did not seek endorsement by the RCG for the expense.[36] The ACCC also notes section 8.2 of the HVAU, which states that:

> ARTC may seek formal endorsement from the RCG of a project identified in the Hunter Valley corridor capacity strategy to proceed to concept assessment and, if endorsed, the costs of undertaking the Concept Assessment Report will be deemed as Prudent and included in the RAB or expensed in the year incurred.

The ACCC is of the preliminary view that, subject to stakeholders not raising any concerns with ARTC's proposed approach to expensing projects in this instance as provided for under section 8.2 of the HVAU, including the $8.97 million in operating expenditure for the 2013 Compliance Period, is likely to be appropriate.

Network control costs and corporate overheads

Combined network control costs for the Constrained Network and Pricing Zone 3 remained largely unchanged for the 2013 Compliance Period compared to the 2012 Compliance Period—reflecting that a slight decrease for the Constrained Network was offset by a slight increase for Pricing Zone 3. In relation to corporate overheads, a decrease for the Constrained Network was partially offset by an increase for Pricing Zone 3 with an overall decrease in combined corporate overhead costs of approximately 11 per cent for the 2013 Compliance Period compared to the 2012 Compliance Period.

The ACCC notes ARTC's submission that the reduction in corporate overheads was due an increased share in interstate non-coal train kilometres compared to Constrained Coal train kilometres resulting in less corporate overheads being allocated to the Constrained Network. In addition, ARTC advised that a restructure within ARTC had the Technical Services division being absorbed by other business divisions and so relevant associated Technical Services cost could be directly identified with specific corridors rather than being allocated as a system wide cost and allocated to the Hunter Valley corridor on a train km basis.

The ACCC is not aware of any circumstances that would have significantly impacted on the overall level of network control costs and corporate overheads for the 2013 Compliance Period compared to the 2012 Compliance Period. The ACCC also notes that these costs make up a relatively smaller proportion of ARTC's total operating expenditure and any minor variations to these costs are unlikely to have a significant impact on the calculation ARTC's allowable revenues. Accordingly, the ACCC's preliminary view is that ARTC's network control costs and corporate overheads for the 2013 Compliance Period are likely to be appropriate.

Other matters

The ACCC notes Asciano's specific concern regarding the lack of incentive scheme for ARTC to efficiently incur all its operating expenditure. Section 13.3 of the HVAU requires ARTC to develop performance incentives that are intended to encourage ARTC, through financial reward, to improve operating, maintenance and capital expenditure efficiency. As set out below in section 2.4 of this paper, ARTC has stated that it intends to develop a performance incentive scheme now that it has concluded its True-Up Test review.

Questions for comment on efficiency of operating expenditure

- Does industry have any comments on any aspect of ARTC's operating expenditure, including maintenance costs, expensed projects, network control and corporate overheads for the 2013 Compliance Period?

[36] ARTC's 2013 Compliance Submission, p. 21.

2.3 Revenue reconciliation with applicable ceiling revenue limits

Section 1.1 of this paper provides an overview of the relevant provisions that prescribe the reconciliation process under the HVAU. Revenue allocation forms an important component of the reconciliation process with the ceiling revenue limits and the application of the 'unders and overs' accounting framework and loss capitalisation.

2.3.1 ARTC's approach to revenue reconciliation

Based on the ACCC's understanding of ARTC's pricing approach and its confidential financial model, the following outlines ARTC's approach to reconciling revenue with applicable ceiling revenue limits under the HVAU.

ARTC's approach to pricing for collecting revenue from Access Holders

ARTC collects revenue from Access Holders by applying various Access Charges as they traverse each Segment of the network that forms part of their journey. In particular, for each Pricing Zone, ARTC levies Access Charges that include a variable usage charge (referred to in ARTC's pricing as the non-TOP component) and a fixed charge (referred to as the TOP charge). The non-TOP charges are set to cover Direct Costs (i.e. efficient variable maintenance expenditure) while the TOP charge is set to recover remaining operating and capital costs. Additionally, both the non-TOP and TOP charges are based on a per thousand gtkm basis.

Accordingly, each Access Holder initially contributes an amount to cover both variable and fixed operating and capital costs as they traverse each part of the network. Importantly, as all Access Holders utilise the Segments in Pricing Zone 1, the Access Charges ensure that all Access Holders contribute toward the costs of that Pricing Zone.

ARTC's approach to revenue allocation and reconciliation with the ceiling revenue limits

As set out above, ARTC levies charges for Access Holders based on the number of gtkm used as they traverse each Segment that forms part of their journey. ARTC first allocates the revenue received from each Access Holder to the Segments and Pricing Zones as per its approach to pricing.

Where revenue has been received and allocated to Segments in Pricing Zone 1 from Access Holders that commenced their journey in Pricing Zone 3, ARTC subsequently deducts the revenue received from their TOP charges from the amount allocated to the Segments in Pricing Zone 1 and applies it to Segments in Pricing Zone 3.

Accordingly, Access Holders commencing in their journey in Pricing Zone 3 contribute only to the Direct Costs as they traverse the network in Pricing Zone 1, with the remainder of the revenue received from those Access Holders applied to cover the costs of Pricing Zone 3.

It is after this allocation that ARTC then reconciles its revenues received with the applicable floor and ceiling limits to determine whether there is any revenue shortfall or surplus in the Constrained Network (which currently excludes Pricing Zone 3).

Effect on the ceiling revenue limit calculation

Importantly, the ACCC notes that the above approach is equivalent to saying that ARTC has calculated the ceiling revenue limits for Segments forming part of Pricing Zone 1 and 2 by excluding only the Direct Costs of Access Holders originating in Pricing Zone 3 as opposed to the incremental costs. Further discussion of the calculation and application of the ceiling revenue limits in subsection 4.3(a) of the HVAU and the important distinction between direct and incremental costs is provided in section 2.3.4 below.

2.3.2 ARTC's Compliance Submission

By following the revenue allocation and reconciliation process described above, ARTC submitted that total revenue of $277.9 million was applied to the Constrained Network[37] while $62.6 million was applied to Pricing Zone 3[38].

ARTC submitted that its reconciliation of this revenue with the applicable ceiling limits demonstrated a $19.60 million shortfall in revenue in the Constrained Network and cumulative losses of $8.80 million in Pricing Zone 3. ARTC proposed to recover the $19.60 million from Constrained Coal Customers as allowed for through the 'unders and overs' accounting framework described in section 1.1 of this paper.

2.3.3 Stakeholder comments

Stakeholders provided comments on ARTC's current approach to revenue allocation and reconciliation with ceiling revenue limits in response to the ACCC's separate Discussion Paper reviewing ARTC's approach to revenue allocation. Submissions have been arranged into the following categories:

- compliance with the revenue ceiling test in the HVAU and attribution of costs;
- transparency; and
- impact on investment decisions.

Compliance with the revenue ceiling test in the HVAU and attribution of costs

ARTC considers that "the current revenue allocation approach is an outcome of the combinatorial ceiling test and is not a separate process undertaken by ARTC. ARTC notes that under the combinatorial ceiling test, traffics that are not part of the Constrained Group of Mines do not come under that test and accordingly do not contribute to the common costs specific to constrained segments, until the point at which they also become constrained".[39]

ARTC states that the Ceiling Test:

- represents a test of revenue for the Constrained Group of Mines (those mines that operate entirely within the Constrained Network) against the Economic Cost of Segments forming part of the Constrained Network, including all cost associated with those Segments; and
- revenue associated with mines existing outside of the Constrained Network (i.e. Gunnedah Basin mines, southern mines) and revenue associated with non-Coal trains is not included in the test. Such revenue is only relevant to testing against the revenue floor limit on Segments forming part of the Constrained Network.[40]

Therefore ARTC asserts that access revenue is not received for a particular pricing zone (as the ACCC has indicated) but based on an access holder's journey and then this is tested against the floor and ceiling limit. Also, a number of different combinations satisfy the floor and

37 ARTC's 2013 Compliance Submission, p. 19.
38 ARTC's 2013 Compliance Submission, p. 8.
39 ARTC, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 21 August 2014, pp. 1, 5, 24, 57-58.
40 Ibid, pp. 46-47.

ceiling test and it becomes a question of identifying the combination that produces the most efficient outcome.[41]

Submissions from producers have expressed broad agreement that Pricing Zone 3 producers should be paying access charges that reflect their use of Pricing Zone 1. For example Vale has submitted that "ARTC's revenue allocation approach to Pricing Zone 1 is not cost reflective and does not provide pricing fairness to Pricing Zone 1 and 2 producers as the revenue allocated to Pricing Zone 1 does not reflect the cost impact of Pricing Zone 3 producers".[42]

Rio Tinto submitted that each producer should pay sufficient revenue to cover the cost of the capacity that they consume, and that there can be no economic justification for cross-subsidies in the system. Rio Tinto also noted that the failure to appropriately match revenue and costs permits ARTC to meet the requirements of the Ceiling Limit, even when one Zone is subsidising another Zone. Rio Tinto considered that it is critical to ensure that revenue is appropriately matched to cost. This could be achieved by conducting the reconciliation on a Zone basis, where all Access revenue collected in the Zone, regardless of the train's origin, is matched to the economic cost of that same Zone.[43]

Further, submissions from producers also note that to avoid a cross subsidy, producers should at least be paying their incremental costs of traversing Pricing Zone 1. For example, Whitehaven submitted that in order to avoid any cross-subsidies, each producer should pay at least the incremental cost of their use of the network.[44] Anglo American agrees and submitted that each pricing zone should be responsible, at least, for their variable costs and share of capital works on the common corridor (PZ1).[45]

Frontier Economics on behalf of BHP noted that Pricing Zone 3 users are not currently meeting their incremental costs of using Pricing Zone 1:

> … access charges appear to be set for users in Zone 3, in a way that does not cover all of the incremental costs that these users are likely to impose on the Hunter Valley rail network, in the long run. This is because Zone 3 users impose additional costs on Zone 1 of the network other than simply the direct operating and maintenance costs they generate in that zone. This is principally due to additional investments needed in the network in Zone 1, to expand capacity in response to growing demand in Zone 3.[46]

Peabody has recommended that in order to have a robust debate about costs there needs to be a thorough examination of investments in Pricing Zone 1:

> Peabody recommends that in order to undertake a robust debate it is prudent to examine the incremental Pricing Zone 1 investment required for Pricing Zone 3 expansion, the contribution to common costs of congestion mitigation projects in Pricing Zone 1, the long term payback scenarios of investment associated with Pricing Zone 3 and the expectation of contribution to the existing Coal Network.[47]

In addition, Glencore has questioned the legality of ARTCs revenue allocation stating that "in our view it is artificial, wrong and improper to undertake 'revenue allocation' in the way that

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41 Ibid, pp. 5, 24-25, 46-49.

42 Vale, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 August 2014, p. 2.

43 Rio Tinto, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 28 July 2014, p. 2.

44 Whitehaven, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 28 August 2014, p. 10.

45 Anglo American, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 August 2014, p. 3.

46 BHP, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 4 September 2014, p. 1.

47 Peabody, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 August 2014, p. 2.

ARTC has done".[48] Glencore considered that as the HVAU is clear that costs and revenue should reconciled on a pricing zone basis:

> The pricing framework mandated by the Access Undertaking relies on the attribution of costs to Pricing Zones in order to compare against actual revenue from that Pricing Zone. Costs must be allocated to Pricing Zones particularly common costs such as corporate overheads and network control costs that are not closely related to the provision of services in respect of a particular Segment or Pricing Zone in accordance with the methodology prescribed in the Access Undertaking to arrive at the Economic Cost of a Segment.[49]

Transparency

ARTC submitted that there has always been full disclosure and transparency in the HVAU and NSWRAU about the revenue allocation process. ARTC also considered that stakeholders have had opportunities to raise concerns about its approach to revenue allocation in relevant consultation processes, including during the early stages of the HVAU development and during ACCC consultation ahead of approval of the HVAU in 2011.[50]

ARTC also noted that information provided in its annual compliance submissions should have provided sufficient information to stakeholders about how the Ceiling Test is applied in the Constrained Network.[51]

Anglo American, Glencore, and Rio Tinto have submitted that ARTC's revenue allocation approach was not transparent and hence stakeholders were not aware of the pricing and investment implications. In particular, Rio Tinto noted that… "critical commercial aspects of the HVAU are based around Pricing Zones, specifically, investment voting rights, economic cost and access pricing. Based on this it was entirely reasonable, and in fact logical, for producers to also assume that all of the revenue earned in a given pricing zone would be applied to recover the full economic cost of that pricing zone."[52] Anglo American stated that it was unaware that Pricing Zone 3 was not contributing to the Pricing Zone 1 common cost or capital works cost[53] and Glencore submitted that fundamental processes which form part of the commercial functioning of the HVAU should be contained in the undertaking and not outside of the terms of the HVAU:

> The fact that Glencore and numerous other Access Holders (according to their submissions) express surprise at the revelation that Zone 1 users are subsidizing Zone 3 users could be the result of poor communication, poor comprehension or even poor corporate memory (as ARTC contends). However, Glencore does not consider that it is appropriate to view these issues on the basis of what information might have been provided by ARTC outside of the terms of the HVAU. Fundamental process which are relevant to the commercial functioning of the HVAU should form part of the access undertaking itself.[54]

BHP and Vale considered that transparency issues occur because of ARTC's confidentiality claims. Vale stated that ARTC's request for confidentiality restricts stakeholder access to information that could provide greater transparency of how the pricing principles are being applied by ARTC under the Hunter Valley Access Undertaking.[55] Frontier Economics on behalf of BHP considered that ARTC's model should be disclosed in the future, subject to appropriate

48 Glencore, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 May 2014, p. 1.

49 Glencore, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 May 2014, p. 1.

50 ARTC, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 21 August 2014, pp. 1, 45-49.

51 Ibid.

52 Rio Tinto, *Supplementary submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 3 October 2014, p. 3.

53 Anglo American, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation,* 29 August 2014, p. 4.

54 Glencore, *Supplementary submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation,* 17 September 2014, p. 2.

55 Vale, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 August 2014, p. 2.

confidentiality arrangements. It observes that this would enable users of the network to better understand and comment on the prices they are asked to pay for access to the rail network.[56]

In contrast Idemitsu considered that some stakeholders should have been aware of the revenue allocation approach, given it had been applied to enable growth and competition in Pricing Zone 2 previously.[57] Whitehaven agreed with Idemitsu and notes that the current revenue allocation has had a long history of use in the Hunter Valley and is supported by regulatory precedent in other jurisdictions.[58]

Impact on investment decisions

Investment and competition

ARTC submitted that the current revenue allocation approach does not have any significant impact on competition in the above-rail market, nor does it distort competition in the end product market in the longer run. ARTC considered that 'it actually encourages entry and growth and development of new coal basins, which is in the broader public interest as it maximises the economic value of the State's coal resources".[59]

In addition ARTC noted that its current approach to revenue allocation was historically applied to the Ulan line when it was Unconstrained and has been a common feature of the NSWRAU and the HVAU. ARTC argued that the ACCC is taking a short term 'snapshot' on revenue allocation whereas ARTC considers a longer term, whole of system view needs to be taken. ARTC submitted that if a long term view is taken, the approach is efficient and equitable as the costs and benefits will balance out so that all coal users will pay a fair share for Hunter Valley investment as and when they can.[60]

Some submissions from producers have highlighted that retaining ARTC's current approach to revenue allocation and the cross subsidy between producers will lead to inefficient investment outcome in the Hunter Valley coal supply chain. For example, Frontier Economics on behalf of BHP has noted that ARTC's current revenue allocation is likely to lead to inefficient investment in both railway infrastructure and coal mines in the Hunter Valley; and inefficient use of railway infrastructure in the Hunter Valley.[61]

Vale considered that ARTC's current revenue allocation creates distortions to investment decisions: [62]

> Due to the revenue reallocation, pricing zone 3 producers would have a long run pricing improvement for capital expansions as the contribution to pricing zone 1 common costs, relating to any expansions, are being offset against any loss capitalisation... this is likely to lead to inefficient capital decisions in pricing zone 1 as pricing zone 1 and 2 producers will pay higher charges due to increased common costs yet pricing zone 3 producers can reduce their future long run pricing by offsetting this increase in pricing zone 1 common costs against any loss capitalisation in pricing zone 3.

Vale believed the revenue allocation approach being adopted by ARTC is likely to lead to inefficient capital expansion decisions by ARTC. ARTC will be incentivised to fund a capacity expansion in pricing zone 1 rather than pricing zone 3 as the revenue reallocation will allow them to recover the revenue earlier. Rio Tinto submitted that in order to achieve the objective of promoting efficient investment and operational decisions it is essential that users are charged

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[56] BHP, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 4 September 2014, p. 1.

[57] Idemitsu, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 1 September 2014, p. 9.

[58] Whitehaven, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 28 August 2014, p. 1.

[59] ARTC, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 21 August 2014, p. 88.

[60] Ibid, pp. 2, 10, 16.

[61] BHP, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 4 September 2014, p. 2.

[62] Vale, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 August 2014, p. 2.

the true cost of the capacity that they consumer.[63] Rio Tinto considered that the current cross-subsidies are material, and threaten the competitive position of some Producers while giving an unjustified advantage to others.[64]

Investment certainty

ARTC considered that any change in the revenue allocation approach will distort investment and development of the network, especially when compared with the development of the network historically. ARTC submits that this could constrain future industry growth by deterring new entrants.[65]

ARTC also considered that changing the current revenue allocation will reduce ARTC's investment incentives as it will be less confident that its efficient costs can be recovered. In particular, ARTC submitted that loss capitalisation will not mitigate its stranding risk as ARTC still needs to be able to eventually recover those capitalised losses via access charges.[66]

ARTC argued that retaining sufficient flexibility to allocate revenue based on capacity to pay reduces the risk that ARTC is unable to recover a full return of, and return on, capital over the long economic lives of its network assets.[67]

Idemitsu and Whitehaven consider changing ARTC's current revenue allocation would undermine investor confidence and increase the risks to investments in the Gunnedah Basin by both ARTC and coal producers. Idemitsu argued that the current revenue allocation has been successful in promoting investment in the Gunnedah Basin and a change in approach at this stage would put further investment by ARTC and the coal producers at risk.[68] Whitehaven also consider that any change to revenue allocation will undermine the HVAU given these issues were extensively consulted upon:[69]

> The HVAU was put in place in July 2011 after an extensive three year industry consultation period. Any changes to ARTC's revenue allocation process, that impacts long term pricing for PZ3, will undermine the extensive industry consultation and agreement on which the HVAU was based. It will also undermine investor confidence for future mining and track infrastructure projects in the Gunnedah Basin.

Glencore, however, does not believe a change to ARTC's current revenue allocation approach will have a detrimental effect on the level of investment in the Gunnedah Basin. Glencore submitted that "it will simply remove the added cost penalty from the Zone 1 and Zone 2 users and slow the recovery of ARTC's investment in Zone 3 infrastructure back to a rate that, we would argue, was envisaged under the Undertaking" .[70]

Investment and the RCG process

Glencore considered that by making the revenue allocation process transparent it may change the future behaviour of producers when endorsing investments in Pricing Zone 1:[71]

> The discovery of the revenue reallocation process throws some doubt over the behaviour of users when voting upon network investments. Certainly, past votes by users to support investment in Zone 1 capacity may not have been carried if users were aware that Zone 3 users would not be contributing to

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63 Rio Tinto, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 28 July 2014, p. 2.

64 Ibid.

65 ARTC, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 21 August 2014, pp. 2, 16.

66 Ibid, pp. 11, 16, 85-88, 102.

67 Ibid, pp. 11, 87-88.

68 Idemitsu, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 1 September 2014, p. 3.

69 Whitehaven, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 28 August 2014, p. 1.

70 Glencore, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation,* 17 September 2014, p. 4.

71 Ibid, p. 5.

> the recovery of investments for some years to come. Glencore suspects a rethink by many users before future votes are taken. This will result in some uncertainty going forward.

Similarly, Anglo American has noted that had producers understood ARTC's current approach to revenue allocation may have led to different outcomes in capital project identification and cost allocation by pricing zone for the common corridor Pricing Zone 1 projects.[72]

2.3.4 ACCC's preliminary assessment

The ACCC's preliminary assessment of ARTC's revenue allocation focuses on the compliance with the ceiling revenue tests in the HVAU and the attribution of costs. The ACCC has also responded to stakeholder comments on the transparency and the implications for efficient investment.

Compliance with the revenue ceiling test in the HVAU and the attribution of costs

As noted in section 1.1, the ceiling test in the HVAU caps the maximum amount of revenue that ARTC is entitled to receive. For Pricing Zone 1 and 2, subsection 4.3(a) of the HVAU states that:

> In relation to Segments identified as forming part of Pricing Zone 1 and 2 in Schedule E, Access revenue from any Access Holder, or group of Access Holders must not exceed the Economic Cost of those Segments which are required on a standalone basis for the Access Holder or group of Access Holders ("Ceiling Limit")

Subsection 4.3(a) therefore caps the revenue of Pricing Zone 1 and 2 to the Economic Cost of the Segments required to service the Access Holders in Pricing Zones 1 and 2 on a 'standalone' basis. The key element of this ceiling test is the interpretation of 'standalone' and how this applies to Economic Cost. This is discussed below.

Economic theory of standalone and incremental costs

In order to avoid a cross-subsidy, a firm that offers a set of services should receive revenue for each service or a group of services that is at least equal to the incremental cost of providing that service or group of services.[73] In addition, the firm should receive revenue for each service or a group of services that is no more than the standalone cost of providing that service or group of services.[74]

In relation to standalone costs, Faulhaber has explained that:[75]

> … the stand-alone cost of any service or group of services of an enterprise is the cost of providing that service (at the existing or "test" demand level) or group of services by themselves, without any other service that is provided by the enterprise. A closely related concept is that of "incremental cost" (IC). The incremental cost of a service or group of services is the additional cost of providing that service or group of services over and above the cost of providing all the remaining services.

In the context of the Hunter Valley Coal Network, the incremental cost associated with Pricing Zone 3 Access Holders in Pricing Zone 1 would include the variable cost associated with the actual usage of the network by Pricing Zone 3 Access Holders plus the fixed costs that could be avoided if the Pricing Zone 3 Access Holders did not use Pricing Zone 1.

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72 Anglo American, *Submission to the ACCC's Discussion Paper on ARTC's revenue reconciliation*, 29 August 2014, p. 3.

73 The relevant timeframe when considering incremental costs is the long-term, which will include fixed costs that may change over the long-term.

74 G. R. Faulhaber, *Cross-subsidization: pricing in public enterprises*, American Economic Review 65(5), December 1975, pp. 966-977.

75 Faulhaber G, *Cross-subsidy analysis with more than two services*, August 2002, p. 1. Accessible at: http://assets.wharton.upenn.edu/~faulhabe/cross%20subsidy%20analysis.pdf.

By applying the above interpretation to the ceiling revenue limits in subsection 4.3(a), it is the ACCC's preliminary view that the standalone cost for Segments forming part of Pricing Zone 1 and 2 is the Economic Cost of the relevant Segments in Pricing Zone 1 and 2 minus the incremental cost for the use of those Segments by Pricing Zone 3 Access Holders. This is because the costs of providing the service to Pricing Zone 3 Access Holders could be avoided in Pricing Zone 1 if the Pricing Zone 3 Access Holders did not use the network.

The ACCC notes that this is consistent with a number of stakeholder submissions set out above, which note that Pricing Zone 3 Access Holders should at least pay their incremental cost of using Pricing Zone 1 to avoid any cross-subsidy.

The incremental costs for Pricing Zone 3 Access Holders using Pricing Zone 1

Based on the above, ARTC needs to quantify the incremental cost of Pricing Zone 3 Access Holders using the Segments in Pricing Zone 1.

The incremental cost associated with Pricing Zone 3 Access Holders' use of Pricing Zone 1 will, at the very least, include Direct costs plus any capital expenditure projects that were commissioned to increase capacity of Pricing Zone 1 solely to accommodate the increase in volumes from Pricing Zone 3.

The ACCC understands that additional investment in Pricing Zone 1 may have been driven (in part) by the increasing use of Pricing Zone 1 by Pricing Zone 3 Access Holders. However, the ACCC does not currently have any information before it to: (i) perform an itemisation of the capital expenditure projects that have occurred in Pricing Zone 1 solely for the purpose of Pricing Zone 3 Access Holders' use; and (ii) to quantify the value of these capital expenditure projects. Therefore the ACCC cannot estimate the likely standalone costs applicable to Pricing Zone 1 and 2 Access Holders.

The ACCC is seeking industry input to reach a resolution on this issue.

ACCC's preliminary view

As highlighted above, ARTC's current revenue allocation approach appears to be inconsistent with the ceiling revenue limits set out in subsection 4.3(a) of the HVAU.

ARTC has calculated the Economic Cost and, therefore, ceiling revenue limits for Pricing Zone 1 and 2 Access Holders by excluding the Direct Costs attributable to Pricing Zone 3 Access Holders rather than the incremental costs.

The effect of ARTC's approach is an overestimate of the ceiling revenue limits by the amount of the fixed cost that could be avoided if Access Holders originating in Pricing Zone 3 did not use Pricing Zone 1. This would result in an over-recovery from Access Holders originating in Pricing Zone 1 and 2 by the same amount.

Therefore, consistent with the economic theory outlined above, a cross-subsidy occurs between Pricing Zone 1 and 2 Access Holders and Pricing Zone 3 Access Holders. After ARTC reallocates revenue received from Pricing Zone 3 Access Holders in Pricing Zone 1 back to Pricing Zone 3, there is insufficient revenue to cover Pricing Zone 3 Access Holders' incremental costs in Pricing Zone 1. As a result, Pricing Zone 1 and 2 Access Holders are required to cover costs in excess of their standalone costs.

The ACCC's preliminary view is that ARTC's 2013 Compliance Submission should be amended to reflect this interpretation of standalone costs for the purposes of complying with the ceiling limit in subsection 4.3(a). This amendment may reduce the amount of the 'under' reported by ARTC depending on the itemisation of capital expenditure projects.

As noted above, the ACCC considers that the incremental cost of Pricing Zone 3 Access Holders' use of Pricing Zone 1 is currently unclear. The ACCC is therefore seeking the input of industry to reach a resolution to this issue.

Transparency

In the ACCC's Discussion Paper relating to revenue allocation, the ACCC noted that the purpose of the review was to assess the level and adequacy of, transparency of information provided to stakeholders on ARTC's current revenue allocation practices. In particular the ACCC focused on subsection 1.2(c) of the HVAU which states that "the intent of the Undertaking is to… use transparent and detailed methodologies, principles and processes for determining Access revenue limits, terms and conditions".

Based on the submissions to this discussion paper, the ACCC considers that greater transparency on revenue allocation and reconciliation, as well the interaction of ARTC's financial model with access charges would be beneficial.

Although ARTC had provided information to stakeholders on the application of ARTC's financial model during previous consultations, the ACCC notes that the majority of stakeholders have submitted that they were not aware of ARTC's approach to revenue allocation as it was not apparent under the terms and conditions of the HVAU.

The ACCC is of the view that this highlights the need for greater transparency and provision of information on ARTC's financial model.

Impact on investment decisions

The ACCC notes that one of the key considerations in accepting the HVAU was to promote efficient use of and investment in infrastructure and promote competitive outcomes within the Hunter Valley coal supply chain.

The ACCC considers that efficient use of and investment in infrastructure occurs where ARTC is able to recover its efficient costs of providing access to its network (including receiving a rate of return commensurate to its risk). The ACCC considers that the existing mechanisms in the HVAU, such as TOP contracts, accelerated depreciation, the rate of return, the 'unders and overs' framework and loss capitalisation in Pricing Zone 3 adequately compensate ARTC for the risks associated with its investments on the Hunter Valley Coal Network and in particular in Pricing Zone 3. Therefore, although ARTC argues that a change to its current revenue allocation practices will stifle investment and increase ARTC's risk, the ACCC considers that existing mechanisms in the HVAU should mitigate this risk.

In addition, to the extent that ARTC's current approach to revenue allocation leads to cross subsidies between Pricing Zone 1 and 2 Access Holders and Pricing Zone 3 Access Holders, the ACCC considers that it is likely it has distorted past investment decisions and if not rectified is likely to continue to send inefficient investment signals to the Hunter Valley supply chain. The ACCC notes that most stakeholders have also submitted similar concerns.

The ACCC recognises Whitehaven and Idemitsu's concerns that significant investments have already been made and that any changes to ARTC's current revenue allocation process could undermine future investment in the Gunnedah Basin and create investment uncertainty. However, the ACCC considers that allowing a cross-subsidy to continue leads to distorted investment incentives and therefore inefficiencies across the supply chain. The ACCC notes that there are mechanisms available within the HVAU, such as loss capitalisation, that enables ARTC to manage these issues while still recovering its costs in the long run.

Questions for comment

- Does industry have any comments about the ACCC's application of the standalone cost test contained in subsection 4.3(a) of the HVAU that requires the incremental costs (as opposed to Direct Costs) of the use of Pricing Zone 1 by Pricing Zone 3 Access Holders to be taken into account in determining the ceiling revenue limits?

- Does industry have any comments on how the capital investments in Pricing Zone 1 should be itemised to determine the incremental cost of Pricing Zone 3 Access Holders? If yes, please explain the approach and rationale.

- Does industry have any further comments on revenue allocation and reconciliation?

2.4 True-Up Test audit

The HVAU incorporates liability arrangements in the Indicative Access Holder Agreement that provides for the payment of rebates to users for ARTC's failure to deliver contracted path usages. The payment of these rebates occurs following the completion of an annual reconciliation process, which is informed by the True-Up Test.

The True-Up Test determines whether there was sufficient capacity available on ARTC's rail network in a given period to meet all contracted entitlements, taking into account reductions in capacity caused by maintenance, usage by non-coal trains and other factors.

Section 4.10(f) of the HVAU requires an independent audit of ARTC's compliance with the True-Up Test, to ensure the integrity of the test and avoid perceptions of conflicts of interest on the part of ARTC. ARTC engaged BDO (SA) Pty Ltd (**BDO**) as auditor for the True-Up Test, which the ACCC approved in accordance with section 4.10(f)(ii).

2.4.1 ARTC's Compliance Submission

ARTC submitted that a 'True-Up Test was conducted for each month and quarter (as applicable) during the [2013] Compliance Period'.[76] BDO prepared a final audit report regarding ARTC's True-Up Test for 2013, which was provided to the ACCC on 21 May 2014 as part of ARTC's compliance submission. ARTC submitted that BDO's final audit report concluded that it was not liable for any rebates for 2013.

2.4.2 ARTC's review of the True-Up Test

The ACCC also notes that ARTC has conducted, in consultation with stakeholders, a review of the operation and effectiveness of the system-wide True-Up Test, as required under section 13.4 of the HVAU.[77] ARTC has decided not to propose a variation to the HVAU in response to the matters raised by stakeholders.

The ACCC notes that ARTC has stated that it will develop a performance incentives proposal for the HVAU now that the True-Up Test review has been finalised. The ACCC encourages ARTC to actively consult with industry in formulating the performance incentive scheme.

[76] ARTC's 2013 Compliance Submission, p. 27.

[77] ARTC's True-Up Test review report can be accessed at: http://www.accc.gov.au/regulated-infrastructure/rail/artc-advices-on-reviews/true-up-test-review

2.4.3 ACCC's preliminary assessment

The True-Up Test is subject to audit by an independent party with the appropriate qualifications in order to ensure the integrity of the test. The ACCC notes that BDO's final audit report concludes that:[78]

> In our opinion, ARTC has complied, in all material respects, with Schedule 2 of the Access Holder Agreements under the HVAU for the year ended 31 December 2013.

The ACCC specifically notes BDO's comments that:

> No system availability shortfall was recorded for any period during the year meaning no accruals were required to be paid.

On the basis of BDO's report, the ACCC's preliminary view is that it is appropriate to accept the outcome of the True-Up Test for the 2013 Compliance Period, being that ARTC is not liable for any rebates for 2013.

[78] BDO, *Independent compliance audit report to Australia Rail Track Corporation Ltd*, 28 March 2014, p. 1.

A ARTC's 2013 Compliance Submission

A.1 RAB roll forward for Pricing Zone 3

Subsection 4.10(d)(i) of the HVAU requires the ACCC to determine whether ARTC has undertaken the roll forward of the Regulatory Asset Base (**RAB**) for Pricing Zone 3 in accordance with the HVAU. The RAB is rolled forward in Pricing Zone 3 for comparison with the RAB Floor Limit to determine if 'loss capitalisation' applies. Subsection 4.4(a) of the HVAU outlines how the RAB is to be rolled forward annually.

Applying the RAB roll forward formula, ARTC determined the closing value of the RAB in Pricing Zone 3 for the 2013 Compliance Period to be as follows:

Table A.1: Pricing Zone 3 RAB roll forward[79]

Value	2012 ($)	2013 ($)
Opening RAB for Pricing Zone 3	192 214 184	286 018 488
add Return on Opening RAB	22 738 938	33 835 987
less Revenue	- 42 878 785	- 62 588 568
add Opex	12 420 623	17 277 336
add Net Capex	95 853 777	12 945 831
add Return on Net Capex	5 669 751	765 746
Closing RAB for Pricing Zone 3	286 018 488	288 254 821

A.2 RAB Floor Limit roll forward

Subsection 4.10(d)(i) of the HVAU requires the ACCC to determine whether ARTC has undertaken the roll forward of the RAB Floor Limit in accordance with the HVAU. The RAB Floor Limit is rolled forward for the following purposes:

- in Pricing Zones 1 and 2, for calculating components of full economic cost
- in Pricing Zone 3, for comparison with the RAB to determine if 'loss capitalisation' applies

Subsection 4.4(b) of the HVAU specifies how the RAB Floor Limit is to be rolled forward annually.

Applying the RAB Floor Limit roll forward formula, ARTC determined the RAB Floor Limit closing value for the total network for the 2013 Compliance Period as follows:

79 ARTC's 2013 Compliance Submission, p. 9.

Table A.2: Network RAB Floor Limit roll forward[80]

Value	2012 ($)	2013 ($)
Opening RAB Floor Limit for entire network	1 073 587 301	1 551 340 789
add CPI	24 717 225	31 876 866
add Net Capital Expenditure	519 404 725	155 187 320
less Depreciation	- 66 368 462	- 85 153 141
Closing RAB Floor Limit for entire network	1 551 340 789	1 653 251 834

ARTC also determined the RAB Floor Limit closing value for those segments in Pricing Zone 3 during the 2013 Compliance Period for the purpose of comparing it to the RAB, as follows:

Table A.3: Pricing Zone 3 RAB Floor Limit roll forward[81]

Value	2012 ($)	2013 ($)
Opening RAB Floor Limit for Pricing Zone 3	186 996 217	275 579 819
add CPI	4 305 218	5 662 599
add Capex	95 853 777	12 945 831
less Depreciation	- 11 575 394	- 14 734 933
Closing RAB Floor Limit for Pricing Zone 3	275 579 819	279 453 315

A.3 Comparison of the RAB and RAB Floor Limit for Pricing Zone 3

As outlined in sections A.1 and A.2 above, ARTC submitted that the closing RAB value for Pricing Zone 3 for the 2013 Compliance Period is $288 254 821 and the closing RAB Floor Limit for Pricing Zone 3 is $279 453 315.

Given that the RAB is greater than the RAB Floor Limit in Pricing Zone 3, ARTC submitted that 'loss capitalisation' applies and it is not required to detail calculations relevant to reconciliation of access revenue with the applicable Ceiling Limit and calculations of any allocation of the total under and overs amount for Pricing Zone 3 (see section 4.3(b) of the HVAU).[82]

The ACCC notes that, based on ARTC's submission, the cumulative losses capitalised into the Pricing Zone 3 asset base as at the end of the 2013 Compliance Period is $8 801 506[83].

80 ARTC's 2013 Compliance Submission, p. 12.

81 ARTC's 2013 Compliance Submission, p. 13.

82 ARTC's 2013 Compliance Submission, p. 13.

83 Cumulative losses capitalised = Closing RAB – Closing RAB Floor Limit for Pricing Zone 3, which at the end of the 2013 Compliance Period includes capitalised losses from 2011, 2012 and 2013.

A.4 Reconciliation of revenues with the applicable Ceiling Limit

Subsection 4.10(d)(ii) of the HVAU requires the ACCC to determine whether ARTC has reconciled access revenue with the applicable Ceiling Limit in accordance with the HVAU.

The Ceiling Limit for Pricing Zones 1 and 2 requires that access revenue from any Access Holder or group of Access Holders must not exceed the Economic Cost of those segments which are required on a standalone basis for the Access Holder or group of Access Holders (see subsection 4.3(a) of the HVAU). As per section A.3 above, ARTC submitted that it is not required to reconcile access revenue with the Ceiling Limit for Pricing Zone 3.

ARTC's ceiling test model calculates the amount of access revenue and the Economic Cost across the segments utilised by a mine or combination of mines. The combination of mines that is closest to, or exceeds, the economic cost for the relevant segments is called the 'Constrained Group of Mines' and the segments comprise the 'constrained' part of the Hunter Valley Coal Network.

ARTC reconciled the access revenue received for Pricing Zones 1 and 2 with Economic Cost for the 2013 Compliance Period as follows:

Table A.4: Ceiling test[84]

Value	2012 ($)	2013 ($)
Operating Expenditure	92 339 014	102 723 043
add Depreciation	54 571 672	70 191 898
add Net loss on disposal	1 744 277	4 449 867
add Return on assets	97 988 734	120 167 711
Full economic cost for 'constrained' network	**246 643 697**	**297 532 519**
Revenue received for 'constrained' network	**241 824 863**	**277 929 657**
Difference for 'constrained' network	**- 4 818 834**	**- 19 602 862**

84 ARTC's 2013 Compliance Submission, p. 19.