Position Paper

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

12 December 2013

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

Contents

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.

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
Proposed 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
RAB	Regulatory Asset Base
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

This Position Paper sets out the Australian Competition and Consumer Commission's (**ACCC's**) preliminary views on the Australian Rail Track Corporation's (**ARTC's**) application to vary the Hunter Valley Access Undertaking accepted by the ACCC on 29 June 2011 (**HVAU**).[1] ARTC submitted its application to vary the HVAU (the **Proposed Variation**) on 28 June 2013. The Proposed Variation seeks to extend the coverage of the HVAU to include Segments from Gap to Turrawan in the Gunnedah Basin. The Proposed Variation includes a depreciated optimised replacement cost (**DORC**) valuation proposal for the Gap to Turrawan Segments prepared by Evans & Peck (Worley Parsons) (**E&P**).

This Position Paper has been released for consultation as part of the ACCC's ongoing assessment as to whether it is appropriate to accept the Proposed Variation under Part IIIA of the *Competition and Consumer Act 2010 (Cth)* (**the Act**). The ACCC has also published a report by Marsden Jacob Associates (**MJA**) reviewing the proposed DORC valuation.[2] The ACCC has chosen to release this Position Paper setting out its preliminary views and is seeking submissions from interested parties.

This is not a formal decision of the ACCC, but rather a statement of the ACCC's preliminary views on the Proposed Variation, including those matters that it considers outstanding in light of the independent review of the proposed DORC valuation by MJA.

Proposed effect of the application

If the ACCC accepts the Proposed 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 will extend to include the Gap to Turrawan Segments - that is, the Hunter Valley rail network as defined in Schedule B of the HVAU (**the Network**) will include the Segments from Gap to Turrawan.

- ARTC's proposed asset value for the Gap to Turrawan Segments, determined using the DORC methodology, will be included in the Regulatory Asset Base (**RAB**) on which ARTC is allowed to earn a regulated rate of return.

- forecast coal volumes and costs will inform ARTC's determination of the Indicative Access Charge for Pricing Zone 3, which will apply to the whole of Pricing Zone 3 (including the Gap to Turrawan Segments).

ACCC preliminary view

Overall, the ACCC considers the proposed incorporation of the Gap to Turrawan Segments into Pricing Zone 3 and the use of the DORC methodology for the valuation of the Gap to Turrawan Segments to be appropriate. However, the ACCC has some concerns with the DORC valuation proposed by ARTC. As such, the ACCC is of the preliminary view that the Proposed Variation is not appropriate to accept pursuant to subsection 44ZZA(7) of the Act taking into account the matters set out in subsection 44ZZA(3).

In particular, the ACCC has formed the following preliminary views regarding aspects of ARTC's proposed DORC valuation:

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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 The report by MJA is available on the ACCC's website at http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2013.

- the inclusion of assets that are not required for hauling coal is not likely to be appropriate;
- 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's views on the proposed DORC valuation are outlined at section 5.4 of this paper.

The ACCC also considers 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 proposed access charges (see section 6.3.2.4 of this paper).

The ACCC has throughout this paper stated its preliminary position on particular issues and also recommended additional issues for further consideration by ARTC. In doing so, the ACCC hopes to provide a path forward by which the assessment of the Proposed Variation may be finalised in a timely fashion. The ACCC recognises that the speed at which this can be done rests in the hands of ARTC and, to some extent, industry.

Seeking stakeholder views

The ACCC is calling for submissions by interested parties on its preliminary views in relation to the appropriateness of ARTC's Proposed Variation (see section 1.2 of this paper). Parties are welcome to comment on any aspect of the Position Paper, the final report on the review of ARTC's valuation for the Gap to Turrawan Segments of the Hunter Valley rail network by MJA (**MJA Final Report**) and the Proposed Variation. Parties are encouraged to address the matters listed in subsection 44ZZA(3) of the Act in their response.

Submissions by interested parties are due on **Friday 17 January 2014**.

1 Introduction

On 28 June 2013, ARTC submitted to the ACCC the Proposed Variation to the HVAU. The Proposed Variation seeks to extend the scope of the infrastructure 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).[3]

1.1 Indicative timeline for assessment

ARTC lodged the Proposed Variation with the ACCC on 28 June 2013. Under subsection 44ZZBC(1) of the Act, the ACCC must make a decision in relation to the application within the period of 180 days starting at the start of the day the application was received.

The Act provides for 'clock-stoppers', meaning that some days will not count towards the 180 days of the expected period in certain circumstances. For example, the clock is stopped where the ACCC publishes a notice inviting public submissions in relation to an undertaking application (subsection 44ZZBD(1)).

The ACCC will be required to make a decision on the Proposed Variation by **14 March 2014**, taking into account the following clock-stoppers:

- 29 day period for submissions on the Consultation Paper.
- 15 day period for ARTC's response to the ACCC's request for information.
- 37 day period for submissions to this Position Paper.

1.2 Invitation to make a submission

The ACCC invites public submissions on the Proposed Variation, in accordance with section 44ZZBD of the Act. Under subsection 44ZZBC(2), this has the effect of extending the timeframe by which the ACCC is required to make a decision on the Proposed Variation.

Submissions should be addressed to:

Mr Matthew Schroder
General Manager
Fuel, Transport and Prices Oversight Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne Vic 3001

Email: transport@accc.gov.au

1.2.1 Due date for submissions

Submissions **must** be received by **Friday 17 January 2014**. It is in your interest that the submission be lodged by this date, as section 44ZZBD of the Act allows the ACCC to disregard any submission made after this date.

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

1.2.2 Confidentiality

The ACCC strongly encourages public submissions. Unless a submission, or part of a submission, is marked confidential, it will be published on the ACCC's website and may be made available to any person or organisation upon request.

Sections of submissions that are claimed to be confidential should be clearly identified. The ACCC will consider each claim of confidentiality on a case by case basis. If the ACCC refuses a request for confidentiality, the submitting party will be given the opportunity to withdraw the submission in whole or in part.

For further information about the collection, use and disclosure of information provided to the ACCC, please refer to the ACCC publication *'Australian Competition and Consumer Commission / Australian Energy Regulator Information Policy – the collection, use and disclosure of information'* available on the ACCC website.

1.3 Further information

ARTC's Proposed Variation and other relevant material, including submissions 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-2013

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'.

Public submissions made in response to this Position Paper will also be posted at this location.

If you have any queries about any matters raised in this document, please contact:

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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**) monitored by the NSW Independent Pricing and Regulatory Tribunal (**IPART**). ARTC have submitted the Proposed Variation to extend the scope of the HVAU to incorporate the rail infrastructure from Gap to Turrawan. Under the Proposed 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. Clause 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 the Proposed Variation.

2.1 ACCC public consultation process

The Act provides that the ACCC may invite public submissions on an access undertaking application.[4]

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

- Asciano Limited
- Idemitsu Australia Resources Pty Ltd
- Whitehaven Coal Limited

All public submissions are available on the ACCC's website at:

http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2013/consultation-paper.

2.2 ACCC requests for further 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 considers relevant to its decision on the Proposed 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.

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

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

http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2013/request-for-information.

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. These requests are outlined in the timeline below.

Table 1: Timeline of Proposed Variation assessment

Date	Task
28 June 2013	ARTC submitted the Proposed Variation to extend the coverage of the HVAU to include the Gap to Turrawan Segments of the Hunter Valley rail network to the ACCC for assessment under Part IIIA of the Act. Commencement of 180 day 'expected period' for assessment.
23 July 2013	The ACCC issued a Consultation Paper calling for submissions from interested parties on the Proposed Variation. Submissions were due by 20 August 2013. Clock-stopped for public consultation (subsection 44ZZBD(1)).
3 September 2013	The ACCC sent a request to ARTC to provide further information to assist in the assessment of the Proposed Variation. Clock-stopped for formal information request (subsection 44ZZBCA(1)).
17 September 2013	ARTC provided a response to the ACCC's request for information sent 3 September 2013.
18 September 2013	The ACCC engaged MJA to conduct a review of the DORC valuation for the Gap to Turrawan Segments prepared by E&P for ARTC.
27 September 2013	The ACCC sent an informal request for further information to ARTC to assist MJA in their review of E&P's DORC valuation.
4 October 2013	ARTC provided a redacted public version of its 17 September 2013 response to the ACCC's request for information.
7 October 2013	The ACCC sent a follow-up informal request for further information to ARTC to assist MJA in their review of E&P's DORC valuation.
10 and 11 October 2013	ARTC provided responses to further request for information sent 27 September 2013.
18 October 2013	ARTC provided a response to further request for information sent 7 October 2013.
22 October 2013	ARTC provided responses to outstanding items from further information requests sent 27 September 2013 and 7 October 2013.

24 October 2013	The ACCC sent a further follow-up informal request for further information to ARTC to assist MJA in their review of E&P's DORC valuation.
15 November 2013	ARTC provided a response to the further request for information sent 24 October 2013.
30 November 2013	MJA's Final Report '*Review of Australian Rail Track Corporation's valuation for the Gap to Turrawan Segment of the Hunter Valley rail network'* provided to the ACCC.
12 December 2013	The ACCC issued a Position Paper calling for submissions from interested parties. Submissions are due by 17 January 2014. Clock-stopped for public consultation (subsection 44ZZBD(1)). Expected period extended to 14 March 2014.

3 Decision-making framework

This chapter provides an overview of the framework under which the ACCC will make its decision on ARTC's Proposed Variation.

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 thinks 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[5], 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;[6] 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
- access price structures should:

5 Section 44AA of the Act.

6 There is currently no access code that applies to services provided under the HVAU.

- 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.

This Position Paper is not a formal decision of the ACCC, but rather a statement of the ACCC's preliminary views on the Proposed Variation, including those matters that it considers outstanding in light of the independent review of the proposed DORC valuation by MJA. The document is also intended to assist stakeholders in their consideration of the issues in response to our request for submissions on ARTC's Proposed Variation.

4 Addition of rail infrastructure from Gap to Turrawan

This chapter sets out the ACCC's preliminary views on extending the coverage of the HVAU to include Segments from Gap to Turrawan in the Gunnedah Basin.

4.1 Proposed 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. Clause 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 clause 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 Proposed Variation at Attachment A.[7]

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 clause 4 of the HVAU:

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

4.2 Submissions in response to the consultation paper

All submissions in response to the consultation paper expressed support for the inclusion of Gap to Turrawan segments in the coverage of the HVAU.

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7 ARTC, *Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, pp. 5-9.

Asciano stated that it believes that ‘it is appropriate to extend the scope of the HVAU to include rail infrastructure from The Gap to Turrawan’.[8]

Whitehaven stated that it ‘fully support[s] the addition of rail infrastructure from Gap to Turrawan in the HVAU’.[9]

Idemitsu considers the inclusion of Gap to Turrawan under the HVAU is ‘reasonable’ and that ‘the most appropriate manner in which to undertake this is to extend the current Pricing Zone 3 rather than creating another Pricing Zone (such as Pricing Zone 4).’[10] Idemitsu was also supportive of ARTC’s proposed division of Gap to Turrawan into four Segments as it is consistent with the approach taken previously in Pricing Zone 1 and Pricing Zone 2.

4.3 ACCC preliminary views

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

The ACCC is supportive of the inclusion of the Gap to Turrawan Segments in the coverage of the HVAU, as it will promote regulatory certainty for users of the Hunter Valley coal network as well as encourage consistency of regulation over the entire Hunter Valley railway network. The ACCC is of the view that these considerations are consistent with the matters set out in subsection 44ZZA(3) of the Act that the ACCC may have regard to when assessing whether a variation to an access undertaking is appropriate. In particular, the ACCC is of the view that the Proposed Variation is likely to be 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 including 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’ the ACCC has had regard to under subsection 44ZZA(3)(e).

The ACCC notes that it is unlikely that the Proposed Variation will be accepted for inclusion in the scope of the HVAU by the proposed 1 January 2014 commencement date. As such, ARTC will need to consider how this transition will be managed in order to ensure certainty for access seekers.

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8 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.

9 Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p.3.

10 Idemitsu, *ARTC’s Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p.2.

5 DORC valuation

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

5.1 Proposed valuation

Clause 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.

ARTC has submitted a DORC valuation proposal to the ACCC for the Gap to Turrawan Segments prepared by E&P. The optimised replacement cost (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 (the **Valuation Report**) is at Attachment C to the Proposed Variation, available on the ACCC's website.

E&P's total proposed valuation for the Gap to Turrawan Segments is $325.4 million. The proposed ORC and DORC values for each of the Segments are presented in table 2 below.

Table 2: ORC and DORC valuations of Gap to Turrawan Segments

Segment (Length)	ORC ($m)	ORC/km ($m)	DORC ($m)	DORC/km ($m)
Gap to Watermark (31.1km)	160.8	4.69	78.5	2.28
Watermark to Gunnedah (33.0km)	174.5	4.63	94.5	2.51
Gunnedah to Boggabri (41.4km)	190.1	4.02	92.1	1.95
Boggabri to Turrawan (27.0km)	132.2	4.90	59.8	2.30
Network Control Centre – allocation	0.7	-	0.5	-
Total (132.5km)	**658.3**	**4.5**	**325.4**	**2.22**

Source: ARTC, *Supporting Documentation*, 28 June 2013, p. 13.

E&P has undertaken the DORC valuation in accordance with the following process:

- asset valuation, involving the process of classifying the asset and undertaking a rate build-up from first principles to value the asset;
- review of the asset standards to determine the appropriate modern engineering equivalent replacement asset (**MEERA**) and its value;

- review of each asset group's practical capacity or useful life to allow the determination of an optimisation factor; and

- asset condition assessment in comparison with the useful life of the asset to determine the remaining life and the depreciation factor.[11]

The allocation of relevant network control centre[12] capital assets included in the total proposed DORC value is to be allocated to each of the Gap to Turrawan Segments on the basis of train kilometres.

The proposed valuation is based on the assets forming the Gap to Turrawan Segments as at 1 January 2013. The proposed commencement date for the variation is 1 January 2014. ARTC proposes to roll forward the DORC value as at 1 January 2013 in accordance with the NSWRAU to determine a value as at 1 January 2014.[13]

5.2 Submissions in response to the consultation paper

5.2.1 Whitehaven

Whitehaven considered that it was not in a position to comment on the overall approach to the determination of the replacement cost for assets in the Gap to Turrawan without conducting a detailed technical review.

Whitehaven considered that the 100% mark-ups that have been applied to the direct costs in respect of the combined contractor's indirect and client's costs for each asset classification are 'excessive and not appropriate'.[14]

Whitehaven noted that it was not in a position to comment on E&P's overall approach to optimisation or the approach to the determination of 'optimisation factors' in the proposed DORC valuation.

Whitehaven noted that with ongoing track conditioning monitoring, sections of the existing rail infrastructure can often be subject to speed restrictions until maintenance rectification work is carried out, indicating that the existing Gap to Turrawan infrastructure as at 1 January 2013 is not a modern equivalent.

Whitehaven considered that the modern equivalent rail asset would have 30 tonne axle load capacity, like in Pricing Zones 1 and 2, but that significant investment would be required in order to remove and replace the existing rail track as part of the planned upgrade to 30 tonne axel load capacity.[15] Whitehaven also noted that the assumptions on page 22 of the Valuation Report make no allowance for the removal of existing infrastructure, and that the existing rail track will need to be removed as part of the upgrade to 30 tonne axle load.[16]

5.2.2 Asciano

Asciano submitted that an independent review of the proposed DORC valuation submitted by ARTC may provide the necessary confidence that the valuation is appropriate. Asciano requested the ACCC also confirm the general consistency of the regulatory asset valuation

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11 E&P, *Valuation Report*, 28 June 2013, p.13.

12 The infrastructure associated with providing network control facilities to any part of ARTC's rail network.

13 ARTC, *Supporting Documentation,* 28 June 2013, p. 10.

14 Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013,p.5.

15 Ibid. p6

16 Ibid. p5

approach used by ARTC in relation to the Gap to Turrawan infrastructure.[17] In addition, Asciano requested the ACCC confirm the $500,000 cost allocation of the ARTC Network Control Centre is not being over-recovered.[18]

5.2.3 Idemitsu

Idemitsu submitted that although DORC valuations are a common methodology in valuing infrastructure, the application of the methodology is subject to making a number of judgements and estimations, which may be subjective.[19]

Idemitsu noted that it is not an expert in DORC valuations and consequently has not conducted a detailed technical review of the Valuation Report in regard to the appropriateness of judgements, estimations, and interpretations used in the report as they apply to items such as optimisation factors, depreciation per asset classification, replacement costs, unit rates, consumption, asset lives and asset classifications. Idemitsu seeks the ACCC's consideration on the reasonableness of the proposed RAB value.

Idemitsu considered the assumptions outlined in section 5 of the Valuation Report to be fair and reasonable, for example brownfields construction, land acquisitions, access roads etc.[20]

Idemitsu raised some concerns regarding the proposed valuation in its submission. Idemitsu considers the mark-ups applied to the direct costs in the valuation report are excessive and should be further examined.[21] Idemitsu is also concerned the valuation may not be appropriate in regard to assets which will soon be scrapped, for example through Network improvements and upgrades over the next 12 to 18 months.[22] Further, Idemitsu is of the view the allocation of Network Capital Control based upon train kilometres is not appropriate as there is no correlation between distance and the increased requirement for capital when considering Network Control capital.[23]

Idemitsu noted the proposed roll forward of 1 January 2013 DORC valuation to 1 January 2014 is consistent with previous sections of the Network.[24]

5.3 Review by Marsden Jacob Associates

The ACCC engaged MJA to independently review 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, including:

- the removal of between 4 and 12 of the passing loops/sidings because of their use by non-coal traffic;
- a reduction in the DORC value to reflect that the total cost for some components are higher than comparable benchmark costs;
- adjustments to the remaining life of particular assets, including bridges, signalling assets, and sleepers;

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17 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

18 Ibid.

19 Idemitsu, *ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p.2

20 Ibid. p3

21 Ibid.

22 Ibid.

23 Ibid.

24 Ibid. p4

- adjustments to reflect that the passing loops and sidings are not all concrete sleepers as assumed in the E&P valuation;
- correction of modelling inconsistencies;
- inclusion of the value of maintenance and operating cost savings associated with modern technology assets; and
- whether the valuation includes financing costs during construction.

MJA noted that it had been difficult to obtain robust benchmarks for track grade costs in particular, as ARTC was not able to provide information on the costs of similar projects to assist in the review.

MJA also noted that the DORC valuation is based on a 25 tonne axle load assumption, but it was difficult to evaluate whether the optimal axle load is 25 or 30 tonnes without undertaking a detailed supply chain study of the benefits and costs of increasing axle loads.[25]

A copy of the report by MJA is available on the ACCC's website at:

http://www.accc.gov.au/regulated-infrastructure/rail/gap-to-turrawan-variation-2013

5.4 ACCC preliminary views

Clause 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. The Gap to Turrawan Segments were not ascribed a regulatory asset value under the NSWRAU. Accordingly, ARTC has submitted a DORC valuation proposal for the Gap to Turrawan Segments as part of the Proposed Variation.

The ACCC has previously endorsed a DORC value for the Segments from Dartbrook to Gap and the Port Waratah Coal Loop Assets for inclusion in the initial RAB under the HVAU. Submissions to the Consultation Paper requested the ACCC confirm the general consistency of the regulatory asset valuation approach used by ARTC in relation to the Gap to Turrawan infrastructure.[26] The ACCC considers the Proposed Variation is appropriate with regards to the objects of Part IIIA in encouraging a consistent approach to access regulation.[27] ARTC states it has 'sought to adopt a similar approach and methodology to that used in previous DORC valuations, except where circumstances have warranted some deviation'.[28] For example, for the Gap to Turrawan DORC valuation ARTC has chosen to use contemporary benchmarked unit procurement and installation rates compared to the inflated historical rates used in the Dartbrook to Gap valuation, and in ARTC's view has also adopted a more extensive consideration of network and infrastructure optimisation.[29]

Overall, the ACCC is of the preliminary view that the use of the DORC methodology for the valuation of the Gap to Turrawan Segments is appropriate. However, the ACCC has some concerns with the DORC valuation proposed by ARTC. In particular, the ACCC has 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;

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25 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.

26 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

27 Subsection 44ZZA(3)(aa) of the Act.

28 ARTC, *Response to ACCC Information Request*, 17 September 2013, p.39.

29 The inflated historical rates included a real cost uplift and a CPI-adjusted uplift for both material and construction costs.

- 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 and it is not likely to be appropriate for these costs to be reflected in the annual compliance assessment;

- 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 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(a)); the objects of Part IIIA (subsection 44ZZA(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 Proposed Variation is sufficient and necessary to maintain those interests. The ACCC has considered whether the Proposed 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 providing 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 rolled into the RAB which will ensure that access seekers are only charged prices that are sufficient to meet ARTC's efficient costs. It is in access seekers' long term interest that prices and returns to ARTC are sufficient to provide the incentives needed to induce ARTC to adequately maintain services.

The reasons behind these preliminary views are outlined below.

5.4.1 Assets included in the DORC valuation

5.4.1.1 Assets for hauling coal

The Valuation Report states that the 'valuation provides the DORC for the 131km line segment from Gap to Turrawan' including 'the 14km of passing loops and sidings specifically associated with the coal infrastructure, providing a total length for the segment of 145 km.'[30]

In addition, the map set out at Appendix 6 of the Valuation Report 'highlights (in red) those parts of the Gap to Turrawan alignment and configuration that are utilised for the benefit of the existing coal haulage task, and are relevant to this re-valuation. Those parts not shown in red are not utilised or required for coal haulage and have not been valued.' [31]

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30 E&P, *Valuation Report*, 28 June 2013, p.9.
31 Ibid, p.25.

In summarising the Valuation Report, ARTC submits that '[a] review of existing network utilisation by coal operations, including campaign haulage, indicated that the existing track alignment and substantial parts of the existing configuration such as loop placement and length would be needed to meet current capacity and performance requirements on a stand-alone coal basis. Certain assets that were identified as providing no benefit to coal operations were excluded.'[32]

In its review of the Valuation Report, MJA has 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]

In its analysis of the proposed valuation, MJA note that E&P's 'DORC valuation has included 14.7 kilometres of passing loops and sidings specifically associated with the coal infrastructure' relating to '18 passing loops and sidings.' MJA also notes that ARTC has indicated that the Burilda, Breeza, Curlewis, Gunnedah Stockyards, Emerald Hill and Boggabri passing loops are required for coal operations.[34]

In relation to the remaining 12 sidings and passing loops, however, MJA note that ARTC has indicated that 'three sidings are used solely by non-coal trains (equating to 0.941 kilometres) and one asset is largely privately maintained and owned (1.495 kilometres).' MJA are of the view that 'these four assets should potentially be excluded from the DORC valuation on the basis that we are undertaking a coal only valuation. Moreover, it is likely that if there was no non-coal traffic on the rail segment these assets would not be required.[35]

In addition, MJA note that 'if there was no non-coal traffic on the rail segment it is possible that some or all of other eight passing loops and sidings (which also form part of the remaining 5.7 kilometres) would not be required.' While ARTC has 'indicated that some of these eight assets are used for coal operations (e.g. for storage of and access to maintenance equipment and assets and to store coal trains off the mainline in order to effect crew change)', it is clear that the length of six of the eight passing loops and sidings is less than 500 metres long which restricts its uses for coal operations. [36]

The ACCC is of the preliminary view that, as the DORC valuation proposed by ARTC is calculated on a stand-alone coal basis, then the four assets identified by MJA that are not required for the coal haulage task – including the three sidings used solely by non-coal trains and the one privately owned and maintained asset – should be excluded from the DORC valuation.

In addition, the ACCC is of the preliminary view that those six passing loops and sidings that are less than 500 metres long, which appears to indicate that their use is restricted to non-coal trains only, should also be excluded from the valuation. The ACCC is also of the preliminary view that those assets (which include the six passing loops noted above) 'that are used for the storage of and access to maintenance equipment and assets and to store coal trains off the mainline in order to effect crew change' should be excluded from the valuation. As the Gap to Turrawan line is not congested, and would be less so if non-coal trains were removed, then these assets would not be required for the coal haulage task and should be excluded from the DORC valuation. Further, in its assessment of the optimisation component MJA states that another existing coal passing loop may also not be required but could be retained to ensure practical operational flexibility (including crewing and above rail fleet availability – this is discussed in section 5.4.3.2 below).[37] On this basis the ACCC considers that even without the 12 sidings and passing loops discussed above, the asset configuration appears likely to retain sufficient operational flexibility for coal operations.

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32 ARTC, *Supporting Documentation*, 28 June 2013 p .15.
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,16.
34 Ibid.
35 Ibid, p.17.
36 Ibid.
37 Ibid, p.23.

The ACCC notes that the exclusion of these 12 sidings and passing loops would require adjustments to the total DORC value of ballast, earthworks, sleepers, rail and signalling.

The ACCC is of the preliminary view that the inclusion of the 12 sidings and passing loops set out above in the DORC valuation is not likely to be appropriate under subsection 44ZZA(3) as it would not be in the interests of coal producers who are seeking to use these parts of the Network. In particular, the inclusion of these assets in the initial RAB for the Gap to Turrawan Segments would likely result in higher access charges for coal producers for those Segments compared to a valuation which included only those assets required for coal haulage.

5.4.1.2 Allocation of network control centre costs

The Valuation Report notes that ARTC undertook a substantial train control consolidation project in NSW in 2006-07, costing in the order of $80m. ARTC allocated $13.175m of these network control centre capital costs to Pricing Zones 1 and 2 of the Hunter Valley coal network in ARTC's 2006-07 compliance submission to IPART. Additionally, $12.2m of this amount was added to the RAB in 2006-07, with the remaining amount to be recovered at some time in the future. An amount of $340,000 was included in the 2008 DORC valuation of the Dartbrook to Gap rail segment. An amount of $516,750 has been included as part of the Gap to Turrawan valuation to allow for its allocation of network control costs.

Asciano's submission to the ACCC's Consultation Paper sought confirmation that the cost allocation of the network control centre was not being over-recovered, as any further recovery of fixed costs from a new network segment would imply a reduction in the allocated network control centre costs for existing segments.[38] ARTC noted that the total amount now determined for allocation for the different parts of the Hunter Valley coal network reconciles with the amount originally approved for the Network in 2006-07 within a reasonable margin of error, suggesting that no double counting in different parts of the Network has occurred.[39] ARTC's response appears to address Asciano's concern that the network control centre costs will not be over-recovered.

ARTC also noted that regulatory approval has been granted for the allocation of network control centre costs applicable to both parts of the Hunter Valley coal network as well as parts of ARTC's interstate network within NSW and other parts of the NSW network managed by ARTC. ARTC is of the view that this indicates that no network control centre costs have been double counted.[40]

MJA was of the view that the placing of the network control centre costs in the Gap to Turrawan DORC valuation seemed reasonable, and it did not appear that they were being over-recovered.[41] Although high in comparison to the Dartbrook to Gap Segments, MJA do not consider that any changes to the allocation would materially impact the DORC valuation given that the difference is only around 0.1%. In particular, MJA noted ARTC's view that volumes in the zone incorporating the Gap to Turrawan Segments have increased relative to other zones, which may have led to a higher allocation when the original allocations were made.[42]

Whitehaven was of the view that it was not appropriate for ARTC to include an allocation of the value of Network Control Centre capital assets based on train kilometres, as it does not reflect the use of those assets.[43] Idemitsu was also of the view that the allocation of capital by distance does not provide a true representation of the required capital or application of such

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38 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
39 ARTC, *Response to ACCC Information Request*, 17 September 2013, p.25.
40 Ibid.
41 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.20.
42 Ibid.
43 Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013,p.4.

capital .[44] The ACCC notes the concerns with the use of train kilometres as a basis for cost allocation. However, the ACCC notes that network control centre costs have already been allocated on the basis of train kilometres to other parts of the network and the ACCC considers it is likely to be appropriate to maintain a consistent allocation methodology.[45] Further, the ACCC notes that the amount of network control centre costs is a relatively small proportion of the total DORC value and therefore an adjustment to the allocation methodology is likely to have a minor impact on the DORC.

The ACCC is of the preliminary view that the allocation of network control centre costs proposed by ARTC is likely to be appropriate under subsection 44ZZA(3) as it encourages a consistent approach to regulation of the Hunter Valley rail network.

5.4.1.3 Financing costs

The ACCC considers that it is currently unclear whether the DORC valuation provided by E&P includes the cost of financing construction in the mark-ups that have been proposed.

MJA state in their review of the Valuation Report that:

- 'there does not appear to be a consistent approach taken across other valuations to this issue with some including it and others not including it;
- previous valuations of ARTC's interstate network and the Dartbrook to Gap valuation do not appear to include financing costs; and
- it is critically linked to the construction timeframe, which is not taken into consideration as part of the E&P DORC valuation process.'[46]

The ACCC is of the preliminary view that 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 are not already included in the proposed mark-ups (applied to direct costs as a means of calculating indirect costs) 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.

The ACCC has formed the preliminary view that the inclusion of financing costs may be appropriate in principle, but the above issues around the clear identification, calculation and implementation of these costs would need to be resolved.

5.4.2 Benchmark replacement costs

E&P has 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.

Submissions to the Consultation Paper raised concerns about the appropriateness of the mark-ups. Idemitsu submitted the mark-ups applied to the direct costs in the valuation report are excessive and should be further examined.[47] Whitehaven considered that the 100% mark-ups that have been applied to the direct costs in respect of the combined contractors indirect and client's costs for each asset classification are excessive and not appropriate.[48]

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[44] Idemitsu, *ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p.3.

[45] ARTC, *Response to ACCC Information* Request, 17 September 2013, p. 24.

[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.17.

[47] Idemitsu, *ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p.3.

[48] Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p.5.

MJA's review of the six major asset components indicates that the E&P mark-ups for the following asset components are higher than the costs of comparable engineering projects:

- Ballast
- Sleepers
- Rail
- Signalling

MJA notes that it had been difficult to obtain robust benchmarks for track grade costs, as ARTC was not able to provide information on the costs of similar projects to assist in the review. However, based on the benchmark information available MJA considered that the track grade/earthwork costs appear reasonable. MJA states that their 'review has considered whether Evans & Pecks track grade costs fall within a reasonable range' based on comparisons with the cost per kilometre of track grade costs of previous valuations. In particular, MJA considered whether the cost per kilometre is comparable with the cost per kilometre quoted in a PWC report on The Pilbara Infrastructure (TPI) railway between Christmas Creek mine and Port Hedland and the cost per kilometre quoted in the valuation of the Dartbrook to Gap segments.[49]

The ACCC's preliminary view is that the E&P mark-ups for the components of the DORC valuation identified by MJA as being comparatively high (i.e. ballast, sleepers, rail and signalling costs) are too high and therefore of themselves are unlikely to be appropriate. The mark-ups for these components may be appropriate if they are reduced to reflect the total cost identified by MJA as being reasonable having regard to comparable benchmark costs or if further information is provided to support the proposed mark-ups.

5.4.3 Optimisation

In considering the appropriateness of the optimisation component of the DORC valuation, the ACCC has considered the assumptions regarding maximum axle loads, the inclusion of certain coal passing loops, and the operating and maintenance costs associated with the modern equivalent asset. In forming these views, the ACCC has had regard to the findings in the Proposed Variation, Valuation Report and the MJA Final Report. The ACCC's preliminary views are set out below.

5.4.3.1 Optimisation assumptions

The DORC valuation takes into account differences between the total useful life of a 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 actually in place, the optimisation factor will have the effect of reducing the asset valuation.

The assumptions underpinning these calculations include the assumption that the track is able to handle a maximum of 25 tonne axle load. MJA has formed the view that this assumption is reasonable given that 25 tonne axle load is the current track standard, and given that it would be difficult to evaluate whether the optimal axle load is 25 or 30 tonnes without undertaking a detailed supply chain study of the benefits and costs of increasing the axle loads.[50]

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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. 56.

[50] 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.

However, the ACCC notes Whitehaven's submission that the existing Gap to Turrawan infrastructure is currently subject to speed restrictions and is not a modern equivalent, and that the modern equivalent rail asset would have 30 tonne axle load capacity.[51] The ACCC's understanding is that if the 25 tonne axle load assumption were to be varied, the DORC valuation would likely be affected through changes to the assumed remaining lives of the existing assets (as 30 tonne axle load usage would result in more wear and tear and shorter remaining lives for the existing assets) and changes to the assumed MEERA standard (as the MEERA would need to provide for 30 tone axle load usage).

The ACCC is aware that the issue of maximum axle loads is currently being reviewed by ARTC and industry, and the ACCC considers that at this time it is unclear whether a 25 or 30 tonne axle load is optimal from a whole of coal supply chain perspective.

5.4.3.2 Optimisation of passing loops

The MJA report concludes that the assumptions made by E&P relating to the size and configuration of the optimised rail segment are reasonable subject to some additional examination of passing loops. ARTC has justified the inclusion of these passing loops by noting that while one less passing loop for coal operations would appear sufficient, there would be practical considerations which would make this unworkable, such as crewing and above rail fleet availability. MJA states that ARTC's explanation appears reasonable, but that a more detailed examination would be required to validate the explanation. Such an examination has not been possible based on the information provided. MJA further notes that the impact on removing one coal passing loop is not likely to be large in the context of the overall DORC valuation ($1.5m).

The ACCC notes the lack of certainty regarding the inclusion of the six existing passing loops for coal operations, and that it is theoretically possible that one of the existing coal passing loops would not be required for an optimised network. However, the ACCC notes that a number of other existing assets (passing loops and sidings) may already be excluded as discussed in section 5.4.1.1 above, and that it is reasonable for the optimised network to retain some operational flexibility. In the absence of further information, it is the ACCC's preliminary view that it is likely to be appropriate for the six coal passing loops to form part of the valuation.

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

ARTC submits that it has considered approaches to ensure consistency between the optimisation assumptions in the asset valuation and the treatment of maintenance expenditure related to those assets. Specifically, ARTC notes that maintenance expenditure included in Economic Cost should be based on consistent optimisation assumptions to those made in the asset valuation. Rather than including maintenance costs adjustments in the valuation itself, ARTC proposes to identify any necessary adjustments to actual maintenance expenditure each year as part of the annual compliance assessment conducted by the ACCC under clause 4.10 of the HVAU.[52]

The ACCC is of the preliminary view that ARTC's proposed approach to reflecting the cost savings associated with a modern equivalent asset in the annual compliance assessment raises concerns as outlined below.

ARTC argues that it should not deduct the full amount of the cost savings in the DORC valuation, because it is likely to replace these assets in the short term. However, the ACCC considers that a DORC value at a particular point in time is forward-looking and assumes that

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[51] Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p.6.
[52] ARTC, *Supporting Documentation*, 28 June 2013, p. 17.

the valued assets will provide benefits over their remaining useful life. To ensure the DORC valuation is internally consistent, the assumed remaining useful life which underpins the calculation of depreciation should also underpin the calculation of the present value of cost savings.

The ACCC is 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, which is likely to occur given planned infrastructure upgrades in Pricing Zone 3 to support 30 tonne axle loads.[53] The ACCC considers this is unlikely to be appropriate as it will result in internal inconsistency in the DORC valuation.

The ACCC considers that if ARTC wishes to reflect in the DORC value any planned infrastructure upgrades which would result in the replacement of some assets in the short term, this should be done consistently across the components of the DORC. For example, if ARTC is likely to replace an asset in two years, and therefore wishes to only calculate the value of cost savings for two years, the depreciation component should also reflect an expected remaining life of two years.

In addition, the ACCC considers that there are likely to be practical difficulties with implementing ARTC's proposed approach in the annual compliance assessment. The annual compliance assessment examines the efficiency of ARTC's actual operating costs for the Hunter Valley rail network, and the ACCC considers that introducing hypothetical costs to this assessment is likely to be problematic. For example, it would then be difficult to determine whether ARTC has applied the correct level of hypothetical operating expenditure (or the correct level of a deduction from actual operating expenditure) in a given year due to the 'lumpy' nature of operating and maintenance expenditure over time. Further, ARTC's proposed approach would require consideration of hypothetical operating expenditure (based on a set of particular assumptions) for the Gap to Turrawan Segments, and actual operating expenditure (based on actual incurrence) for the rest of the network. The basis for the two types of operating expenditure may not be consistent, and the ACCC considers this is likely to limit the comparability of ARTC's operating expenditure levels across segments and over time, and may thereby undermine the effectiveness of the assessment.

The ACCC is also concerned that incorporating the value of cost savings of a modern equivalent asset in the annual compliance assessment may create perverse incentives for ARTC. For example, ARTC may have an incentive to minimise operating and maintenance expenditure on old existing assets where it is unable to recover the actual expenditure due to the adjustment. The ACCC considers that it is much less likely for any adverse incentives to exist if the present value of cost savings are deducted up-front in the DORC value and ARTC is subsequently able to recover whatever actual efficient expenditure it incurs on all asset types.

For these reasons, the ACCC is of the preliminary view that differentials in operating and maintenance expenditure between existing assets and modern equivalent assets over their expected remaining life should be reflected in the initial asset valuation by deducting the present value of any such costs savings from the proposed DORC value. The ACCC considers that ARTC's proposal to reflect operating and maintenance expenditure differentials in the annual compliance assessment until the asset is replaced is unlikely to be appropriate.

5.4.4 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 straight line depreciation methodology, whereby the asset is assumed to depreciate by a constant amount each year.

[53] Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p.5.

The ACCC is of the preliminary view that the use of straight line depreciation methodology is likely to be appropriate as it is a well-recognised approach and is consistent with the depreciation methodology required under the HVAU.

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 conducting its review of the E&P DORC valuation, MJA formed the view that the remaining life of a small number of assets is not reasonable. In particular:

- E&P has 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. If this adjustment is made, MJA estimates that it is likely to increase the DORC value by $1.15 million.

- 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. If this adjustment is made, MJA estimates that it is likely to decrease the DORC value by $7.15 million.

- 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. MJA estimates that if this adjustment is made it is likely to decrease the DORC value by $0.07 million.

The ACCC considers that it is 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. Accordingly, the ACCC is of the preliminary view that in order for the DORC valuation of the Gap to Turrawan assets to be appropriate, it should be adjusted to reflect the revised remaining life assumptions proposed by MJA. The net effect of these adjustments is likely to decrease the DORC by $6.1 million.

The ACCC notes submissions from Idemitsu and Whitehaven expressed concern that the valuation may not be appropriate with regard to assets which will soon be scrapped, for example through improvements and upgrades over the next 12 to 18 months. Whitehaven noted that in particular no allowance is made for the removal of existing infrastructure as part of the upgrade to 30 tonne axle load. The ACCC notes that the DORC valuation proposed by ARTC reflects the assets in place as at 1 January 2013, and is determined having regard to the assumed purpose and capacity of the assets in place at that time.[54] One of the first stages of a DORC valuation is 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). However, projected demand that is beyond the life cycle of existing assets may not be relevant to the DORC valuation.

Therefore, the DORC valuation does not necessarily require consideration of forward investment programs intended to modify the purpose and capacity of the existing assets unless the projection of demand – which necessitates the forward investment program – affects DORC system assumptions and the life cycle costs of assets that are subject to DORC valuation. For example, if the optimised assets were assumed to have a 30 tonne axle load, rather than a 25 tonne axle load, then planned infrastructure upgrades intended to facilitate 30 tonne axle loads may become relevant (the 25 tonne axle load assumption is discussed at section 5.4.3.1 above).

54 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, pp. 22-25.

As discussed above in section 5.4.3.3, the ACCC considers that remaining life assumptions should be consistently applied across the components of the DORC. If the forward investment program is not taken into account in the DORC valuation, the HVAU provides that where assets are disposed of before they are fully depreciated (i.e. before the end of their remaining life), the residual asset value is recovered either through scrap value sale or as a disposal expense, or a combination of the two. Where ARTC proposes to undertake an infrastructure upgrade program involving the removal of existing assets, the HVAU provides for parties to have input through the RCG capacity expenditure endorsement process.

5.4.5 Modelling inconsistencies

The MJA report identifies a number of inconsistencies in the E&P DORC modelling. These are listed in the MJA report[55] as:

- the full cost of the 47kg rail has not been included in the model;
- there is a misspecification of one section of track as 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 ACCC understands that (based on MJA's estimate) the DORC value would be adjusted upwards by $5m if these modelling inconsistencies were resolved (irrespective of the effect of other issues raised in this paper). This adjustment would also need to reflect that the passing loops and sidings are not all concrete sleepers as assumed in the E&P valuation.[56]

The ACCC is of the preliminary view that the E&P valuation containing such errors is unlikely to be appropriate for acceptance under subsection 44ZZA(3); however, the ACCC notes that ARTC has indicated that it will address these errors in a revised submission.

5.4.6 Rolling forward the 2013 value

The proposed DORC valuation is based on the assets forming the GAP to Turrawan Segments as at 1 January 2013. The proposed commencement date for the variation is 1 January 2014. The ACCC's views on the commencement date are set out above at section 4.3 of this paper. ARTC proposes to roll forward the DORC value as at 1 January 2013 in accordance with the NSWRAU to determine a value as at 1 January 2014.

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

The ACCC is of the preliminary view that ARTC's proposed roll forward of the 1 January 2013 DORC valuation is likely to be appropriate given ARTC has advised that producers have endorsed the capital expenditure through the Rail Capacity Group (**RCG**) process.

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55 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.ESiv.

56 Ibid. p 42

6 Indicative Service and Indicative Access Charges

This chapter sets out the ACCC's preliminary views on the Indicative Service and pricing aspects of ARTC's Proposed Variation.

6.1 Proposed variation

ARTC proposes 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:[57]

- providing for a 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.

The proposed Initial Indicative Service and Initial Indicative Access Charge for the Gap to Turrawan Segments for the 2014 calendar year are detailed in table 3 below.

Table 3: 2014 Initial Indicative Service and Access Charge

Pricing Zone 3	Non-TOP $/kgtkm (ex GST)	TOP $/kgtkm (ex GST)	Initial Indicative Service Characteristics
Initial Indicative Service 1	0.958	6.276	25 tonne axle load 80 kph maximum speed (loaded) 80 kph maximum speed (empty) 82 wagon length 1350 metres maximum train length Section run times as per applicable Hunter Valley standard working timetable

Source: ARTC, *Supporting Documentation*, 28 June 2013, p. 21.
Note: TOP refers to take or pay. Charges are based on a combination of TOP and non-TOP.

[57] ARTC, *Supporting Documentation*, 28 June 2013, p.9.

6.1.1 ARTC's proposed Indicative Service

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 port.

6.1.2 ARTC's methodology for determining Indicative Access Charges

ARTC submits that the charges are based on current expectations of volumes and costs for the 2014 calendar year for Pricing Zone 3. ARTC submits that it has also taken a number of other factors into account in determining the Initial Indicative Access Charge, including ARTC's current forecast of operating expenditure for Pricing Zone 3, the existing 2013 Initial Indicative Access Charge for Pricing Zone 3 and the pricing principles in clause 4.13 of the HVAU.

ARTC's response to the ACCC's request for information supplements the information provided by ARTC in the Supporting Documentation dated 28 June 2013.

At the time the Proposed Variation was submitted, Access Holders had not yet provided or proposed variations to their 2014 volumes in accordance with clause 4.20(a) of the HVAU. ARTC has advised that once the 2014 volumes are finalised it will resubmit a finalised Initial Indicative Access Charge for Pricing Zone 3 for the ACCC's approval.

6.2 Submissions in response to the Consultation Paper

6.2.1 Asciano

Asciano noted the 2014 forecast prices in Pricing Zone 3 seemed to indicate a re-balancing between the 'non-take or pay' price and the 'take or pay' price. Asciano requested that the ACCC consider the tariff rebalancing to ensure that it is justifiable, and that no pricing anomalies or perverse price signals occur.[58]

6.2.2 Idemitsu

Idemitsu considers the proposed Initial Indicative Service is appropriate but has concerns about the Initial Indicative Access Charge. These concerns relate to the transparency of the access charge as well as the need to understand the impact of any revised volumes for the extended Pricing Zone 3 on the Indicative Access Charge.[59]

6.3 ACCC preliminary views

6.3.1 Indicative service

The ACCC's preliminary view is 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 is appropriate having regard to the matters in subsection 44ZZA(3).

In particular, the ACCC considers that applying the same Initial Indicative Service will allow for consistent access arrangements for the Access Holders that are required to use the Gap

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[58] 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.2.

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

to Turrawan Segments and the existing Pricing Zone 3 Segments, and will thereby promote a consistent approach to access regulation (subsection 44ZZA(3)(aa)). The ACCC notes that submissions from Idemitsu and Whitehaven are supportive of Pricing Zone 3 being extended to cover the access arrangements in the Gap to Turrawan Segments, and therefore this approach is likely to reflect the interests of access seekers (subsection 44ZZA(3)(c)).[60]

6.3.2 Indicative Access Charges

The HVAU 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, clause 4 of the HVAU contains general principles and objectives for setting prices, including the structure of charges for coal access rights (clause 4.11); pricing objectives (clause 4.13) and the revenue limits for access revenue (clause 4.2 and 4.3 – see Box 1 below).

Box 1: Revenue limits in the HVAU

4.2 Floor Revenue Limits

(a) Access revenue from every Access Holder must at least meet the Direct Cost imposed by that Access Holder.

(b) For each Segment or group of Segments, Access revenue from Access Holders should, as an objective, meet the Incremental Cost of those Segments ("Floor Limit").

4.3 Ceiling Revenue Limits

(a) In relation to Segments identified as forming part of Pricing Zone 1 and 2 in Schedule E, Access revenue from any Access Holder, or group of Access Holders must not exceed the Economic Cost of those Segments which are required on a stand alone basis for the Access Holder or group of Access Holders ("Ceiling Limit").

(b) In relation to Segments identified as forming part of Pricing Zone 3 in Schedule E, the Access revenue from any Access Holder, or group of Access Holders must not exceed the Ceiling Limit where the RAB for those Segments is equal to, or falls below, the RAB Floor Limit for those Segments at the end of the calendar year (t -1).

(c) Access revenue for the purposes of this section 4.3 does not include Access Revenue returned to a Contributor as a result of the operation of a user funding agreement between the Contributor and ARTC.

The ACCC's preliminary view on ARTC's proposed TOP and non-TOP components of the Initial Indicative Access Charges for the extended Pricing Zone 3 is set out below.

6.3.2.1 Non-TOP charges and the variable component of costs

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

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 of achieving full recovery

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

of the variable component of costs from all Access Holders on the basis of actual Network usage (clause 4.13 of the HVAU).

For the purposes of the revenue limits, the VCC is equivalent to the Direct Cost, which is the relevant floor limit. It is therefore the ACCC's preliminary view that the level of the non-TOP charge is appropriate as it recovers the costs that Access Holders directly impose on ARTC from their use of the Network. This reflects the legitimate business interests of ARTC (subsection 44ZZA(3)(a)).

6.3.2.2 TOP charges and the fixed component of costs

The TOP charge is set so as 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 clause 4.13 of the HVAU for ARTC to set Access Charges to achieve full recovery of the variable component of costs, and maximum recovery of the fixed component of costs and new capital component of costs. 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.

ARTC states 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".[61] 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.[62]

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 unlikely to recover full Economic Cost in the short term as it is likely to be in the legitimate business interests of ARTC (subsection 44ZZA(3)(a)).[63] However, the ACCC notes that the magnitude of Economic Cost will depend on the determination of an appropriate initial RAB value based on the DORC methodology, as discussed above in chapter 5.

ARTC submits that, outside of differentiation considerations, the proposed TOP component of charges seeks to recover the same amount of the fixed component of costs from all Access Holders equally.[64] The ACCC considers that this is likely to be appropriate, and that this is consistent with the principle in the HVAU that the proportion of FCC recovered through a TOP component be consistently applied to all Access Holders holding coal access rights within a Pricing Zone.

6.3.2.3 Charge differentiation

For services other than the Initial Indicative Service, clause 4.15 of the HVAU sets out various factors which ARTC will have regard to in determining charges. 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 Indicative Service, and the logistical impacts of the service on ARTC’s business. The HVAU also sets limits on such charge

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[61] 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.

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

[63] The ACCC considers its decision is not inconsistent with the other matters listed in subsection 44ZZA(3).

[64] ARTC, *Supporting Documentation*, 28 June 2013, p.29.

differentiation in clause 4.16, such as that ARTC will not have regard to the identity of the applicant in differentiating charges.

The ACCC considers 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 this is likely to be in the interests of access seekers (subsection 44ZZA(3)(c)). In particular, the ACCC notes it is an objective of the HVAU to provide access in a transparent, efficient and non-discriminatory manner.

6.3.2.4 Pricing transparency

Submissions have expressed concern that the basis on which ARTC has determined the proposed Initial Indicative Access Charges for the extended Pricing Zone 3 is not sufficiently transparent and that Access Holders are unable to estimate the magnitude of the losses that will be capitalised for future recovery.[65]

The ACCC notes ARTC's response to the ACCC's information request that:

> the level of recovery of full economic cost in Pricing Zone 3 is not the output of a formula driven approach, as might be the case in a constrained environment, but more-so the result of ARTC seeking a reasonable balance between the above factors, and ultimately subject to negotiation with Access Holders or dispute resolution as described above.
>
> The TOP component will reflect the market factors and ARTCs governing principles of preserving forecast revenue, whilst mitigating any increases in access charges based on current market conditions and economic environment.

The ACCC accepts that it may be difficult for ARTC to provide the exact magnitude of losses that are likely to be capitalised, as the losses are finalised as part of the ACCC's annual compliance process every year. Further, the ACCC accepts 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.

However, the ACCC considers 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 (which follows the process for finalising contracted volumes each year in accordance with clause 4.20(a) of the HVAU). The ACCC considers that this is likely to be appropriate as it would improve transparency around the charges that Access Holders are likely to face over time, given that ARTC has discretion to set charges at a level that does not recover full Economic Cost in Pricing Zone 3 in the short term.

One way that this could be achieved is through an amendment to clause 4.20(d) of the HVAU which sets out the information ARTC is to provide to Access Holders on 1 November each year. The ACCC is open to feedback as to how an appropriate level of transparency may be achieved in practice.

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

7 Drafting amendments

7.1 ARTC's proposed drafting changes

ARTC has proposed a number of drafting changes in the Proposed 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 in the HVAU, which is to be rolled forward in accordance with the principles in clause 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.

The proposed drafting amendments are attached to ARTC's variation application at Attachment A, which is available on the ACC's website.[66]

7.2 Submissions in response to the consultation paper

Whitehaven considers that the changes to the drafting by combining the Gap to Turrawan Segments into Pricing Zone 3 were minimal. Whitehaven also considered that the drafting of the Proposed Variation was consistent with the intention of the Proposed Variation as stated by ARTC in its variation application.[67]

Idemitsu considers that the proposed drafting currently represents the intentions of the proposed changes to the HVAU; however, given the concerns raised by Idemitsu, there may be a requirement for further drafting amendments.[68]

7.3 ACCC preliminary views

Subject to consideration of a revised 'New Segments Commencement Date' and any further amendments that ARTC may make to its Proposed Variation in light of the above-mentioned concerns, the ACCC is of the preliminary view that the current proposed drafting amendments to the HVAU are appropriate having regard to the matters in subsection 44ZZA(3) of the Act.

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66 ARTC, *Application by ARTC to vary the Hunter Valley Access Undertaking to incorporate Gap to Turrawan Segments*, 28 June 2013, pp.5-9.

67 Whitehaven Coal, *Whitehaven Submission on ARTC proposed variation to include Gap to Turrawan*, 20 August 2013, p.8.

68 Idemitsu, *ARTC's Proposed Variation to the Hunter Valley Rail Network Access Undertaking to include Gap to Turrawan Segments*, 22 August 2013, p.5.

8 Conclusion

The ACCC is of the preliminary view that the Proposed Variation is not appropriate to accept pursuant to subsection 44ZZA(7) of the Act taking into account the matters set out in subsection 44ZZA(3) for the reasons set out above. The ACCC is supportive of the inclusion of the Gap to Turrawan segments in the coverage of the HVAU, as it will promote regulatory certainty for users of the Hunter Valley coal network (subsection 44ZZA(C)) as well as encourage consistency of regulation over the entire Hunter Valley railway network (subsection 44ZZA(3)(aa)).

The ACCC also considers that including 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' the ACCC has had regard to under subsection 44ZZA(3)(e).

However, although there are elements within the Proposed Variation that are likely to be considered to be appropriate, there are additional issues that need to be considered by ARTC. In particular, the ACCC has 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;
- the magnitude of the mark-ups on direct costs (as a means of calculating indirect costs) are not likely to be appropriate as they appear to be high compared to relevant benchmark costs;
- the present value of costs savings associated with a modern asset should be included in the DORC valuation up-front and it is not likely to be appropriate for these costs to be reflected in the annual compliance assessment;
- 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 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(a));
- the objects of Part IIIA (subsection 44ZZA(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)).

The ACCC also considers 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 proposed access charges.

The ACCC has throughout this paper, stated its position on particular issues and also recommended additional issues for further consideration by ARTC. In doing so, the ACCC hopes to provide a path forward by which the assessment of the Proposed Variation may be finalised in a timely fashion.