



## TAHE compliance – Hunter Valley Coal Network

2018-19 to 2019-20

# Final Report

November 2021

Transport »

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## **Tribunal Members**

The Tribunal members for this review are:

Ms Carmel Donnelly, Chair  
Ms Deborah Cope  
Ms Sandra Gamble

Enquiries regarding this document should be directed to a staff member:

Joyce Tapper	(02) 9290 8464
Melanie Mitchell	(02) 9113 7743

## **The Independent Pricing and Regulatory Tribunal (IPART)**

Further information on IPART can be obtained from [IPART's website](#).

## **Acknowledgment of Country**

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.

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## Overview

IPART is required to assess the Transport Asset Holding Entity's (TAHE) annual compliance with the NSW Rail Access Undertaking<sup>1</sup> (the 'undertaking') for its Hunter Valley Coal Network. This compliance assessment relates to the 2018-19 and 2019-20 financial years.

The NSW Government-owned TAHE is the operator of the Hunter Valley Coal Network rail infrastructure subject to the undertaking (see Figure 1). The network includes 5 sectors of the Hunter Valley Coal Network between Newstan Junction and Woodville Junction. TAHE sells rail access to coal and non-coal freight train operators.

This section of the Hunter Valley Coal Network was previously owned by RailCorp. It was transferred to TAHE on 1 July 2020, when TAHE was established as a State-Owned Corporation. RailCorp was the owner of the Hunter Valley Coal Network for the 2018-19 and 2019-20 financial years that are the subject of this assessment. However, TAHE, as the new owner, has assumed responsibility for the assessment in these years. In this report, we refer to TAHE when discussing the rail assets formerly held by RailCorp.

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



Source: Transport for NSW.

The undertaking limits the revenue that TAHE can earn each year. It was designed to ensure that monopoly track owners provide prices and conditions of access to existing and future access seekers on reasonable terms. Access seekers are usually train operators, but they could also be cargo owners such as coal mines.

As a rail infrastructure owner, TAHE is required to submit annual compliance statements to IPART. These statements allow IPART to determine whether TAHE has complied each year with certain price-related requirements of the undertaking. These are that the revenue for any group of access seekers for that year has not exceeded the economic costs of providing the service (the 'ceiling test'), calculated in accordance with the asset valuation roll forward principles, and for a standalone network.

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We determine whether TAHE has complied with these principles by testing the logic of TAHE's calculations and reasonableness of the cost inputs. We have regard to the proposal put forward by TAHE, benchmarking data and our previous regulatory decisions. We received 2 submissions in response to our Draft Report, from TAHE and Qube Logistics, and have also considered these in finalising our assessment and recommendations.

We have found that for 2018-19 and 2019-20, TAHE has not complied with the asset valuation roll forward principles or the ceiling test. The non-compliance relates to two key aspects of TAHE's proposal:

1. TAHE has calculated depreciation based on a shorter asset life than IPART determined in 2014 and 2019.<sup>2</sup>
2. TAHE has not allocated costs to combined coal and non-coal customers on a standalone basis. TAHE has included some passenger network costs, rather than including only capital and operating costs directly related to transporting coal and general freight on the network).

Based on our calculations, TAHE exceeded the ceiling test for the combined coal and non-coal access seeker group by \$3 million or 22% over the 2 years. In each year it has received around \$8.5 million in revenue, compared to its annual economic costs of around \$7 million.

The most recent over-recoveries have contributed to a cumulative unders and overs account balance of \$11 million. Access seekers may be able to apply to TAHE for a refund subject to the terms and conditions in their individual access agreements.

We recommend that TAHE:

- updates its Regulatory Asset Base and unders and overs account as of 30 June 2020 consistent with our decisions
- makes a plan to return the unders and overs account balance to zero and keep it within 5% of forecast access revenue as the undertaking requires
- establishes an unders and overs account policy in consultation with access seekers and submits it to IPART for approval as required by the undertaking.

These findings and recommendations are consistent with those in our Draft Report.

We are currently [reviewing the undertaking](#) under a separate terms of reference. We will review and consult on an appropriate regulatory framework that should apply to the Hunter Valley Coal Network, including pricing principles and compliance mechanisms. We have released our [Issues Paper](#) for consultation, with submissions due 17 December 2021.<sup>3</sup> Our Final Report to the Minister for this review is due by August 2022. Our recommendations will not apply retrospectively.

Our decisions and recommendations for this compliance assessment are listed below.

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## Decisions

1.	TAHE has not complied with the asset valuation roll forward principles in the NSW Rail Access Undertaking in 2018-19 and 2019-20.	2
2.	TAHE has not complied with the ceiling test in the NSW Rail Access Undertaking in 2018-19 and 2019-20, as its access revenue for 2 groups of access seekers exceeded the full economic cost of providing access.	6

## Recommendations

1.	TAHE updates the value of its Regulatory Asset Base as at 30 June 2020 consistent with our decision on compliance with the asset valuation roll forward principles.	2
2.	TAHE updates its unders and overs account balance as at 30 June 2020 consistent with our decision on compliance with the ceiling test set out in Table 3.1. This results in a closing balance at 30 June 2020 of \$11m (over recovery).	15
3.	TAHE makes a plan to return the unders and overs account to zero each year and maintain a balance within 5% of forecast revenue, consistent with clause 4(e) of Schedule 3 of the Undertaking.	15
4.	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.	15

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# Contents

<b>Overview</b>	<b>iii</b>
<b>1 Assessment of compliance with the asset valuation roll forward principles</b>	<b>1</b>
1.1 Overview of our decision	1
1.2 Remaining asset lives	3
<b>2 Assessment of compliance with the ceiling test</b>	<b>5</b>
2.1 Overview of our decision	5
2.2 Relevant access seekers or groups of access seekers	7
2.3 Assessment of full economic costs on a standalone basis	7
<b>3 Operation of TAHE's unders and overs account</b>	<b>13</b>
3.1 The unders and overs account balance	13
3.2 Updating the overs and unders accounts	14

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# 1 Assessment of compliance with the asset valuation roll forward principles

TAHE is required to comply with the asset valuation roll forward principles.<sup>4</sup> These principles require that the Regulatory Asset Base (RAB) in any given year is equal to the RAB in the prior year plus the CPI increase on that prior RAB, plus capital expenditure, less depreciation and any asset disposals in the given year. Depreciation must be calculated on a straight-line basis using the estimate of the remaining mine life set by IPART.<sup>5</sup> We determine the remaining mine life every 5 years. We last reviewed it in 2019.

## 1.1 Overview of our decision

Our decision is that TAHE has not complied with the asset valuation roll forward principles. TAHE proposed new estimates for the remaining mine life, rather than applying IPART's determined asset lives.<sup>6</sup>

Table 1.1 compares our decision on the asset valuation roll forward for the combined coal and general freight access seekers, with TAHE's proposal. The key difference between our decision and TAHE's proposal is in the calculated depreciation, which is a result of applying different remaining asset lives.

Table 1.1 IPART's decision: asset valuation roll-forward combined coal and general freight access seekers (\$)

	2017-18	2018-19	2019-20
<b>IPART's decision</b>			
Opening RAB	14,564,098	14,338,286	14,080,485
Opening RAB × CPI	294,292	293,672	232,915
Add CAPEX	0	0	0
Add Additions	0	0	0
Less Depreciation	-520,325	-551,473	-670,499
Less Disposals	0	0	0
Closing RAB	14,338,286	14,080,485	13,642,901
<b>TAHE's proposal</b>			
Opening RAB	14,564,098	14,338,226	13,673,335
Opening RAB × CPI	294,292	293,671	226,180
Add CAPEX	0	0	0
Add Additions	0	0	0
Less Depreciation	-520,325	-955,694	-954,918
Less Disposals	0	0	0
Closing RAB	14,338,286	13,673,335	12,933,305

Note: The figures in the 2017-18 year are from our 2015-16 to 2017-18 final decision. The IPART determined remaining mine life is 26 years in 2018-19, and 21 years in 2019-20.

Source: [TAHE's compliance submission](#), June 2021, Table 4, p 13. IPART analysis.

## Decision



1. TAHE has not complied with the asset valuation roll forward principles in the NSW Rail Access Undertaking in 2018-19 and 2019-20.

## Recommendation



1. TAHE updates the value of its Regulatory Asset Base as at 30 June 2020 consistent with our decision on compliance with the asset valuation roll forward principles.



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## 1.2 Remaining asset lives

IPART's determined asset life is 26 years in 2018-19, based on a 2044 terminal date, and 21 years in 2019-20, based on a 2040 terminal date.

In its compliance proposal, TAHE submitted that the terminal date of 2040 underpinning IPART's determination presents a risk of stranding assets, because the network:

- supplies coal to Eraring and Vales Point power stations, which are currently planned to operate until 2029 and 2032
- enables supply from Centennial Coal's mines in the west and from the Lake Macquarie region and:
  - the Clarence mine (Western coal fields) is expected to close in 2033 based on current export mine production of 3 million tonnes per annum
  - the Mandalong mine (Macquarie region) has an implied mine life of 2032 based on current production of 5 million tonnes per annum (including for the Eraring and Vales Point power stations)
  - there is uncertainty around the future of coal mines and coal-fired power stations in these regions, depending on government policies on energy and climate change.<sup>7</sup>

TAHE proposed asset lives of 15 years in 2018-19 and 14 years in 2019-20, based on a terminal date of 2033. This increases depreciation by over 80% from RailCorp's proposal in 2017-18.

The undertaking requires IPART to determine the remaining mine life for the purpose of calculating depreciation every 5 years. The undertaking does not allow IPART to accept stakeholder-proposed alternative asset lives between mine life reviews. IPART's decision on the remaining mining life is in effect until 2024,<sup>8</sup> when we would review it again, seeking input from stakeholders.

The information TAHE provided in its compliance submission is consistent with the information we considered at our 2019 review of remaining mine life. In our 2019 review, we brought forward the terminal date from 2044 to 2040, taking account of various factors, including:

- proved and probable coal reserves of the most substantial, longest-lived mines that use the sectors, which resulted in estimated terminal dates ranging from 2024 to 2065
  - we noted that smaller mines in the south-west, including Clarence and Mandalong had comparatively shorter lives and that TAHE was unlikely to recover its depreciation costs from these users alone
- the notional terminal dates for Eraring (2032) and Vales point (2029), noting that they depend on trends in electricity pricing and government policy on energy and climate change
- balancing TAHE's potential asset stranding risk and customer price impacts.

TAHE's submission to our Draft Report stated that it would amend the RAB consistent with our decision.<sup>9</sup> It acknowledged that the undertaking limits IPART's flexibility to consider stakeholder proposed alternative asset lives for the calculation of depreciation and RAB.<sup>10</sup> TAHE submitted that the current framework would benefit from added flexibility to enable rail owners to respond to uncertainty in regard to power station and mine lives and the future demand for coal leading to the potential for stranded assets.<sup>11</sup>

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We are currently reviewing the [rail access undertaking](#) to ensure it remains fit-for-purpose. During this process we will consider more broadly the appropriate pricing principles to apply to access prices. This includes whether calculating depreciation on a straight-line basis remains appropriate, and whether the undertaking provides sufficient flexibility to respond to the uncertainty around future demand for coal. We are seeking stakeholders' views on our Issues Paper by 17 December 2021.<sup>12</sup>

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## 2 Assessment of compliance with the ceiling test

The undertaking requires TAHE to demonstrate that it has complied with the ceiling test. 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.<sup>13</sup>

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 – where we found TAHE had not done this, we substituted our own estimates
- 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.

### 2.1 Overview of our decision

Our decision is that TAHE has not complied with the ceiling test for 2018-19 or 2019-20. We consider that TAHE has calculated the ceiling test for the appropriate groups of access seekers. However, we do not accept all TAHE's proposed values of full economic costs. We have used our own estimates, which results in a lower estimate of the full economic costs.

Using our estimate of full economic costs, the access revenue received by TAHE exceeds the full economic costs of providing services for the combined and coal access seeker groups for 2018-19 and 2019-20 (Table 2.1).

Each of the costs in Table 2.1 are discussed in more detail in the sections below.

Table 2.1 IPART's ceiling test (\$)

	2017-18	2018-19	2019-20
<b>Combined</b>			
Maintenance costs	4,491,905	4,475,468	4,549,757
Network control costs	626,903	564,403	571,250
Corporate and system overheads	470,930	463,668	471,133
Depreciation	520,325	551,473	670,499
Return on assets	852,620	838,354	734,670
Full economic cost	6,962,684	6,893,366	6,997,308
Access revenue	8,756,261	8,590,292	8,299,762
Over recovery	1,793,577	1,696,926	1,302,454
<b>Coal only</b>			
Maintenance costs	4,010,751	4,081,991	4,172,581
Network control costs	626,903	564,403	571,250
Corporate and system overheads	426,664	427,468	436,432
Depreciation	520,325	551,473	670,499
Return on assets	852,620	838,354	734,670
Full economic cost	6,437,263	6,463,689	6,585,433
Access revenue	6,931,163	6,739,328	6,655,240
Over recovery	493,900	275,639	69,807
<b>General freight</b>			
Maintenance costs	4,061,912	4,068,782	4,132,601
Network control costs	626,903	564,403	571,250
Corporate and system overheads	431,371	426,253	432,754
Depreciation	520,325	551,473	670,499
Return on assets	852,620	838,354	734,670
Full economic cost	6,493,131	6,449,264	6,541,775
Access revenue	1,825,098	1,850,964	1,644,522
Over recovery	-4,668,033	-4,598,300	-4,897,253

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).

Source: IPART analysis, [TAHE's compliance submission](#), June 2021, pp 14-16.

## Decision



2. TAHE has not complied with the ceiling test in the NSW Rail Access Undertaking in 2018-19 and 2019-20, as its access revenue for 2 groups of access seekers exceeded the full economic cost of providing access.

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## 2.2 Relevant access seekers or groups of 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.

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.

## 2.3 Assessment of full economic costs on a standalone basis

The undertaking requires TAHE to calculate full economic costs on a standalone basis for each access seeker or group of access seekers (see Box 2.1). To assess 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. 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.

In its compliance proposal, TAHE stated that the Hunter Valley Coal Network should not be treated as a standalone rail network for the purposes of determining efficient maintenance costs. TAHE argued that the actual Hunter Valley Coal Network incurs additional costs because it is part of a shared network, and the costs of a standalone network is not a reasonable comparison.

TAHE considers it would be more equitable and transparent for mixed rail networks to calculate maintenance costs on efficient actual costs, rather than a theoretical construct required by the undertaking.<sup>14</sup>

However, TAHE stated that it developed its compliance submission based on the Hunter Valley Coal Network being a standalone freight network. TAHE did this by:

- retaining only assets that are required for a standalone freight network e.g. track, civil and signalling
- removing the costs of electric traction, passenger facilities, stations and rolling stock
- reducing the costs of signalling assets by 50% to reflect the requirements of a standalone freight network
- removing other costs related to works outside the Hunter Valley Coal Network.<sup>15</sup>

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TAHE did remove costs of some assets not needed by a freight-only network. However, its maintenance cost estimates remained too high. It based cost rates on the average rates across the Sydney Trains network. As this is predominantly a passenger network these rates include certain cost that a freight-only network would not incur. For example, a passenger network requires frequent manual track inspections for safety reasons, but a freight network does not. Maintenance work must be undertaken at night and on weekends on a busy passenger network. This adds significant cost to the maintenance activity that a freight network would largely avoid.

In contrast, we developed our stand-alone freight maintenance cost estimates based on maintenance cost observations from actual coal-only networks in New South Wales and Queensland. This information was provided by a consultant to Transport for NSW in 2019. Qube Logistics' supports this approach.<sup>16</sup>

As part of our broader review of the [undertaking](#), we are seeking stakeholder input on all aspects of the ceiling test, including whether benchmarking costs on a standalone basis remains appropriate for shared networks such as the Hunter Valley Coal Network. If not, we are interested in whether there is an alternative method that would still protect access seekers from paying too much and promote efficient use of and investment in the network.

### Box 2.1 Requirements for assessing compliance with the undertaking

The ceiling test at clause 1 of schedule 3 to the NSW Rail Access Undertaking states:

- For any Access Seeker, or group of Access Seekers, access revenue must not exceed the Full Economic Cost of the Sectors which are required on a standalone basis for the Access Seeker or group of Access Seekers ("**ceiling test**").

The full economic cost is defined in the undertaking as follows (emphasis added):

- Full Economic Costs are Sector Specific costs including a permitted Rate of Return and Depreciation and an allocation of non-Sector specific costs such as train control and overheads including a Rate of Return and Depreciation on non-Sector specific assets. All included items are to be assessed on a **standalone** basis.

Source: [NSW Rail Access Undertaking](#)

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We calculated the full economic costs for each group of access seeker on a standalone basis, by summing the following cost components:

- maintenance costs (fixed and variable)
- network control costs
- corporate and system overheads
- depreciation
- return on assets.

We discuss our assessment of the full economic costs in the sections below.

### 2.3.1 Maintenance costs

To assess the efficient maintenance costs for the Hunter Valley Coal Network on a standalone basis for 2018-19 and 2019-20, we applied the same approach that we applied in our [2015-16 to 2017-18 final decisions](#) (our 2017-18 decision).

In our 2017-18 decision, we used benchmarking data provided by SNC Lavalin<sup>a</sup> to determine the benchmark fixed maintenance costs (per km of track) and variable costs (per thousand gross tonne kilometres (gtk)). We derived the coefficients for this maintenance cost function by applying linear regression to the data benchmarked by SNC Lavalin for comparable coal network operators.

We applied a Maintenance Cost Index (MCI) to inflate the maintenance costs for 2019-20.<sup>b</sup> Table 2.2 shows the benchmark rates we used to estimate the maintenance costs.

Table 2.2 IPART's calculation of fixed and variable maintenance costs (\$)

	2017-18	2018-19	2019-20
Fixed maintenance cost (per km of track)	68,861	70,679	72,220
Variable cost (per thousand gtk)	1.58	1.63	1.66

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).  
Source: IPART analysis.

We use the benchmark costs in Table 2.2 to estimate the total maintenance costs by access seeker group. Table 2.3 compares our derived maintenance costs with TAHE's proposed maintenance costs.

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<sup>a</sup> RailCorp contracted SNC Lavalin to estimate efficient costs of its Hunter Valley Coal Network for the 2015-16 to 2017-18 compliance assessments. SNC Lavalin benchmarked the costs of comparable coal networks. Its final report was provided to IPART in-confidence and is not publicly available.

<sup>b</sup> 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).

Table 2.3 Maintenance costs – by access seeker group (\$)

	Combined	Coal	General freight
<b>IPART's decision</b>			
2017-18	4,491,905	4,010,751	4,061,912
2018-19	4,475,468	4,081,991	4,068,782
2019-20	4,549,757	4,172,581	4,132,601
<b>TAHE's proposal</b>			
2017-18	5,749,204	2,713,192	3,036,012
2018-19	11,985,425	10,979,998	11,130,815
2019-20	12,093,392	10,927,726	11,073,694

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).  
Source: [TAHE's compliance submission](#), June 2021, pp 14-16 and IPART analysis.

Table 2.3 shows a significant increase in TAHE's proposed maintenance expenditure between 2017-18 and its current proposal. A key driver of the increased costs is that TAHE has used levelised costs based on data from Sydney Trains, which includes passenger services. Sydney Trains' maintenance costs are significantly higher than the maintenance costs that are required for a coal and freight network based on the SNC Lavalin benchmarking. TAHE submitted that Sydney Trains was not able to provide it with sufficiently granular cost data to separately allocate costs to freight lines and passenger only lines, for the Metropolitan Rail Network and the Hunter Valley Coal Network.<sup>17</sup>

In response to our Draft Report, TAHE recognised that as a result of using Sydney Train's maintenance costs, its estimate of standalone costs is likely to reflect a higher cost structure, typical of a larger shared network. The additional activities, driven by passenger operations are not required by standalone freight operations, so their costs must be excluded according to the undertaking.

As noted above, TAHE considers it would be more equitable and transparent for maintenance costs to be based on efficient actuals, rather than a theoretical construct. However, TAHE has acknowledged that, in any case, data on actual costs is not available from Sydney Trains at present.

### 2.3.2 Network control costs

We have adopted TAHE's proposed network control costs of \$2.86 per train kilometre for the combined group of access seekers.<sup>c</sup> However, for the coal only and general freight access seeker groups, TAHE did not calculate network control costs on a standalone basis. We have adopted the same estimates for these groups as the combined group, reflecting the fixed nature of these costs. This is consistent with our 2017-18 decision. Table 2.4 shows our network control costs compared to TAHE's proposed network control costs. TAHE proposed lower costs for the coal and general freight access seekers. However, consistent with previous decisions, the costs are largely fixed and therefore should not vary by access seeker group.

<sup>c</sup> This cost estimate was escalated by CPI to be in nominal terms for 2018-19 and 2019-20.



Table 2.4 Network control costs – by access seeker group (\$)

	Combined	Coal	General freight
<b>IPART's decision</b>			
2017-18	626,903	626,903	626,903
2018-19	564,403	564,403	564,403
2019-20	571,250	571,250	571,250
<b>TAHE's proposal</b>			
2017-18	626,903	260,544	366,360
2018-19	564,403	219,324	345,080
2019-20	571,250	221,813	349,437

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).  
Source: [TAHE's compliance submission](#), June 2021, pp 14-16 and IPART analysis.

### 2.3.3 Corporate and system overheads

We have determined 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.<sup>18</sup> 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 proposed a rate of 13.7% of the sum of maintenance and network control costs to determine corporate and system overheads. This percentage is the maintenance recovery rate identified by Sydney Trains for routine maintenance, major periodic maintenance, capital, external works internal resource delivery. TAHE used the Sydney Trains rate because most of its programs are delivered by internal Sydney Trains resources.<sup>19</sup> This is the same rate proposed by RailCorp in previous compliance submissions, which we found to be unreasonable.

Table 2.5 compares our decision on corporate and system overheads with TAHE's proposed overhead costs.

Table 2.5 Corporate and system overheads – by access seeker group (\$)

Year	Combined	Coal	General freight
<b>IPART's decision</b>			
2017-18	470,930	426,324	431,371
2018-19	463,668	427,468	426,253
2019-20	471,133	436,432	432,754
<b>TAHE's proposal</b>			
2017-18	873,527	407,402	466,125
2018-19	1,719,326	1,534,307	1,572,197
2019-20	1,735,056	1,527,487	1,564,969

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).  
Source: IPART analysis, [TAHE's compliance submission](#), June 2021, pp 14-16,

## Regulatory compliance costs

TAHE included a separate amount of \$1.3 million in regulatory compliance costs for 2018-19 only. TAHE stated that this was for modelling and analysis to support their previous compliance submission, which avoided additional internal salary costs that they would otherwise have incurred.

We consider that regulatory compliance activities are a standard cost of doing business, and these costs should be met within the corporate and systems overhead allowance by an efficient firm. TAHE did not provide further information about the efficiency of these costs and why they should be recovered from access seekers in its submission to our Draft Report. Therefore, we have continued to exclude these regulatory compliance costs from the ceiling test calculation.

## Depreciation and return on assets

As noted in Chapter 2, we found that TAHE did not calculate depreciation using the remaining mining life from our 2014 and 2019 determination. We have recalculated depreciation using the IPART determined remaining mine lives. We have also recalculated the return on assets, based on the revised values of the RAB and the rate of return from our 2019 decision.

Table 2.6 compares our decisions on depreciation and return on assets by access seeker group with TAHE's proposed costs. The RAB, depreciation and return on assets are the same for each of the access seeker groups. This is because both the coal and general freight groups use the same 5 sectors of TAHE's Hunter Valley Coal Network. TAHE has agreed to update the depreciation and return on assets consistent with our decision, while noting its concerns with the current undertaking.<sup>20</sup>

Table 2.6 Depreciation and return on assets – by access seeker group (\$)

	Combined		Coal		General freight	
	Return on assets	Depreciation	Return on assets	Depreciation	Return on assets	Depreciation
<b>IPART's decision</b>						
2017-18	852,620	520,325	852,620	520,325	852,620	520,325
2018-19	838,354	551,473	838,354	551,473	838,354	551,473
2019-20	734,670	670,499	734,670	670,499	734,670	670,499
<b>TAHE's proposal</b>						
2017-18	852,620	520,325	409,502	269,696	443,118	250,629
2018-19	826,342	955,694	826,342	955,694	826,342	955,694
2019-20	705,076	954,918	705,076	954,918	705,076	954,918

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).  
Source: IPART analysis, [TAHE's compliance submission](#), June 2021, pp 14-16.

### 3 Operation of 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 over or under-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.

#### 3.1 The unders and overs account balance

We have found that the cumulative balance as at 30 June 2020 is an over-recovery of approximately \$11 million.

To calculate the cumulative balance of the unders and overs account we start with the closing balance we determined as at 30 June 2018. We then use the results of our ceiling tests for 2018-19 and 2019-20 to determine the closing balance of the unders and overs account as at 30 June 2020. Table 3.1 shows that the under and over recoveries that result from our decisions give a positive balance (i.e. an over recovery).

Table 3.1 Unders and overs account based on our decisions compared to TAHE's proposal (\$)

	Combined	Coal	General freight
<b>IPART's decision</b>			
Balance at 30 June 2018	7,956,472		
2018-19 result	1,696,926		
Balance at 30 June 2019	9,653,398		
2019-20 result	1,302,454		
Balance at 30 June 2020	10,955,852		
<b>TAHE's proposal</b>			
Balance at 30 June 2018	7,956,472		
2018-19 result	-8,799,795	-8,443,148	-13,651,250
Balance at 30 June 2019	-843,323		
2019-20 result	-7,760,118	-7,681,782	-13,003,758
Balance at 30 June 2020	-8,603,441		

Note: The figures in the 2017-18 year are from our [2015-16 to 2017-18 final decision](#).  
Source: IPART analysis, [TAHE's compliance submission](#), June 2021, pp 14-16.

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TAHE's calculation of the unders and overs account balance for the combined access seeker group at 30 June 2020 is an under payment by customers of \$8.6 million (Table 3.1). The main reason for the difference between TAHE's estimated unders and overs account balance and ours is the difference in maintenance costs. This is largely attributable to TAHE's calculation of maintenance costs for a shared network, rather than a standalone network.

TAHE also proposed unders and overs account balances for the other 2 groups of access seekers. However, the undertaking does not allow for separate unders and overs account balances for each access seeker group.

## 3.2 Updating the overs and unders accounts

We recommend that TAHE updates its unders and overs account consistent with our decisions. We also recommend that TAHE returns the unders and overs account balance to zero each year and maintains a balance within 5% (above or below) of forecast access revenue, 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 as required by the undertaking.

In its submission to our Draft Report, TAHE stated that it would update its unders and overs balance in line with our decisions. TAHE will also develop a management plan to address the over recovery balance, including a plan to manage the unders and overs to a zero balance in future and the establishment of a policy to govern the process.<sup>21</sup>

Qube Logistics proposed that TAHE work with rail operators to efficiently invest the \$11 million in network infrastructure to support movement of coal and general freight along the Main Northern line corridor.<sup>22</sup>

The unders and overs account is designed to manage deviations around the maximum rate of return. Any over recovery must be reconciled with the applicable access seekers each year.<sup>23</sup> Investments in the rail network should be driven by an asset management plan, independent of any over or under recovery of efficient costs over time. Where there is an identified need for investment, TAHE could consult on options such as the one raised by Qube Logistics with all its stakeholders as a part of developing its unders and overs account policy for our approval.

In recognition of Railcorp's previous over recoveries, TAHE has introduced a 20% reduction in coal access charges for 2020-21, in addition to waiving a CPI escalation on 2019-20 access charges. TAHE notes this is an effective reduction of 23% in real terms. Also, TAHE states that lower volumes of coal freight have resulted in a 50% reduction in coal access revenue, which is likely to result in an under recovery of \$2.1 million for the combined coal and freight group in 2020-21.<sup>24</sup>

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TAHE is due to submit its compliance statement for 2020-21 in December 2021.<sup>d</sup> We will then assess its compliance for 2020-21. While this reduction in charges will ensure that the over recovery does not continue to grow, it may only partly address the existing balance. This will be considered as part of our assessment for 2020-21.

## Recommendations

- 2. TAHE updates its unders and overs account balance as at 30 June 2020 consistent with our decision on compliance with the ceiling test set out in Table 3.1. This results in a closing balance at 30 June 2020 of \$11m (over recovery).
- 3. TAHE makes a plan to return the unders and overs account to zero each year and maintain a balance within 5% of forecast revenue, consistent with clause 4(e) of Schedule 3 of the Undertaking.
- 4. 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.

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<sup>d</sup> IPART granted TAHE an extension to submit its 2020-21 compliance proposal by 10 December 2021 in order to take into account our final decisions on its compliance for 2018-19 and 2019-20.

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- <sup>1</sup> NSW Rail Access Undertaking.
- <sup>2</sup> See IPART, *NSW Rail Access Undertaking – Review of the rate of return and remaining mine life from 1 July 2014, Final Report and Decision*, July 2014 and IPART, *Rate of return and remaining mine life 2019-2024*, Final Report, July 2019.
- <sup>3</sup> IPART, *Review of the NSW Rail Access Undertaking*, Issues Paper, November 2021.
- <sup>4</sup> These principles are set out in Clause 3 of Schedule 3 of the *Undertaking*.
- <sup>5</sup> IPART, *NSW Rail Access Undertaking – Review of the rate of return and remaining mine life from 1 July 2014, Final Report and Decision*, 15 July 2014 and IPART, *Rate of return and remaining mine life 2019-2024*, Final Report, July 2019.
- <sup>6</sup> IPART, *NSW Rail Access Undertaking – Review of the rate of return and remaining mine life from 1 July 2014, Final Report and Decision*, 15 July 2014 and IPART, *Rate of return and remaining mine life 2019-2024*, Final Report, July 2019.
- <sup>7</sup> TAHE, *Hunter Valley Coal Network, submission on compliance with the pricing principles in the NSW Rail Access Undertaking 2018-19 and 2019-20*, June 2021, pp 8-9.
- <sup>8</sup> IPART, *Rate of return and remaining mine life 2019-2024*, Final Report, July 2019, p 24.
- <sup>9</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 1.
- <sup>10</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 1.
- <sup>11</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 3.
- <sup>12</sup> IPART, *Review of the NSW Rail Access Undertaking*, Issues Paper, November 2021.
- <sup>13</sup> The Ceiling Test is set out in clause 1 of Schedule 3 of the *Undertaking*.
- <sup>14</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 5.
- <sup>15</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 4.
- <sup>16</sup> Qube Logistics, *Submission to the draft report*, 15 October 2021, p 1.
- <sup>17</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 5.
- <sup>18</sup> IPART, *Compliance with the NSW Rail Access Undertaking RailCorp HVCN*, 2009/10, Final Report, August 2012, p 8 and Sapere Research Group, *A ceiling test protocol for RailCorp – prepared for IPART, November 2011*, p 12.
- <sup>19</sup> TAHE, *Hunter Valley Coal Network, submission on compliance with the pricing principles in the NSW Rail Access Undertaking 2018-19 and 2019-20*, June 2021, p 8.
- <sup>20</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 3.
- <sup>21</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 1.
- <sup>22</sup> Qube Logistics, *Submission to the draft report*, 15 October 2021, p 1.
- <sup>23</sup> NSW Rail Access Undertaking, Schedule 3, clauses 4(a) and 4(c).
- <sup>24</sup> TAHE, *Submission to the draft report*, 18 October 2021, p 1.

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