



Mr Matthew Schroder  
General Manager Infrastructure & Transport – Access & Pricing Branch  
Australian Competition and Consumer Commission  
GPO Box 520  
Melbourne VIC 3001

Email: [transport@acc.gov.au](mailto:transport@acc.gov.au)

### Consultation Paper on 2016 Hunter Valley Access Undertaking

7 March 2016

Dear Mr Schroder

Aurizon Operations (**Aurizon**) welcomes the opportunity to provide a submission on the Australian Competition and Consumer Commission's (**ACCC**) consultation paper on the Australian Rail Track Corporation's (**ARTC**) proposed 2016 Hunter Valley Access Undertaking (**2016HVAU**).

The proposed 2016HVAU reflects the outcomes of engagement between ARTC and access holders, particularly the Hunter Rail Access Task Force (**HRATF**)<sup>1</sup>. Aurizon is not a member of the HRATF and as such does not have a complete understanding of the economic or commercial drivers of some of the proposed changes.

Aurizon is also mindful that some aspects of the proposed changes in the 2016HVAU may be subject to an agreed set of changes and that modification through one or more amendments may have consequential impacts on other aspects. As such, Aurizon's approach to responding to the ACCC's consultation paper is to raise constructive matters for ARTC and the HRATF members to consider in the broader context of the 2016HVAU as a whole. Aurizon may adopt a more definitive position on some aspects once the potential outstanding matters between ARTC and the HRATF become clearer through the stakeholder submissions and would welcome the opportunity to discuss the submission in further detail with customers ARTC, the ACCC and other interested parties.

The focus of this submission is to provide additional information to the ACCC and other stakeholders on:

1. the inclusion of the Services Envelope in the Minor Variations framework;
2. the application of the innovation incentive and its interaction with rail operators;

---

<sup>1</sup> The exception being the privatisation clauses which have not been subject to consultation.

3. considerations regarding path based pricing for an unconstrained network where the industry objective is cost containment; and
4. the suitability and efficacy of the privatisation clauses.

## **1. Services Envelope**

Aurizon is supportive of mechanisms that provide for flexibility in the HVAU, particularly given the duration of the proposed 2016HVAU. The Administrative Provisions of the 2016HVAU that will be subject to this mechanism are not large in scope and are largely uncontroversial and to that extent Aurizon supports the proposal to introduce a Minor Variations framework.

Aurizon acknowledges the primacy of the relationship between ARTC and the producers as the access holders and parties responsible for the payment of access charges associated with funding investment in the network. Nevertheless, there are a potential range of areas where the interests of rail operators can be adversely affected by a change in the Services Envelope.

The Services Envelope is the foundation for access pricing under the 2016HVAU and requires broader stakeholder consultation and input than is proposed for the operation of the mechanism and as such is out of proportion to the other Administrative HVAU Provisions proposed to be subject to the Minor Variation process. A proposal and subsequent change that could lead to operators having to conform to or adopt certain train configurations, which may be inefficient from a commercial and operational perspective and could impact on longer term investment decisions, should be subject to a more robust consultation process than is envisaged by the proposed mechanism.

In addition, there is little insight provided as to what the variations to the Services Envelope will cover or what factors will be taken into account when developing changes to the Services Envelope. It is unclear the level of granularity that is intended to be included within the Services Envelope or whether it will include activities currently undertaken by rail operators on ARTC leased infrastructure. There are a range of factors, for example the circumstances where a change will be proposed, what modelling will be required to support the change, amongst others, that suggest that a variation to the Services Envelope is not minor as demonstrated by the indicative service process under the existing HVAU.

A more robust consultation process encompassing all of industry and interested parties would serve to facilitate a discussion on what operations could look like over an extended timeframe, and ensure the outcomes are appropriate and properly reflective of the whole supply chain and the role of each stakeholder in that supply chain.

## **2. Innovation Incentive**

The proposed mechanism and objective of the Innovation Incentive is appropriate and welcomed by Aurizon. However, Aurizon seeks clarity as to how the mechanism will operate in the context of initiatives proposed that have the potential to reduce operational costs outside of costs directly between the access holder and ARTC, for example operator costs<sup>2</sup>.

The proposal provides for an ability to direct costs to specific access holders who will directly benefit from particular initiatives. For proposed initiatives that potentially have a direct impact on non-access holders (clause 14.1(b)(i) 2016 HVAU) consideration should be given to including consultation provisions, similar to that proposed under clause 2.4 of the 2016HVAU.

---

<sup>2</sup> ARTC 2016 Hunter Valley Coal Network Access Undertaking Explanatory Guide, December 2015, p 18

In this regard, Aurizon seeks to clarify how the costs will be applied where an initiative is developed that has the potential to reduce the costs of operators and to what extent these cost reductions could be passed on to producers or other stakeholders in the coal chain.

### 3. Path Based Pricing

A significant variation in the 2016HVAU relative to the 2011 access undertaking is the introduction of 'path-based' pricing. A key factor in its introduction is the recognition by ARTC of the divergent views on the most efficient expansion pathway to meet the needs of the coal industry. This broadly reflects the large range of contributing factors to rail capacity including train velocity and the yet to be determined impact of the introduction of the Advanced Train Management System<sup>3</sup>.

ARTC, through HRATF engagement, has determined that the use of a train path charge will provide the appropriate capacity signal and avoid the requirement for ARTC to define an efficient train. Aurizon does not seek to interfere with commercial outcomes that have been agreed between industry and ARTC, but raises the following matters for consideration in the move to path based pricing:

- a) the conventional role of path-based pricing in rail pricing models;
- b) whether path based pricing is preferred in an environment of cost containment; and
- c) the potential outcomes of its introduction.

#### a) *What is the role of 'path-based' pricing?*

Pricing rail services on the basis of a train path charge is typically applied as a means to provide a price signal on the opportunity costs of the consumption of network capacity. It is particularly useful where a network is utilised by trains operating at different train speeds with reference to some form of reference train.

This is consistent with the application of path based pricing in the Central Queensland Coal Network where producers have not supported increases in the train path charge to promote stronger capacity signals. In part this is largely reflective of the relative uniformity of train configurations and section run times where operators also have strong incentives to operate longer train services due to the longer haulage distances.

For example, Aurizon has pursued increased efficiencies through the operation of longer train services in both the Goonyella and Blackwater systems to improve the payload per train path within the existing infrastructure constraints<sup>4</sup>. The increase in train length has also occurred within the efficient envelope while operating the same number of locomotives and has avoided a net reduction in capital efficiency through the addition of another locomotive. That is, the operation of the longer train is efficient from the perspective of above and below rail and the supply chain as a whole.

Importantly, the use of path-based pricing is rarely applied to recover the full common costs with the proportion of access charges comprising the path based component usually being limited to some concept of opportunity cost, or avoidable costs in order to avoid distorting

---

<sup>3</sup> Talebian, M., Savelsbergh, M. and Moffiet, C. (2016) A new rail access charging policy: Hunter Valley coal chain case study, Transport Policy, Vol. 46, February, pp. 101-108

<sup>4</sup> Aurizon (2015) 2014 Sustainability Report: Aurizon Beyond 2020, p. 23. Available at <http://www.aurizon.com.au/sustainability/overview>

economically efficient outcomes in upstream or downstream markets (i.e. not a measure of average costs).

An efficient train path charge would generally be limited to the avoidable costs of relieving the bottleneck in the rail system. For example, the Office of Rail Regulation is currently evaluating alternative approaches to below rail pricing and notes long run marginal costs (LRMC) as representing an efficient means of valuing the price of access:

*For example, an approach that could promote more efficient use of the network involves basing charges on a calculation of LRMC. LRMC are defined as the costs attributable to an extra permanent unit of traffic in bringing forward the future capital programme. One important difference between opportunity cost based capacity pricing options and LRMC pricing is that where current demand is lower than available capacity, scarcity costs tend to be low (i.e. zero). Additionally, at times and in areas where supply is lower than demand, the scarcity costs which reflect the costs of foregone demand could potentially be much higher than estimated LRMC<sup>5</sup>.*

The value of a train path may also be inferred by the pricing of other traffics operating over the Hunter Valley rail network as it would be expected that these prices would need to reflect some estimate of their opportunity costs in terms of alternate use.

Where the efficient train path charge is not sufficient to recover the full economic costs then it is typically supplemented with another pricing mechanism which is generally unrelated to the cost drivers of providing the service. However, Aurizon recognises that this may be undesirable for ARTC and producers given the inter-relationship between the price structure and a range of other administrative processes in the 2016HVAU which refer to only one Take or Pay (**ToP**) component.

*b) Is capacity sufficiently scarce to require strong capacity signals?*

The development of the 2011DAU and the subsequent consultations on the Final Indicative Service were representative of a substantially different economic climate where the industry had a strong focus on expanding the system capacity with the objective of minimising the infrastructure investment required to meet the prospective demand. However, it is acknowledged that over the 10.5 year term of the 2016HVAU there is the potential for market and demand conditions to change.

It is widely recognised that thermal coal producers are operating in a difficult economic environment with substantial reductions in the price of the commodities they export<sup>6</sup>. The implication of the current and foreseeable prices for coal exports is that industry participants have a much stronger focus towards cost containment and reduction and deferring or avoiding costs is important.

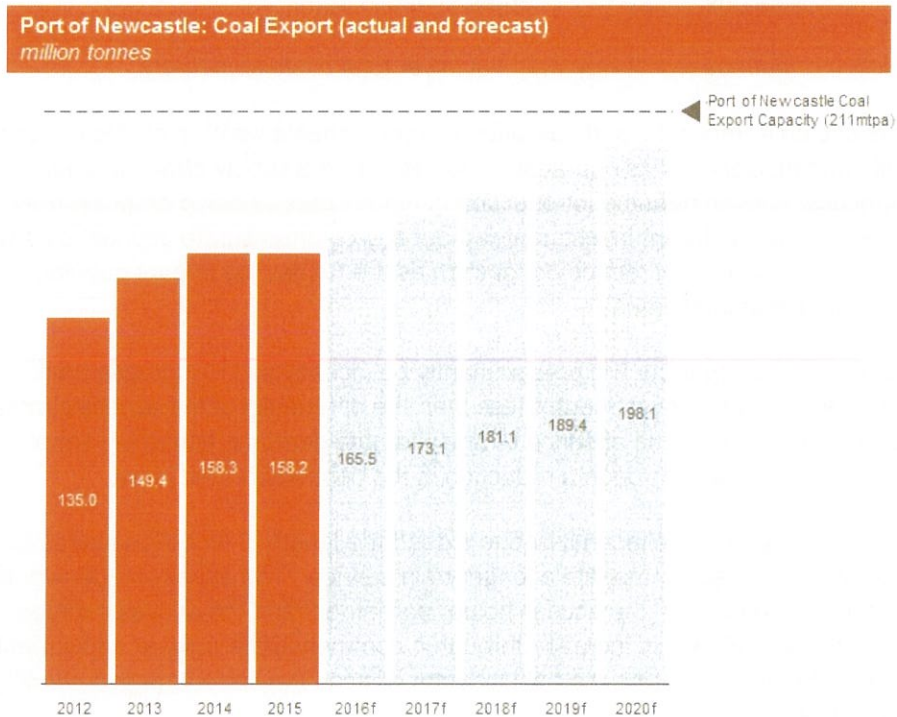
---

<sup>5</sup> Office of Rail Regulation (2015) Draft impact assessment on the impact of the value-based capacity package, Network Charges – a consultation on how charges can improve efficiency, December, p. 22

<sup>6</sup> For example, the New South Wales Mineral Council submission to the National Competition Council's draft decision regarding the application for declaration of the Port of Newcastle notes the comments from Glencore that:

- even incremental cost increases at the margin may drive coal producers to exit the market; and
- while the current shipping charge may be less than 1% of the FOB costs of export coal, that represents 10% to 100% of the available sale margin in current market circumstances.

These market conditions suggest that the demand for expansions of the system capacity will remain depressed over the short to medium term and that reasonable estimates of forecast coal exports will be accommodated well within existing port capacity as shown in the following graph<sup>7</sup>.



Source: *International Energy Agency: Medium-Term Coal Market Report 2015, PWCS website, NCIG website*

The 2015-24 Hunter Valley Corridor Capacity Strategy also indicates that on the basis of current contract volumes no expansion projects are required in Zones 1 to 3 and that prospective volumes, should they eventuate and not obtain transferred capacity, would trigger expansion projects only in Zone 2 from 2022 and Zone 3<sup>8</sup>.

The demand projections strongly suggest that the scarcity value of train paths in Zone 1 is immaterial<sup>9</sup>. Assuming industry participants do respond to the price incentives and increase the length of trains and passing loops without any alternate demand for contracted train paths, then the practical consequence is that the access charges on a dollar per train kilometre basis would need to increase for all users to reflect the reduction in train paths required to meet the same volume projections.

Importantly, Aurizon is of the view that, in the absence of alternate demand, the reduction in train paths in an access holder's agreement, associated with an increase in train payloads as promoted by the path-based pricing, is unreasonably subject to ARTC's discretion to consent to the variation. This would give rise to a circumstance where an access holder seeks to improve its competitiveness on a \$ per net tonne kilometre basis by operating train services with increased payloads but also remain exposed to the ToP obligations. This would be

<sup>7</sup> Aurizon forecasts based on 2015 export volumes and applying the International Energy Agency (IEA) forecasts of 4.6% CAGR in Australian thermal coal export volume through to 2020.

<sup>8</sup> ARTC (2015) 2015-2024 Hunter Valley Corridor Capacity Strategy, July, Tables 5 and 6, pp. 31-32

<sup>9</sup> The 2015-2024 Hunter Valley Corridor Capacity Strategy also notes that the projections have been based on current rollingstock and infrastructure configurations. Therefore, the project requirements are not contingent on material increases in the average train payload within the Services Envelope.

materially misaligned to the purported capacity and efficiency objectives of the pricing proposal. In order to avoid this outcome, the access holder agreement should include appropriate provisions which ensure that where a rail operator increases its train payload the access holder can permanently vary its train paths and ARTC will be required to relieve the access holder of its obligations to pay ToP charges on those paths.

*c) The introduction of path based charge may not lower total costs to industry*

Aurizon supports pricing frameworks and operational improvements which promote increases in the productivity and efficiency of its operations and those of the supply chain as whole. In an environment of cost containment the introduction of a path-based pricing proposal may incentivise upstream or downstream investment without any commensurate economic benefit. For example, longer trains may not reduce congestion as the trains may impact queuing at the port due to more variable unload times<sup>10</sup>.

Assuming a producer or rail operator will predominantly be incentivised to increase train payloads where the costs of the investment is less than the differential of the access charge under path-based pricing then, in the absence of any alternate demand, this would simply lead to the cost transfer to the system through a reduction in the contracted train paths.

As an example, a producer may be incentivised to extend the length of its balloon loops and/or hopper recharge capacity to accommodate a longer train service. The access holder would reduce the number of train paths in the access holder agreement and the access charges and ToP liabilities over the system would increase through a commensurate upward adjustment to prices. It is unclear whether increasing the total industry costs in the current market conditions is a desirable objective.

The contrary scenario is that the costs associated with making additional investments to maximise train payload within the Services Envelope would exceed the net change in the average access cost. In this circumstance, and without alternate demand which would otherwise trigger the need for further network investment, the adoption of path-based pricing serves merely to introduce a discriminatory price impact in \$ per net tonne kilometre between different users of the system based on their legacy investment decisions, including those made in response to the incentives inherent in the current and past price structures (for example, maximising gross to net ratio and improving above rail efficiency).

These factors would suggest that the implementation of path-based pricing could be deferred until it becomes apparent that ARTC would need to undertake further network investment to increase Network capacity.

#### **4. Privatisation Clauses**

The 2016HVAU includes a requirement in clause 2.2(c) that in the event of a transfer of the existing lease, or the granting of a lease to the network, to an entity other than ARTC then ARTC will seek to withdraw the undertaking and also undertake to procure that the lessee gives an undertaking on same terms of the approved 2016HVAU. On lodgement of an undertaking on the same terms the ACCC will approve that undertaking.

---

<sup>10</sup> Short trains may reduce port congestion by reducing the port unload time and clearing the port precinct more quickly relative to a longer trains.

Aurizon is of the view that the inclusion of these clauses would not permit the ACCC to approve the 2016HVAU for the following reasons:

- There is considerable uncertainty as to the identity and the incentives of the potential lessee of the network. The 2016HVAU has been lodged with the ACCC by a publicly owned railway business with no commercial interests in upstream or downstream markets. It is prudent that the undertaking be amended to reflect the incentives of a privately owned railway manager and/or where there is any alignment of interests which have potential competition and market power impacts associated with the ownership structures.
- It is unclear whether the ACCC can, or should, be required to approve an access undertaking under section 44ZZA of the *Competition and Consumer Act 2010 (the Act)* which pre-approves a voluntary access undertaking to be given to the ACCC by a separate legal entity under subsequent and independent application under section 44ZZA of the Act.
- Given the various and differing potential ownership models that may be contemplated by the Scoping Study it is not feasible to contemplate the myriad of potential variations that might be required to address the competition or efficiency incentives under every prospective model.

Aurizon also notes that the ACCC's consultation paper on these provisions frames the questions in a manner which seeks to define on what circumstances the 2016HVAU would not be appropriate and what changes, if any, would be needed to address those concerns. Aurizon suggests that these matters are beyond the scope of the 2016HVAU and are not relevant to the ACCC's considerations under section 44ZZA of the Act. That is, a voluntary access undertaking should not be assessed or amended to address issues or matters the ACCC thinks might arise from the privatisation of ARTC. The adequacy of the access undertaking, or the suitability of section 50 of the Act or subsequent implementation of other forms of regulation should be reviewed through the scoping study and not as a supplementary process through the approval of the 2016HVAU.

The proposed clause 2.2(c) should be excluded from the approved 2016HVAU.

Aurizon acknowledges the role ARTC and access holders have taken in the development of the 2016HVAU to date. This submission is provided in the context of an appreciation of the role of ARTC and access holders and is intended to provide constructive feedback on the issues identified that could benefit from further consideration by industry and access holders within existing market conditions and being mindful of the target implementation date. Aurizon will continue to seek engagement from its customers, the ACCC and ARTC as the process continues and welcomes the opportunity to discuss this submission in further detail.

Should you have any questions in relation to the submission please contact Amy Kirk, Manager Access, Commercial and Marketing by phone on (07) 3019 9198 or via email at [Amy.Kirk@aurizon.com.au](mailto:Amy.Kirk@aurizon.com.au).

Yours sincerely



Ed McKeiver  
Vice President, Marketing