Decision

Australian Rail Track Corporation's variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments

25 June 2014

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

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Glossary

Capitalised terms not listed in this glossary are as defined in clause 14.1 of the accepted Hunter Valley Access Undertaking, available on the ACCC's website.

2013 Variation	ARTC's proposed variation to extend the Hunter Valley rail network covered by the Hunter Valley Access Undertaking to include the Segments from Gap to Turrawan submitted on 28 June 2013
ACCC	Australian Competition & Consumer Commission
the Act	Competition and Consumer Act 2010 (Cth)
ARTC	Australian Rail Track Corporation
CRIA	Country Rail Infrastructure Authority
DORC	Depreciated Optimised Replacement Cost
E&P	Evans & Peck (WorleyParsons)
gtkm	Gross tonnes multiplied by kilometres
HVAU	The Hunter Valley Access Undertaking accepted by the ACCC on 29 June 2011 and varied on 17 October 2012
Indicative Access Charge	Charge for use of train paths on the Hunter Valley rail network
Indicative Service	Coal train configuration representing most efficient utilisation of Coal Chain Capacity on the Hunter Valley Rail Network
IPART	NSW Independent Pricing and Regulatory Tribunal
MEERA	Modern Engineering Equivalent Replacement Asset
MJA	Marsden Jacob Associates
MJA Final Report	The final report on the review of the proposed DORC valuation for the Gap to Turrawan segments provided by MJA on 30 November 2013
the Network	Hunter Valley rail network covered by the Hunter Valley Access Undertaking
NSWRAU	New South Wales Rail Access Undertaking
ORC	Optimised Replacement Cost
RAB	Regulatory Asset Base
Revised Variation	ARTC's proposed variation to extend the Hunter Valley rail network covered by the Hunter Valley Access Undertaking to include the Segments from Gap to Turrawan submitted on 24 March 2014
Segment	Component of the Hunter Valley rail network
TOP	Take or Pay
Valuation Report	Report prepared by Evans & Peck (Worley Parsons) in June 2013 proposing a DORC valuation for the Gap to Turrawan Segments of the Hunter Valley rail network

Summary

On 25 June 2014, the Australian Competition and Consumer Commission (**ACCC**) consented to the Australian Rail Track Corporation's (**ARTC's**) 24 March 2014 application to extend the coverage of the Hunter Valley Access Undertaking (**HVAU**) to include the Segments from Gap to Turrawan in the Gunnedah Basin (the **Revised Variation**).[1]

The ACCC has consented to this variation of the HVAU under subsection 44ZZA(7) of the *Competition and Consumer Act 2010* (Cth) (**the Act**) having regard to the matters set out in subsection 44ZZA(3) of the Act.

Background

The Revised Variation was submitted by ARTC following consultation on a previous variation application by ARTC dated 28 June 2013 (the **2013 Variation**). The 2013 Variation was based on a depreciated optimised replacement cost (**DORC**) valuation of the Gap to Turrawan Segments that had been prepared by Evans & Peck (Worley Parsons) (**E&P**).

The use of a DORC methodology to value the Gap to Turrawan Segments is required under subsection 4.4(a)(ii) of the HVAU.[2] The DORC valuation is equal to the cost of building or buying modern equivalent assets taking account of any scope for efficiencies and depreciated to reflect the shorter remaining life of the existing assets. The DORC methodology is applied to value assets because it is either consistent with the price that would be expected to be paid by an efficient new entrant into an industry, or is consistent with the price that a firm with certain service requirements would expect to pay for existing assets in preference to replicating the assets in a competitive market.

On 12 December 2013, the ACCC released a Position Paper stating its preliminary views on ARTC's 2013 Variation. The ACCC also published a report by Marsden Jacob Associates (**MJA**) reviewing ARTC's proposed DORC valuation.[3] The Position Paper set out the ACCC's concerns with the valuation proposed by ARTC, and as such was of the preliminary view that the 2013 Variation was not appropriate to accept pursuant to subsection 44ZZA(7) of the Act.[4]

ARTC withdrew the 2013 Variation on 20 February 2014 and engaged in further negotiations with stakeholders before submitting a revised application to the ACCC.

2014 Revised Variation

On 24 March 2014, ARTC submitted its Revised Variation to the ACCC. In summary, the main differences from the 2013 Variation include:

- a reduction in the proposed DORC valuation (excluding financing costs) from $325.41 million to $296.43 million; and

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1 The HVAU has previously been varied once on 17 October 2012. The current version of the HVAU is available on the ACCC's website at http://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking.

2 Subsection 4.4(a)(ii) of the HVAU defines the optimised replacement cost (**ORC**) as the cost of replacement by commercially efficient application of best known current available technology based on existing capacity and performance characteristics of the asset.

3 The report by MJA is available on the ACCC's website at http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2014.

4 See Chapter 1 for a summary of the ACCC's specific concerns.

- as a result of the negotiated agreement between ARTC and relevant stakeholders in Pricing Zone 3, a reduction in the proposed financing costs from $56.8 million in ARTC's submission in response to the ACCC's Position Paper, to a figure of $26.94 million.

The specific changes in the Revised Variation compared with the 2013 Variation relate to the proposed DORC valuation for the Gap to Turrawan Segments (see **Table 1**) and the proposed Indicative Access Charges for the extended Pricing Zone 3 (see **Table 2**).

Table 1: Gap to Turrawan Segment proposed DORC values

Segment (length)	**Proposed DORC asset valuation (as at 1 January 2013)**	
	2013 Variation (withdrawn)	**Revised Variation (current)**
Gap – Watermark (31.1km)	$78.47m	$75.17m
Watermark – Gunnedah (33.0km)	$94.48m	$87.99m
Gunnedah – Boggabri (41.4km)	$92.09m	$79.66m
Boggabri – Turrawan (27.0km)	$59.86m	$53.08m
Network control centre	$0.52m	$0.52m
Total without financing costs	*$325.41m*	*$296.43m*
Financing costs	$0	$26.94m
Total	*$325.41m*	*$323.37m*

The 2013 variation did not include financing costs. ARTC subsequently proposed financing costs of $56.8 million in its submission to the Position Paper which if added to the proposed DORC asset valuation would have totalled $382.21 million.

In the Revised Variation, ARTC adjusted the DORC value of the Gap to Turrawan Segments to reflect the ACCC's views in its Position Paper and negotiated with relevant stakeholders on the remaining outstanding issues. The key amendments and the value of these individual adjustments (as set out in greater detail in Chapter 5) include:

- a revised total DORC valuation for the Gap to Turrawan Segments of $323.37 million taking into account:
    - removal of assets not required for coal haulage (deducting $3.42 million);
    - reductions in the proposed mark up on direct costs (as a means of calculating indirect costs) for signalling and track assets (deducting $13.6 million);
    - the inclusion of the present value of cost savings associated with the operation and maintenance of certain modern equivalent assets (deducting $0.985 million);

    - an adjustment to the remaining life of bridges, signalling assets and track with a mix of timber and steel sleepers (deducting $5.78 million);

    - an adjustment to the remaining lives of relevant assets planned to be replaced in coming years under the planned 30 tonne axle load investment program, to align to the expected time for replacement and disposal of those assets (deducting $10.1 million); and

    - inclusion of an amount representing financing costs (interest during construction) of $26.94 million. The $26.94 million represents around 9.06 per cent of the proposed DORC value, excluding financing costs, of $296 million.

- application of a retrospective operative date of 1 January 2014 for the Revised Variation to enable the provisions of the HVAU to become operative in respect of the additional Segments.

Access Charges

In accordance with its revised DORC value and confirmed volumes for 2014, ARTC also submitted that the Initial Indicative Access Charge for Pricing Zone 3 as published on ARTC's website effective from 1 January 2014 would also apply to the Gap to Turrawan Segments.

Table 2: 2014 Initial Indicative Access Charges for Pricing Zone 3 under the Revised Variation

Initial Indicative Service Assumptions	**Non-TOP** $/kgtkm (ex GST)	**TOP** $/kgtkm (ex GST)
<u>Indicative Service 1</u> 25 tonne maximum axle load 80 kph maximum speed (loaded) 80 kph maximum speed (empty) 82 wagon train length 1350 metres maximum train length Section run times as per applicable Hunter Valley standard working timetable.	1.496	9.635

Source: ARTC Revised Variation, *Supporting Documentation*, p. 29.

ARTC has also made amendments in the Revised Variation to address issues raised in the Position Paper regarding the transparency of access charges. ARTC proposes to amend subsection 4.20(d) of the HVAU to provide Access Holders in Pricing Zone 3 with ARTC's estimate of the starting and ending RAB values for Pricing Zone 3 (in aggregate) for the following calendar year at the same time as aggregate coal volumes, forecast costs and relevant charges are provided under subsection 4.20(d).

ACCC view

The ACCC notes that the Revised Variation includes amendments to address the issues raised by the ACCC in its Position Paper and the MJA Final Report. The ACCC is of the view that ARTC has appropriately adjusted the DORC value for the Gap to Turrawan Segments to reflect the concerns raised by the ACCC in its Position Paper (as summarised in Chapter 5) to:

- reduce the DORC value to reflect that the total cost for some components was higher than comparable benchmark costs;
- adjust the remaining life of particular assets, including bridges, signalling assets and sleepers;
- make adjustments to reflect that the passing loops and sidings are not all concrete sleepers as assumed in the E&P valuation;
- correct the relevant modelling inconsistencies; and
- include the value of maintenance and operating cost savings associated with modern technology assets.

In addition, the matters identified by the ACCC as outstanding in its Position Paper in light of the independent review of the proposed DORC valuation by MJA (set out below), have been agreed on between ARTC and Pricing Zone 3 coal producers and incorporated into the Revised Variation.

In its Position Paper, the ACCC was of the preliminary view that the inclusion of passing loops and sidings that do not appear to be required for coal haulage would not be in the interests of coal producers because doing so would unnecessarily result in higher access charges for Access Holders. The ACCC specifically noted that MJA had identified between four and 12 passing loops and sidings that may not be required.

In its Revised Variation, ARTC proposed to remove seven of the assets identified by MJA. However, ARTC also proposed to retain five of the sidings and passing loops on the basis that it considers practical capacity entitlements could not be met on a stand-alone basis without these assets and as such they are essential for the efficient operation of the Network. The ACCC notes that the submissions from Pricing Zone 3 coal producers supported ARTC's position that the five sidings and passing loops are necessary for providing the regulated service in relation to the Gap to Turrawan Segments. Given that ARTC's proposal is consistent with the finding in the MJA Final Report, and is supported by relevant stakeholders, the ACCC is of the view that the retention of those five sidings and passing loops in the Revised Variation is appropriate.

The ACCC has formed its views in relation to the amendments by ARTC in response to the recommendations set out in the Position Paper and the MJA Final Report having regard to the matters listed in subsection 44ZZA(3) of the Act. The relevant matters include:

- the legitimate business interests of ARTC (subsection 44ZZA(3)(a));
- the objects of Part IIIA as set out in section 44AA (subsection 44ZZA(3)(aa));
- the pricing principles referred to in subsection 44ZZA(3)(ab) and set out in subsection 44ZZCA of the Act; and
- the interests of current and future Pricing Zone 3 Access Holders who might want access to the Gap to Turrawan Segments under the HVAU (subsection 44ZZA(3)(c)).

When having regard to ARTC's legitimate business interests, the ACCC considered whether the Revised Variation is sufficient and necessary to maintain those interests. The ACCC has considered whether the Revised Variation provides, in line with the objects and the pricing principles in the Act, for a DORC value to be set that allows ARTC to: generate expected revenue that is at least sufficient to meet the efficient costs of ARTC providing access to the regulated service that will run on the Gap to Turrawan Segments; and includes, for ARTC, a return on investment commensurate with the regulatory and commercial risks involved in running the service. In particular, the ACCC has had regard to the investments made by ARTC on the Gap to Turrawan segments prior to 1 January 2013 and ensuring that the DORC value at that date reflects those investments.

In considering the interests of current and future Gap to Turrawan Access Holders, the ACCC considered whether only those assets necessary for the regulated service have been included in the DORC valuation and whether the appropriate methodology has been applied in valuing those assets. By ensuring that the Gap to Turrawan Segments are valued appropriately, an economically efficient value will be included into the RAB which will ensure that access seekers are only levied access charges that are sufficient to meet ARTC's efficient costs. It is in access seekers' long term interest that charges and returns to ARTC are sufficient to provide the incentives needed to induce ARTC to adequately maintain services.

Consultation on and agreement on outstanding issues with stakeholders

Since the release of the Position Paper and withdrawal of the 2013 Variation, ARTC has engaged in direct negotiations with all existing coal producers who use the Gap to Turrawan Segments in the Gunnedah Basin[5] to come to an agreed position on the remaining outstanding issues in the Position Paper on which the ACCC did not form a final view.

ARTC states that in response to those discussions, it has incorporated a package of adjustments put forward and accepted by all relevant stakeholders into the Revised Variation.[6] The package includes:

- financing costs (interest during construction) of $26.94 million, representing 9.06 per cent of the proposed DORC value, excluding financing costs, of $296 million;
- adjustments to the proposed DORC value to reflect the move to a 30 tonne axle load; and
- measures to improve pricing transparency around the losses that are likely to be capitalised.

With regard to the first two dot points, ARTC submitted that these adjustments reflect an agreed position with Pricing Zone 3 coal producers. ARTC has stated that they are applied in the specific circumstances of the DORC for the Gap to Turrawan Segments only and that ARTC does not intend to use them as a precedent for future valuations or variation applications.[7]

The ACCC has received public submissions from Pricing Zone 3 producers Whitehaven and Idemitsu stating that the package of adjustments proposed by ARTC in the Revised Variation is consistent with the agreed outcomes from their negotiations and that they support financing costs of $26.94 million and a move toward a 30 tonne axle load. Both Whitehaven and Idemitsu support ARTC's Revised Variation and consider it appropriate to extend the scope of the HVAU to include the Gap to Turrawan Segments.[8]

The ACCC is of the view that the negotiated outcome between ARTC and producers on these limited outstanding issues is appropriate in the context of the current assessment. In particular, the outcome appears to strike an appropriate balance between the interests of ARTC and the current users of the network who will be required to pay the access charges that flow from the increased RAB value.[9] In forming this view, the ACCC notes that endorsement of ARTC's package of adjustments by all current Access Holders in Pricing Zone 3 is a key consideration in the assessment of the Revised Variation as it reflects a commercial agreement between the parties. As ARTC has reached agreement with all

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5 The current users of the Segments are Whitehaven Coal Limited (**Whitehaven**) and Idemitsu Australia Resources Pty Ltd (**Idemitsu**).

6 ARTC Revised Variation, *Supporting Documentation*, 24 March 2014.

7 Ibid*,* pp. 16 and 24.

8 Idemitsu, S*ubmission - Consultation - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014),* 8 May 2014; Whitehaven, *Whitehaven Submission on ARTC's Revised Application to include the Gap to Turrawan*, 5 May 2014.

9 Subsections 44ZZA(3)(a) and (c).

relevant coal producers, the ACCC notes that it has not formed a view on the parameters and assumptions underlying the financing costs that have been agreed on in this instance.

It is important to emphasise that had the ACCC not previously conducted its own independent analysis of ARTC's DORC valuation as provided in the 2013 Variation, it would have had reservations with merely accepting an 'agreed' position, as it is not the case that an agreed DORC valuation between an access provider and a group of access holders will be appropriate to accept in all circumstances. An agreed DORC valuation may not necessarily promote the efficiency and competition objectives of Part IIIA, the public interest, or the interest of all access seekers if it were significantly higher or lower than an efficient value. For example, if a higher than efficient valuation were included in the RAB then the future development of mines in Pricing Zone 3 might be inefficiently deterred due to the imposition of higher than efficient access charges. Conversely, a lower than efficient valuation would send incorrect pricing signals to users about the costs they impose on the network and might not provide sufficient incentive for ARTC to adequately maintain the network.

In relation to future coal producers seeking access to the extended Pricing Zone 3 under the HVAU, the ACCC notes that ARTC is obliged under subsection 3.14(b)(i)(C) of the HVAU to offer future access seekers with the same market terms and conditions as existing Access Holders, if they meet the relevant conditions precedent for access.

In accepting this negotiated package as part of the Revised Variation, the ACCC specifically notes that ARTC does not intend to use the negotiated outcomes as a precedent for future valuations or variation applications. The ACCC agrees and highlights that any future valuations or variation applications by ARTC or other will need to be supported with the appropriate level of analysis and evidence in the context of those applications.

Operative date of 1 January 2014

In response to ACCC comments in the Position Paper regarding ARTC's transition to a retrospective operative date, ARTC's Revised Variation included an amendment to subsection 2.2(a)(iii) of the HVAU to enable the provisions of the HVAU to become operative in respect of the Additional Segments on and from 1 January 2014.

In support of this commencement date, ARTC set out the regulatory and administrative efficiencies that will accrue to both access holders and ARTC from the proposed retrospective operative date (see Chapter 4). Stakeholder submissions acknowledged these various benefits, and did not raise objections to the proposed approach.

The ACCC is of the view that given the large number of regulatory obligations under the HVAU that operate on a calendar year basis, to have a substantial section of Pricing Zone 3 operating on a different regulatory timeframe would introduce an unnecessary complexity to the HVAU and impose a significant and undue regulatory burden on both ARTC and access seekers alike. The ACCC also notes that submissions on the Revised Variation did not raise concerns with the proposed operative date. For these reasons, the ACCC considers a retrospective operative date of 1 January 2014, in relation to the amendments to the HVAU that cover the additional Gap to Turrawan Segments, to be appropriate. The ACCC notes that this decision does not impact any parties' rights or obligations under section 44ZZBA of the Act.

Improved transparency measures

ARTC has proposed amendments to subsection 4.20(d) to provide transparency over the estimate of losses to be capitalised for the following calendar year by providing forecast starting and ending RAB values to Access Holders for Pricing Zone 3.

ARTC submits that providing the starting and ending RAB values will enable Access Holders in Pricing Zone 3 to estimate the amount that will be capitalised into the asset base for that year.

ARTC estimates that if the Revised Variation is accepted, the starting RAB for the extended Pricing Zone 3 as at 1 January 2014 will be $648 million, and the closing RAB as at 31 December 2014 will be $696.5 million. Based on these values, ARTC submits that the amount to be capitalised in 2014 for future recovery would be $48.5 million.

In response to ARTC's Revised Variation, Idemitsu submits that ARTC should, in addition to the measure proposed, 'provide Pricing Zone 3 Access Holders a component breakdown of the RAB movement by dollar amount (i.e. loss capitalisation, capital expenditure, operating costs, rate of return and revenue) … [and that] the loss capitalisation amount should be clearly defined in the annual compliance assessment for the extended Pricing Zone 3'.[10]

The ACCC noted in its Position Paper that it may be difficult for ARTC to provide the exact magnitude of losses that are likely to be capitalised, as the losses are determined as part of the ACCC's annual compliance process each year. In addition, the ACCC noted that ARTC currently has flexibility under the HVAU to consider a range of factors in determining the proportion of economic cost in Pricing Zone 3 it will recover through access charges.[11]

It is the ACCC's view that ARTC's proposed transparency measure strikes an appropriate balance between the legitimate business interests of ARTC having flexibility to determine the proportion of economic cost it will recover in Pricing Zone 3 and the interests of access seekers being provided with an estimate of the likely losses to be capitalised in advance of completion of the annual compliance process. The ACCC acknowledges that ARTC can only ever provide forecasts at the beginning of a calendar year, with the final loss capitalisation amount being determined by the ACCC during the annual compliance process at the end of each year. These estimates should help inform relevant coal producers' investment decisions and will allow comparisons between ARTC's estimates and what has actually been incurred following the ACCC's annual compliance assessment.

The ACCC recognises however that this is only a first step toward improving transparency for Pricing Zone 3 producers and is of the view that this approach does not impose an undue regulatory burden on ARTC. Related to this, the ACCC notes that as part of its determination on ARTC's compliance with the financial model and pricing principles in the HVAU for the 2012 calendar year, the ACCC flagged its intention to undertake a public review of the provision of information to stakeholders and the methodologies underpinning revenue allocation across the Hunter Valley Coal Network. This review has commenced, and the ACCC will be using the outcome of that consultation process to inform its consideration of ARTC's information provision obligations.[12] Finally, the ACCC also notes that stakeholders will have an additional chance in the near future to review how these measures operate in practice when (it is expected) ARTC submits a new undertaking to the ACCC to replace the existing HVAU.

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10 Idemitsu, *Submission - Consultation - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014),* 8 May 2014, p. 3.

11 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 34.

12 Details of the Revenue Allocation Review process can be accessed at the ACCC's website here: http://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/revenue-allocation-review.

1 Introduction

On 24 March 2014, ARTC submitted to the ACCC its Revised Variation to the HVAU. The Revised Variation seeks to extend the scope of the network subject to regulation by the ACCC under the HVAU to include the Segments from Gap to Turrawan.

Under subsection 44ZZA(7) of the Act, the ACCC may consent to a variation of an accepted access undertaking if it thinks it appropriate to do so having regard to the matters listed in subsection 44ZZA(3).[13]

1.1 The ACCC's decision

The Revised Variation has been submitted by ARTC following consultation on a previous variation application that was dated 28 June 2013 relating to the Gap to Turrawan Segments.

The ACCC formed the preliminary view that the 2013 Variation was not appropriate to accept, and provided ARTC with guidance on how the application could be revised such that it would be likely to be accepted. At the same time, the ACCC published MJA's Final Report that reviewed ARTC's proposed DORC valuation.
In particular, the ACCC formed the following preliminary views regarding aspects of ARTC's proposed DORC valuation:

- the inclusion of assets that are not required for hauling coal is not likely to be appropriate, noting that MJA had identified between four and 12 sidings and loops that may not be required for coal haulage;
- the magnitude of the mark-ups on direct costs (as a means of calculating indirect costs) is not likely to be appropriate as they appear to be high compared to relevant benchmark costs;
- the present value of cost savings associated with a new and modern asset should be included in the DORC valuation up-front rather than accounting for these costs in the annual compliance assessment process;
- several remaining asset life assumptions underpinning the proposed DORC valuation are unlikely to be appropriate; and
- the modelling underpinning the proposed DORC valuation contains a number of errors and is unlikely to be appropriate.

The ACCC also considered that it may be appropriate for ARTC to provide additional transparency to access seekers regarding the extent of capitalised losses that are likely to result from the proposed access charges.

In its Position Paper, the ACCC did not form a final view on several outstanding issues that were raised during consultation, instead seeking further information and views from stakeholders as part of the consultation process. These outstanding issues included:

- the appropriate level of financing costs for inclusion in the DORC valuation;
- whether the DORC valuation should be based on an optimal axle load of 30 or 25 tonnes; and

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13 See chapter 3 of this document for further information on these provisions.

- the additional information ARTC should provide to producers to address the concerns regarding pricing transparency and loss capitalisation.

In addition, the ACCC noted that it was unlikely the 2013 Variation would be accepted for inclusion in the scope of the HVAU by the proposed 1 January 2014 commencement date. As such, it was recognised that ARTC would need to consider how this transition would be managed in order to ensure certainty for access seekers.

The ACCC conducted two consultation processes and issued one formal information request that 'stopped the clock' as part of its assessment of the 2013 Variation. ARTC withdrew its 2013 Variation on 20 February 2014.[14]

The 24 March 2014 Revised Variation incorporates revisions to accommodate the ACCC's views from its previous assessment and also includes a package of adjustments negotiated with stakeholders on a number of outstanding issues. The ACCC conducted a three week public consultation process on the Revised Variation.

Having regard to the matters listed in subsection 44ZZA(3) of the Act, the ACCC is of the view that it is appropriate under subsection 44ZZA(7) of the Act to accept ARTC's application, made on 24 March 2014, to vary the 29 June 2011 HVAU (that was subsequently varied on 17 October 2012).

The ACCC's reasons for this decision are set out in this document.

1.2 Effect of the decision to accept the Revised Variation

With the ACCC's acceptance of the Revised Variation, ARTC will provide access to the Gap to Turrawan Segments in accordance with the provisions in the HVAU. Specifically:

- the scope of the HVAU has been extended to include the Gap to Turrawan Segments - that is, the Hunter Valley rail network as defined in Schedule B of the HVAU (**the Network**) includes the Segments from Gap to Turrawan;

- ARTC's proposed asset value for the Gap to Turrawan Segments, determined using the DORC methodology, and incorporating the negotiated package of amendments, has been included in the RAB from 1 January 2014, on which ARTC is allowed to earn a regulated rate of return; and

- the Initial Indicative Access Charge for Pricing Zone 3, as published on ARTC's website effective from 1 January 2014, applies to the Gap to Turrawan Segments.[15]

1.3 Structure of this Decision

This Decision is structured as follows:

Chapter 2 – Background sets out the process that led to the ACCC's decision to accept the June 2011 HVAU, the background to ARTC submitting the Revised Variation, and the process of the ACCC's assessment of the Revised Variation.

Chapter 3 – Decision-making framework provides an overview of the matters that the ACCC must have regard to when assessing a request to vary an access undertaking under Part IIIA of the Act.

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[14] ARTC's withdrawal letter is available on the ACCC's website at http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2014/application-withdrawn .

[15] In calculating the charges for 2014, ARTC assumed that the Gap to Turrawan Segments would be covered by the HVAU.

Chapter 4 – Addition of rail infrastructure from Gap to Turrawan sets out the ACCC's views on extending the coverage of the HVAU to include Segments from Gap to Turrawan in the Gunnedah Basin.

Chapter 5 – DORC valuation sets out the ACCC's views on the DORC valuation for the Gap to Turrawan Segments.

Chapter 6 – Indicative Service and Indicative Access Charges discusses the ACCC's views on the Indicative Service and pricing aspects of ARTC's Revised Variation.

Chapter 7 – Drafting amendments considers the drafting changes in the Revised Variation designed to implement ARTC's Revised Variation.

Chapter 8 – Conclusion

1.4 Further information

ARTC's Revised Variation and other relevant material, including its 2013 Variation, submissions to the various processes and the currently accepted HVAU, are available on the ACCC's website at the following link:

http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2014

Alternatively, go to the ACCC's homepage at www.accc.gov.au and follow the links to 'Regulated Infrastructure' and 'Rail' and 'ARTC Hunter Valley Access Undertaking'.

2 Background

The HVAU was accepted by the ACCC on 29 June 2011. The HVAU regulates access to the Hunter Valley rail network operated by ARTC in New South Wales. ARTC leases the Hunter Valley rail network from the New South Wales government under a 60 year lease granted on 5 September 2004.

The Gap to Turrawan Segments came under ARTC's management as of 1 July 2011 when ARTC incorporated the Northern line from Gap to Boggabilla into its Hunter Valley lease and are currently covered under the NSW Rail Access Undertaking (**NSWRAU**) overseen by the NSW Independent Pricing and Regulatory Tribunal (**IPART**).

The Gap to Turrawan Segments service mines in the Gunnedah Basin region. The current users of the Segments are Whitehaven Coal and Idemitsu Australia. Whitehaven Coal is the largest coal producer in the Gunnedah Basin, operating the Gunnedah and Narrabri mines. Whitehaven is also developing its Maules Creek mine, a large new development in the Hunter Valley. Idemitsu operates the Boggabri mines. An additional coal producer in the region is expected to require access to the Segments in the near future.

ARTC has submitted the Revised Variation to extend the scope of the HVAU to incorporate the rail infrastructure from Gap to Turrawan. Under the Revised Variation the Gap to Turrawan Segments will become part of Pricing Zone 3 of the Network covered by the HVAU.

The Gap to Turrawan Segments were not ascribed a regulatory value under the NSWRAU. Subsection 4.4(a)(ii) of the HVAU requires that those Segments that were not ascribed a regulatory asset value in accordance with the NSWRAU be initially valued using the DORC methodology and approved by the ACCC. Accordingly, ARTC has submitted a DORC valuation proposal to the ACCC for the Gap to Turrawan Segments prepared by E&P as part of its variation application.

As part of its Revised Variation, ARTC has proposed a total DORC valuation for the Gap to Turrawan Segments of $323.37 million as at 1 January 2013, which will be rolled forward to the effective start date of 1 January 2014.

2.1 ACCC assessment process

The Act provides that the ACCC may invite public submissions on an access undertaking application.[16]

Consultation Paper

The ACCC published a Consultation Paper on 23 July 2013 inviting submissions on the 2013 Variation. The ACCC received public submissions from the following parties:

- Asciano Limited (20 August 2013)
- Whitehaven Coal (20 August 2013)
- Idemitsu Australia (22 August 2013)

These submissions were taken into account in the ACCC's 12 December 2013 Position Paper.

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16 Subsection 44ZZBD(1) of the Act. Under section 44B, an 'access undertaking application' includes a request made to vary an access undertaking.

Requests for information

On 3 September 2013, the ACCC sent a request for information to ARTC under section 44ZZBCA of the Act. The purpose of the request was to seek further explanation in relation to some of the documentation provided by ARTC and to request additional documentation that the ACCC considered relevant to its decision on the 2013 Variation. On 17 September 2013, ARTC provided a response to the request for information. On 4 October 2013, the ACCC received a redacted public version of this response.

The ACCC's request for information and a public version of ARTC's response is available on the ACCC's website.

The ACCC also sent a number of informal requests for information to ARTC in order to assist MJA in their review of the proposed DORC valuation and follow up on previous responses. The timing of these requests are outlined in the ACCC's Position Paper.

Position Paper

The ACCC published a Position Paper on 12 December 2013 outlining its preliminary view on the 2013 Variation and inviting submissions. The ACCC received public submissions from the following parties in response to the Position Paper. All submissions were considered and where relevant, have been summarised throughout this document.

- Whitehaven Coal (8 January 2014, with a supplementary submission received 29 January 2014)
- Australian Risk Policy Institute (14 January 2014)
- Australian Rail Track Corporation (17 January 2014)
- Idemitsu Australia (17 January 2014)

ARTC withdrew its 2013 Variation on 20 February 2014 and engaged in further negotiations with stakeholders. After reaching agreement with relevant coal producers on these issues, ARTC submitted its Revised Variation on 24 March 2014.

Consultation Letter

On 15 April 2014, the ACCC published a Consultation Letter seeking submissions on ARTC's Revised Variation during a three week consultation process. In response, the ACCC received the following public submissions:

- Whitehaven Coal (5 May 2014)
- Idemitsu Australia (8 May 2014)

The ACCC notes that these submissions support ARTC's Revised Variation and consider it appropriate to extend the scope of the HVAU to include the Gap to Turrawan Segments. Where relevant, these submissions have been summarised throughout this document.

All public submissions in relation to this assessment process are available on the ACCC's website at:

https://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2014

3 Decision-making framework

This chapter provides an overview of the framework under which the ACCC has made its decision on ARTC's Revised Variation.

3.1 Legislative framework under Part IIIA

Under subsection 44ZZA(7)(b) of the Act, an access provider may withdraw or vary an access undertaking at any time after it has been accepted by the ACCC, but only with the consent of the ACCC.

If the ACCC consents to the variation, the provider is required to offer third party access in accordance with the varied access undertaking. An access undertaking is binding on the access provider and can be enforced in the Federal Court upon application by the ACCC.

Subsection 44ZZA(7) allows the ACCC to consent to a variation of an accepted access undertaking if it considers it appropriate to do so, having regard to the matters contained in subsection 44ZZA(3), which are:

- the objects of Part IIIA of the Act[17], which are to:
    - promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
    - provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry;
- the pricing principles specified in section 44ZZCA of the Act (see further below);
- the legitimate business interests of the provider of the service;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of persons who might want access to the service;
- whether the undertaking is in accordance with an access code that applies to the service;[18] and
- any other matters that the ACCC thinks are relevant.

In relation to the pricing principles, section 44ZZCA of the Act provides that:

- regulated access prices should:
    - be set so as to generate expected revenue for a regulated service that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
    - include a return on investment commensurate with the regulatory and commercial risks involved; and

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[17] Section 44AA of the Act.

[18] There is currently no access code that applies to services provided under the HVAU.

- access price structures should:
    - allow multi-part pricing and price discrimination when it aids efficiency; and
    - not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and
- access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

3.2 Timeframes for ACCC decisions and clock-stoppers

Subsection 44ZZBC(1) of the Act provides that the ACCC must make a decision on an access undertaking application within the period of 180 days starting on the day the application is received (referred to as 'the expected period'). A request made to the ACCC for the withdrawal or variation of an access undertaking is an access undertaking application.

If the ACCC does not publish a decision on an access undertaking application under section 44ZZBE of the Act within the expected period, it is taken, immediately after the end of the expected period, to have:

- made a decision to not accept the application; and
- published its decision under section 44ZZBE and its reasons for that decision: see subsection 44ZZBC(6).

The Act contains 'clock-stoppers' that mean certain time periods are not taken into account when determining the expected period (see subsection 44ZZBC(2)). In particular, the clock may be stopped:

- by written agreement between the ACCC and the access provider (in this case, ARTC), and such agreement must be published: subsections 44ZZBC(4) and (5);
- if the ACCC gives a notice under subsection 44ZZBCA(1) requesting information in relation to the application;
- if a notice is published under subsection 44ZZBD(1) inviting public submissions in relation to the application; and
- if a decision is published under subsection 44ZZCB(4) deferring consideration of whether to accept the access undertaking, in whole or in part, while the ACCC arbitrates an access dispute.

3.3 Information requests

Subsection 44ZZBCA(1) provides that the ACCC may give a person a written notice requesting the person give to the ACCC, within a specified period, information of a kind specified in the notice that the ACCC considers may be relevant to making a decision on an access undertaking application.

Subsection 44ZZBCA(3) states that the ACCC must have regard to any information given in compliance with a notice under subsection 44ZZBCA(1) in making its decision.

As noted above, the period within which the ACCC requests information constitutes a clock-stopper.

4 Addition of rail infrastructure from Gap to Turrawan from 1 January 2014

This chapter sets out the ACCC's decision on ARTC's proposal to extend the coverage of the HVAU to include Segments from Gap to Turrawan in the Gunnedah Basin and for the Revised Variation to become operative from 1 January 2014.

4.1 Revised Variation

The addition of rail infrastructure from Gap to Turrawan in the scope of the HVAU is achieved by re-drafting provisions of the HVAU, specifically Schedules B and E.

Schedule B defines the Network for the purposes of the HVAU. Section 2 of the HVAU, which outlines the scope and administration of the undertaking, defines the Network covered by the HVAU as the network of railway lines delineated or defined in Schedule B.

Schedule E of the HVAU lists all the Segments in the Network. A 'Segment' is defined in section 14 of the HVAU to mean a component of the Network as defined in Schedule E**,** and is the smallest component for which the revenue floor and ceiling limits apply.

4.1.1 Schedule B

ARTC seeks to vary Schedule B of the HVAU in order to incorporate the rail infrastructure acquired under the lease from the NSW Government from Gap to Turrawan in the Gunnedah Basin. ARTC also seeks to vary Annexure 1 to Schedule B to clarify that the map at Annexure 1 to Schedule B represents the Hunter Valley rail network, including the Gap to Turrawan Segments.

The proposed drafting amendments are attached to ARTC's Revised Variation at Attachment A.[19]

4.1.2 Schedule E

ARTC seeks to vary Schedule E of the HVAU in order to break down the rail infrastructure from Gap to Turrawan into four separate Segments for the purpose of applying the pricing principles contained in section 4 of the HVAU:

- Gap to Watermark (31.1km)
- Watermark to Gunnedah (33.0km)
- Gunnedah to Boggabri (41.4km)
- Boggabri to Turrawan (27.0km)

ARTC's Revised Variation also amends certain existing Pricing Zone 3 Segments to align to a historical classification in their description.[20]

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[19] ARTC, *Revised Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 24 March 2014, pp. 12-13.

[20] Ibid, p. 13.

4.1.3 Operative date - subsection 2.2(a)(iii)

ARTC proposes to amend subsection 2.2(a)(iii) of the HVAU to enable the provisions of the HVAU to become operative in respect of the Additional Segments on and from 1 January 2014.[21]

4.2 Submissions

All submissions in response to the ACCC's consultation paper on the 2013 Variation expressed support for the inclusion of the Gap to Turrawan segments in the coverage of the HVAU.[22]

In relation to a 1 January 2014 commencement date, ARTC submitted that significant benefits accrued to both access holders and ARTC from the proposed retrospective commencement date as it:

- aligns to ARTC's obligations under the HVAU in relation to pricing, performance reporting, annual compliance assessment and Access Holder entitlements, which are undertaken on a calendar year basis;

- reduces the regulatory burden on ARTC in relation to the annual compliance assessment, RAB and RAB Floor Limit roll forward (including the application of loss capitalisation) and unders and overs accounting for the Additional Segments which are undertaken on a calendar year basis. An earlier or later operational date would result in a complex part year application of these provisions; and

- results in simpler application of commercial arrangements with Access Holders including the system wide true-up test and annual TOP rebate reconciliation which are undertaken on a calendar year basis.[23]

On this point, submissions received in response to the Consultation Letter on the Revised Variation consider it appropriate to extend the scope of the HVAU to include the Gap to Turrawan Segments, acknowledge the benefits outlined by ARTC (as set out above), and do not raise objections to a retrospective effective commencement date of 1 January 2014.[24]

4.3 ACCC view

The ACCC is of the view that the inclusion of the Gap to Turrawan Segments in the coverage of the HVAU is appropriate.

As set out in its Position Paper, the ACCC continues to be of the view that inclusion of the Gap to Turrawan segments in the coverage of the HVAU would promote regulatory certainty for users of the Hunter Valley rail network, as well as encourage consistency of regulation over the entire Hunter Valley rail network.

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21 ARTC, *Revised Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 24 March 2014, p. 8.

22 Asciano, *Asciano Submission to the ACCC relating to the ARTC relating to the ARTC Hunter Valley Access Undertaking Proposed Variation to Include Turrawan to the Gap*, 20 August 2013, p.1; Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p.3; Idemitsu, *ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p. 2.

23 ARTC, *Revised Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 24 March 2014, p. 6.

24 Idemitsu, S*ubmission - Consultation - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014),* 8 May 2014; Whitehaven, *Whitehaven Submission on ARTC's Revised Application to include the Gap to Turrawan*, 5 May 2014.

The ACCC is also of the view that these considerations are consistent with the matters set out in subsection 44ZZA(3) of the Act. In particular, the ACCC is of the view that the Revised Variation is appropriate with regards to the interests of persons who might want to access the service (subsection 44ZZA(3)(c)), as well as the objects of Part IIIA in encouraging a consistent approach to access regulation (subsection 44ZZA(3)(aa)).

The ACCC also considers that inclusion of the Gap to Turrawan segments in the HVAU will facilitate supply chain alignment in the Hunter Valley by enabling consistent access regulation and contractual arrangements for producers operating in the Gunnedah Basin. Supply chain alignment is a relevant ‘other matter’ that the ACCC has had regard to under subsection 44ZZA(3)(e).

In relation to the proposed operative date of 1 January 2014, the ACCC is of the view that given the large number of regulatory obligations under the HVAU that operate on a calendar year basis, to have a substantial section of Pricing Zone 3 operating on a different regulatory timeframe would introduce an unnecessary complexity to the HVAU and impose a significant and undue regulatory burden on both ARTC and access seekers alike. The ACCC also notes that submissions on the Revised Variation did not raise concerns with the proposed operative date.

For these reasons, the ACCC considers a retrospective operative date of 1 January 2014, in relation to the amendments to the HVAU that cover the additional Gap to Turrawan Segments, to be appropriate. The ACCC notes that this decision does not impact any parties’ rights or obligations under section 44ZZBA of the Act.

5 DORC valuation

This chapter sets out the ACCC's view on the DORC valuation for the Gap to Turrawan Segments proposed as part of ARTC's Revised Variation.

5.1 2013 valuation

Section 4 of the HVAU implements a revenue cap based on the economic cost of providing services, which constrains the revenues ARTC may receive from access charges. Economic cost includes a return earned on assets, and therefore requires a regulatory asset value be ascribed to all relevant assets for inclusion in the RAB.

As part of its 2013 Variation, ARTC submitted a DORC valuation proposal to the ACCC for the Gap to Turrawan Segments prepared by E&P. The ORC means 'the cost of replacement by commercially efficient application of best known currently available technology based on existing capacity and performance characteristics of the asset'. Depreciation is applied to the ORC to determine a DORC value.

The Valuation Report prepared by E&P is at Attachment C to the 2013 Variation, available on the ACCC's website. E&P's total proposed valuation for the Gap to Turrawan Segments was $325.4 million. Details of the approach taken by E&P are set out in the ACCC's 12 December 2013 Position Paper.[25]

5.2 Review by MJA and the Position Paper

On 30 November 2013, the ACCC received MJA's Final Report setting out its findings in relation to its independent review of ARTC's DORC valuation prepared by E&P. MJA concluded that the DORC valuation would be reasonable subject to a range of issues being addressed.[26]

On 12 December 2013, the ACCC released a Position Paper stating its preliminary views on ARTC's 2013 Variation. The ACCC also published MJA's Final Report.[27]

In its Position Paper, the ACCC set out the following concerns with the valuation proposed by ARTC:

- the inclusion of assets that are not required for hauling coal is not likely to be appropriate, noting that MJA had identified between four and 12 sidings and loops that may not be required for coal haulage;
- the magnitude of the mark-ups on direct costs (as a means of calculating indirect costs) is not likely to be appropriate as they appear to be high compared to relevant benchmark costs;
- the present value of cost savings associated with a new and modern asset should be included in the DORC valuation up-front rather than accounting for these costs in the annual compliance assessment process;
- several remaining asset life assumptions underpinning the proposed DORC valuation are unlikely to be appropriate; and

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25 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, pp. 16-17.

26 Ibid, pp.18-19.

27 The report by MJA is available on the ACCC's website at http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2014.

- the modelling underpinning the proposed DORC valuation contains a number of errors and is unlikely to be appropriate.

In the Position Paper, the ACCC did not form a final view on several outstanding issues that were raised during consultation, instead seeking further information and views from stakeholders as part of the consultation process. These outstanding issues included:

- the appropriate level of financing costs for inclusion in the DORC valuation; and

- whether the DORC valuation should be based on an optimal axle load of 30 or 25 tonnes.

ARTC withdrew the 2013 Variation on 20 February 2014, engaged in further negotiations with stakeholders, and came to an agreed position on the remaining outstanding issues, which form part of the Revised Variation.[28]

5.3 Revised Variation

On 24 March 2014, ARTC submitted its Revised Variation to the ACCC. In summary, the main differences from the 2013 Variation include:

- a reduction in the proposed DORC valuation (excluding financing costs) from $325.41 million to $296.43 million; and

- as a result of the negotiated agreement between ARTC and relevant stakeholders in Pricing Zone 3, a reduction in the proposed financing costs from $56.8 million in ARTC's submission in response to the ACCC's Position Paper, to a figure of $26.94 million.

The specific changes in the Revised Variation compared with the 2013 Variation relate to the proposed DORC valuation for the Gap to Turrawan Segments and can be seen in Table 3 below.

Table 3: Gap to Turrawan Segment proposed DORC values

Segment (length)	**Proposed DORC asset valuation (as at 1 January 2013)**	
	2013 Variation (withdrawn)	**Revised Variation (current)**
Gap – Watermark (31.1km)	$78.47m	$75.17m
Watermark – Gunnedah (33.0km)	$94.48m	$87.99m
Gunnedah – Boggabri (41.4km)	$92.09m	$79.66m
Boggabri – Turrawan (27.0km)	$59.86m	$53.08m
Network control centre	$0.52m	$0.52m
Total without financing costs	*$325.41m*	*$296.43m*

[28] ARTC, *Revised Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 24 March 2014, p. 4.

Segment (length)	Proposed DORC asset valuation (as at 1 January 2013)	
	2013 Variation (withdrawn)	Revised Variation (current)
Financing costs	$0	$26.94m
Total	*$325.41m*	*$323.37m*

In the Revised Variation, ARTC adjusted the DORC value of the Gap to Turrawan Segments to reflect the changes proposed by the ACCC in the Position Paper and negotiated with relevant stakeholders on the remaining outstanding issues. The amendments and the value of these individual adjustments include:

- a revised total DORC valuation for the Gap to Turrawan Segments of $323.37 million as at 1 January 2013, which would then be rolled forward to the effective start date of 1 January 2014 in accordance with the RAB Floor Limit roll forward methodology in the HVAU. The revised DORC value takes into account the following adjustments:

  - Removal of a number of assets that are not required for coal haulage. The removed assets comprise six sidings and one junction. ARTC also proposed to retain a number of sidings used for maintenance and above rail activities. ARTC determined that these adjustments reduce the proposed DORC valuation by $3.42 million. This reduction also reflects a closer assessment by ARTC of the mix of sleeper types for the relevant assets;

  - Reductions in the proposed mark up on direct costs (as a means of calculating indirect costs) for signalling assets from 115 per cent to 102 per cent, and for track assets including ballast, rail and sleepers from 100 per cent to 74 per cent. ARTC has determined that these adjustments result in a reduction to the proposed DORC valuation of $13.6 million;

  - The inclusion of the present value of cost savings associated with the operation and maintenance of a modern equivalent asset (an optimised asset compared to an existing asset). ARTC identified that the only affected assets that require consideration are:

    - the existing non-60kg rail and turnouts that are planned to be replaced over the period 2014-2018 to be upgraded for 30 tonne axle load operations, and which ARTC has adjusted to have a shorter remaining life of 1.5 to 4 years

    - other rail assets which are not modern engineering equivalent standard, and which are assumed to have an average remaining life of 10 years.

    ARTC determined that the total amount deducted from the DORC valuation for the present value of cost savings is $0.985 million;

  - An adjustment to the remaining life of a number of assets including bridges, signalling assets and track with a mix of timber and steel sleepers. ARTC determined these adjustments result in a net reduction to the total DORC valuation of $5.78 million;

  - An adjustment to the remaining lives of relevant assets planned to be replaced in coming years under the planned 30 tonne axle load investment program, to align to the time for replacement and disposal of those assets. ARTC determined this reduces the proposed DORC valuation by $10.1 million;

- Correction of several errors in the modelling underpinning the proposed DORC valuation including: (i) failure to include the full cost of 47kg rail, adding $0.54 million; (ii) a misspecification of one section of track as being timber instead of concrete for the purposes of adjusting for useful life, adding $8.09 million; and (iii) previous double counting of ballast costs, which will subtract $3.66 million; and

- Inclusion of an amount representing financing costs (interest during construction) of $26.94 million. Financing costs were not originally included in ARTC's 2013 Variation. The financing costs of $26.94 million represent around 9.06 per cent of the proposed DORC value, excluding financing costs, of $296 million. The total proposed DORC, including financing costs, is $323.37 million. ARTC had initially proposed financing costs of $56.8 million based on a construction period of four years in its submission to the Position Paper. The ACCC notes that the financing costs of $26.94 million are based on a more conservative project time frame of nine months for pre-construction and two years and three months for construction, which results in a lower total financing costs figure.

As a result of the above amendments, the DORC valuation proposed in the Revised Variation totals $323.37 million. The proposed ORC and DORC values for each of the Segments are presented in Table 4 below.

Table 4: ORC and DORC valuations of Gap to Turrawan Segments

Segment (Length)	ORC ($m)	ORC/km ($m)	DORC ($m)[29]	DORC/km ($m)
Gap to Watermark (31.1km)	154.76	4.98	82.10	2.64
Watermark to Gunnedah (33.0km)	165.85	5.03	95.41	2.89
Gunnedah to Boggabri (41.4km)	173.53	4.19	87.38	2.11
Boggabri to Turrawan (27.0km)	121.79	4.51	58.48	2.17
Total (132.5km)	**615.93**	**4.65**	**323.37**	**2.44**[30]

Source: ARTC, *Revised Variation, Supporting Documentation*, 24 March 2014, p. 26.

5.4 Stakeholder submissions

In response to the Revised Variation, Idemitsu acknowledged that the DORC valuation contained in the Revised Variation has complied with the prescribed process in the HVAU.[31]

In addition, Whitehaven submits that ARTC's Revised Variation is consistent with the agreed outcomes of its consultation with ARTC.[32]

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29 The segment values include financing and network control costs.

30 The total ORC/km and DORC/km is the weighted average ORC and DORC per km respectively.

31 Idemitsu, *Submission - Consultation - ARTC's Proposed Variation to the Hunter Valley Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014)*, 8 May 2014, p. 3.

32 Whitehaven, *Whitehaven Submission on ARTC's Revised Application to include the Gap to Turrawan*, 5 May 2014, p. 2.

5.5 ACCC views

The ACCC notes that the Revised Variation includes amendments to address the issues raised by the ACCC in the Position Paper and the MJA Final Report. The ACCC is of the view that ARTC has appropriately adjusted the DORC value for the Gap to Turrawan Segments to reflect the concerns raised by the ACCC in the Position Paper to:

- reduce the DORC value to reflect that the total cost for some components were higher than comparable benchmark costs;
- adjust the remaining life of particular assets, including bridges, signalling assets and sleepers;
- make adjustments to reflect that the passing loops and sidings are not all concrete sleepers as assumed in the E&P valuation;
- correct the relevant modelling inconsistencies; and
- include the value of maintenance and operating cost savings associated with modern technology assets.

Detailed reasons behind the ACCC's view are set out below.

5.5.1 Assets included in the DORC valuation

5.5.1.1 Assets for hauling coal

In its review of the E&P Valuation Report, MJA found that while overall 'all relevant assets have been included in the DORC valuation', they 'question whether all of the passing loops and sidings' that have been included '*should* be included in the valuation' [emphasis added].[33] The MJA report noted that between four and 12 assets should potentially be excluded from the DORC valuation on the basis that they were either used by non-coal traffic or were privately owned and maintained, and that if there were no non-coal traffic on the rail segment that these assets would likely not be required.[34]

In the Position Paper the ACCC was of the view that, as the DORC valuation proposed by ARTC was calculated on a stand-alone coal basis, the assets identified by the MJA Final Report that were not required for the coal haulage task, or whose use was restricted to non-coal trains, should be excluded from the valuation.[35] Submissions to the ACCC's Position Paper also supported the removal of the assets from the DORC valuation as they were not required for coal haulage.[36]

ARTC's Revised Variation proposes to remove seven of the assets identified in the MJA report as potentially not being required for coal haulage. These removed assets comprise of six sidings and one junction to the extent that the asset is not owned by ARTC.

ARTC has retained five of the sidings and passing loops on the basis that it considers practical capacity entitlements could not be met on a stand-alone basis without these assets, and as such they are essential for the efficient operation of the Network.[37] In its

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33 Marsden Jacob Associates, *Review of Australian Rail Track Corporation's valuation for the Gap to Turrawan Segment of the Hunter Valley rail network*, 30 November 2013, p. 21.

34 Ibid, p.17.

35 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 21.

36 Whitehaven, *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 2; Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 3.

37 ARTC, *ARTC submission to ACCC Position Paper*, 17 January 2014, p. 7.

supplementary submission to the Position Paper Whitehaven acknowledged the need to include the sidings for the efficient delivery of maintenance services.[38] ARTC has determined that these adjustments will reduce the DORC valuation by $3.42 million. This reduction also reflects a closer assessment by ARTC of the mix of sleeper types for the relevant assets.

The ACCC is of the view that the removal of seven assets and the retention of five of the sidings and passing loops is appropriate given industry's support and on the basis that this is consistent with the findings in the MJA Final Report. The ACCC considers that the inclusion of these assets is consistent with the object of promoting the economically efficient operation and use of the Hunter Valley rail network. It is also in the interests of access seekers who are seeking to use these parts of the Network as ARTC submits this represents the minimum extent of these types of assets required to deliver the existing contractual requirement for coal paths.

5.5.1.2 Financing costs

The MJA Final Report noted that it was not clear whether the DORC valuation prepared by E&P included financing costs (interest during construction) as part of the mark-ups that had been proposed. The MJA report also noted that the inclusion of these financing costs would act to increase the DORC value.[39]

The ACCC was of the preliminary view that while the inclusion of financing costs may be appropriate in principle, if ARTC were to seek to have financing costs included in the DORC valuation, it would be necessary for ARTC to demonstrate that those costs were not already included in the proposed mark-ups and would not be 'double-counted'. In addition, it would be necessary for ARTC to devise an appropriate construction timeframe and distribution of costs over that timeframe based on efficient benchmarks.[40]

In its submission to the Position Paper, ARTC confirmed that the E&P report supporting its initial proposed DORC valuation of $325.41 million did not include financing costs in the proposed mark ups. As discussed below, ARTC has revised its DORC valuation to reflect MJA mark-ups on direct cost. The ACCC is satisfied that the MJA mark-ups do not already include financing costs, and therefore it is appropriate that ARTC include a separate financing costs amount.

ARTC subsequently proposed financing costs of $56.8 million (amounting to approximately 19 per cent of the total DORC valuation proposed by E&P) based on a four year construction timeframe.

The ACCC sought industry views on ARTC's proposed financing costs. Both Whitehaven and Idemitsu noted their concerns at the magnitude of these proposed financing costs in their submissions to the Position Paper.

Idemitsu noted that it had concerns regarding the level of accuracy and reasonableness that would be essential in identifying and calculating construction financing costs, and as such did not consider the inclusion of such costs in the DORC valuation as appropriate.[41] Whitehaven considered that the $56.8 million value proposed by ARTC to be excessive given previous DORC valuations across similar coal networks.[42]

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38 Whitehaven, *Further Whitehaven Submission on ACCC's Preliminary Views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 29 January 2014, p. 1.

39 Marsden Jacob Associates, *Review of Australian Rail Track Corporation's valuation for the Gap to Turrawan Segment of the Hunter Valley rail network*, 30 November 2013, p.17.

40 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 23.

41 Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 3.

42 Whitehaven, *Further Whitehaven Submission on ACCC's Preliminary Views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 29 January 2014, p. 1.

The ACCC understands that ARTC engaged with producers on the issue of financing costs (among other issues) and as part of a package of adjustments accepted by relevant stakeholders, revised the level of financing costs.

In its Revised Variation, ARTC has proposed a more conservative construction project timeframe of nine months for pre-construction and two years and three months for construction. This results in proposed financing costs of $26.94 million, representing 9.06 per cent of the proposed DORC valuation, excluding financing costs, of $296 million.

Overall, the ACCC is of the view that the inclusion of financing costs in the DORC valuation is appropriate. The ACCC considers the inclusion of financing costs is consistent with the objects and pricing principles specified in section 44ZZCA of the Act, particularly that regulated access prices be set so as to generate expected revenue for a regulated service that is at least sufficient to meet the efficient costs of providing access to the service and includes a return on investment commensurate with the regulatory and commercial risks involved. The inclusion of financing costs in the Revised Variation is considered to be appropriate because construction of major rail infrastructure will generally be spread out over a number of years (as proposed by ARTC) as the project develops from its pre-construction, construction and commissioning stages, and the financing associated costs of construction should be captured in the DORC valuation. In considering the level of financing costs, the ACCC notes submissions to the Consultation Letter supported the level of financing costs proposed by ARTC as part of an agreed outcome to resolve outstanding concerns regarding the DORC valuation. The ACCC notes however that it has not reviewed the construction timeframe proposed by ARTC against benchmarks and has not approved the methodology proposed by ARTC in determining the relevant figure.

The ACCC is of the view that the negotiated agreement between ARTC and producers on the financing costs figure of $26.94 million to be appropriate in the context of the current assessment. In particular, the outcome appears to strike an appropriate balance between the interests of ARTC and the current users of the network who will be required to pay the access charges that flow from the increased RAB value.[43] In forming this view, the ACCC notes that endorsement of ARTC's package of adjustments by all current Access Holders in Pricing Zone 3 is a key consideration in the assessment of the Revised Variation as it reflects a commercial agreement between the parties. As ARTC has reached agreement with all relevant coal producers, the ACCC notes that it has not formed a view on the parameters and assumptions underlying the financing costs that have been agreed on.

It is important to emphasise that had the ACCC not previously conducted its own independent analysis of ARTC's DORC valuation as provided in the 2013 Variation, it would have had reservations with merely accepting an 'agreed' position, as it is not the case that an agreed DORC valuation between an access provider and a group of access holders will be appropriate to accept in all circumstances. An agreed DORC valuation may not necessarily promote the efficiency and competition objectives of Part IIIA, the public interest, or the interest of all access seekers if it were significantly higher or lower than an efficient value.

The ACCC also notes that all future financing costs for Pricing Zone 3 will be calculated using the *actual* construction timeframes and the accepted rate of return in accordance with the accepted interest during construction calculation methodology in the HVAU. Finally, ARTC submits, and the ACCC accepts, that the inclusion of and adjustment to financing costs in the Revised Variation does not represent a precedent for future valuations or applications made by ARTC.[44]

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[43] Subsections 44ZZA(3)(a) and (c) of the Act.

[44] ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 23.

5.5.1.3 Benchmark replacement costs

E&P determined asset replacement values for each asset component by adding together direct and indirect costs. The indirect costs are calculated as a percentage mark-up on the direct cost of each asset.

Industry submissions to the Consultation Paper raised concerns about the appropriateness of the mark-ups. Stakeholders expressed concerns that the mark-ups applied by E&P were excessive and should be further examined.[45]

MJA examined E&P's mark-ups based on benchmark information available to them. The MJA Final Report indicated that the E&P mark-ups for the following asset components were higher than the costs of comparable engineering projects:[46]

- Ballast
- Sleepers
- Rail
- Signalling

The ACCC was of the preliminary view that the E&P mark-ups for these components of the DORC valuation submitted in ARTC's 2013 Variation were high, and therefore of themselves were unlikely to be appropriate.[47] The ACCC noted that the mark-ups for these components may be considered appropriate if reduced to reflect the total cost identified by MJA as being reasonable (having regard to comparable benchmark costs), or if ARTC was able to provide further information to support the proposed mark-ups.[48]

In the Revised Variation ARTC reduced the proposed mark-up on direct costs as follows:

- Ballast – from 100 per cent to 74 per cent
- Sleepers – from 100 per cent to 74 per cent
- Rail – from 100 per cent to 74 per cent
- Signalling – from 115 per cent to 102 per cent

ARTC determined that these adjustments will result in a reduction to the proposed DORC valuation of $13.6 million.

The ACCC considers the reduction in benchmark replacement costs proposed by ARTC reflects the comparable benchmark costs identified by MJA and addresses the ACCC's concerns that were set out in the Position Paper. The ACCC considers the mark-ups are appropriate having regard to subsection 44ZZA(3) of the Act, in particular the interests of access seekers. By ensuring the Gap to Turrawan assets are valued appropriately, an economically efficient value will be rolled into the RAB which will ensure access seekers are only charged prices that are sufficient to meet ARTC‘s efficient costs.

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[45] Ibid.

[46] Marsden Jacob Associates, *Review of Australian Rail Track Corporation's valuation for the Gap to Turrawan Segment of the Hunter Valley rail network*, 30 November 2013, p. 53.

[47] ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 24.

[48] Ibid.

5.5.2 Optimisation

5.5.2.1 Optimisation assumptions

The DORC valuation takes into account differences between the total useful life of a modern engineering equivalent replacement asset (**MEERA**) and existing non-MEERA assets by applying 'optimisation factors' to the non-modern assets. Where the total useful life of a MEERA is considered to be longer than the total useful life of the asset that is actually in place, the optimisation factor will have the effect of reducing the asset valuation.

ARTC's DORC valuation in the 2013 Variation was based on an assumed axle load of 25 tonnes.

The MJA report considered that the 25 tonne axle load assumption was reasonable given that it was the current track standard. MJA noted that it would be difficult to evaluate whether the optimal axle load was 25 or 30 tonnes without undertaking a detailed supply chain study of the benefits and costs of increasing the axle loads.[49]

In its response to the ACCC's Consultation Paper, Whitehaven noted that the existing Gap to Turrawan infrastructure is currently subject to speed restrictions indicating that it is not a modern equivalent asset. Whitehaven submitted that the modern equivalent asset would have 30 tonne axle load capacity.[50] Whitehaven and Idemitsu also noted that a significant investment program was planned for the Gap to Turrawan segments in order to upgrade capacity to 30 tonne axle load. Both stakeholders raised concerns that producers could effectively be double charged if the DORC valuation did not reflect that the assets were soon to be disposed of and therefore had a shorter remaining life.[51]

Given the planned upgrade to 30 tonne axle load, the ACCC's Position Paper noted that it was not clear whether a 25 or 30 tonne axle load is optimal from a whole of coal supply chain perspective. The ACCC noted that the use of a 30 tonne axle load would decrease the DORC valuation as the relevant assets would be given shorter asset lives to reflect that they will become redundant earlier through increased wear and tear. Use of a 30 tonne axle load may also change the assumed MEERA standard.[52]

The ACCC also noted that, although the DORC valuation prepared by E&P reflected the assets in place at 1 January 2013, one of the first stages of a DORC valuation was the setting of system or network assumptions. DORC system assumptions are defined by the forecast configuration of, and demand for, the service (that includes the projected utilisation of existing capacity and projected demand for future capacity). The DORC valuation does not necessarily require consideration of forward investment programs intended to modify the purpose or capacity of the existing assets, unless the projection of demand underlying the DORC system assumptions necessitates the investment program.

Following negotiations with relevant stakeholders, in its Revised Variation ARTC has proposed to retain the 25 tonne axle load assumption, but has adjusted the remaining life of assets to be replaced in coming years under the 30 tonne axle load investment program. These asset lives now align to the expected time for replacement and disposal of those assets of 1.5 to 4 years. The effect of this adjustment is to reduce the DORC valuation by $10.1 million.

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[49] Marsden Jacob Associates, *Review of Australian Rail Track Corporation's valuation for the Gap to Turrawan Segment of the Hunter Valley rail network*, 30 November 2013, p. 24.

[50] Whitehaven, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p. 6.

[51] Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 3; *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 2.

[52] ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 25.

In light of the endorsement of stakeholders[53], and having regard to the matters in subsection 44ZZA(3)(a) and (c) of the Act, the ACCC is of the view that ARTC's proposed adjustments to the optimisation assumptions are appropriate as it reflects the interests of access seekers by ensuring that they will not be effectively 'double charged' for assets soon to be disposed of, without requiring a complete revaluation according to a revised MEERA standard.

5.5.2.2 Operating and maintenance cost savings associated with the modern equivalent asset

In its 2013 Variation, ARTC submitted that it had considered approaches to ensure consistency between optimisation assumptions in the asset valuation and the treatment of maintenance expenditure related to those assets. ARTC initially proposed to identify any necessary adjustments to actual maintenance expenditure as part of the annual compliance assessment process conducted by the ACCC under section 4.10 of the HVAU. ARTC argued that it should not deduct the full amount of the cost savings in the DORC valuation because it was likely to replace assets in the short term.

The ACCC was concerned that ARTC's proposed approach would truncate the deduction of cost savings if an asset was disposed of before the end of its expected useful life. The ACCC considered that in order to ensure that the DORC valuation was internally consistent the assumed remaining useful life that underpins the calculation of depreciation should also underpin the calculation of the present value of cost savings.[54] In addition, the ACCC also noted there were likely to be practical difficulties with implementing ARTC's proposed approach in the annual compliance assessment which involves consideration of actual operating expenditure, rather than hypothetical operating expenditure.[55]

In submissions to the Position Paper, Idemitsu and Whitehaven were of the view that it was not likely to be appropriate for the present value of cost savings associated with new and modern assets to be reflected in the annual compliance assessment, and they should be included up-front in the DORC valuation.[56]

The Revised Variation deducts the present value of cost savings associated with the operation and maintenance of certain modern equivalent assets for the following assets:[57]

- the existing non-60kg rail and turnouts to be upgraded for 30 tonne axle load operations that are planned to be replaced over the period 2014-2018, which ARTC has adjusted to have a remaining life of between 1.5 to 4 years; and

- other rail assets which are not modern engineering equivalent standard, and which are assumed to have an average remaining life of 10 years.

These adjustments resulted in a reduction in the DORC valuation of $0.985 million.

The ACCC considers that these adjustments are appropriate having regard to the matters in subsection 44ZZA(3) of the Act, in particular the interest of access seekers. By ensuring the Gap to Turrawan Segments are valued appropriately, an economically efficient value will be

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53 Whitehaven, *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 2; Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 3.

54 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 26.

55 Ibid.

56 Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 4; *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 4.

57 ARTC Revised Variation, *Supporting Documentation*, 24 March 2014, pp. 19-22.

rolled into the RAB which will ensure access seekers are only levied access charges that are sufficient to meet ARTC's efficient costs.

5.5.3 Depreciation

The proposed DORC valuation has been calculated by applying depreciation to the ORC values. The depreciation amount is determined having regard to the condition and remaining life of the assets and using a straight line depreciation methodology, whereby the asset is assumed to depreciate by a constant amount each year.

As noted in the Position Paper, the ACCC is of the view that the use of straight line depreciation methodology is appropriate as it is a well-recognised approach and is consistent with the depreciation methodology required under the HVAU.[58]

The basis for determining the total and remaining life of the assets is specific to each asset classification, and ranged from asset utilisation to date, survey of asset condition, or age of the asset depending on such things as historically accepted practice and availability of historical utilisation, condition and age data.

In reviewing the E&P DORC valuation, the MJA Final Report noted that the remaining life of a small number of assets was not reasonable. In particular:[59]

- E&P assumed a remaining life of zero for two bridges built in 1909. However, MJA considers that the remaining life of these bridges is actually likely to be at least five years;
- E&P has assumed a remaining life of up to 40 years for certain signalling assets. However, MJA considers that the remaining life of all signalling assets should be no more than 30 years; and
- MJA considers that the remaining life of sections of track that have a mix of timber and steel sleepers should be adjusted to allow for the remaining life of the timber sleepers.

Submissions to the ACCC's Position Paper from Whitehaven and Idemitsu expressed concern that the valuation may not be appropriate with regard to assets that were soon to be scrapped, for example through improvements and upgrades over the next 12 to 18 months.[60] In particular, the 30 tonne axle load upgrade investment program as discussed above at section 5.5.2.1.

In the Position Paper, the ACCC was of the preliminary view that it was important for the assumptions regarding the remaining life of particular assets to be reasonable, as these assumptions have a material impact on the overall DORC valuation.[61] As such, the ACCC considered that in order to be appropriate the DORC valuation of the Gap to Turrawan Segments should be adjusted to reflect the revised remaining life assumptions proposed by MJA. The ACCC estimated that the net effect of these adjustments would be likely to decrease the DORC by $6.1 million.

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58 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 27.

59 Marsden Jacob Associates, *Review of Australian Rail Track Corporation's valuation for the Gap to Turrawan Segment of the Hunter Valley rail network*, 30 November 2013, p. 27.

60 Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 5; *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 4.

61 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 27.

The Revised Variation proposes to adjust the remaining asset life assumptions identified by the MJA Final Report as not being reasonable as follows:[62]

- adjust the remaining life of the two bridges built in 1909 to reflect the MJA report. ARTC proposes the effect of this adjustment is to increase the DORC value by $1.18 million;
- reduce the economic life of all signalling and telecommunication assets to 30 years with the exception of certain 'civil' asset types. ARTC proposes the effect of this adjustment will reduce the DORC value by $6.66 million; and
- adjust the installation date for one in four sleepers to 1993 to result in a weighted remaining life of 10 years. ARTC proposes the effect of this adjustment is to reduce the DORC value by $0.3 million.

The total effect of these proposed adjustments will be to reduce the DORC valuation by $5.78 million.

The ACCC is of the view that the amendments proposed by ARTC address the ACCC's concerns that were set out in the Position Paper. Taking into account the matters under subsection 44ZZA(3) of the Act, the ACCC considers the amendments to the remaining asset life assumptions proposed by ARTC are appropriate.

5.5.4 Modelling inconsistencies

The MJA Final Report identified a number of inconsistencies in the E&P DORC modelling:

- the full cost of the 47kg rail has not been included in the model;
- there is a misspecification of one section of track being timber instead of a concrete sleeper for the purposes of adjusting for useful life; and
- ballast costs have been double counted for one section of the rail segment.

The MJA report estimated that the DORC value in ARTC's 2013 Variation would be adjusted upwards by $5 million if these modelling inconsistencies were resolved. The MJA report also noted that the adjustment would also need to reflect that the passing loops and sidings are not all concrete sleepers as was assumed in the E&P valuation.

In its Position Paper the ACCC was of the view that it would not be appropriate to accept a DORC valuation containing such errors under subsection 44ZZA(3) of the Act.

In the Revised Variation ARTC corrected these modelling errors in its Revised Submission, with the effect on the DORC valuation as follows:

- the full cost of the 47kg rail was included, adding $0.54 million;
- correction of the misspecified section of track being timber instead of concrete, adding $8.09 million; and
- ensuring that ballast costs had not been double counted, subtracting $3.66 million.

Idemitsu noted these corrections to the modelling errors and acknowledged that the DORC valuation contained in the Revised Variation had complied with the prescribed process in the HVAU.[63]

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[62] ARTC Revised Variation, *Supporting Documentation*, 24 March 2014, p. 22.

The ACCC is of the view that, to the extent that the earlier errors have been addressed by ARTC, the valuation is appropriate to accept under subsection 44ZZA(3) of the Act.

5.5.5 Rolling forward the 2013 value

ARTC has proposed to roll forward the DORC value as at 1 January 2013 in accordance with the principles outlined in the NSWRAU in order to determine a value as at 1 January 2014.

ARTC submitted that this approach is consistent with the previous valuation accepted by the ACCC under the HVAU in relation to the Dartbrook to Gap Segments and the Port Waratah Loop Assets. Idemitsu also submitted that the proposed roll forward is consistent with the approach for previous sections of the Network.[64]

The ACCC's views on the commencement date of the variation are outlined above at section 4.3.

The ACCC is of the view that ARTC's proposed roll forward methodology of the 1 January 2013 DORC valuation is appropriate as it will promote consistency of regulation (subsection 44ZZA(3)(aa)) as the process is consistent with the approach previously employed for other sections of the Network.

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[63] Idemitsu, *Submission - Consultation - ARTC's Proposed Variation to the Hunter Valley Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014)*, 8 May 2014, p. 3.

[64] Ibid.

6 Indicative Service and Indicative Access Charges

This chapter sets out the ACCC's decision on the Indicative Service and pricing aspects of ARTC's Revised Variation.

6.1 Revised Variation

ARTC has proposed that the rail infrastructure from Gap to Turrawan will form part of Pricing Zone 3 for the purpose of determining the Indicative Service and the associated Indicative Access Charges. ARTC considers that incorporating the Gap to Turrawan Segments into Pricing Zone 3 has a number of advantages and efficiencies, such as:

- providing for simpler pricing and performance management structure for both Access Holders and ARTC;
- allowing a single application of the RAB and RAB Floor Limit roll-forward, loss capitalisation, pricing limits and unders and overs accounting in the extended Pricing Zone 3; and
- allowing a single application of the system wide true-up test to the extended Pricing Zone 3 under the HVAU.[65]

The proposed Initial Indicative Service and Initial Indicative Access Charges for the Gap to Turrawan Segments for the 2014 calendar year are detailed in Table 5 below. The Initial Indicative Service characteristics have not changed from the 2013 Variation.

Table 5: 2014 Initial Indicative Service and Access Charges for Pricing Zone 3 under the Revised Variation

Initial Indicative Service in Pricing Zone 3	2013 Variation (withdrawn)	Revised Variation	Initial Indicative Service Characteristics
Non-TOP $/kgtkm* (ex GST)	$0.958	$1.496	25 tonne maximum axle load 80kph maximum speed (loaded) 80kph maximum speed (empty) 82 wagon train length 1350 metres maximum train length Section run times as per applicable Hunter Valley standard working timetable.
TOP $/kgtkm (ex GST)	$6.276	$9.635	

Source: See ARTC's Revised Variation, *Supporting Documentation,* p.29
* kgtkm means one thousand gross tonne kilometres

65 ARTC Revised Variation, *Supporting Documentation*, 24 March 2014, p. 9.

6.1.1 Proposed Indicative Service

The Initial Indicative Service is a reference service intended to be the most efficient train configuration in a pricing zone given existing infrastructure constraints. Charges for other services are based on the charges for the Initial Indicative Service and differentiated according to various factors outlined in the HVAU, including the relative consumption of capacity.

The Initial Indicative Service proposed by ARTC in the Revised Variation is unchanged from the 2013 Variation and is the same as the Initial Indicative Service currently applying to the remainder of Pricing Zone 3 under the HVAU.

ARTC considers that it is appropriate to apply the existing Pricing Zone 3 Initial Indicative Service to the Gap to Turrawan Segments because the infrastructure configuration and capacity in the Gap to Turrawan Segments is similar to that for existing Pricing Zone 3 Segments, and all coal trains originating from the Gap to Turrawan Segments operate over the entirety of Pricing Zone 3 to get to the port.[66]

In the Position Paper, the ACCC was of the preliminary view that incorporating the Gap to Turrawan Segments into Pricing Zone 3 and applying the same Initial Indicative Service as the existing Pricing Zone 3 Segments was likely to be appropriate.

The ACCC continues to be of the view having regard to the matters in subsection 44ZZA(3) of the Act, as it would promote a consistent approach to access regulation (subsection 44ZZA(3)(aa)) and is likely to be in the interests of access seekers (subsection 44ZZA(3)(c)).

6.1.2 Indicative access charge

6.1.2.1 Methodology for determining Indicative Access Charges

The ACCC does not prescribe a particular process by which ARTC must determine the Initial Indicative Access Charges (and the Interim Access Charges) for the Gap to Turrawan Segments. However, section 4 of the HVAU contains general principles and objectives for setting prices.[67]

At the time the 2013 Variation was submitted, Access Holders had not yet provided or proposed variations to their 2014 volumes in accordance with section 4.20(a) of the HVAU.

ARTC has since developed and published on its website the proposed Initial Indicative Access Charge for the 2014 calendar year for the extended Pricing Zone 3, in accordance with the process under section 4.20 of the HVAU. The charges for the 2014 calendar year are based on forecasts of 2014 costs and contracted volumes in the extended Pricing Zone 3.[68] ARTC has provided the ACCC with the confidential modelling underpinning the 2014 Initial Indicative Access Charges.

In accordance with its revised DORC value and confirmed volumes for 2014, ARTC has submitted that the Initial Indicative Access Charge for Pricing Zone 3, as published on ARTC's website and effective from 1 January 2014, will also apply to the Gap to Turrawan Segments.

ARTC has noted that adjustments to the most recent modelling have no impact on 2014 Initial Indicative Access Charges for the extended Pricing Zone 3 finalised under section 4.20 of the

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[66] Ibid, p. 8.

[67] See sections 4.2 and 4.3 for revenue limits, section 4.11 for the structure of charges and section 4.13 for pricing objectives.

[68] ARTC, *Revised Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 24 March 2014, p. 5.

HVAU, but will impact on the forecast of any amount to be capitalised in the extended Pricing Zone 3 in 2014.[69]

The ACCC's view of the Initial Indicative Access Charges for the extended Pricing Zone 3 is set out below.

6.1.2.2 Overall view on the Initial Indicative Access Charges

As noted in sections 6.1.2.3 and 6.1.2.4 below, the ACCC considers that the considerations that ARTC has taken into account to determine the Initial Indicative Access Charges are likely to be appropriate under subsection 44ZZA(3) of the Act as they reflect a balance between the legitimate business interests of both ARTC and Access Holders.

The ACCC has not, however, made a determination on the appropriateness of the level of the Access Charges. The ACCC considers that given that the Access Charges have been determined in accordance with the process under section 4.20 of the HVAU and have not been disputed by any Access Holder it would be inappropriate for the ACCC to reopen the Access Charges for 2014. The ACCC considers that this would create unnecessary pricing uncertainty and instability.

6.1.2.3 Non-TOP charges and the variable component of costs

ARTC has stated that the non-TOP component of charges is aligned to the variable component of costs (**VCC**), being the forecast variable maintenance costs.

As noted in the Position Paper, the ACCC considers that it is appropriate that ARTC achieve full recovery of the VCC from all Access Holders as this is consistent with the HVAU pricing objective that the VCC recover costs from all Access Holders on the basis of actual Network usage (section 4.13 of the HVAU).[70]

The ACCC was also of the preliminary view that as the VCC is equivalent to the Direct Costs, which is the relevant floor limit (under section 4.2 of the HVAU), it is appropriate that ARTC recovers the costs that Access Holders directly impose on ARTC from their use of the Network.

The ACCC considers that this reflects the legitimate business interests of ARTC under subsection 44ZZA(3)(a).

However, submissions to the Position Paper have raised concerns that the non-TOP component of the Initial Indicative Access Charges in the Revised Variation has increased.

Whitehaven submitted that there had been a significant percentage increase from ARTC's proposed pricing in its 2013 Variation in the non-TOP component of the Indicative Access Charge, which was beyond Whitehaven's expectations.[71] Whitehaven also considered that the increase in 2014 pricing was slightly more than what, in Whitehaven's opinion, was fair and appropriate. Idemitsu also submitted that the 2014 prices saw a significant increase in the non-TOP component of the access charges for Pricing Zone 3 with the inclusion of the extended Pricing Zone 3.[72]

Based on confidential information provided to the ACCC, the ACCC understands that the increase in the non-TOP component of the access charge is partly reflective of ARTC's

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[69] ARTC Revised Variation, *Supporting Documentation*, 24 March 2014, p. 29.

[70] ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 31.

[71] *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 6.

[72] Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 5.

increases in its maintenance program. In particular, the ACCC understands that ARTC is undertaking a significant ballast cleaning program in Pricing Zone 3 in both 2014 and 2015.

6.1.2.4 TOP charges and the fixed component of costs

The TOP component is set to recover part of the remainder of the full Economic Cost after the non-TOP component of the charge has been determined.

The ACCC notes that it is an objective under section 4.13 of the HVAU for ARTC to set Access Charges to achieve full recovery of VCC, and maximum recovery of the fixed component of costs (**FCC**) and new capital component of costs (**NCC**). However, if ARTC charges less than economic cost in Pricing Zone 3, the 'loss capitalisation' mechanism will enable ARTC to recover capitalised losses from Access Holders in Pricing Zone 3 once volumes increase.

In its 2013 Variation, ARTC stated that 'the current volumes and level of market affordability do not permit ARTC to fully recover the economic cost of Pricing Zone 3 and that 'in setting Initial Indicative Access Charges, ARTC has had regard to a number of factors and aims to achieve a balance between its own reasonable business interests and those of relevant Access Holders'.[73] ARTC states that because its Access Charges are below economic cost it will not breach the Ceiling Limit and the economic 'loss' will be capitalised and be recovered at some point in the future.[74]

As noted above in Table 5, the TOP component of the Initial Indicative Access Charge has also increased in the Revised Variation.

Whitehaven submitted that while the 2014 pricing represented a significant increase over the 2014 Pricing Zone 3 proposed pricing in ARTC's 2013 Variation, the TOP pricing component was consistent with Whitehaven expectations.[75]

While the DORC value in the Revised Variation is lower than in the 2013 Variation, Idemitsu submits that it understands that there is no change to Indicative Access Charges due to ARTC exercising their discretion in setting access charges (not recovering full Economic Cost). Idemitsu also noted that the Initial Indicative Access Charge submitted in the Revised Variation is priced below ceiling, and any shortfall will be recovered through loss capitalisation.[76]

The ACCC agrees with Idemitsu that ARTC has discretion under the HVAU to set Access Charges below the recovery of Economic Cost in Pricing Zone 3 in the short term because over the long term ARTC is likely to recover Economic Cost (including the capitalised losses). Accordingly, the ACCC considers that it is likely to be appropriate that ARTC has proposed TOP charges in Pricing Zone 3 which are below full Economic Cost in the short term as it is likely to be in the legitimate business interests of ARTC (subsection 44ZZA(3)(a)) and the legitimate business interests of access seekers (subsection 44ZZA(3)(c)) for Access Charges to reflect market conditions and the ability of Pricing Zone 3 producers to incur a particular level of Access Charges.

Additionally, as noted by the ACCC in its Position Paper and Idemitsu above, it is likely to be appropriate that the proposed TOP component of the charges seeks to recover the same

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73 Factors noted by ARTC include those set out in clause 4.14(b)(ii) of the HVAU. Other factors that ARTC highlighted are: Internal corporate financial objectives and meeting shareholder expectations of corporate profitability; existing coal market and general economic cost conditions, including any specific Access Holder insights; access pricing in other parts of the Hunter Valley coal network; and flexibility in balancing current and future needs that is provided for under the Loss Capitalisation approach.

74 ARTC, *Response to ACCC Information Request*, 17 September 2013, pp. 47-8.

75 Whitehaven, *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 5.

76 Idemitsu, *Submission - Consultation - ARTC's Proposed Variation to the Hunter Valley Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014)*, 8 May 2014, p. 3.

amount of the fixed component of costs from all Access Holders equally, as it is consistent with the requirements in section 4.15 of the HVAU that the proportion of FCC received through a TOP component be consistently applied to all Access Holders within a pricing zone.[77]

6.1.2.5 Charge differentiation for services other than the Initial Indicative Service

Section 4.15 of the HVAU sets out various factors which ARTC will have regard to in determining charges for services other than the Initial Indicative Service. These factors include, amongst other things, the commercial impact on ARTC's business of the relative consumption of Capacity and Coal Chain Capacity compared to the Initial Service, and the logistical impacts of the service on ARTC's business. The HVAU also sets limits on such charge differentiation in section 4.16, such as that ARTC will not have regard to the identity of the applicant in differentiating charges.

In its Position Paper, the ACCC considered that it is likely to be appropriate that ARTC will differentiate charges for services other than the Initial Indicative Service in the extended Pricing Zone 3 in accordance with the HVAU as it was likely to be in the interests of access seekers (subsection 44ZZA(3)(c)).

The ACCC continues to be of the view that it is appropriate for ARTC to differentiate charges for services other than the Initial Indicative Service as the differentiation reflects the relative use of the network and therefore promotes the efficient operation of, use of, and investment in the Hunter Valley rail network (subsection 44AA(a)).

6.1.2.6 Pricing transparency

In its Position Paper, the ACCC noted that ARTC has discretion to set charges at a level that does not recover full Economic Cost in Pricing Zone 3. Submissions to the Position Paper also expressed concerns that the basis on which ARTC has determined the proposed Initial Indicative Access Charges for the extended Pricing Zone 3 was not sufficiently transparent, and that Access Holders were unable to estimate the magnitude of the losses that will be capitalised for future recovery.[78]

The ACCC considered that ARTC could provide an estimate of the likely losses to be capitalised to Access Holders during the annual process for finalisation of Access Charges, and that one way to achieve this could be through an amendment to subsection 4.20(d) of the HVAU (which sets out the information ARTC is required to provide to Access Holders).

Whitehaven supported the ACCC's preliminary view that it may be appropriate for ARTC to provide additional transparency to access seekers regarding the extent of capitalised losses.[79] Idemitsu submitted that the amount of loss that will be capitalised for future recovery was not sufficiently transparent in the pricing information published by ARTC in October 2013, and that such transparency is essential for all applicable access holders to not only understand the proposed annual pricing but the potential exposure to future loss recovery by ARTC.[80]

In its Revised Variation, ARTC has proposed to amend subsection 4.20(d) of the HVAU to require ARTC to provide Access Holders in Pricing Zone 3 with a forecast of the RAB for the extended Pricing Zone 3 at the start of, and at the end of that year, during the determination

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77 See also ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 32.

78 Idemitsu, *ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p. 4.

79 Whitehaven, *Whitehaven Submission on ACCC's preliminary views in relation to ARTC's proposed variation to include the Gap to Turrawan*, 8 January 2014, p. 6.

80 Idemitsu, *Position Paper - ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 17 January 2014, p. 5.

of the Initial Indicative Access Charge. This information will enable Access Holders in Pricing Zone 3 to determine an estimate of the likely amount to be capitalised each calendar year, being the difference between the starting and ending RAB in each year.[81]

Idemitsu supports the concept of improved transparency by ARTC providing an estimate of likely losses to be capitalised during the annual pricing process. Idemitsu requested that ARTC provide Access Holders a component breakdown of the RAB movement by dollar amount (i.e. loss capitalisation, capital expenditure, operating costs, rate of return and revenue).[82] Idemitsu also considered that the loss capitalisation amount should be clearly defined in the annual compliance assessment for the extended Pricing Zone 3.

The ACCC noted in its Position Paper that it may be difficult for ARTC to provide the exact magnitude of losses that are likely to be capitalised, as the losses are determined as part of the ACCC's annual compliance process each year. In addition, the ACCC noted that ARTC currently has flexibility under the HVAU to consider a range of factors in determining the proportion of economic cost it will recover through access charges applicable in Pricing Zone 3.[83]

It is the ACCC's view that ARTC's proposed transparency measures strike an appropriate balance between the legitimate business interests of ARTC having flexibility to determine the proportion of Economic Cost it will recover in Pricing Zone 3 and the interests of access seekers being provided with an estimate of the likely losses to be capitalised in advance of completion of the annual compliance process. The ACCC acknowledges that ARTC can only ever provide forecasts at the beginning of a calendar year, with the final loss capitalisation amount being determined by the ACCC during the annual compliance process at the end of each year. These estimates should help inform relevant coal producers' investment decisions and will allow comparisons between ARTC's estimates and what has actually been incurred following the ACCC's annual compliance assessment.

The ACCC recognises however that this is only a first step towards improving pricing transparency for Pricing Zone 3 producers and is of the view that this approach does not impose an undue regulatory burden on ARTC. Related to this, the ACCC notes that as part of its determination on ARTC's compliance with the financial model and pricing principles in the HVAU for the 2012 calendar year, the ACCC flagged its intention to undertake a public review of the provision of information to stakeholders and the methodologies underpinning revenue allocation across the Hunter Valley Coal Network. This review has commenced, and the ACCC will be using the outcome of that consultation process to inform its consideration of ARTC's information provision obligations.[84] Finally, the ACCC also notes that stakeholders will have an additional chance in the near future to review how these measures operate in practice when (it is expected) ARTC submits a new undertaking to the ACCC that will likely commence in 2016.

Therefore the ACCC is of the view that ARTC's proposed amendment to subsection 4.20(d) of the HVAU is appropriate, as it is in interests of access seekers that transparency around the likely amount of capitalised losses is increased(subsection 44ZZA(3)(c)).

As a result of accepting the Revised Variation, ARTC has informed stakeholders that the starting RAB for the extended Pricing Zone 3 as at 1 January 2014 is $648 million, and the closing RAB as at 31 December 2014 is $696.5 million. Based on these values, ARTC has

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81 ARTC, *Revised Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 24 March 2014, p. 7.

82 Idemitsu, *Submission - Consultation - ARTC's Proposed Variation to the Hunter Valley Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014)*, 8 May 2014, p. 3.

83 ACCC, *Position Paper in relation to Australian Rail Track Corporation's proposed variation of the Hunter Valley Access Undertaking to include the Gap to Turrawan Segments,* 12 December 2013, p. 34.

84 Details of the Revenue Allocation Review process can be accessed at the ACCC's website here: http://www.accc.gov.au/regulated-infrastructure/rail/artc-hunter-valley-access-undertaking/revenue-allocation-review.

submitted that the amount to be capitalised in 2014 in Pricing Zone 3 for future recovery would be $48.5 million.[85]

[85] ARTC Revised Variation, *Supporting Documentation*, 24 March 2014, p. 32.

7 Drafting amendments

7.1 ARTC's proposed drafting amendments

ARTC proposed a number of drafting amendments in the 2013 Variation in order to:

- incorporate the Gap to Turrawan Segments under the HVAU;
- include the four additional Segments from Gap to Turrawan in Pricing Zone 3;
- include the Gap to Turrawan Segments in relevant illustrative maps;
- clarify the Initial RAB for the Gap to Turrawan Segments as at the date they are incorporated into the HVAU, which is to be rolled forward in accordance with the principles in section 4.4 of the HVAU;
- to prescribe the Initial Indicative Access Charges for the extended Pricing Zone 3; and
- recognise ARTC's quarterly and annual reporting obligations apply to the Gap to Turrawan Segments.

Submissions considered that the proposed drafting accurately represents the intent of the proposed changes to the HVAU, although noted that further drafting amendments to the proposed transparency measures could be made.[86]

In the Position Paper, the ACCC was of the preliminary view that ARTC's proposed drafting amendments were appropriate, subject to consideration of a revised 'New Segments Commencement Date' and any further amendments that ARTC may make to its 2013 Variation in light of concerns raised in the Position Paper.

In its Revised Variation, ARTC has made the following drafting amendments, in addition to those in the 2013 Variation:

- Commencement date – As noted in section 4.1.3 ARTC proposes to amend subsection 2.2(a)(iii) of the HVAU so that the relevant provisions of the HVAU have retrospective application to the Gap to Turrawan Segments, effective from 1 January 2014; and
- Increased transparency – As set out above in section 6.1.2.6, ARTC has proposed to amend subsection 4.20(d) of the HVAU so as to increase transparency around the charges that Access Holders in Pricing Zone 3 would likely face over time.

The proposed amendments are detailed at Attachment A of ARTC's Revised Application.

In line with the ACCC's views set out in the preceding chapters, the ACCC is of the view that the drafting amendments to the HVAU reflect ARTC's intent and are appropriate having regard to the matters in subsection 44ZZA(3) of the Act.

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86 Idemitsu, *Submission - Consultation - ARTC's Proposed Variation to the Hunter Valley Network Access Undertaking to include Gap to Turrawan Segments (Revision 24 March 2014)*, 8 May 2014, p. 5.

8 Conclusion

For the reasons set out in the preceding chapters, the ACCC is of the view that ARTC's Revised Variation is appropriate to accept pursuant to subsection 44ZZA(7) of the Act, taking into account the matters set out in subsection 44ZZA(3).

The ACCC considers that the inclusion of the Gap to Turrawan Segments in the coverage of the HVAU will promote regulatory certainty for users of the Hunter Valley coal network (subsection 44ZZA(3)(c)) as well as encourage consistency of regulation over the entire Hunter Valley railway network (subsection 44ZZA(3)(c)).

The ACCC also considers that including the Gap to Turrawan Segments will facilitate supply chain alignment in the Hunter Valley by enabling consistent access regulation and contractual arrangements for producers operating in the Gunnedah Basin. Supply chain alignment is a relevant 'other matter' the ACCC has had regard to under subsection 44ZZA(3)(e).

The ACCC has formed these views having regard to the matters listed in subsection 44ZZA(3) of the Act. The relevant matters include:

- the legitimate business interests of ARTC (subsection 44ZZA(3)(a));
- the objects of Part IIIA as set out in section 44AA (subsection 44ZZA(3)(aa));
- the pricing principles referred to in subsection 44ZZA(3)(ab) and set out in section 44ZZCA of the Act; and
- the interests of current and future Pricing Zone 3 Access Holders who might want access to the Gap to Turrawan Segments under the HVAU (subsection 44ZZA(3)(c)).