



TAHE's compliance for its Hunter Valley Coal Network – 2020-21

18 February 2022

The NSW Rail Access Undertaking (the 'Undertaking') provides for third party access to certain parts of the NSW rail network. It limits the amount of revenue that rail owners can charge these third-party businesses to use the network. Rail owners cannot receive more revenue than the economic costs of providing the service.

IPART is required to assess the Transport Asset Holding Entity's (TAHE) annual compliance with the Undertaking¹. This compliance assessment relates to the 2020-21 financial year for TAHE's Hunter Valley Coal Network. The network includes 5 sectors of the Hunter Valley Coal Network between Newstan Junction and Woodville Junction (Figure 1).

This section of the Hunter Valley Coal Network was previously owned by RailCorp. On 1 July 2020, RailCorp became TAHE (a State-Owned Corporation). This is our first assessment of TAHE's compliance since it became the owner of the Hunter Valley Coal Network.

Figure 1 Map of TAHE's Hunter Valley Coal Network (blue shaded area)



IPART acknowledges the Traditional Custodians of the lands where we work and live. We pay respect to Elders, past, present and emerging. We recognise the unique cultural and spiritual relationship and celebrate the contributions of First Nations peoples.

Summary of our draft decision

TAHE submitted its compliance proposal for its Hunter Valley Coal Network to us in December 2021. It made some errors in applying the remaining life to calculate depreciation and indexation of the asset base, which are used to calculate the economic costs of providing the Hunter Valley Coal Network. TAHE resubmitted its compliance proposal in February 2022 to correct for these errors.

Based on TAHE's revised proposal, our draft decision is that TAHE has complied with the ceiling test in the Undertaking for its Hunter Valley Coal Network for the 2020-21 compliance year.

Across all access seekers, TAHE under recovered its costs of servicing the combined coal and freight group of access seekers on the network by \$2.2 million in 2020-21, after reducing charges for coal customers by 20% in 2020-21.² Previously, RailCorp had over-recovered \$11 million from its access seekers. TAHE's under-recovery in 2020-21 has reduced this cumulative balance to \$8.8 million as at June 2021.

We recognise the steps TAHE has taken to reduce the cumulative over-recovery. However, the Undertaking requires TAHE to return any over-recovery to a zero balance each year. At current prices and volumes, it will take around 4 years.

Over the next 12 months, TAHE should attempt to return the over-recovery to a zero balance and establish a policy for future balances.

1 How we assessed compliance

The Undertaking requires TAHE to demonstrate that it has complied with the ceiling test for its Hunter Valley Coal Network. This test requires that for any access seeker, or group of access seekers, access revenue must not exceed the full economic costs of providing access on a standalone basis.³

To assess TAHE's compliance with the ceiling test we:

- Considered whether TAHE had performed the test for all relevant access seekers or groups of access seekers
- Considered whether TAHE had correctly calculated the full economic costs of the Hunter Valley Coal Network on a standalone basis for each of those groups. This included testing whether TAHE had complied with the asset roll forward requirements in the Undertaking. We compared TAHE's calculations against our own assessment of costs.
- Compared access revenues received by TAHE, with our calculations of full economic costs for each group.

The ceiling test is failed if revenues exceed costs for any of those groups.

2 Relevant access seekers

TAHE submitted ceiling tests conducted on 3 different groups of access seekers:

1. Combined coal and general freight
2. Coal
3. General freight.

We find the 3 groups proposed by TAHE are appropriate.^a

Both coal and general freight access seekers need to use the same assets. This means the full economic cost is similar for each group, differing only by the extent that direct costs (i.e. variable maintenance costs) are different.

3 Assessment of costs and revenue

We consider that an assessment of the ceiling test on a standalone basis requires estimating costs for a hypothetical network that is purpose-built and optimised for that group of access seekers. The actual costs of the existing infrastructure are not relevant unless they are efficient for a group of access seekers.^b Specifically, any extra costs that are driven by passenger trains must be excluded from the ceiling test for a group of coal or freight-only access seekers. TAHE applied the theoretical standalone freight only network model as guided by the Undertaking and consistent with our 2019-20 decision.⁴

TAHE calculated the full economic costs for each group of access seeker on a standalone basis (Table 3.1). It included the following cost components:

- Maintenance costs
 - TAHE applied the same general approach that we used in our [2019-20 decision](#).⁵ It used the benchmarking data provided by SNC Lavalin^c to determine the benchmark fixed maintenance costs (per km of track) and variable costs (per thousand gross tonne kilometres (gtk)) (Table 3.2).

a Passenger services also use this network, as part of their operations on TAHE's wider metropolitan rail network. We will assess TAHE's compliance in relation to passenger service access seekers as part of a separate review of compliance for the non-Hunter Valley networks.

b The measure of economic costs is not dependent on the entity that actually incurs these costs. For example, if maintenance costs were incurred by Sydney Trains or NSW Trains instead of TAHE, they would still be included in the measure of full economic costs.

c RailCorp contracted SNC Lavalin to estimate efficient costs for the 2015-16 to 2017-18 compliance assessments.

- TAHE's proposed maintenance expenditure in 2020-21 is slightly higher than our own estimates (Table 3.2), however we consider TAHE's estimates to be reasonable. The difference is due to TAHE using CPI to index the 2019-20 costs, while we applied a maintenance cost index (MCI).^dThe Undertaking doesn't specify how rail owners should estimate maintenance costs.
- Network control costs
 - TAHE has proposed network control costs of \$2.89 per train kilometre^e. It has applied the same rate per train of kilometre to the coal and general freight access seekers, consistent with our 2019-20 decision. This reflects the fixed nature of these costs.
- Corporate and system overheads
 - TAHE has used IPART's 2019-20 estimate of an efficient level of corporate and system overheads equal to 9.2% of the sum of maintenance and network control. This is derived from industry benchmarking we commissioned in 2009-10.⁶ This 'mark-up' approach is generally accepted industry practice. We would not expect the percentage of costs allocated for corporate and system overheads to increase over time for an efficient firm.
 - TAHE expressed concern that our 9.2% estimate does not reflect efficient overheads, however, it has applied this rate for the purposes of calculating corporate and system overheads.
- Depreciation
 - TAHE has used the correct RAB value in the prior year to calculate depreciation (Table 3.3).
 - It has then applied the correct rate of depreciation to the Regulatory Asset Base (RAB). Depreciation must be calculated on a straight-line basis using the estimate of the remaining mine life set by IPART. We determine the remaining mine life every 5 years.⁷ We last reviewed it in 2019 and set a terminal date of 2040. This results in a remaining mine life of 20 years in 2020-21, which was applied by TAHE.⁸
- Return on assets
 - TAHE has calculated the RAB for 2020-21 according to the roll forward principles in the Undertaking (Table 3.3). It must use the RAB in the prior year plus the CPI increase on that prior RAB, plus capital expenditure in the given year, less depreciation and any asset disposals in the given year.
 - TAHE has then applied the correct rate of return to the average of the opening and closing values of the RAB. The rate of return is set by IPART in our 5-yearly review.

^d The Maintenance Cost Index was developed as part of our [2010-11 review of RailCorp compliance with the NSW Rail access Undertaking](#). We engaged [Sapere Research Group](#) who developed the Maintenance Cost Index in July 2013. We have since applied the maintenance cost index to increase maintenance costs overtime in our compliance assessments for RailCorp (now TAHE).

^e This cost estimate was escalated by CPI to be in nominal terms for 2020-21.

Table 3.1 TAHE's ceiling test (\$)

	2019-20	2020-21
Combined		
Maintenance costs	4,549,757	4,461,392
Network control costs	571,250	579,837
Corporate and system overheads	471,133	463,793
Depreciation	670,499	682,145
Return on assets	734,670	708,762
Full economic cost	6,997,308	6,895,929
Access revenue	8,299,762	4,741,291
Cost recovery	1,302,454	-2,154,638
Coal only		
Maintenance costs	4,172,581	4,072,231
Network control costs	571,250	579,837
Corporate and system overheads	436,432	427,990
Depreciation	670,499	682,145
Return on assets	734,670	708,762
Full economic cost	6,585,433	6,470,965
Access revenue	6,655,240	3,219,801
Cost recovery	69,807	-3,251,164
General freight		
Maintenance costs	4,132,601	4,174,641
Network control costs	571,250	579,837
Corporate and system overheads	432,754	437,412
Depreciation	670,499	682,145
Return on assets	734,670	708,762
Full economic cost	6,541,775	6,582,796
Access revenue	1,644,522	1,521,490
Cost recovery	-4,897,253	-5,061,306

Note: The figures for 2019-20 are from our [2019-20 final decision](#).

Source: TAHE, [Revised Hunter Valley Coal Network submission 2020-21](#), February 2022, Table 4, p 5.

Table 3.2 Draft maintenance costs – by access seeker group

	IPART's final decision 2019-20	TAHE's proposal 2020-21	IPART's estimate 2020-21	Difference
Unit rates				
Fixed maintenance cost (per km of track)	72,220	73,306	72,732	
Variable cost (per thousand gtk)	1.66	1.68	1.67	
Total maintenance costs				
Coal	4,172,581	4,072,231	4,041,491	1%
General Freight	4,132,601	4,174,641	4,143,530	1%
Combined (all access seekers)	4,549,757	4,461,392	4,402,931	1%

Note: The figures in the 2019-20 are from our [2019-20 final decision](#).

Source: TAHE, [Revised Hunter Valley Coal Network submission 2020-21](#), February 2022, Table 5, p 7, Table 6, p 8, and IPART analysis.

Table 3.3 TAHE's Asset roll forward valuation for combined coal and general freight access seekers (\$)

	2019-20	2020-21
Opening RAB	14,080,485	13,642,901
Opening RAB × CPI	232,915	142,083
Add CAPEX	0	0
Add Additions	0	0
Less Depreciation	-670,499	-682,145
Less Disposals	0	0
Closing RAB	13,642,901	13,102,839

Note: The figures in 2019-20 are from our 2019-20 final decision.

Source: TAHE, *Revised Hunter Valley Coal Network submission 2020-21*, February 2022, Table 2, pp 3-4.

Draft Decisions



1. TAHE has complied with the ceiling test for its Hunter Valley Coal Network, as it received less revenue than the economic costs of providing the infrastructure for each group of access seekers.



2. TAHE has complied with the asset valuation roll forward principles in the NSW Rail Access Undertaking for its Hunter Valley Coal Network in 2020-21. These are used to calculate TAHE's economic costs.

4 TAHE's unders and overs account

When the Undertaking was established, it was recognised that it may be impractical to set access prices in a way that would always avoid over-recovery of full economic costs. This is because prices must be set before the eventual tonnage for the year is known. Prices set with an expectation of low tonnage will generate too much revenue if tonnage turns out to be high (and vice versa).

In order to adjust for these inadvertent under or over-recoveries of the ceiling revenue, the Undertaking provided for an unders and overs account. The expectation was that the net balance of this account would remain close to zero, even though it might fluctuate from time to time.

While we are not required to assess compliance with the unders and overs account, we must have regard to the operation of the unders and overs account as part of our compliance reviews.

4.1 The unders and overs account balance

Our draft finding is that we agree with TAHE's proposal that the cumulative balance of the unders and overs account as at 30 June 2021 is an over recovery of approximately \$8.8 million (Table 4.1). This is a reduction in the balance of \$2.2 million from 30 June 2020.

To calculate the cumulative balance of the unders and overs account we start with the closing balance we determined as at 30 June 2020. We then add the difference between the revenue and the full economic costs for 2020-21 to determine the closing balance of the unders and overs account as at 30 June 2021.

TAHE also submitted unders and overs account balances for the other 2 groups of access seekers.

Table 4.1 Unders and overs account (\$)

	Combined	Coal	General freight
Balance at 30 June 2020	10,955,852		
2020-21 revenue minus costs	-2,154,638	-3,251,164	-5,061,306
Balance at 30 June 2021	8,801,213		

Note: The balance as at 30 June 2020 is from our 2018-19 final decision.

Source: TAHE, *Revised Hunter Valley Coal Network submission 2020-21*, February 2022, Table 11, pp 12-13.

4.2 Returning the unders and overs account balance to zero

Assuming traffic volumes remain constant on the network, it would take TAHE around 4 years to return the unders and overs account balance to zero at 2020-21 prices. This is not consistent with the Undertaking's requirements to attempt to return the account balance to zero each year.⁹

In its submission to our 2019-20 draft decision, TAHE stated that it would 'formulate a management plan in regard to the over recovery balance, TAHE will consult with IPART to form a mutually acceptable position. This will include amongst other things the development of a plan to manage the unders and overs to a zero balance and the establishment of a policy to govern the process.'¹⁰

Our draft recommendation is that TAHE makes a plan to return the unders and overs account balance to zero within 12 months and maintains a balance within 5% (above or below) of forecast access revenue (while attempting to return the balance to \$0 each year), consistent with the Undertaking's requirements.

Access seekers may be able to apply to TAHE for a refund subject to the terms and conditions in their individual access agreements. To provide transparency and guidance for access seekers about the process of seeking refunds, TAHE should establish an unders and overs account policy in consultation with access seekers and submit it to IPART for approval. Our draft recommendation is that TAHE should do this within the next 12 months.

We welcome stakeholders' views on this matter.

Draft Recommendations

1. That TAHE makes a plan to return the unders and overs account to zero within 12 months and maintain a balance within 5% of forecast revenue (while attempting to return the balance to \$0 each year), consistent with clause 4(e) of Schedule 3 of the Undertaking.
2. That TAHE establishes an unders and overs account policy in consultation with access seekers and submits it to IPART for approval as required under clause 4(f) of Schedule 3 of the Undertaking within 12 months.

Have your say

Your input is critical to our review process.

[Submit feedback >](#)

You can get involved by making a submission or submitting feedback.

We are seeking feedback on our draft decisions by **25 March 2022**.

- ¹ NSW Rail Access Undertaking.
- ² TAHE, *Revised Hunter Valley Coal Network submission 2020-21*, February 2022, p 12.
- ³ The Ceiling Test is set out in clause 1 of Schedule 3 of the *Undertaking*.
- ⁴ IPART, *TAHE compliance – Hunter Valley Coal Network 2018-19 to 2019-20*, Final Report, November 2021, pp 7-8.
- ⁵ IPART, *TAHE compliance – Hunter Valley Coal Network 2018-19 to 2019-20*, Final Report, November 2021.
- ⁶ IPART, *Compliance with the NSW Rail Access Undertaking RailCorp HVCN, 2009/10*, Final Report, August 2012, p 14. and Sapere Research Group, *A ceiling test protocol for RailCorp – prepared for IPART*, November 2011, p 12.
- ⁷ NSW Rail Access Undertaking, Schedule 3, clause 3.2(c)(iv).
- ⁸ IPART, *Rate of return and remaining mine life 2019-2024*, Final Report, July 2019.
- ⁹ NSW Rail Access Undertaking, Schedule 3, clauses 4(c) and 4(d).
- ¹⁰ TAHE, *Compliance submission 2018-19 and 2019-20*, October 2021, p 1.

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