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Australian Competition and Consumer Commission
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Dear Ms Arblaster,

ARTC Rail Access Undertaking – Interstate Network

The NSW Minerals Council ("**NSWMC**") welcomes the opportunity to make this submission to the Australian Competition and Consumer Commission ("**ACCC**") regarding the Australian Rail Track Corporation ("**ARTC**") Rail Access Undertaking for the Interstate Network ("**Undertaking**").

NSWMC's Hunter Rail Access Task Force ("**HRATF**") represents coal end-users of ARTC's Hunter rail network ("**Hunter Network**") and the three contiguous rail networks: the Interstate network leased by ARTC ("**Interstate Network**"); the NSW country network owned by Rail Infrastructure Corporation ("**Country RIC**") and the NSW inter-urban network owned by Rail Corporation of NSW ("**RailCorp**").

The coal end-users currently rail about 80 Mtpa of export coal worth \$7bn in export earnings and 5 Mtpa of domestic coal on these networks as part of the Hunter coal logistics chain from mine to ship or power station ("**Hunter Coal Chain**"). Rail access charges for the Hunter coal traffic of around \$100M pa are around one third of ARTC's total revenues

Need for Compatibility with Hunter Coal Traffic

NSWMC believes that the Undertaking, while focused on the requirements of interstate rail traffic, must also be compatible with the operating and commercial characteristics of the Hunter coal traffic because

- some Hunter coal traffic has to use ARTC's Interstate Network and/or the Country RIC and RailCorp networks as well as using or interfacing with the Hunter Network
- non-coal traffic from ARTC's Interstate network (and the RailCorp and Country RIC networks) has to use or interface with coal traffic on the Hunter Network
- the operational and commercial characteristics of the Hunter coal traffic are largely determined by the requirements of the optimised Hunter Coal Chain
- all the networks used by the Hunter coal traffic are presently governed by the NSW Rail Access Undertaking which has provisions more appropriate to the characteristics of the coal traffic.

ARTC intends to develop a separate access undertaking for its Hunter Network ("**Hunter Undertaking**") because of "operational and commercial differences". The Undertaking must not set precedents for the Hunter Undertaking that will impinge upon the coal traffic on the Hunter Network as that traffic is very large and economically important, pays high access charges and plays a critical role in the optimization of the whole Hunter Coal Chain.



Different Characteristics of the Hunter Coal Traffic

NSWMC notes that COAG has agreed to a simpler, consistent national system of rail access regulation, using ARTC's 2002 Interstate Undertaking ("2002 Undertaking") as a model.

However some provisions of ARTC's 2002 Undertaking would be inappropriate, inadequate and potentially unworkable if they were carried into the 2007 Undertaking and the subsequent Hunter Undertaking and thereby applied to Hunter Coal Traffic

In its submission to the ACCC on the 2002 Undertaking, NSWMC pointed out that none of the characteristics of ARTC's Interstate Network in 2002, which allowed ACCC to accept those provisions as appropriate then, apply to Hunter coal traffic for which

- rail is not in competition with road
- ARTC currently recovers the full economic cost of most network segments used, and
- ARTC currently applies price discrimination between users and is no longer committed to ongoing reductions in real prices charged to users

In addition, some access pricing principles have been included in the Undertaking which appear to be substantial departures from those in the 2002 Undertaking and other access regimes in Australia.

As a result, for Hunter Coal Traffic, changes to the provisions of the Undertaking and the subsequent Hunter Undertaking will be needed in many aspects of the access pricing principles (including the definition of floor and ceiling limits, the absence of a stand-alone test, price differentiation and discrimination, the effect of traffic priority, the structure and escalation of access charges and inadequate pricing information), as well as many aspects of the allocation of capacity and provision of additional capacity.

This Submission sets out NSWMC's concerns, putting forward specific principles or amendments for the Undertaking and for ARTC's eventual Hunter Undertaking. NSWMC's views are supported by detailed previous submissions to ACCC and the Productivity Commission.

We also look forward to working constructively with ARTC and the Hunter coal haulage Operators to develop a Hunter Undertaking that is substantially acceptable to all parties.

For further information, please do not hesitate to contact me or HRATF directly (Mr Geoff Andrews Tel: 02 9386 9957; Email: an53696@bigpond.net.au).

Yours sincerely

Dr Nicole B Williams
CHIEF EXECUTIVE OFFICER



**NSW MINERALS COUNCIL
HUNTER RAIL ACCESS TASK FORCE**

**RESPONSE TO
AUSTRALIAN COMPETITION AND
CONSUMER COMMISSION**

ISSUES PAPER

**REGARDING
AUSTRALIAN RAIL TRACK CORPORATION**

**2007 ACCESS UNDERTAKING
FOR ITS INTERSTATE RAIL NETWORK**

August 2007

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1. EXECUTIVE SUMMARY

The New South Wales Minerals Council ("**NSWMC**") welcomes the opportunity to respond to the Australian Competition and Consumer Commission ("**ACCC**") Issues Paper regarding the Australian Rail Track Corporation ("**ARTC**") 2007 Access Undertaking ("**Undertaking**") for its Interstate Rail Network ("**Interstate Network**").

The Interstate Network now includes the NSW sections of the Interstate Network leased by ARTC but not the Hunter Valley network leased by ARTC ("**Hunter Network**").

NSWMC's Hunter Rail Access Task Force ("**HRATF**") represents coal end-users of the Hunter Network and the three contiguous rail networks: ARTC's Interstate Network; the NSW country network owned by Rail Infrastructure Corporation ("**Country RIC**") and the NSW inter-urban network owned by Rail Corporation of NSW ("**RailCorp**").

The coal end-users currently rail about 80 Mtpa of export coal, worth \$7bn in export earnings, and 5 Mtpa of domestic coal ("**Hunter Coal Traffic**") on these networks as part of the Hunter coal logistics chain from mine to ship or power station ("**Hunter Coal Chain**"). Rail access charges for the Hunter coal traffic of around \$100M pa are around one third of ARTC's total revenues.

ARTC has stated that, because of "operational and commercial differences", it intends to develop a separate access undertaking for its Hunter Network ("**Hunter Undertaking**"). In the absence of any details of ARTC's Hunter Undertaking, NSWMC is concerned that rail access arrangements meet the needs of the Hunter Coal Traffic on both the Hunter Network and the Interstate and other contiguous networks.

This Submission sets out NSWMC's concerns with the Undertaking in relation to Hunter coal traffic and puts forward specific principles or amendments to address the concerns in the Undertaking and in ARTC's eventual Hunter Undertaking.

1.1 Need for Compatibility with Hunter Coal Traffic

NSWMC believes that the Undertaking, while focused on the requirements of interstate rail traffic, must also be compatible with the operating and commercial characteristics of the Hunter Coal Traffic, because

- some Hunter Coal Traffic has to use ARTC's Interstate Network and/or the Country RIC and RailCorp networks as well as using or interfacing with the Hunter Network
- non-coal traffic from ARTC's Interstate network (and the RailCorp and Country RIC networks) has to use or interface with coal traffic on the Hunter Network
- the operational and commercial characteristics of the Hunter Coal Traffic are largely determined by the requirements of the optimised Hunter Coal Chain
- all the networks used by the Hunter Coal Traffic are presently governed by the NSW Rail Access Undertaking which has provisions more appropriate to the characteristics of the Coal Traffic.

As well, the Undertaking must not set precedents for the Hunter Undertaking that will impinge upon the operational and commercial characteristics of Hunter coal traffic on that network.

However, NSWMC believes various provisions of the Undertaking are not compatible with the operating and commercial characteristics of the Hunter Coal Traffic, which are very different to those of other traffics using the Interstate and Hunter Networks, as ARTC has acknowledged.

Those characteristics are driven by the complex logistics of the Hunter Coal Chain and the high coal traffic levels on the Hunter Network. They need to be fully accommodated in the Undertaking and the Hunter Undertaking because the Hunter Coal Traffic

- plays a critical role in the optimisation of the whole Hunter Coal Chain

- pays high access charges
- is very large and economically important.

NSWMC believes ACCC should require ARTC to make the provisions of the Undertaking compatible with the needs of the Hunter Coal Traffic using the principles set out in this Submission. NSWMC also anticipates discussing with ARTC and Hunter coal haulage Operators the best means of achieving this objective in the eventual Hunter Undertaking.

1.2 Different Characteristics of Hunter Coal Traffic

NSWMC notes that COAG has agreed to implement a simpler and consistent national system of rail access regulation, using ARTC's 2002 Undertaking for the interstate network ("**2002 Undertaking**") as a model.

However some of the provisions of the 2002 Undertaking would be inappropriate, inadequate and potentially unworkable if they were carried into the 2007 Undertaking and the subsequent Hunter Undertaking and thereby applied to the Hunter Coal Traffic.

In its submission to the ACCC on the 2002 Undertaking, NSWMC pointed out that none of the characteristics of ARTC's Interstate Network in 2002, which allowed ACCC to accept those provisions then, apply or are likely to apply to Hunter Coal Traffic for which

- rail is not in competition with road
- ARTC currently recovers the full economic cost of most network segments used, and
- ARTC currently applies price discrimination between users and is no longer committed to ongoing reductions in real prices charged to users.

To apply to Hunter Coal Traffic, changes to the provisions of the Undertaking and the subsequent Hunter Undertaking will be needed in many aspects of the access pricing principles (including the definition of floor and ceiling limits, the absence of a stand-alone test, the price differentiation and discrimination provisions, the effect of traffic priority on pricing, the structure and escalation of access charges and inadequate pricing information), as well as many aspects of the allocation of capacity and provision of additional capacity.

The different characteristics of Hunter Coal Traffic and the provisions of the Undertaking they affect are set out in more detail in Section 4 of this Submission.

The following subsections summarise NSWMC's concerns with key elements of the Undertaking, which are set out in more detail in Section 5 of this Submission.

1.3 Negotiating for Access

Some provisions, covering Negotiating for Access, in Parts 2 and 3 of the Undertaking appear to disadvantage Applicants/Access Seekers. The Submission proposes amendments to address these concerns

- the initial estimate of the Access Charges provided to the Applicant by ARTC (Clause 3.8 (c) (v)) should be accompanied by a full explanation of the "transparent and detailed methodologies, principles and processes for determining revenue limits, terms and conditions".

The explanation should include the numerical data used by ARTC to determine the Access Charges in line with Schedule 5 of the NSW Rail Access Regime.

ARTC should also be required to provide to the Applicant the same information in relation to other relevant Services for which Access prices have published on ARTC's website (Clause 2.7 (b) (iv))

Without this information, the Access Seeker will not be able to adequately evaluate ARTC's proposal and meaningfully negotiate the Access Charges and will, almost inevitably, be forced to initiate arbitration.

This is particularly relevant for Hunter Coal Traffic, where Access Charges are likely to be above the floor limit.

- the provisions allowing ARTC to unilaterally cease negotiations and force an Applicant to endure the delays and costs of the dispute resolution process should be modified or deleted (Clause 3.10 (b) (iv) and (v))
- where Applicants are seeking mutually exclusive Access Rights (which could be likened to an auction), ARTC should make known to each Applicant all the information needed to adequately inform the Applicants in the negotiations and meet the intents of the Undertaking set out in Clauses 1.2 (a), (b) and (c).

Clause 3.10 (d) (ii) presently falls well short of this objective, which will be particularly relevant on the heavily trafficked sections of the networks used by Hunter Coal Traffic.

- ARTC should make absolutely clear that any and all matters covered in the Undertaking, including all matters relating to Parts 4, 5, 6 and 7 as well as Part 3, are subject to the dispute resolution provisions of Clause 3.12.

NSWMC's concerns and the principles which NSWMC believes should apply are discussed in detail in Sections 5.2 and 5.3 of this Submission.

1.4 Pricing Principles

Some access pricing principles in Part 4 of the Undertaking appear to be a substantial departure from ARTC's 2002 Undertaking and from other third party access regimes and undertakings currently in force in Australia and would have major implications for access pricing for Hunter Coal Traffic.

In particular, the pricing principles appear to be inconsistent with currently accepted practice in pricing of regulated monopoly services in such matters as the definition of floor and ceiling revenues, the omission of the stand-alone principle and the escalation of charges. NSWMC's concerns include

- the floor limit includes avoidable costs rather than incremental costs
- ARTC can waive the obligation of rail users to meet the floor limit and thereby charge less than incremental cash costs, resulting in incremental costs those users impose on the network having to be paid by other users
- the costs used in determining the ceiling limit "shall comprise ARTC's reasonably anticipated costs over a reasonable future timeframe", allowing ARTC to include costs it hasn't incurred yet, and may not
- the ceiling limit effectively allows ARTC to recover capitalised shortfalls from the ceiling limit from previous years
- the stand-alone principle does not apply to the floor or ceiling tests, thereby allowing cross-subsidisation between traffics and the imposition of monopoly rent
- ARTC may escalate access charges by up to CPI compared to 2/3rds of CPI or CPI - 2%, whichever is greater, in the 2002 Undertaking.

NSWMC is also concerned that the Undertaking

- contains apparent inconsistencies between its objective of non-discrimination, the recent changes to National Competition Policy that encourage price discrimination where this promotes economic efficiency, and Clause 4.2 which sets out the basis upon which ARTC may apply 'differentiation' to access charges

does not specify the principles for applying Charge Differentiation, effectively allowing ARTC to apply any charge it likes (within the limits in Clauses 4.3 and 4.4)

- does not, in the limits on Charge Differentiation, effectively define when Services are 'alike' and does not state that all coal is considered to have the same end market
- does not specify that, in its charges, ARTC recover no more than efficient costs
- proposes a (more conservative) "prudent" debt to equity ratio for determining WACC rather than one that is optimum to its business.

NSWMC's concerns and the principles which NSWMC believes should apply are discussed in detail in Section 5.4 of this Submission.

1.5 Management of Capacity

NSWMC believes the provisions of the Undertaking covering capacity management are designed for non-coal traffic on the Interstate Network and are inappropriate, inadequate and potentially unworkable for Hunter Coal Traffic on the Interstate Network and Country RIC and RailCorp networks that are contiguous with the Hunter Network, and on the Hunter Network itself.

The Hunter Coal Traffic requires a quite different approach to the management of capacity, including allocation of capacity, train scheduling/pathing, network management principles (real-time train control) and provision of additional capacity, to that set out in the Undertaking.

Details of NSWMC's concerns are set out in Section 5.3 (Part 3: Negotiating for Access - Clause 3.6/Schedule B and 3.8); Section 5.5 (Part 5: Management of Capacity – Clauses 5.3 and 5.4); Section 5.6 (Part 6: Network Additions and Connections - Clause 6.2); and Section 5.7 (Part 7/Schedule F: Network Transit Management) of this Submission.

For the Allocation of Capacity, NSWMC believes the provisions of Clauses 3.6, 3.8, 5.3, 5.4 and 7/Schedule F should be consistent with the principles that

- for coal traffic, an existing access holder or an Applicant may submit applications to ARTC for network capacity without nominating specific Train Paths
- traffic that pays higher access charges than other traffic will have capacity and Train Path priority over that other traffic, except as provided for in legislation. Therefore, if a coal traffic pays a higher price for access than a non-coal traffic, it will have priority over that non-coal traffic (other than traffic that has legislated priority) in short and longer-term capacity allocation and in resolving short-term train conflicts (train scheduling and network transit management)
- required annual capacity for coal traffic on the Interstate Network contiguous with the Hunter Network and the Hunter Network itself will be determined by the Hunter Coal Chain participants in consultation with ARTC
- where traffic on the Interstate Network interfaces with Hunter traffic, the capacity and mode of operation of the Hunter Network will be taken into account when determining capacity of the Interstate Network
- Hunter Coal Chain participants, rather than ARTC, will determine between themselves how coal trains are scheduled in relation to other coal trains, to maximise the capacity and efficiency of the Coal Chain
- coal users will be entitled to nominate mandatory Train Paths subject to the conditions which preserve the efficient operation of the Hunter Coal Chain.

For the provision of Additional Capacity, NSWMC believes Clause 6.2 of the Undertaking is inadequate and potentially unworkable for Hunter coal traffic because there is

- no requirement for ARTC to consult generally with Operators and End Users on capacity issues and expansion plans and capital expenditure plans and projects
- no obligation on the infrastructure owner, ARTC, to invest in new capacity
- no provision for tests of prudence of scope, standard and cost of capital projects

- no provision for audit of capital costs that are included in the asset base.

NSWMC believes the Undertaking's provisions for planning, approval and inclusion in the asset base of capital projects should include

- full consultation between ARTC, Operators and major End Users on capital projects, before and after their construction, in line with S3.4 of Schedule 3 of the NSW Rail Access Undertaking and also incorporating procedures in the QR Undertaking
- an obligation on ARTC to invest in asset replacement and new capacity if the project is expected to earn the maximum rate of return permitted by the regulator
- inclusion in the rate of return, by the regulator, of an investment incentive component to reflect an appropriate incentive for the ARTC to invest
- the right for an Operator or an End-User to elect to pay for a new capacity project through a capital contribution. Any access revenue from third parties utilising the new capacity, above the incremental costs they impose, would be credited to the party that financed the new capacity
- the investment incorporated into the asset base to be based on efficient costs, with prudence tests such as those in the QR Undertaking, and its effect on access pricing to be determined under a ceiling test such as that in the NSW Undertaking (which incorporates the stand-alone principle)
- a post-construction audit by a specialist in the field with Operators or End Users entitled to procure their own audit
- transparency of the highest order, no less effective than the provisions in the QR Undertaking.

Other provisions in the Undertaking relating to the Management of Capacity which NSWMC believes are unsatisfactory now give ARTC complete discretion to choose whether to

- charge the Applicant a fee for the Capacity Analysis ARTC carries out in preparing its Indicative Access Proposal, without the scope of the Analysis and the fee being agreed with the Applicant and the Applicant having the right to the report and details of the Analysis (Clause 5.1 (b))
- reserve capacity for longer than six months, as coal End Users and their rail and port operators will often need when they make the large investments required to develop additional mine, rail loadpoint, rail haulage and port terminal capacity (as well as introducing a Capacity Reservation Fee, inflated above the actual opportunity cost forgone) (Clause 5.2)
- minimise interference to Train Paths granted to an Operator, caused by a future direction of Government, and make the costs of doing so payable by the Operator (Clause 6.3).

NSWMC's concerns and the principles which NSWMC believes should apply for each Clause are discussed in detail in the body of this Submission.

1.6 Conclusion

NSWMC has made detailed submissions to ACCC in relation to ARTC's 2002 Undertaking and, more recently, to the Productivity Commission's 2006 Review of Economic Costs of Freight Infrastructure and Efficient Approaches to Transport Pricing which support NSWMC's positions set out in this Submission.

Nevertheless, NSWMC will be pleased to supply any further information required by ACCC in relation to the concerns outlined and the principles and amendments proposed in this Submission.

NSWMC may also wish to make comments on other aspects of the Undertaking at a later stage, depending on ACCC's views on submissions made by other parties.

NSWMC looks forward to working constructively with ARTC and the Hunter coal haulage Operators to develop a Hunter Undertaking that is substantially acceptable to all parties.

2. BACKGROUND

2.1 Role of NSW Minerals Council

NSWMC welcomes the opportunity to respond to the ACCC Issues Paper regarding ARTC's Undertaking.

NSWMC represents the State's \$9 billion mining industry. NSWMC works closely with government, other industry groups and key stakeholders to foster a dynamic, efficient and sustainable mining industry in NSW. One of the primary objectives of NSWMC is to ensure that the legislative and regulatory framework is relevant and effective for an industry which is operating in highly competitive domestic and international markets.

For environmental and social reasons it is impracticable to transport most coal by road. Rail is therefore fundamental to the export and domestic coal supply chain, and will become even more critical as areas more remote from ports are opened up for large-scale development.

The efficient use of rail infrastructure and the ongoing price of access are significant determinants in the viability of existing coal mines and new projects. Investment in rail infrastructure is also an imperative for the State's continued economic prosperity. By supporting coal and other mineral exports, rail ensures the long term viability of NSW ports and cities.

Most export and domestic coal transported in the Hunter region of NSW is railed on a track network extending from Ulan (west), Whitehaven (northwest), Stratford (north) and Vales Point (south) to the Port of Newcastle. This Hunter Coal Traffic utilises ARTC's Hunter Network and three contiguous networks (ARTC's Interstate Network; the NSW country network owned by Country RIC and the NSW inter-urban network owned by RailCorp)

The Hunter Coal Traffic is part of the Hunter Coal Chain which comprises over 25 mines/loadpoints railing coal to ships at the 3 export coal terminals (2 operating and 1 planned) in the port of Newcastle and/or to 4 power stations on the Hunter and RailCorp networks.

NSWMC's HRATF represents coal rail end-users of ARTC's Hunter Network and the three contiguous rail networks. These end-users currently rail about 80 Mtpa of export coal, worth \$7bn in export earnings, and 5 Mtpa of domestic coal on the networks and rail access charges for the Hunter coal traffic of around \$100M pa are around one third of ARTC's total revenues.

ARTC has stated that, because of "operational and commercial differences", it intends to develop a separate access Hunter Undertaking for its Hunter Network.

NSWMC's HRATF is concerned that rail access arrangements ensure the efficient rail haulage of coal not only on ARTC's Hunter Network but also on the contiguous networks. Because ARTC has yet to put forward its Hunter Undertaking, the particular focus of this submission is Hunter coal traffic hauled on ARTC's Interstate and Hunter Networks.

NSWMC wants to ensure that ARTC's Interstate Undertaking is not only suitable for coal traffic on the Interstate Network but that it also does not set precedents for ARTC's Hunter Undertaking that will impinge upon the efficient rail haulage of coal on the Hunter Network.

2.2 Current and Future Access to the Hunter Network

The NSW section of the Interstate Network, the Hunter Network and the Country RIC and RailCorp networks all presently operate under the NSW Rail Access Undertaking ("**NSW Undertaking**") which was developed by Rail Infrastructure Corporation ("**RIC**") pursuant to Schedule 6AA of the *Transport Administration Act 1988* (NSW) ("**Transport Administration Act**").

This is not an undertaking in the sense of that word in Part IIIA of the *Trade Practices Act 1974* (Cth) ("**Trade Practices Act**"). Rather it is an access regime, an earlier version of which was certified in

November 1999 as being effective (as that word is defined in the Trade Practices Act). Certification lapsed in December 2000 and has not been renewed.

Since then, the QR Access Undertaking 2005 (as endorsed on 30 June 2006) ("**QR Undertaking**") has been developed and its extensive and detailed provisions covering access arrangements, terms and conditions have applied to all Queensland coal traffic using the QR Network.

When ARTC entered into the lease and management arrangements for the NSW sections of the Interstate Network and the Hunter Network in September 2004, it indicated it would submit an access undertaking to the Australian Competition and Consumers Commission (ACCC) for the track it leased, while the Country RIC and RailCorp track it does not lease would continue to be subject to the NSW Undertaking, which is under the control of the NSW Government.

ARTC's 2002 Interstate Access Undertaking to the ACCC ("**2002 Undertaking**"), which applies to the ARTC network excluding NSW, expires in 2007. It will be replaced by the ARTC's 2007 Undertaking.

The 2007 Undertaking has to be consistent with the February 2006 amendments by the Council of Australian Governments ("**COAG**") to the Competition Principles Agreement and the August 2006 *Trade Practices Amendment (National Access Regime) Act* (Cth).

COAG also agreed to implement a simpler and consistent national system of rail access regulation, using ARTC's 2002 Undertaking as a model, to apply to agreed nationally significant railways.

ARTC's 2007 Undertaking will thus apply to all its Interstate Network and will replace the NSW Undertaking in relation to the NSW section of the Interstate Network.

When developed and approved by the ACCC, ARTC's Hunter Undertaking will apply to the Hunter Network and replace the NSW Undertaking as it applied to the Hunter Network. Until then, the NSW Undertaking will continue to apply.

3. NEED FOR COMPATIBILITY WITH HUNTER COAL TRAFFIC

NSWMC believes that ARTC's 2007 Undertaking, while focused on the requirements of Interstate rail traffic, must also be compatible with the operating and commercial characteristics of Hunter Coal Traffic because

- some Hunter coal traffic uses ARTC's Interstate Network and/or the Country RIC and RailCorp networks as well as using or interfacing with the Hunter Network
- non-coal traffic from ARTC's Interstate network (and the RailCorp and Country RIC networks) has to use or interface with coal traffic on the Hunter Network
- the operational and commercial characteristics of the Hunter coal traffic are largely determined by the requirements of the optimised Hunter Coal Chain
- all the networks used by the Hunter coal traffic are presently governed by the NSW Rail Access Undertaking which has provisions more appropriate to the characteristics of the coal traffic.

As well, the Undertaking must not set precedents for the Hunter Undertaking that will impinge upon the operational and commercial characteristics of Hunter Coal Traffic on that network.

However, NSWMC believes various provisions of the Undertaking are not compatible with the operating and commercial characteristics of the Hunter Coal Traffic, which are very different to those of other traffics using the Interstate and Hunter Networks, as ARTC has acknowledged.

Those characteristics, driven by the complex logistics of the Hunter Coal Chain and the high coal traffic levels on the Hunter Network, need to be fully accommodated in the Undertaking and the Hunter Undertaking because the Hunter Coal Traffic

- plays a critical role in the optimisation of the whole Hunter Coal Chain
- pays high access charges
- is very large and economically important

NSWMC believes ACCC should require ARTC to make the provisions of the Undertaking compatible with the needs of the Hunter Coal Traffic using the principles set out in this Submission. NSWMC also anticipates discussing with ARTC and Hunter coal haulage Operators the best means of achieving this objective in the eventual Hunter Undertaking

4. DIFFERENT CHARACTERISTICS OF HUNTER COAL TRAFFIC

NSWMC notes that COAG has agreed to implement a simpler and consistent national system of rail access regulation, using ARTC's 2002 Undertaking as a model.

However, implementing a simpler and consistent national system of rail access regulation, using the 2002 Undertaking as a model, will pose considerable challenges in relation to Hunter Coal Traffic.

The need for compatibility with the operating and commercial characteristics of the Hunter Coal Traffic means some of the provisions of the 2002 Undertaking would be inappropriate, inadequate and potentially unworkable if they were carried into the 2007 Undertaking and the subsequent Hunter Undertaking and thereby applied to the Hunter coal traffic.

ACCC accepted those provisions in the 2002 Undertaking because

- rail was considered to be in competition with other modes of transport for the end market, and
- ARTC did not recover full economic cost on any segment of its network, and
- ARTC applied principles of non-discrimination between users and intended to commit to ongoing reductions in real prices charged to users.

In a submission to the ACCC on the 2002 Undertaking, NSWMC pointed out that, as is still the case, none of these circumstances applies or is likely to apply to almost all Hunter Coal Traffic

- nearly all Hunter coal mines are obliged, as a condition of their mining leases or development consents, to use rail to transport coal for export so there is no competition from other transport modes, and
- the full cost of the Hunter Coal Traffic is currently being recovered, except for the Werris Creek to Muswellbrook line and the Maitland to Stratford line on which coal traffic is minor compared to non-coal traffic
- price discrimination (now explicitly endorsed in National Competition Policy) is currently applied on the Hunter Network, between coal traffic and non-coal traffic, between export coal traffic and domestic coal traffic, and between export coal traffic from various rail loadpoints.

Most Hunter Coal Traffic currently pays both its marginal cost and all fixed costs and capital-related charges associated with most of the Hunter Network on a stand-alone basis. All other traffic is thought to pay only the marginal costs of its access to the Hunter Network.

In addition, the Undertaking removes ARTC's 2002 commitment to ongoing reductions in real prices charged to users by now allowing escalation of access charges by up to full CPI.

The different circumstances applying to Hunter Coal Traffic will require changes to the provisions of the Undertaking and the subsequent Hunter Undertaking in the following areas

- Pricing Principles: If the pricing provisions in both the 2002 Undertaking and the 2007 Undertaking were to be applied to the Hunter Coal Traffic, some parts of the pricing principles could be contradictory, the absence of a stand-alone test for the floor and ceiling limits would allow cross-subsidisation and the collection of monopoly rent, the provisions relating to charge differentiation would be too general and non-prescriptive, and the Access Charge structure may not be consistent with the capacity characteristics of the Network.

Also, great care would have to be given to satisfactorily addressing the issues associated with the implementation of price discrimination, determining floor and ceiling limits and other features that were untested in the 2002 Undertaking.

In addition, access pricing principles added to the 2007 Undertaking appear to introduce some substantial departures from the 2002 Undertaking and other access regimes and undertakings for rail access and other services currently in force in Australia, in relation to the definition of floor and ceiling limits and the escalation of Access Charges.

Details of these concerns with the pricing principles and the changes needed in the Undertaking and subsequent Hunter Undertaking are set out under Clauses 4.2, 4.3, 4.4, 4.5 and 4.6 in Section 5.4 of this Submission.

- Passenger Traffic Priority: Under s19D(2)(f) of the Transport Administration Act, the current infrastructure owner is required to maintain reasonable priority to passenger train services in NSW, including on the Hunter Network.

There is a particular problem of applying priority to passenger traffic when price discrimination may result in that traffic paying less than traffic given lower priority. This discrimination in access priority has the opposite effect to the purpose of price discrimination. The economic inefficiency of this would be exacerbated if an Applicant for Access had to pay the full cost of Additional Capacity, and then have a lower priority than passenger traffic to use that Additional Capacity.

An outline of the approach needed in the Undertaking and the subsequent Hunter Undertaking is set out under Clause 3.6 in Section 5.3 of this Submission.

- Provision of Price Information: The information provided by ARTC under Clause 3.3 of both the 2002 Undertaking and the 2007 Undertaking will not allow rail users to establish where ARTC's revenue limits actually lie on any particular segment.

Details of the information needed are set out under Clause 3.3 in Section 5.3 of this Submission and also relevant to Clauses 2.7 (b) (iv) and Clause 3.8 in Section 5.

- Determination of Capacity: The experience of the NSWMC on the Hunter Network is that the active cooperation of the network manager is needed to adequately determine the capacity of the network, because of the high degree of interdependence of the various traffics when demand on the network is nearing capacity.

The Hunter Coal Traffic Operators and End Users have received a high degree of cooperation, originally from Rail Infrastructure Corporation and then from ARTC, in analysing the capacity of the Hunter and contiguous Networks and understanding fully the capacity issues on the Networks, under the provisions in S3.4 of Schedule 3 of the NSW Undertaking.

However, there is no provision in both the 2002 Undertaking and the 2007 Undertaking for this process to continue, leaving Operators and End Users entirely dependent on the continuing cooperation of ARTC and setting no basis or parameters for the consultation process.

An outline of the process needed in the Undertaking is set out under Clause 6.2 (a) B) (Provisions Needed for Coal Traffic) in Section 5.6 of this Submission.

- Allocation of Capacity: In both the 2002 Undertaking and the 2007 Undertaking, allocation of mutually exclusive capacity is considered only in the context of a contracted Train Path. Because the nature of the coal transport task on the Hunter Network makes regular contracted Train Paths irrelevant, a different approach to capacity allocation, train scheduling/pathing and network management principles (real-time train control) is needed for such traffic.

An outline of the approach needed in the Undertaking is set out under Clauses 3.6, 3.8, 5.3, 5.4 and 7/Schedule F in Section 5 of this Submission.

Additionally, as ARTC recognises, operational and commercial differences will require other significant changes in the provisions of the 2002 and 2007 Undertakings relating to the provision of additional capacity if they are to be applied to Hunter coal traffic.

While opportunities to clarify aspects of the ARTC's proposed Hunter Undertaking have been limited, NSWMC also looks forward to working constructively with ARTC and the Hunter coal haulage Operators (Pacific National and QRNational) to address these matters in the development of ARTC's Hunter Undertaking with the goal of formulating an undertaking that is substantially acceptable to all parties.

5. ISSUES

To address the issues in this Section of the Submission, NSWMC has commented in detail on the provisions of the Undertaking, explaining its concerns and putting forward specific principles or amendments to address them in the Undertaking and the subsequent Hunter Undertaking.

For ease of reference, NSWMC's comments for each Part of the Undertaking, as set out using the same Part and Clause numbers as the Undertaking.

NSWMC will be pleased to supply any further information required.

5.1 Part 1: Preamble

Clause 1.1 (c) Full Recovery of Costs

This Clause includes the statement that "Accordingly, in ARTC's view, it is unlikely to be able to price in any of its markets at levels which will fully recover the full economic costs of its assets."

However, as outlined in Section 4 of this Submission, it is expected that, for most Hunter coal traffic, ARTC is currently, and will in future continue to be, able to recover the full economic costs of the assets.

While ARTC's Interstate Undertaking does not apply to the Hunter Network, where ARTC is able to fully recover the full economic costs of its assets, NSWMC suggests that this statement be modified appropriately.

Clause 1.2 (c) Efficient Costs

In this Clause and elsewhere in the Undertaking, costs are referred to frequently, including such terms as 'reasonable costs' and 'costs reasonably incurred by ARTC'.

Where monopoly service providers' costs are recovered through charges on customers, it has now, quite correctly, been established that the service provider is entitled to recover no more than efficient costs where these are less than actual costs. This has been acknowledged to some extent in the definition of Out-turn Opex and Net Capex in Clause 4.4 (d), where these costs are defined as "on an industry efficient basis" and "on a Prudent basis". This qualification does not however follow through to such definitions as 'Economic Costs of a Segment', 'Segment Specific Costs' and 'Non-Segment Specific Costs'.

NSWMC suggests that wherever there is mention of costs that are recovered from rail users, it needs to be made clear that these costs are always efficient costs.

Clause 1.2 (c) Price Discrimination

This Clause says "The intent of the Undertaking is to ... reach an appropriate balance between: and (iii) the interests of Applicant's [sic] wanting Access to the Network, including.....(B) providing Access in an open, efficient and non-discriminatory manner.

However, this Undertaking may be the first major undertaking proposed under the 2006 amendments to the Trade Practices Act. These amendments allow price discrimination where this aids economic efficiency. The COAG Communiqué of 10 February 2006 said that ARTC's Undertaking would be a model for other major undertakings.

In Clauses 4.2 and 4.3, the Undertaking provides for 'Charge Differentiation'. While this avoids the term 'discrimination' these Clauses do appear to provide for price discrimination. Also, as outlined in Section 4 of this Submission, it is expected that the Hunter Undertaking will clearly provide for price discrimination.

In addition to price discrimination, the Undertaking has to accommodate various States' requirements for priority to be given to passenger trains on the rail network managed by ARTC. The COAG communiqué reinforced this obligation on ARTC. This represents a form of non-price discrimination that ARTC and the Undertaking cannot avoid.

ARTC is therefore unable to comply with the objective of providing Access in a non-discriminatory manner.

NSWMC suggests that the Undertaking acknowledge in the Preamble that there will be both price and non-price discrimination. As discussed in Section 5.4 of this Submission it is suggested that the Undertaking require that ARTC justify to an Applicant any price or non-price discrimination that it applies to the Applicant and that non-price discrimination be taken into account in relative pricing of access.

5.2 Part 2: Scope of Undertaking

Clause 2.7 (b) (iv) Publication of Access Prices for Existing Services

In this Clause, the provision for ARTC to publish "prices for which Access has been granted together with a general description of the Services to which such prices relate" is critical if ARTC is to achieve the objectives in Clause 1.2 to

- (a) establish a workable, open, non-discriminatory, efficient and inclusive process for lodging and processing Access Applications
- (b) use transparent and detailed methodologies, principles and processes for determining access revenue limits, terms and conditions.

NSWMC suggests this provision be made effective and strengthened by adding "and the factors which have been applied to determine such prices".

An Access Seeker needs to understand the way in which other access prices have been determined if it is to be adequately informed in negotiating access with ARTC. Without such information, the Access Seeker cannot meaningfully compare prices and judge an appropriate price for the Access it is seeking. Provision of this information is fundamental to achieving the objective of transparency.

5.3 Part 3: Negotiating for Access

Clause 3.3 (a) (ix) Provision of Access Pricing Information

This Sub-clause does not provide sufficient information about access pricing for the Segments for which Access is being sought. As a guide, the minimum information required is as specified in Schedule 5 of the NSW Undertaking, with the following qualifications

- cost information should be on a forward looking efficient cost basis
- cost information should be provided segment-by-segment
- cost attribution methodology should be in sufficient detail to determine all costs on a segment-by-segment basis
- the portion of costs that are incremental costs for the purpose of the Floor Limit should be identified
- full details of the determination of major periodic Maintenance should be provided
- usage should be precisely defined, rather than in wide bands.

Clause 3.4 (d) (ii) and (iii) Prudential Requirements

Sub-clause (ii) allows ARTC to refuse to commence negotiations with an Applicant in Material Default of any agreement with ARTC or other rail infrastructure agreement currently or in the previous two years.

The Sub-clause is much too restrictive and an inappropriate barrier to negotiation: it would include legitimate business disputes between ARTC and existing rail operators which have yet to be legally resolved or which have been legitimately resolved in the previous two years as well disputes between the Applicant and other access providers about which ARTC is unlikely to be in possession of all the facts. The Sub-clause should be modified accordingly.

Sub-clause (iii) requires an Applicant to demonstrate its prudential capacity to the satisfaction of ARTC before ARTC will negotiate with it.

This Subclause is a time-consuming cost imposition on Applicants and an unnecessary barrier to negotiation. It is a requirement that can, is, and would normally be, addressed in the Access Agreement. The Subclause should be removed from the Undertaking.

Clause 3.6 Information Required by ARTC in Schedule B

This Clause provides that the Applicant must submit an Access Application to ARTC accompanied by the information set out in Schedule B.

NSWMC believes the provisions of this Clause and others in the Undertaking dealing with capacity management are designed for non-coal traffic on the Interstate Network and are inappropriate, inadequate and potentially unworkable for the Hunter Coal Traffic on the Interstate Network and Country RIC and RailCorp networks that are contiguous with the Hunter Network and on the Hunter Network itself.

NSWMC considers that the Undertaking and the subsequent Hunter Undertaking must allow for the fact that the operating and commercial characteristics of that coal traffic, including allocation of capacity, train scheduling/pathing and network management principles (real-time train control), are very different to those of other traffics using the Interstate Network and the Hunter Network.

Given the critical role of the Hunter Coal Traffic in the optimization of the complex logistics of the Hunter Coal Chain, the magnitude and economic importance of the Hunter coal traffic and the high access charges it pays, the Undertaking and the Hunter Undertaking should fully accommodate the particular operating and commercial characteristics of that traffic. Clauses in the Undertaking where this will be necessary include

- Clause 3.6 and Schedule B Item 2, particularly sub-items (b), (c) and (e), dealing with the Access Application
- Clause 3.8 dealing with the Indicative Access Proposal
- Clause 4.5 dealing with the structure of Access Charges
- Clauses 5.3 and 5.4 dealing with capacity allocation and capacity transfer
- Clause 7 and Schedule F dealing with Network Transit Management.

NSWMC suggests that the provisions of the above Clauses and Schedule in the Undertaking and Hunter Undertaking should be consistent with the principles that

- for coal traffic, an existing access holder or Applicant may submit applications to ARTC for network capacity without nominating specific Train Paths
- traffic that pays higher access charges than other traffic will have capacity and Train Path priority over that other traffic, except as provided for in legislation. Therefore, if a coal traffic pays a higher price for access than non-coal traffic, it will have priority over that non-coal traffic (other than traffic that has legislated priority) in short and longer-term capacity allocation and in resolving short term train conflicts (train scheduling and network transit management)

- required annual capacity for coal traffic on the Interstate Network contiguous with the Hunter Network and the Hunter Network itself will be determined by the Hunter Coal Chain participants in consultation with ARTC
- where traffic on the Interstate Network interfaces with Hunter traffic, the capacity and mode of operation of the Hunter Network will be taken into account when determining capacity of the Interstate Network
- Hunter Coal Chain participants, rather than ARTC, will determine between themselves how coal trains are scheduled in relation to other coal trains, to maximise the capacity and efficiency of the Coal Chain.

The preferred mechanism for allocating capacity and Train Paths for coal in the Undertaking and the Hunter Undertaking should not prohibit users from nominating mandatory Train Paths for coal if they so desire, but detailed provisions should be developed with the Hunter Coal Chain participants.

Clauses 3.8 (a), (b) and (e) Timely Provision of the Indicative Access Proposal

In Clause 3.8 (a), ARTC is required to “use reasonable efforts to provide the Indicative Access Proposal to the Applicant within thirty (30) Business Days of [ARTC’s] acknowledgement” but there is no course of action specified if ARTC does not provide the information within the thirty day period.

In Clause 3.8 (b), where ARTC “consider[s] that, due to the complexity of the Access Application or due to other extenuating circumstances it is not reasonable for it to provide an Indicative Access Proposal within thirty (30) Business Days,..... it will advise of such in its acknowledgement and will advise the Applicant of its estimate of the time required to deliver the Indicative Access Proposal [and] use reasonable efforts to provide the Indicative Access Proposal within [ARTC’s] estimated time....or [the time] as otherwise determined by the arbitrator....”. Again, there is no course of action specified if ARTC does not provide the information within the estimated or determined period.

Clause 3.8 (e), provides that “If [after the time periods in Clauses 3.8 (a) or Clause 3.8 (b)], the Applicant believes that ARTC is not making reasonable progress in the preparation of the proposal, then the Applicant may refer the matter to the arbitrator for a determination ***in relation to the progress of the Indicative Access Proposal*** (NSWMC emphasis) in accordance with Clause 3.12.4.” The words in ***italics*** are not in the corresponding Clause 3.8 (e) of the 2002 Undertaking but have been added to this 2007 Undertaking.

To meet the Undertaking’s intent in Clause 1.2 (a) to establish a workable and efficient process for processing Access Applications, NSWMC believes that an Applicant should not be unnecessarily delayed in negotiating access terms and conditions, and that ARTC must be accountable if it does not meet its obligations under the Undertaking, whether after reasonable efforts or not.

NSWMC suggests that Clause 3.8 (e) be amended by deleting the words in ***italics*** and, for clarity, substituting the words “of access terms and conditions”.

Clause 3.8 (c) (v) Charges for Access Rights

This Clause requires ARTC to set out, in the Indicative Access Proposal it provides to the Applicant, “an initial estimate of the Charges for the Access Rights, based on the pricing principles in Part 4” of the Undertaking.

NSWMC believes that, under this provision, the Access Proposal will not

- contain sufficient information and details about the Access Charges to enable the access Seeker to adequately evaluate the Proposal
- provide an adequate basis for meaningful negotiation of Access Charges

NSWMC believes that, unless the initial estimate of the Access Charges is accompanied by a full explanation of ARTC's derivation of the charges including the numerical data used, in line with the provisions of Schedule 5 of the NSW Undertaking, as detailed under Clause 3.3 (a) (ix) in Section 5.3 of this Submission, this provision cannot possibly comply with the intent of the Undertaking in

- Clause 1.2 (b), to "use transparent and detailed methodologies, principles and processes for determining revenue limits, terms and conditions".
- Clause 1.2 (c), to "reach an appropriate balance between (i) the legitimate business interests of ARTC [including] (A) the recovery of all reasonable costs associated with the granting of Access to the Network [and] (B) a fair and reasonable return on ARTC's investment in the Network and Associated Facilities commensurate with its commercial riskand (iii) the interests of Applicant's [sic]...including (A) providing Access to the Network on fair and reasonable terms; and (B) providing Access in an open, efficient and non-discriminatory manner".
- Clause 1.2 (a) "to establish a workable, open, non-discriminatory, efficient and inclusive process for lodging and processing Access Applications".

This is particularly relevant for coal traffic on the Interstate Network contiguous with the Hunter Network and on the Hunter Network itself, where Access Charges are likely to be above the conventional floor limit as defined in other rail access regimes (see the discussion under Section 5.4, Part 4: Pricing Principles, Clause 4.4 of this Submission).

Provision of a full explanation and data is fundamental to effectively evaluating the proposal and providing an adequate basis for meaningful negotiations. The Applicant must be able to assess how the Access Charge proposed by ARTC relates to the Floor and Ceiling limits and the Access Charges for other relevant Services. Without this information, the Applicant will, in many cases, almost inevitably be forced to initiate the arbitration process.

NSWMC suggests that, in Clause 3.8 (c) (v) and where appropriate elsewhere in Part 3, the Undertaking make clear that the proposed Access Charges will be accompanied by a full explanation, including supporting numerical data, of how ARTC determined the initial estimate of the Access Charges and any Access Charges it subsequently proposes during the negotiating process.

Clause 3.10 (b) (iv) and (v) Cessation of the Negotiation Period

In the Undertaking, sub-clause 3.10 (b) (iv) in the 2002 Undertaking has been split into two Sub-clauses, (iv) and (v). These two Sub-clauses would substantially prejudice the interests of Applicants in that they

- do not provide sufficient clarity about the instances in which ARTC can cease negotiations
- allow ARTC an inappropriate level of discretion to cease negotiations; and hence
- do not achieve an acceptable balance between the interests of ARTC and Applicants.

Sub-clause (iv) in the Undertaking provides for the negotiation period to cease "if ARTC is of the view that the negotiations are not progressing in good faith towards the development of an Access Agreement within a reasonable time period".

This Sub-clause would give excessive and unfair negotiating power to ARTC by allowing it to cease negotiations at its whim, to the disadvantage of the Applicant. The disadvantage would arise because it is not clear from the wording of the Undertaking that a dispute "in relation to the negotiation of Access" would exist (negotiation having "ceased") thereby allowing the dispute to be dealt with under Clause 3.12. Even if Clause 3.12 did apply, the Applicant would have no alternative but to endure the delays and costs of the processes in Clause 3.12.

Sub-clause (v) in the Undertaking provides for the negotiation period to cease if "sub-clause (iv) applies and ARTC refers the matter to the arbitrator under clause 3.12.4 for a determination and such determination is found in ARTC's favour".

However, if the Applicant is of the view that the negotiations are not progressing in good faith, there is no reciprocal right for the Applicant to refer the matter to the arbitrator. This Sub-clause generates unequal negotiating power between the two parties.

NSWMC suggests that Sub-clauses (iv) and (v) be recombined and made reciprocal. Alternatively, the Sub-clauses could be deleted altogether and each party allowed recourse to dispute settlement, including arbitration under Clause 3.12.1 (a).

Clause 3.10 (d) (ii) ARTC Acceptance of the Most Favourable Access Agreement

The possibility of two or more Applicants seeking mutually exclusive access rights is most likely on heavily trafficked segments of the Interstate Network including those carrying heavy coal traffic contiguous to the Hunter Network and on the Hunter Network itself. In many cases, however, sufficient Additional Capacity to provide capacity for all Applicants may be able to be provided relatively quickly and at relatively low extra cost.

NSWMC believes that two or more Applicants concurrently negotiating for access in such circumstances is akin to an auction and the Applicants should have the protections bidders would have in an auction. Without such protections, Applicants will not be adequately informed about how ARTC intends to negotiate on access and ARTC will not meet the intent of the Undertaking in Clauses 1.2 (a), (b) and (c) to establish a workable, open, non-discriminatory, efficient and inclusive process; use transparent processes for determining access terms and conditions; and reach an appropriate balance between the legitimate business interests of ARTC and the interests of the Applicants wanting Access to the Network.

Clause 3.10 (d) (ii) presently falls well short of these objectives. To adequately inform the Applicants in the negotiations, ARTC should make known to each Applicant involved

- any criteria (in addition to the highest net present value to ARTC) against which ARTC will determine the most favourable Access Agreement for the Available Capacity
- costs of providing Additional Capacity for the unsuccessful Applicant(s) (per Clause 6.2 of the Undertaking)
- the Access Charges for each Applicant that are equivalent to the other Applicant(s) offer(s)
- the process and schedule for initial, further and final offers by Applicants.

Also to help protect the interests of the Applicants, NSWMC believes the Undertaking should make absolutely clear in this Clause that Applicants have a right to refer the matters involved to the arbitrator under Clause 3.12.4.

Clause 3.12.1 (a) Dispute Resolution

NSWMC's interpretation and understanding of this Clause is, like ACCC's, that any and all matters covered in the Undertaking, including all matters relating to Parts 3, 4, 5, 6 and 7 in particular, are subject to the Dispute Resolution provisions of Clause 3.12.

As this understanding is fundamental to ensuring that this Undertaking provides an acceptable balance between the interests of ARTC and Access Seekers, NSWMC requests that this understanding be formally confirmed with ARTC as part of ACCC's consideration of the Undertaking.

5.4 Part 4: Pricing Principles

This Part of ARTC's Undertaking appear to be a substantial departure from ARTC's 2002 Undertaking and from other third party access regimes and undertakings for rail access and other services currently in force in Australia. It would have major implications for access pricing for Hunter Coal Traffic on the Interstate Network contiguous with the Hunter Network and the Hunter Network itself.

In particular, the pricing principles proposed appear to be inconsistent with currently accepted practice in pricing of regulated monopoly services in Australia in such matters as the omission of the stand-alone principle, the definition of floor and ceiling revenues and proposals for escalation of charges.

These deficiencies in access pricing mean that the Undertaking does not

- achieve the stated objective of striking a balance among the interests of ARTC, Access Seekers and the general public
- provide sufficient clarity about the application of several components of the access charges

NSWMC presents the following comments in response to its understanding of the Undertaking.

Clause 4.1 Objectives

This Clause says that “ARTC will develop its Charges with a view to achieving the objectives set out in clause 1.2 (c)”.

The comments on Clause 1.2 (c) in Section 5.1 of this Submission address the apparent inconsistencies between the objective of non-discrimination, the recent amendments to National Competition Policy that encourage price discrimination where this promotes economic efficiency, and the contents of Clause 4.2 which sets out the basis upon which ARTC may apply ‘differentiation’ to access charges.

The comments on Clause 1.2 (c) in Section 5.1 also explain why the reference to cost recovery in this Clause should make it clear that, while ARTC has a legitimate business interest in recovering all of its reasonable costs, ARTC should be entitled by these pricing principles to recover no more than ‘efficient costs’.

NSWMC also notes that the provisions of this Clause comprise parts of Clauses 1.1 (c) and 2.1 (c) with minor variations. NSWMC suggests that, to avoid confusion, this Clause be deleted and our comments above and in Section 5.1 of this Submission addressed in the appropriate Clauses of the Undertaking.

Clause 4.2 Charge Differentiation

NSWMC notes that the changes to National Competition Policy effected by the *Trade Practices Amendment (National Competition Policy) Act 2006* (Cth) now specifically recognise that access undertakings may apply discriminatory pricing where this aids economic efficiency.

NSWMC also notes the intent of the Undertaking in Clause 1.2 (b) to “use transparent and detailed methodologies, principles and processes for determining access revenue limits, terms and conditions”. In Clause 1.2 (c) (iii) its intent is to “reach an appropriate balance between ... the interests of Applicant’s [sic] wanting Access to the Network, including ... (B) providing Access in a open, efficient and non-discriminatory manner”. (Clause)

However, Clause 4.2, which sets out factors that ARTC may use in applying ‘Charge Differentiation’, will compromise the achievement of these objectives. Key concerns are that Clause 4.2

- does not explicitly provide for price discrimination, although it is expressed in such vague terms that price discrimination could be applied in a non-transparent manner
- does not specify the principle or principles upon which Charge Differentiation may be applied
- does not say how the factors listed may affect the Access Charge - for example whether different axle loads would result in a higher or lower Charge, and by how much
- effectively allows ARTC to apply any Access Charge it likes (within the limits specified in Clauses 4.3 and 4.4) without quantifying how the factors listed in Clause 4.2 contribute to the Charge or to

the difference between Charges for different Services.

NSWMC believes that the principles that apply to 'Charge Differentiation' should be clearly stated and should include

- there should be no discrimination in access pricing between the same types of traffic
- where discrimination is applied, if requested by an affected user of the relevant Service ARTC should be required to justify that discrimination to the ACCC on the basis of improved economic efficiency
- where discrimination is not applied, the Undertaking should state that the objective of 'Charge Differentiation' is to recover from each user the same proportion of the costs imposed on the Network by that user
- the Undertaking should clearly state how the factors listed in Clause 4.2 (c) affect the costs imposed on ARTC. This would help users in determining the most cost-effective train configurations, enhance transparency and encourage efficient use of the Network for the benefit of ARTC and all users.

NSWMC also suggests that Charge Differentiation should not be based on credit risk (Sub-clause (c) (v)) or performance risk (Sub-clause (d) (i)), which should be dealt with in the Access Agreement by means of performance obligations, guarantees and warranties, and that Sub-clause (d) should be deleted as the remaining factors can be considered under the factors in Sub-clause (c).

NSWMC notes the paragraph "For the purpose of clause 4.2 (c) (iv), ARTC will have regard to the predominant usage of the Network being for Indicative Services to which Indicative Access Charges apply".

This suggests that, if non-typical Services use the Network, ARTC will consider their effect on Train Paths used by typical Services in assessing the charge on the non-typical services.

This is particularly relevant for the Hunter Network, where the predominant usage of the Network is for coal Services. If this approach is applied, ARTC, in assessing the Access charges for other Services, will have to consider the effect of those other Services on Train Paths used by coal Services.

Clause 4.3 Limits on Charge Differentiation

This Clause sets out the circumstances under which the Charge differentiation provided for in Clause 4.2 will not be applied. However, further to the discussion on Clause 4.2 in this Submission, it is unclear whether the limits on Charge differentiation set out in Clause 4.3 apply to 'differentiation' or 'discrimination'.

NSWMC supports non-differentiation or non-discrimination between Applicants as set out in Clause 4.3(a) but is concerned that

- Clause 4.3 (b), without explicitly saying so, would allow ARTC to apply Charge discrimination as now permitted by the 2006 amendments to the Trade Practices Act
- in the absence of the stand-alone principle (see the discussion on Clause 4.4 in this Submission), Clause 4.3 does not apply any quantitative limits on Charge differentiation or discrimination.

A further concern is the imprecise definition of the circumstances in Clause 4.3 (b) in which ARTC would not differentiate or discriminate in formulating its Charges. The Clause states that "...ARTC will not differentiate between Applicants in circumstances where: (i) the characteristics of the Services are alike; and (ii) the Applicants are operating within the same end markets. For the purposes of this clause, ARTC shall determine whether the characteristics of two Services are alike having regard to matters including ... **characteristics of the Service** (NSWMC emphasis)...".

Clause 4.3 (b) does not effectively define when Services are alike. For example, it is not clear how

'alike' characteristics such as axle loads, train lengths, origin and destination and arrival and departure times need to be for ARTC to consider them 'alike'. It is also not clear whether it means that Applicants operating within the same end market would pay differentiated Charges where other terms of their Access Agreements are different or where the Train Paths sought have different market values.

NSWMC believes the imprecision and circularity of Clause 4.3 (b) would be removed if the various factors considered by ARTC and their exact effect were clearly specified as suggested in the discussion on Clause 4.2.

Also, in the case of coal Services, clarification will be needed in relation to the end market. The market for export coal is considered by many to be a single market, but by others to represent many markets. NSWMC considers that all coal should be treated equally and suggest that this be clearly specified, for example by stating that for the purposes of the Undertaking all coal (including coal intended for Australian domestic markets) is considered to have the same end market.

Clause 4.4 Revenue Limits

This Clause represents a substantial departure from nearly all current Australian rail access undertakings and regimes, including ARTC's own 2002 Undertaking which COAG suggested be a model for all Australian rail access regimes.

These current undertakings have revenue limits with the following principles

- there is a floor limit to revenue from each train service (or group of services) represented by the incremental cost that that service (or group of services) imposes on the infrastructure owner
- this incremental cost is effectively a cash cost and excludes fixed costs, depreciation and return on capital
- there is a ceiling limit to revenue from each train service (or group of services) represented by the full economic cost that that service (or group of services) imposes on the infrastructure owner.
- this full economic cost includes relevant fixed costs, depreciation and return on capital
- most undertakings, including the NSW Undertaking and the QR Undertaking but excluding ARTC's 2002 Undertaking, apply the floor and ceiling limits on a stand-alone basis.

Floor and ceiling limits in ARTC's Undertaking have the following features

- the floor limit includes avoidable costs rather than incremental costs
- ARTC's charges have to be not lower than the floor **unless otherwise agreed by ARTC** (NSWMC emphasis).

This means that there is no genuine floor equivalent to the floor in the current ARTC 2002, NSW or QR Undertakings. Under this principle, a traffic could be given access at a very low or even zero Access Charge. This could result in some rail users paying the incremental costs imposed on the Network by other rail users - in effect a cross-subsidy to those users.

For example, if this pricing principle were applied to the Interstate Network contiguous with the Hunter Network and the Hunter Network itself, ARTC could let non-coal traffic have access for less than the incremental costs imposed by that traffic. It could make up the revenue by increasing the Access Charges on coal traffic.

- the ceiling limit effectively allows the infrastructure owner to recover capitalised shortfalls from the ceiling limit in previous years.

It is not equitable that a new rail user, coming along in future years, or even an existing user can be called upon to pay accumulated losses that ARTC has incurred in serving other users in the previous years. This would also be completely inconsistent with the principle of efficient pricing

and the principle that the user of a monopoly service should pay no more than it would pay if the service were provided under conditions of competition.

- All costs used in determining the ceiling limit “shall comprise ARTC’s reasonably anticipated costs over a reasonable future timeframe”.

ARTC wants to include costs it hasn’t incurred yet, and may not. As well, this provision is too vague and its effect on Access Charges would be anomalous and hard to assess. ARTC is well protected against cost increases by the inflation adjustment provisions in Clause 4.6(e).

- the stand-alone principle does not apply to floor or ceiling tests.

The stand-alone principle is the principle that infrastructure users or groups of infrastructure users must be required to pay costs not lower than a floor value and must not be required to pay costs higher than a ceiling value on a stand-alone basis.

It is this principle that ensures that individual users or groups of users pay at least the incremental costs they impose on the infrastructure owner and that they pay for no more services, or for services of no higher standard, than they require for their own operations alone.

Without this principle, one type of traffic could be made to pay for rail infrastructure standards and capacity that it does not need or want. This too would be entirely inconsistent with the principle of efficient pricing and the principle that the user of a monopoly service should pay no more than it would pay if the service were provided under conditions of competition.

Implementation of this principle prevents cross-subsidisation between traffics and users and the imposition of monopoly rents on users.

Of course, in this context, NSWMC recognises that the minimum practicable rail infrastructure provided by the infrastructure owner can be of larger capacity than required for small amount of traffic.

NSWMC considers that the following principles should apply to floor and ceiling limits to revenue for all segments of the Interstate and Hunter Networks used by the Hunter Coal Traffic

- the stand-alone principle must apply.

Rail users must be required without exception to pay at least the incremental costs they impose on the infrastructure owner, on a service-by-service and group basis. They must not be required to pay for more than the services they require for their own operations alone.

- the floor test should include only genuine incremental costs

ARTC should not have the discretion to waive the obligation of any user or group of users to pay at least incremental costs

- the ceiling revenue should be limited to full economic costs and not include capitalised shortfalls from the ceiling in previous years carried forward (and compounded), except for new investments in the circumstances discussed below.

For the Hunter Coal Traffic, any shortfalls or surpluses of revenue resulting from variations from forecast traffic levels and costs can be adjusted on an annual basis by an “unders and overs” arrangement similar to that in the NSW Undertaking

- “Reasonably anticipated costs over a reasonable future timeframe should not be included in current Access Charges, even for a ceiling Charge, unless there is an “unders and overs” arrangement in place.

For Hunter Coal Traffic, actual costs incurred during the year should be used in determining the “unders and overs” adjustments each year, which is the practice under the NSW Undertaking and verified by the Regulator each year.

NSWMC acknowledges that there may be circumstances for a new asset investment where it may be appropriate for the infrastructure owner to recover shortfalls from its ceiling revenue in later years. Such circumstances might include the case of a user or group of users who require investment in new increment of capacity or improved Service capability where the users' current traffic levels are not sufficient to fully utilise the new increment of capacity or service capability and carry the cost increment in imposes but traffic levels are expected to increase over time to the utilisation levels needed to fully recover the incremental costs.

In these circumstances, those users might enter into a long-term agreement with the infrastructure owner that averages the Access Charge over the term of the agreement at a constant unit charge to enable the infrastructure owner to recover its investment as utilisation increases, rather than applying a unit charge that is initially high but which reduces over time as utilisation increases. However NSWMC does not consider that such a mechanism should be applied to currently existing assets.

Clause 4.4 (a) Revenue Limits Where RAB is Not Less Than RAB Floor Limit

Clause 4.4 (a) specifies a revenue limit for the case where the RAB is less than the RAB Floor Limit at the commencement of any year, but does not specify how a revenue ceiling is determined where the RAB is not less than the RAB Floor Limit at the commencement of any year. If, as is suggested in Clauses 1.1 (c) and 4.1, ARTC's revenue does not match the level permitted by the ceiling, it would appear that RAB would normally be not less than the RAB Floor Limit.

Clauses 4.4 (d) and (e) Rollover of RAB

A difficulty with the drafting of this clause is that there is still no clearly specified relationship between the RAB and the RAB Floor Limit and the value of Segment Specific Assets and Non-Segment Specific Assets in the definition of Economic Costs of a Segment (Clause 4.4 (f)).

The roll forward formula for RAB (and the definitions of Segment Specific Costs and Non-Segment Specific Costs) refers to operating expenditure incurred by ARTC without defining what is included in or excluded from operating expenditure. It is suggested that a clear statement is needed of what is included in operating costs for the purposes of those definitions.

As previously discussed, the purpose of defining a RAB and a RAB Floor Limit appears to be to allow ARTC to capitalise shortfalls from its ceiling revenue and recover them in subsequent years. This was addressed in the discussion on floor and ceiling limits.

Clause 4.4(h) Rate of Return

This Clause states that the elements of the WACC shall comprise "... a debt to equity ratio that would be considered prudent for ARTC's business in relation to the Network by reputable lenders; and an appropriate adjustment (beta) factor to the equity risk margin appropriate for investment in railway infrastructure forming part of the network".

NSWMC considers that

- the debt to equity ratio should be one that is considered the optimum target level for companies seeking to retain an investment grade credit rating appropriate for ARTC's business (as stated by the Independent Pricing and Regulatory Tribunal of NSW in its Final Report on Aspects of the NSW Rail Access Regime, 28n April 1999) in comparison with similar infrastructure businesses, rather than prudent as decided by reputable lenders. The latter would result in unduly low gearing being assumed for the purpose of calculating the rate of return
- it is unclear whether the reference to "an appropriate adjustment (beta) factor to the equity risk margin appropriate for investment in railway infrastructure forming part of the Network" is a reference to an appropriate beta, or an adjustment to the beta related to investment in railway infrastructure.

In several recent submissions by NSWMC to the Productivity Commission, NSWMC has advocated that the WACC applied to regulated monopoly services include a separately identified 'investment encouragement' component to ensure the WACC really is high enough to encourage investment, provided that this is determined by the regulator and does not result in double counting of an investment risk premium incorporated into the beta as well as a separate investment incentive component. NSWMC continues to hold that view.

Clause 4.5 Structure of Charges

This Clause provides that Access Charges will comprise flagfall and variable components and another component, an excess network occupancy charge, that is not present in ARTC's 2002 Undertaking. NSWMC has no objection in principle to a multipart access charging structure as a means of encouraging optimum track utilisation for traffic other than Hunter Coal Traffic.

However, for Hunter Coal Traffic operating under circumstances of constrained capacity on the Hunter Network, recent experience has indicated that a multipart tariff needs to be carefully designed so that it is consistent with the capacity characteristics of the Network. For example, maximising train lengths may not result in the most efficient utilisation of the Hunter Network in its current configuration and as part of the Hunter Coal Chain.

In these circumstances, NSWMC believes that carefully designed multipart pricing (flagfall plus \$/gtk) may be appropriate in the medium or longer term. In the shorter-term, while the Hunter Network is subject to capacity constraints and work continues to optimize use of the Network in conjunction with the whole Hunter Coal Chain, NSWMC believes that Access Charges for all Hunter Coal Traffic using the Interstate, RIC or RailCorp Networks contiguous with the Hunter Network and the Hunter Network itself should be expressed as a uniform rate per net tonne kilometre (\$/ntk).

Clause 4.6 Indicative Access Charge

NSWMC notes that the Undertaking does not refer to different classes of access e.g. the low, standard, high, premium and super premium categories that are currently offered by ARTC. If these classes of access are to continue, the need for transparency dictates that the differences between them should be explained in the Undertaking.

Clause 4.6 (e) Inflation Adjustment

Clause 4.6 (e) provides for inflation adjustment of the Access Charge. It permits ARTC to increase Charges each year by less than CPI if it chooses to do so, but if it does increase the Charges in any year by less than CPI, it can catch up in subsequent years if it likes. This would potentially allow ARTC to escalate Charges by much more than permitted in the 2002 Undertaking, which provides for inflation adjustment of 2/3rds of CPI or CPI-2%, whichever is greater.

NSWMC believes that the inflation adjustment sought in the Undertaking is inappropriate, in that virtually all other third party access regimes in Australia, including ARTC's 2002 Undertaking, provide for inflation adjustment of less than the full value of the CPI. To do otherwise is to invite inefficient operating and maintenance practices.

NSWMC recognises however that there may be circumstances where it is appropriate for unit Access Charges to increase year-on-year by more than the rate of inflation, where these Charges are consistent with efficient costs. Such circumstances may be brought about by lower demand or investment in increased capacity or improved quality of the Service.

NSWMC considers that, where ARTC believes this is the case, it should be required to justify the increase to the ACCC or to the Operators and End Users by means of the consultation process suggested by NSWMC under Clause 6.2 in Part 5.6 of this Submission.

NSWMC also believes that, for Hunter Coal Traffic where Access Charges are recovering Ceiling Limit revenues on most segments, the Interstate Undertaking and subsequent Hunter Undertaking should

provide for Access Charges be adjusted on an annual basis by an “unders and overs” arrangement similar to that in the NSW Undertaking.

Part 5: Management of Capacity

General

NSWMC suggests that, as Clauses 5.1, 5.2 and 5.3 are part of the process of negotiating for Access, the Undertaking should make absolutely clear that they are subject to the dispute resolution provisions of Clause 3.12 of the Undertaking.

Clause 5.1 (b) Payment for Capacity Analysis

Clause 5.1 (b) allows ARTC to charge an additional fee, based on reasonable cost, in the case where a Capacity Analysis has to be done in more detail because there may be major impediments to the provision of Additional Capacity.

NSWMC believes that Clause 5.1 (b) should be amended to provide that

- the scope of the Capacity Analysis and the fee will be agreed by ARTC and the Applicant beforehand
- in return for paying for the Capacity Analysis, the Applicant will have full access to the report and details of the Analysis
- any application of Clause 5.1 (b) should be subject to the dispute resolution provisions of the Undertaking.

Clause 5.2 (a) Capacity Reservation

Clause 5.2 (a) provides that, where an Applicant seeks to execute an Access Agreement more than six months prior to using those Access Rights, “ARTC will, at its absolute discretion, execute the Access Agreement subject to

- (i) there being sufficient available capacity to accommodate the Services until the commencement of operating the Services
- (ii) the Applicant agrees (sic) to pay any Reservation Fee that may be sought by ARTC in relation to the period between execution of the Access Agreement and commencement of operating the Services”.

Clause 5.2 (a) (ii) also provides that “in determining the Reservation Fee, ARTC will have regard to the opportunity cost forgone in relation to the reserved Access Rights, the period of reservation, and any other demand for the Access Rights [and that] the Reservation Fee will be reduced to the extent of any utilisation of the Access Rights during the period of reservation by another Access Seeker”.

NSWMC believes that the issue of Capacity reservation needs to be addressed in the Undertaking. Coal End Users and their rail haulage and port terminal operators will want certainty of Access before committing to the large investments often required to develop additional mine, rail loadpoint, rail haulage and terminal capacity. These investments often have lead times well beyond six months e.g. one, two or even three years. Many new non-coal traffics will also want certainty of access before they commit to substantial investments.

Certainty of Access will be particularly relevant when, from time to time in future, utilisation under existing Access Agreements may be relatively close to capacity for segments of the Hunter Network and contiguous segments of the Interstate Network.

However, Clause 5.2 (a), which was not in ARTC’s 2002 Undertaking, does not provide any certainty that the rail Access needed by the End Users and their operators will be available beyond six months.

In addition, the approach to determining the Reservation Fee in Clause 5.2 (a) would inflate the fee above the actual opportunity cost forgone, if any. This is because, if a subsequent Applicant utilises the Access Rights reserved for the first Applicant during the reservation period (and then, when the first Applicant starts to utilise its Access Rights, utilises its own Additional Capacity), there will be no opportunity cost forgone by ARTC. If the subsequent Applicant cannot utilise the Access Rights during the reservation period there is no opportunity cost foregone by ARTC anyway.

NSWMC believes that the reservation of Available Capacity and of Additional Capacity on the Interstate Network contiguous with the Hunter Network and on the Hunter Network itself should be made under the arrangements for allocation of Capacity discussed in this Submission under Clause 3.6 and the arrangements for provision of Additional Capacity discussed under Clause 6.2 (a) B Provisions Needed for Coal Traffic.

NSWMC also anticipates discussing with ARTC and the Hunter coal haulage Operators detailed provisions for the Hunter Undertaking covering the expected growth of Hunter Coal Traffic.

Clause 5.2 (b) Limits on Charge Differentiation with Capacity Reservation

Clause 5.2 (b) provides that "Limits on charge differentiation in relation to clause 4.3 do not apply to Access Rights made available under this clause."

NSWMC can see no reason why the limits on Charge Differentiation should not apply when Capacity is reserved as there will be no opportunity costs forgone by ARTC. Even if there were opportunity costs, they should be recovered in any reservation fee rather than by removing the limits on charge differentiation which would allow ARTC 'open slather' in setting access charges.

NSWMC believes that Clause 5.2 (b), which was not in ARTC's 2002 Undertaking, should be deleted.

Clause 5.3 Capacity Allocation

Clause 5.3 (a) provides that "Subject to clause 5.2 (b), Access Rights will be allocated to the first Customer with whom ARTC can negotiate and execute an Access Agreement which, in the opinion of ARTC, is most favourable to it."

The reference to "clause 5.2 (b)" appears to be an incorrect reference to "clause 5.3 (b)". However, if it is in fact a reference to Clause 5.2 (b), it should not be included for the reasons Clause 5.2 (b) should not be included as set out in the above Section of this Submission.

More critically, the application of the two Sub-clauses, 5.3 (a) and 5.3 (b), is confusing. If ARTC is negotiating with one Applicant (Sub-clause 5.3 (a)?), then it should allocate Access Rights when it executes an Access Agreement that is satisfactory (rather than "most favourable") to it. If it is negotiating with more than one Applicant for the same Access Rights (Sub-clause 5.3 (b)?), then it should allocate the Access Rights to the Applicant who will execute the Access Agreement that is most favourable to ARTC, as provided for in Clause 5.3 (b).

In fact, the intent of the Undertaking would be much clearer if Clause 5.3 did not exist: the content of Sub-clause 5.3 (a) more properly belongs in Clause 3.10: and Sub-clause 5.3 (b) appears unnecessary as it has the same purpose and content as Clause 3.10 (d).

NSWMC suggests that, to avoid doubt, the whole of Clause 5.3 be deleted and that the content of Clause 5.3 (a) be clarified and incorporated in an expanded Clause 3.10 dealing with the conclusion of negotiations by executing an Access Agreement.

Clause 5.4 Capacity Transfer

Clause 5.4 covers methods for varying Capacity Entitlement where it is under-utilised by the Customer. The following Sub-clauses provide

- (a) that ARTC may unilaterally remove particular Train Paths, subject to the dispute resolution provision in the Access Agreement
- (b) for the Customer to cancel Train Paths in accordance with the terms of the Access Agreement
- (c) for the Customer to assign Train Paths to a third party in accordance with the terms of the Access Agreement.

NSWMC supports the objective of building flexibility into the Capacity Entitlement provisions of the Undertaking and the Access Agreements while also pursuing the intent of the Undertaking set out in Clause 1.2 (c).

This objective will be particularly relevant in the case of Hunter Coal Traffic using the Interstate Network contiguous with the Hunter Network and the Hunter Network itself where there will be

- inevitable short-term fluctuations in quantities being railed due to short-term variations in operational and business circumstances
- gradual growth in railings due to gradual growth in coal shipments from existing mines
- more substantial changes to railings resulting from revisions to Operators' and End Users' business plans and the closure of existing and development of new coal production capacity.

NSWMC also believes it is essential to facilitate above rail competition for coal haulage by providing for the Capacity Entitlement used by an Operator for a particular End User's haulage contract to be available to another Operator who subsequently wins that haulage contract. As the Hunter Network is likely to be capacity constrained or close to it for the term of the Undertaking, it is critical that existing Operators are not able to prevent effective above rail competition by preventing their competitors accessing relevant Capacity Entitlements in these circumstances.

NSWMC anticipates discussing with ARTC the best means of achieving this flexibility in the Hunter Undertaking but, in the meantime, suggests that, for the Interstate Undertaking

- Clause 5.4 (a) should provide for the terms of the Access Agreement to allow for under-utilisation due to force majeure, tolerances for normal fluctuations in railings and for Customers to have the right to retain the Capacity Entitlement while it is not sought by another Applicant
- where an End User enters a haulage contract with a new Operator which supersedes the original Operator's contract, the new Operator have the right to seek assignment or termination of the original Operator's Access Rights where that is necessary to provide sufficient capacity for the new Operator.

5.6 Part 6: Network Connections and Additions

General

NSWMC suggests that, as Clauses 6.1 and 6.2 are part of the process of negotiating for Access, the Undertaking should make absolutely clear that they are subject to the dispute resolution provisions of Clause 3.12 of the Undertaking.

To facilitate a consistent and complete approach to Capacity Management in negotiating for Access and in Access Agreements, Clauses 6.2 and 6.3 would seem more appropriately located in Part 5 of the Draft Undertaking (Management of Capacity), as the detailed comments in the following sections highlight.

Clause 6.1 (b) Refusal of Consent to Network Connections

This Clause provides that "If ARTC has refused consent [to connect track to the Network] under clause 6.1 (a) (ii), ARTC will, if requested by the Applicant, notify the Applicant in writing of the reasons why the connection would, in its view reduce Capacity."

NSWMC believes that, to provide more flexibility, this Clause should be amended to require also that, if requested by the Applicant, ARTC will notify the Applicant of the changes to the connection needed to maintain Capacity and/or any extra charge that may be needed by ARTC to compensate for the Capacity reduction if it were to accept the connection.

Clause 6.2 (a) Conditions for Provision of Additional Capacity

A) Approach Taken in the Undertaking

Clause 6.2 (a) provides that “ARTC will consent to the provision of Additional Capacity if

- (i) in ARTC’s opinion, such provision is commercially viable to ARTC...; or
- (ii) the Applicant agrees to meet the cost of the Additional Capacity; and
- (iii) the Additional Capacity...is, in the opinion of ARTC, technically and economically feasible, consistent with the safe and reliable operation of the Network, will not impact on the safety of any user of the Network, does not reduce capacity, meets ARTC’s engineering and operational standards and does not compromise ARTC’s legitimate business interests.”

NSWMC believes that these conditions are confusing in that economic considerations are mixed up with technical considerations and economic considerations are not applicable if the Applicant agrees to meet the cost of the Additional Capacity. They do not provide a sound, clear basis for determining whether ARTC should consent to the provision of Additional Capacity

NSWMC believes that the conditions should be restated for clarity as follows

- (i) the Additional Capacity..., in the opinion of ARTC, is technically feasible, is consistent with the safe and reliable operation of the Network, will not impact on the safety of any user of the Network, and meets ARTC’s engineering and operational standards; and
- (ii) provision of the Additional Capacity does not reduce existing Capacity, or where it does, the Applicant is prepared to accept an extra charge to compensate for the Capacity reduction; and
- (iii) in ARTC’s opinion, such provision is economically feasible and commercially viable to ARTC...; or
- (iv) the Applicant agrees to meet the cost of the Additional Capacity.

B) Provisions Needed for Coal Traffic

NSWMC believes Clause 6.2 (a) is designed for non-coal traffic on the Interstate Network and is inadequate, inappropriate and potentially unworkable for the capacity and investment issues that will arise for Hunter Coal Traffic on the Interstate Network and Country RIC and RailCorp networks contiguous with the Hunter Network and the Hunter Network itself.

NSWMC is concerned that the Clause, even as clarified above, has a number of weaknesses in relation to Hunter Coal Traffic that need to be addressed in the Undertaking and Hunter Undertaking because there is

- no requirement for the infrastructure owner, ARTC, to consult with Operators and End Users generally on capacity issues, capacity expansion plans and capital expenditure plans and projects.

Without regular, detailed consultation, prospective capacity shortfalls and capital costs may only become apparent to Operators and End Users when they make an application for Access requiring Additional Capacity

- no obligation on ARTC, to invest in new capacity

- no provision for tests for prudence of scope, standard and cost of capital projects
- no provision for audit, whether by the regulator or otherwise, of capital costs that are included in the asset base.

NSWMC believes the provisions of the Undertaking and the Hunter Undertaking for planning, approval and inclusion in the asset base of capital projects should include

- full consultation between ARTC, Operators and major End Users such as Hunter coal producers on capacity utilization and capital projects, both before commencement and after completion of projects.

This consultation should be more or less in line with the provisions in S3.4 of Schedule 3 of the NSW Undertaking, but with no opportunity for ARTC and Operators to exclude End Users from the consultation process.

Procedures for consultation between ARTC and End Users, such as in the QR Undertaking, should also be incorporated

- an obligation on ARTC to invest in asset replacement and new capacity (both gradual expansion of capacity to allow for gradual increases in the railings of existing End Users over time and more specific increments of capacity for significant new railings) if the project is expected to earn ARTC the maximum rate of return permitted by the regulator of the Undertaking, when evaluated in accordance with criteria such as those incorporated in the ceiling test in the NSW Undertaking
- an investment incentive component included in the rate of return by the regulator, to reflect an appropriate incentive for ARTC to invest in monopoly infrastructure facilities in accordance with National Competition Policy
- the investment incorporated into the asset base to be based on efficient costs, with prudence tests such as those in the QR Undertaking.

The effect on pricing should be consistent with a ceiling test such as that in the NSW Undertaking which incorporates the stand-alone principle

- a post-construction audit by a person or entity with specialist knowledge in the field and entitling Operators or End Users to procure their own audit, at their own expense, if they wish to do so
- transparency of the highest order, no less effective than the provisions in the QR Undertaking.

NSWMC anticipates discussing with ARTC the best means of incorporating these elements in the Hunter Undertaking. In the meantime, NSWMC believes ARTC should be required to incorporate provisions meeting these requirements in the Interstate Undertaking in a form appropriate to the Undertaking.

Clause 6.2 (b) Costs of Providing Additional Capacity

A) Approach Taken in the Undertaking

Clause 6.2 (b) provides that "In the event that ARTC agrees to the creation of Additional Capacity, ARTC's costs of providing the Additional Capacity may be met by the Applicant:

- (i) reimbursing the relevant costs as and when they are incurred by ARTC; or
- (ii) through increased Charges, or making other periodic payments, reimbursing ARTC for recurring costs, plus an annuity in advance calculated by application of WACC to ARTC's capital outlay."

NSWMC believes that these provisions are confusing especially when taken in conjunction with Clause 6.2 (a). They do not provide a sound, clear basis for determining whether ARTC should consent to the provision of Additional Capacity and how ARTC's costs of providing the Additional Capacity should be met.

For example, the difference between the “provision” of Additional Capacity in Clause 6.2 (a) and the “creation” of Additional Capacity in Clause 6.2 (b) is not clear. Nor is the relationship between the Access Charges determined according to Part 4 of the Undertaking and Applicant’s agreement to meet the costs of providing the Additional Capacity in Clause 6.2 (a) and the two mechanism options for doing so which are nominated in Clause 6.2 (b). It is not clear which costs are covered by Part 4 and which by Clauses 6.2 (a) and (b).

Further, where an Applicant meets the whole cost of providing Additional Capacity and that results in ARTC receiving revenue from other users that it would otherwise not have received, there is no provision for the Applicant to be reimbursed the capital component of that extra revenue or for its Access Charges to be correspondingly reduced.

NSWMC believes that Clauses 6.2 (a) and (b) should be amended to clarify all these matters.

B) Provisions Needed for Coal Traffic

NSWMC believes that, like Clause 6.2 (a), Clause 6.2 (b) is designed for non-coal traffic on the Interstate Network and is inadequate, inappropriate and potentially unworkable for the capacity and investment issues that will arise for Hunter Coal Traffic on the Interstate Network and Country RIC and RailCorp networks contiguous with the Hunter Network and the Hunter Network itself. NSWMC is concerned that the Clause, even if amended to clarify the matters set out above, has a number of weaknesses in relation to coal traffic that need to be addressed in the Undertaking and Hunter Undertaking.

Under the Alternative Approach to Clause 6.2 (a) proposed by NSWMC, ARTC would have the obligation to invest in new capacity, where the project is guaranteed to earn the maximum rate of return permitted by the regulator.

Under this approach, NSWMC believes the Undertaking should allow another party, such as an Operator or an End User utilising the new capacity or their nominee, to elect to pay for a project providing new capacity through a capital contribution. In this case

- the party concerned would reimburse the audited efficient project cost when it is incurred by ARTC or by an agreed schedule of periodic payments and the cost of the project would not be recovered in the access charges
- any additional access revenue received by ARTC as a result of third parties utilising the new capacity, above the incremental costs they impose, should be credited to the party that finances the new capacity until its capital contribution and an appropriate rate of return is recovered.

As with Clause 6.2 (a), NSWMC anticipates discussing with ARTC the best means of incorporating these elements in the Hunter Undertaking. In the meantime, NSWMC believes ARTC should be required to incorporate provisions meeting these requirements in the Interstate Undertaking in a form appropriate to the Undertaking.

Clause 6.2 (d) Rights to Use Additional Capacity

Clause 6.2 (d) provides that “Any Additional Capacity, once created, shall be owned and managed by ARTC.”

NSWMC believes that, like Clause 6.2 (a) and Clause 6.2 (b), this Clause is designed for non-coal traffic on the Interstate Network and is inadequate, inappropriate and potentially unworkable for the capacity and investment issues that will arise for coal traffic on the Interstate Network and Country RIC and RailCorp networks contiguous with the Hunter Network and the Hunter Network itself. In many cases the Clause would not provide sufficient incentive for an Applicant to meet the costs of Additional Capacity, particularly where, for technical reasons, the minimum possible increment of Additional Capacity is greater than initially required by the Applicant and it has a long economic life.

NSWMC believes that Clause 6.2 (d) should be amended to provide that, where an Applicant meets the whole cost of providing Additional Capacity

- its initial Access Rights should extend for the economic life of the Additional Capacity
- it should have the right at any time in the future to expand its current Access Rights to any part of that Additional Capacity which is Available Capacity at the time
- any access revenue from third parties utilising the new capacity, above the incremental costs they impose, should be credited to the party that financed the new capacity until its capital contribution and an appropriate rate of return is recovered.

Clause 6.2 (e) Basis of Decisions in Relation to Additional Capacity

This Clause provides that “Where requested to do so by an Applicant, ARTC will provide the Applicant written reasons for the basis of decisions made by it in relation to Additional Capacity.”

NSWMC believes that ARTC will need, as a matter of course, to provide adequate information supporting its reasons so as to facilitate efficient negotiations and otherwise meet the intent of the Draft Undertaking set out in Clause 1.2.

NSWMC suggests that Clause 6.2 (e) be amended to provide that the written reasons should be provided at all times and accompanied by full details of ARTC’s assumptions in relation to the capital and other costs of the Additional Capacity over its economic life, its expected utilisation over that period and any other relevant factors.

Clause 6.3 Costs Incurred by ARTC to Maintain Existing Access Rights

This Clause provides that, where a lawful direction of the Victorian Government to ARTC “interferes with existing Train Paths granted by ARTC to other rail operators and, in order to minimise or prevent any interference to such existing Train Paths, ARTC, acting reasonably, chooses to effect improvements or extensions to the Network or Associated Facilities, the reasonable costs incurred by ARTC in effecting [them] shall be payable by the Operator.”

NSWMC would be concerned if the principles embodied in this Clause were to be applied where they may affect Hunter Coal Traffic on the Interstate Network and the Country RIC and RailCorp networks contiguous with the Hunter Network or the Hunter Network itself. Under this Clause, ARTC has complete discretion to choose whether to act or not. If ARTC does act, the third party, the Operator, must bear the cost. If ARTC does not act, the Operator’s Access Rights are compromised. In addition, ARTC has no incentive to resist such Government directives nor seek compensation for the cost of preventing any interference to the Operator’s existing Train Paths nor to compensate the Operator for the costs imposed on it.

NSWMC suggests that the principles embodied in this Clause should not be extended to apply anywhere else in the Interstate or Hunter Networks. Were they to be extended elsewhere, they should be amended to provide that ARTC is obliged to effect the necessary improvements or extensions or compensate the Operator at ARTC’s own cost or at the cost of the body giving the direction.

5.7 Part 7: Network Transit Management

Because the Hunter Coal Traffic plays such a critical role in the optimisation of the Whole Hunter Coal Chain, a very large and economically important export-orientated industry, it is crucial that Network Management Principles facilitate the efficient operation of the Hunter Coal Traffic on the Interstate Network and the Country RIC and RailCorp networks contiguous with the Hunter Network and the Hunter Network itself.

NSWMC anticipates discussing with ARTC and the Hunter Coal Traffic Operators appropriate Principles for the Hunter Undertaking, particularly in relation to the following matters

- Train Decision Factors

- the desirability of Hunter coal trains arriving at their destinations on time and in the scheduled order (particularly loaded trains arriving at the Newcastle port terminals and empty trains arriving at the mine loadpoints)
- the need to give higher priority to Hunter Coal Traffic that pays higher Access Charges than non-coal traffic on the Interstate Network and the Hunter Network, which is not presently the case.

In the meantime, NSWMC believes that ARTC should be required to incorporate provisions in the Undertaking providing for the Network Management Principles for Hunter Coal Traffic on the Interstate Network to be compatible and consistent with the Principles incorporated in the Hunter Undertaking.

5.8 Part 8: Performance Indicators

To provide Operators and End Users of the Interstate Network with meaningful information on the efficiency of operation of the Interstate Network, NSWMC believes the provisions for reporting of performance set out in Clause 8.2 and the Performance Indicators set out in Schedule G of the Undertaking need to require reporting for the Interstate Network of

- service quality performance (Table 1) by relevant subsections of the Network
- service quality performance (Table 1) by individual Operator
- service quality performance (Table 1) against benchmarks
- ARTC unit costs (Table 2) by Network Segment
- ARTC unit costs (Table 2) against benchmarks.

5.9 Part 9: Definitions and Interpretation

The NSW Leased Network delineated or defined in Schedule E includes track used to haul coal from

- Stratford to Newcastle and domestic customers (power stations)
- Hunter coal mines/loadpoints to Newcastle and domestic customers (power stations) where that traffic uses the non-coal tracks between Maitland and Newcastle (Islington Junction)

The principles that will apply to these hauls and the rest of the Hunter Coal Traffic on the Hunter Network need to apply when these hauls run on the Interstate Network and the Country RIC and RailCorp networks contiguous with the Hunter Network, as has been discussed wherever relevant in this Submission.