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15 April 2014

Dear Stakeholder

Re: Consultation on ARTC's revised Gap to Turrawan variation

The ACCC is seeking submissions on the Australian Rail Track Corporation's (**ARTC's**) revised application to extend coverage of the Hunter Valley Access Undertaking (**HVAU**) to include the Segments from Gap to Turrawan (the **Revised Variation**). The Revised Variation was submitted on 24 March 2014.

The Revised Variation, together with supporting materials from ARTC, is available on the ACCC's website at:

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

Alternatively, you may go to the ACCC's homepage, www.accc.gov.au, and follow the links to 'Regulated Infrastructure' and 'Rail' and 'Gap to Turrawan variation 2014'.

Background

The Revised Variation has been submitted by ARTC following consultation on a previous variation application that was dated 28 June 2013 (the **2013 Proposed Variation**) relating to the Gap to Turrawan Segments. ARTC withdrew its 2013 Proposed Variation on 20 February 2014.

The Revised Variation includes a number of amendments intended to address issues raised by the ACCC in its 12 December 2013 Position Paper. In addition, ARTC states that it has incorporated into the Revised Variation 'a package of adjustments put forward and accepted by relevant stakeholders' following further consultation with the ACCC and industry.[1]

Parties are encouraged to view ARTC's proposed amendments in the Revised Variation documentation available on the ACCC's website. A brief overview of these amendments is provided below.

Proposed effect of the application

If the ACCC accepts the Revised Variation, ARTC will provide access to the Gap to Turrawan Segments in accordance with the provisions in the HVAU. Specifically:

- The Hunter Valley rail network as defined in Schedule B of the HVAU will be extended to include the Segments from Gap to Turrawan.

1 ARTC's Revised Variation, *Supporting Documentation*, p. 17.

- ARTC's proposed asset value for the Gap to Turrawan Segments, determined using the Depreciated Optimised Replacement Cost (**DORC**) methodology, will be included in the regulatory value of assets on which ARTC is allowed to earn a regulated rate of return.

- The Initial Indicative Access Charge for Pricing Zone 3 as published on ARTC's website effective from 1 January 2014 will also apply to the Gap to Turrawan Segments.[2]

2014 Revised Variation

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.

ARTC proposes 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.[3] 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 to the extent the asset is not owned by ARTC. ARTC also proposes to retain a number of sidings used for maintenance and above rail activities. ARTC has determined that these adjustments will 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.

- Inclusion of an amount representing financing costs (interest during construction) of $26.94 million. Financing costs were not originally included in ARTC's 2013 Proposed Variation. In its response to the ACCC's 2013 Position Paper, however, ARTC proposed to include financing costs of $56.8 million based on a construction period of four years. In its Revised Variation, ARTC has proposed 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 financing costs figure. The financing costs of $26.94 million represent around 9.06% of the proposed DORC value, excluding financing costs, of $296 million. The total proposed DORC, including financing costs, is $323.37 million.

- Reductions in the proposed mark up on direct costs (as a means of calculating indirect costs) for signalling assets from 115% to 102%, and for track assets including ballast, rail and sleepers from 100% to 74%. ARTC has determined that these adjustments will 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 – (as

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

3 ARTC has proposed to roll forward the value using the principles outlined in the New South Wales Rail Access Undertaking (NSWRAU) overseen by the Independent Pricing and Regulatory Tribunal (IPART).

compared to an existing asset). ARTC has identified that the only affected assets that require consideration are:

- 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, and which ARTC has adjusted to have a remaining life of 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.

ARTC has 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. These adjustments will 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. This will reduce 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.

Proposed Access Charges

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

Table 1: 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

Table sources: See ARTC's Revised Variation, *Supporting Documentation*, p. 29.

ARTC has also made amendments in the Revised Variation to address issues raised in the ACCC's 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).

ARTC submits that providing the starting and ending RAB values for Pricing Zone 3 will enable Access Holders in Pricing Zone 3 to better estimate the amount that will be capitalised into the asset base for that year.[4]

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 $648.0 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.

Submissions

The ACCC encourages parties seeking to make a submission on the Revised Variation to do so as soon as possible and at the latest by **5:00pm on 8 May 2014**. It is in your interest that the submission be lodged by this date, as section 44ZZBD of the *Competition and Consumer Act* 2010 (Cth) (**the Act**) allows the ACCC to disregard any submission made after this date.

The main aspects of ARTC's Revised Variation which differ from the 2013 Proposed Variation are set out above. The ACCC is particularly interested in commentary on these issues. Parties are however welcome to comment on any aspect of the Revised Variation. In doing so, parties are encouraged to address the matters listed in subsection 44ZZA(3) of the Act.

Submissions should be addressed to:

Mr Matthew Schroder
General Manager
Fuel, Transport and Prices Oversight
ACCC
GPO Box 520
MELBOURNE VIC 3001
Email: transport@accc.gov.au

In deciding whether to consent to a variation of an access undertaking under subsection 44ZZA(7) of the Act, the ACCC considers the matters set out in subsection 44ZZA(3) of the Act. Essentially, the ACCC may accept the Revised Variation if it thinks it appropriate to do so, having regard to various matters set out in the Act.[5]

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4 The RAB is rolled forward in accordance with the formula in subsection 4.4(a) of the HVAU.

5 The ACCC notes that this consultation on the Revised Variation stops the clock for the purposes of calculating the 'expected period' within which the ACCC must make a decision on ARTC's Revised Variation, in accordance with subsection 44ZZBC(2) of the Act.

If you have any questions in relation to this consultation letter, please contact Grant Kari on (03) 9290 1807.

Yours sincerely

Matthew Schroder
General Manager
Fuel, Transport and Prices Oversight