Statement of Approach

Valuation of the Interstate network

8 November 2019

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1. Summary

In preparation for submitting the replacement IAU, ARTC has proposed to revalue the Interstate network using the Depreciated Optimised Replacement Cost (**DORC**) methodology. Prior to formal submission, ARTC has sought the ACCC's views on whether the ACCC would consider a full DORC revaluation appropriate.[1]

On 12 September 2019, the ACCC published an issues paper and sought stakeholder submissions on the most appropriate method for valuing the Regulatory Asset Base (**RAB**) on the Interstate network in the replacement Interstate Access Undertaking (**IAU**), between:

- rolling forward the RAB from the 2008 IAU RAB value; or
- undertaking a full network revaluation, using the DORC methodology, with the ACCC engaging a consultant.

The ACCC's preliminary view in the issues paper was that undertaking a full network revaluation, using the DORC methodology, with the ACCC engaging a consultant, is likely to be the most appropriate approach.

ACCC approach

The ACCC's approach maintains its preliminary view that a full DORC revaluation is the most appropriate approach to valuing the RAB on the Interstate network in the replacement IAU, with the ACCC engaging a consultant.

In reaching its view, the ACCC has considered stakeholder submissions. The ACCC received 10 submissions from stakeholders. The majority of stakeholders submitted their support for the ACCC's preliminary view, with one stakeholder submitting that a RAB roll forward is most appropriate.

The ACCC considers that, compared with the alternative option of rolling forward the RAB from the 2008 IAU RAB value, a full DORC revaluation:

- promotes the economically efficient operation of, use of and investment in the Interstate network (section 44ZZA(3)(aa))
- is in ARTC's legitimate business interests (section 44ZZA(3)(a)
- is in the interests of those seeking to access the Interstate network (section 44ZZA(3)(c))
- promotes clarity and certainty in the operation of the IAU (section 44ZZA(3)(e)).

Ordinarily a RAB roll forward is the preferred approach to valuing the RAB. However, the ACCC considers that a RAB roll forward is not appropriate in this case due a significant lack of information from ARTC about expenditure incurred, and the treatment of that expenditure in ARTC's financial model, over the term of the 2008 IAU. Going forward, the ACCC expects that the replacement IAU will set out:

- clear processes for the annual RAB roll forward, including what sorts of information ARTC will provide to the ACCC on an annual basis in order for the ACCC to undertake a prudency assessment for inclusion of expenditure into the RAB, and to assess ARTC's annual RAB roll forward
- clear and transparent capitalisation rules in respect of what expenditures will be treated as capital and consequently rolled into the RAB, and what expenditures will be expensed. This includes rules in respect of how ARTC will treat grants (or gifted funds),

[1] ARTC, ARTC proposal to ACCC re Methodology for Revaluation of the Interstate Network, 23 August 2019.

including what supporting documents ARTC will provide to the ACCC to demonstrate it should earn a commercial return on that expenditure.

Next steps

The ACCC now seeks a public commitment from ARTC that it will constructively engage with the ACCC and its consultant, so the consultant can undertake its assessment. Further, once the valuation is completed, that ARTC will adopt the ACCC's RAB value in the financial model that accompanies its replacement IAU application and will accept the RAB value as a basis in future IAU applications, with appropriate RAB roll forward mechanisms in place. Once ARTC provides this public commitment, the ACCC will engage a consultant with rail engineering and economics expertise to undertake the valuation.

As flagged in the ACCC's issues paper, the ACCC expects that it will take at least 6 months to complete the DORC revaluation on the Interstate network.[2] The ACCC considers there is likely to be a number of proposals in ARTC's replacement IAU, which the ACCC, and stakeholders, will not be able to form a view on until the RAB valuation is undertaken. In particular, proposals relating to Access Charges and an annual reporting framework. This is because the ACCC's assessment is likely to be impacted by where ARTC's revenue is sitting against its Floor and Ceiling Limits, which cannot be calculated until the RAB value is known. As such, the ACCC encourages ARTC not to submit its replacement IAU for ACCC assessment until the RAB valuation is complete.

Given the above and the outstanding issues to be addressed from the assessment of the 2018 IAU, the ACCC considers the timeframe for assessing the replacement IAU prior to the current expiry date of the 2008 IAU on 30 June 2020, is extremely tight.[3] As such, the ACCC encourages ARTC to consider submitting another application to extend the term of the 2008 IAU to ensure there is regulatory certainty over the terms of access to the Interstate network during the assessment of the replacement IAU. The length of a further extension required will become clear once the DORC consultant has been engaged.

The ACCC encourages ARTC and stakeholders to constructively engage with each other to resolve other key issues of concern, prior to ARTC formally submitting its replacement IAU application. This approach will reduce the number of unresolved issues in ARTC's replacement IAU application, and allow the ACCC to expedite its assessment.

[2] ACCC, *Issues paper: Valuation approach for the Interstate network*, 12 September 2019, p. 21.

[3] Following ARTC's 29 July 2019 application to vary the expiry date of the 2008 IAU, on 29 September 2019 the ACCC issued a notice to extend the term of the 2008 IAU until 30 June 2020.

2. Background

2.1. 2008 IAU

On 30 July 2008, the ACCC accepted the 2008 IAU under Part IIIA of the then *Trade Practices Act 1974* (Cth). The 2008 IAU sets out the terms and conditions by which above rail operators can access the standard gauge tracks on the Interstate network.

The 2008 IAU was originally due to expire on 21 August 2018. ARTC has since varied the 2008 IAU five times to extend the term of the 2008 IAU. The 2008 IAU is currently due to expire on 30 June 2020.[4]

2.2. 2018 IAU application

On 6 March 2018, ARTC submitted the 2018 IAU to the ACCC for assessment under the *Competition and Consumer Act 2010* (Cth) (**the Act**). The 2018 IAU was intended to replace the 2008 IAU. In the proposed 2018 IAU, ARTC proposed to roll forward the RAB from $3.7 billion (in 2006–07) to $10 billion (in 2017–18).

ACCC draft decision

On 20 December 2018, the ACCC released a draft decision to not accept the 2018 IAU. The ACCC set out a number of concerns with ARTC's application, including that ARTC's proposal to roll forward the RAB to an opening value of $10 billion for 2017–18 was not appropriate having regard to the relevant matters under section 44ZZA(3). Specifically, the ACCC had significant concerns regarding:[5]

- **Initial RAB values for new Segments** – ARTC sought to include the cost of the Metropolitan Freight Network (**MFN**), Queensland Border to Acacia Ridge and South Sydney Freight Line (**SSFL**) into the RAB, at a value of $1.25 billion. However, ARTC did not provide DORC assessments for MFN and SSFL, a requirement under the 2008 and 2018 IAU.[6] Further, the ACCC had a number of concerns with ARTC's submitted DORC assessment for the Queensland Border to Acacia Ridge Segment.
- **Prudency of capex** – ARTC sought to include 104 capex projects, at a cost of $2.8 billion in its RAB roll forward. Under the 2008 IAU, ARTC was required to seek the ACCC's approval to increase capex exceeding 20 per cent of that forecast for projects set out in Schedule H of the 2008 IAU.[7] Although there were a number of instances where ARTC's actual capex for those projects was more than 20 per cent higher than forecast in a single year, or not forecast for, ARTC did not seek the ACCC's approval. ARTC did not provide sufficient supporting documentation for the ACCC to undertake a prudency assessment on the majority of capex projects submitted by ARTC.
- **Capex funded by government grants** – ARTC sought to include $581 million of capex funded through grants (or gifted funds) into the RAB, which would allow ARTC to earn a return on capital and depreciation. However, ARTC's response to the ACCC's information requests did not indicate that ARTC was required to generate a commercial return to government for this grant funding.

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4 On 26 September 2019, the ACCC issued a notice to extend the period of the 2008 IAU, in response to ARTC's 29 July 2019 variation application.

5 ACCC, Draft decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking, 20 December 2019, pp. 39–98.

6 Section 4.4(d)(i).

7 Section 4.4(e) of the 2008 IAU.

- **Replacement expenditure** – ARTC sought to include expenditure on track assets into the RAB where under the 2008 IAU financial model, track assets on the Interstate network are assumed to exist in perpetuity, with assets maintained at a 'steady state' through Major Periodic Maintenance (**MPM**) expenditure. The ACCC considered that a number of these projects, such as those involving rerailing and resleepering, should be considered replacement expenditure and consequently not included in the RAB. Based on ACCC analysis, replacement expenditure accounted for approximately $1.5 billion of expenditure that ARTC sought to roll into the RAB. Similarly, ARTC sought to roll in $340.5 million of corridor capital into the RAB, which the ACCC considered should also be considered replacement expenditure and not rolled into the RAB.
- **Capex allocation to asset types** – The ACCC noted concerns with ARTC's allocation of capex between track (considered perpetual and not subject to depreciation) and signalling and communication (considered to have a finite life and subject to depreciation). In particular, ARTC allocated a number of capex projects as track assets, which the ACCC considered should be allocated as signalling and communication assets.
- **Asset disposals** – ARTC did not propose to include any disposals in the RAB roll forward for the 2018 IAU. However, the ACCC considered there were a number of projects undertaken by ARTC that necessitated the disposal of assets, such as rerailing and resleepering.
- **Financial models** – ARTC's financial model included instances of negative capex and capex on Segments not part of the Interstate network.
- **Indexation** – ARTC proposed to apply indexation to the RAB from 2006–07 when the ACCC considered it should have been applied from the date of the opening RAB, 2007–08. Additionally, the ACCC considered ARTC applied the wrong inflation rate.

ARTC proposed no changes to its RAB annual roll forward equation in the 2018 IAU. In its draft decision, the ACCC considered the RAB annual roll forward equation remained appropriate.[8]

On 25 January 2019, following discussions with the ACCC, ARTC withdrew the 2018 IAU from the ACCC's assessment.[9]

2.3. Replacement IAU - RAB valuation

On 23 August 2019, ARTC sent a letter to the ACCC proposing to revalue the RAB on the Interstate network using the DORC methodology.[10] In its letter, ARTC stated that it was seeking views on its proposal prior to formally submitting its replacement IAU application for ACCC assessment. ARTC additionally committed to set Access Charges in its replacement IAU independent of the RAB valuation approach taken, and RAB value, stating:[11]

> *Importantly, ARTC would like to reaffirm its public statements that irrespective of the outcome of the RAB valuation ARTC will not change its published standing offer pricing. This is consistent with the pricing implemented under the IAU where there is no direct link between the costs incurred in maintaining, operating and investing in the network and the price for access in any one year. For this reason, ARTC is happy to commit to the statement that its pricing is independent of the RAB methodology.*

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[8] ACCC, Draft decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking, 20 December 2019, p. 40.

[9] ARTC, 2018 IAU – Withdrawal letter, 25 January 2019.

[10] ARTC, ARTC proposal to ACCC re Methodology for Revaluation of the Interstate Network, 23 August 2019.

[11] Ibid, p. 4.

ACCC issues paper

On 13 September 2019, the ACCC published an issues paper detailing the following two options for valuing the RAB in the replacement IAU:[12]

- rolling forward the RAB from the 2008 IAU RAB value
- undertaking a full network revaluation, using the DORC methodology (with the ACCC engaging a consultant).

The ACCC's preliminary view was that a full DORC revaluation is likely to be the most appropriate approach for valuing the RAB in the replacement IAU. The ACCC sought stakeholder submissions on ARTC's proposal and the ACCC's preliminary view.

Specifically, the issues paper states:[13]

> *ARTC has not been able to provide the documentation necessary for the ACCC to progress with a RAB roll forward in the replacement IAU, in particular, documentation to demonstrate capex prudency. The ACCC is concerned that even with additional time ARTC may not be able to provide the information necessary for the ACCC to undertake a robust RAB roll forward. In the absence of this information, the ACCC is considering alternative approaches to determine what capex is and is not considered prudent under a RAB roll forward, such as calculating and applying a benchmark to determine what proportion of capex is included in the RAB. However, the ACCC considers this process will be very complex and will require the ACCC to make assumptions where there are information gaps.*
>
> *Additionally, the ACCC considers an efficient RAB roll forward should exclude all replacement expenditures incurred over the term of the 2008 IAU, given these expenditures should have been expensed, not capitalised, under the 2008 IAU perpetual RAB model. However, this process will require the ACCC to apply complex adjustments to ARTC's proposed RAB roll forward in the 2018 IAU. At this stage, the ACCC is unsure what adjustments will need to be made to the RAB under a RAB roll forward, and what assumptions will need to be made to support those adjustments. The ACCC is concerned that, where there are information gaps, it will need to make a number of assumptions that may not be robust. The ACCC considers that for the purpose of regulatory certainty and consistency, a RAB roll forward is the best approach to setting the opening RAB in a new regulatory period. However, given the extent of information required, the risk that the required information may not be available even within an extended time period and the assumptions and complex adjustments that the ACCC will need to make to roll forward the RAB, the ACCC has formed a preliminary view that a full DORC revaluation is likely to be a more appropriate option for valuing the RAB in the replacement IAU.*

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12 ACCC, *Issues paper: Valuation approach for the Interstate network*, 12 September 2019.

13 Ibid, pp. 2–3.

3. ACCC approach

Consistent with the preliminary views set out in the issues paper, the ACCC considers that a full DORC valuation, with the ACCC engaging a consultant to undertake the valuation, is the more appropriate option for valuing the RAB in the replacement IAU.

The ACCC has considered the appropriate valuation approach for the replacement IAU prior to ARTC formally submitting an undertaking application under Part IIIA of the Act. The ACCC considers that engaging on the issues associated with the valuation approach is an important step in ARTC progressing its replacement IAU application for formal submission.

The ACCC will make a formal decision on the RAB valuation approach, together with ARTC's other proposals, once ARTC formally submits its replacement IAU. However, the ACCC will have regard to all submissions received to the ACCC's issues paper as part of the ACCC's formal assessment of ARTC's replacement IAU. Given this, the ACCC has had regard to the relevant matters for assessing a Part IIIA access undertaking set out in section 44ZZA(3) of the Act, as an objective framework in forming its view on the most approach valuation approach for setting the RAB in the replacement IAU.

In response to the issues paper, the ACCC received submissions from the following parties:

- Arc Infrastructure
- Bowmans Rail
- Genesee & Wyoming Australia (**GWA**)
- Metro Trains Melbourne
- Pacific National (**PN**)
- Qube Logistics (**Qube**)
- SCT Logistics
- Southern Shorthaul Railroad (**SSR**)
- Sydney Rail Services (**SRS**)
- V-Line

In reaching its view, the ACCC has considered the views expressed in each of these submissions. This chapter sets out the ACCC's assessment of:

- the appropriate valuation approach
- the impact of a revaluation on Access Charges
- the appropriate party to manage the valuation process.

3.1. Valuation approach

Stakeholder submissions

The majority of stakeholders that provided submissions in response to the ACCC's issues paper support the ACCC's preliminary view, that a full DORC revaluation is preferable to a RAB roll forward.

In particular, Arc Infrastructure[14], Bowmans Rail[15], GWA[16], Metro Trains Melbourne[17], SRS[18] and V-Line[19] note their support for the ACCC's preliminary view.

SSR agrees with the ACCC's preliminary view that the RAB roll forward approach is not feasible, and that the full DORC revaluation approach is robust and transparent.[20] However, also notes that:[21]

> *There are concerns over how substantial the DORC may be, however it is noted that the ACCC is requesting to manage the process.*

Similarly, Qube agrees with the ACCC's preliminary view that regarding the unreliability of information to support a RAB roll forward, noting that it supports a full DORC revaluation approach.[22] However, Qube also states that:[23]

> *The DORC method that uses the 2019 replacement cost of the Interstate rail network has the potential to result in a significantly higher value than a valuation based on the RAB roll forward method. Qube is concerned to the extent that higher access prices may be justified as a result.*

Additionally, Qube states that following the full DORC revaluation, the RAB roll forward methodology should be used for future IAU applications, '[s]ubject to a sound methodology and the keeping of reliable records in the interim period'.[24]

SCT Logistics considers that ordinarily a RAB roll forward is the preferred approach, stating:[25]

> *Our preferred view is to adopt a RAB roll forward as this has regard for the investments made and paid for by ARTC in developing and upgrading the rail network. We also feel a RAB roll forward is a more reasonable basis of measurement to which the network owner should establish access prices and rate of financial return. Additionally, a RAB roll forward should ordinarily reflect that condition of the asset base through the depreciation rates and effective lives adopted through the roll forward process.*

However, SCT Logistics acknowledges that:[26]

> *Having regard to our preference outlined in question 1, we read with interest the ACCC comments on some of the challenges experienced to date with ARTC providing sufficient evidence and justification to support the RAB roll forward of $10 billion for the 2018 IAU. We acknowledge that the current 2018 IAU assessment process has now been going on for a significant period of time. We further hold the view that if the period was to be extended further, we still find it somewhat unlikely*

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[14] Arc Infrastructure, *Response to the ACCC Issues Paper – Valuation approach for the ARTC Interstate Network*, 4 October 2019, pp. 1–6.

[15] Bowmans Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, pp. 1–2.

[16] Genesse & Wyoming Australia, *Submission – Valuation approach for the Interstate Network*, 4 October 2019, p. 1.

[17] Metro Trains Melbourne, *RE: Issues Paper – Valuation approach for the Interstate network*, 10 October 2019, p. 1.

[18] Sydney Rail Services, *RE: ARTC – Interstate Access Undertaking – Update*, 2 October 2019, p. 1.

[19] V-Line, *RE: Consultation on the most appropriate valuation approach for setting the Regulatory Asset Base (RAB) in the replacement Interstate Access Undertaking (IAU)*, 4 October 2019, p. 1.

[20] Southern Shorthaul Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, pp. 1–2.

[21] Ibid, p. 2.

[22] Qube Logistics, *Re: ARTC IAU – RAB Valuation Method*, 1 October 2019, pp. 1–2.

[23] Ibid, p. 2.

[24] Ibid, p. 1.

[25] SCT Logistics, *Issues Paper – Valuation approach for the Interstate Network*, 3 October 2019, p. 1.

[26] Ibid.

> *that ARTC will be able to produce any further substantial evidence to provide the comfort and justification sought by ACCC. Additionally, concerning to us would be that ACCC, in conjunction with ARTC, continue to pursue a RAB roll forward and at a later point in time still form the view that sufficient evidence and justification to support the RAB roll forward was not available. To us this would be a waste of regulatory time and cost.*

As such, SCT Logistics considers that undertaking a full DORC revaluation is 'the only reasonable and practical alternative to establishing a RAB for the replacement IAU'.[27] However, SCT Logistics consider that the full DORC revaluation should:[28]

- exclude any components of the network funded by government grants
- exclude any components of the network, in full or part, funded by users under an arrangement with ARTC.

PN states it is strongly against a full DORC revaluation of the Interstate network, as it would result in the following:[29]

- Allowing ARTC to include the value of investments made over the term of the 2008 IAU without any economic justification as required under the 2008 IAU.
- A significant windfall gain to ARTC as the Interstate network would be valued at a materially higher value compared with the 2001 RAB valuation (escalated to 2006) due to the increase in construction costs over this period.
- Allowing ARTC to include the value of assets funded by Australian Government grants and / or justified based on benefits to non-freight users.

On the first point, PN notes its concern that:[30]

> *An asset revaluation today would determine a replacement cost based on available benchmarks such as the inland rail business case and the cost of work completed by ARTC on the interstate network in recent years.*

By way of example, PN states:[31]

> *The 2008 DORC valuation resulted in the ARTC network being valued at $1,052,327 per kilometre in 2006 dollars (ACCC, Review of ARTC DORC Valuation, March 2008, Table 6.1). This has* [sic] *figure has been escalated by ARTC using CPI to around $1.2m in 2019. The Inland Rail study estimated the cost per kilometre of the network to be approximately $4,154,800 in 2014 dollars (ARTC Inland Rail Business Case, Table 0.4 – Capital cost $6,926m; length 1,667m). If this figure is escalated by CPI to 2019 it equates to $4.4m, over 3 times higher than the basis of the ARTC valuation.*

On the second point, PN states that a full DORC revaluation will allow for assets that were built, without evidence of prudency as required under the 2008 IAU, to be included in the RAB, stating this:[32]

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27 Ibid, p. 2.

28 Ibid.

29 Pacific National, *ACCC Issues Paper, 'The most appropriate method for valuing ARTC's Regulated Asset Base for the Defined Interstate Rail Network?'*, 15 October 2019, p. 8.

30 Ibid, p. 9.

31 Ibid.

32 Ibid.

> *…creates considerable regulatory uncertainty. It also presents a material risk that assets which were not built prudently, based on the economic merits of the investment at the time will be included in the asset base because the terms of the asset valuation do not allow it to be optimised.*

On the third point, PN notes its concern that a full DORC revaluation will allow assets funded by government grants in response to the global financial crisis to be included in the RAB, stating that:[33]

> *… the investment decisions were primarily based on their ability to prop up the Australian economy. In the case of many other projects, the investments were justified on economic grounds which typically include benefits outside of the rail sector itself. For example, these projects provide associated benefits for road users or the environment which fall outside of the commercial decision making of a rail operator.*

Rather than a full DORC revaluation, PN considers that the RAB should be valued using the 2008 IAU opening RAB and making an adjustment for the following:[34]

- An increase from the value of new Segments (Queensland Border to Acacia Ridge, SSFL and MFN) based on DORC valuations, taking into account whether the new Segments were 'transferred (in part or in full) via the payment of a peppercorn lease agreement ($1) and predicated based on future investment to be undertaken by ARTC in future periods.'
- A decrease from the value of any assets disposed over the term of the 2008 IAU.
- Other investments classified as 'sustaining capex' being excluded from the RAB unless ARTC can demonstrate the new assets:
  - resulted in material additions to the network leading to a significant uplift in rail freight volume being hauled across the Interstate network
  - resulted in improved operational performance of rail freight rolling stock
  - were prudently built, supported by an independently assessed business case, and not funded by government grants.

PN also notes that broadly speaking, it considers neither a DORC revaluation nor RAB roll forward is necessary, stating:[35]

> *…the use of a DORC valuation is historically justified because it provides the most appropriate means of avoiding the circularity that is derived when the DORC value is used to derive a price. Given the prices on the interstate network have been increased at CPI for at least 10 years and are forecast to continue to increase at this rate in the future, independent of investment in the network this argument appears to be redundant. If the regulatory asset base is to be reset, rather than a simple DORC revaluation, consideration should be given to basing the value of the asset base on the discounted value of future cashflows based on these prices.*

ACCC view

The ACCC considers that a full DORC revaluation is the most appropriate approach to valuing the RAB for the replacement IAU. The ACCC considers that compared with the alternative option of rolling forward the RAB, a full DORC revaluation will promote the

33 Ibid, p. 10.

34 Ibid, pp. 12–3.

35 Ibid, p. 15.

economically efficient operation of, use of and investment in the Interstate network, is in ARTC's legitimate business interests and promotes the interests of those seeking to access the Interstate network by providing clarity and certainty in the operation of the IAU (sections 44ZZA(3)(aa), (a) (c) and (e)).

In this section, the ACCC sets out its views in respect of the concerns and proposals raised by stakeholders about undertaking a full DORC revaluation. In particular:

- how the full DORC revaluation may:
    - include assets funded by government grants in the RAB
    - include capex that may be assessed as imprudent under a RAB roll forward, and replacement expenditure, in the RAB
    - lead to ARTC experiencing windfall gains
- an alternative approach to calculating the RAB roll forward
- expectations for future IAU applications.

Assets funded by government grants

As noted above, SCT Logistics considers a full DORC revaluation is the only reasonable and practical option for valuing the RAB in the replacement IAU, however considers the valuation should exclude investments funded by government grants or access seekers under arrangement with ARTC.[36]

PN is also concerned that under a full DORC revaluation, assets funded by government grants over the term of the 2008 IAU will be included in the RAB.[37]

The ACCC notes that in the 2018 IAU, ARTC sought to include $581 million of capex funded by government grants into the RAB without providing information demonstrating it was required to earn a commercial return on that expenditure.[38] The ACCC considers that as a general principle, assets funded by government grants should be excluded from the RAB, unless ARTC can provide supporting documentation demonstrating that ARTC was required to earn a commercial return on that funding. The ACCC considers it inappropriate to include capex into the RAB that was intended by government to achieve non-commercial objectives, such as funding intended to address externalities.

The ACCC will need to consider the balance between the economic efficiency benefits of excluding assets funded by government grants, with the uncertainty and complexity of identifying and removing these assets, given the extent of information gaps in respect of expenditure incurred by ARTC over the term of the 2008 IAU. The ACCC considers that where government grants have contributed to discrete and separable assets, these may be able to be excluded from the RAB following the DORC revaluation. Where government grants have contributed to non-separable and indivisible assets, these assets will likely need to be included in the RAB as it will be difficult to distinguish between what proportion was, and was not, funded by government grants.

The ACCC expects that the replacement IAU should set out clear and transparent capitalisation rules in respect of how ARTC will treat grants (or gifted funds), including what supporting documents ARTC will provide to the ACCC to demonstrate it should earn a

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36 SCT Logistics, *Issues Paper – Valuation approach for the Interstate Network*, 3 October 2019, p. 2.

37 Pacific National, *ACCC Issues Paper, 'The most appropriate method for valuing ARTC's Regulated Asset Base for the Defined Interstate Rail Network?'*, 15 October 2019, pp. 9–10.

38 ACCC, *Draft decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2019, pp. 85–6.

commercial return on that expenditure. The ACCC considers this will promote clarity and certainty in the operation of the IAU, which is additionally in the legitimate business interests of ARTC and the interests of those seeking access to the Interstate network (sections 44ZZA(3)(e), (a) and (c)).

The ACCC notes SCT's request that assets funded by access seekers be excluded from the RAB. The ACCC understands that there are no assets on the Interstate network that have been funded by access seekers, but seeks confirmation from stakeholders and ARTC.

Capex and replacement expenditure

In addition to noting its concern with government grants, PN does not consider a full DORC revaluation is appropriate as it would result in investments made over the term of the 2008 IAU being included in the RAB without any economic justification.

The ACCC acknowledges PN's concern that a full DORC revaluation will allow ARTC to include the expenditure into the RAB without economic justification as required under the 2008 IAU. The ACCC acknowledges that under a DORC revaluation, historic expenditure will not be assessed for prudency. Given ARTC has undertaken a large program of capex over the term of the 2008 IAU, a full DORC revaluation is likely to include a large proportion of this capex in the RAB in the replacement IAU. Similarly, ARTC has undertaken an extensive replacement expenditure program over the term of the 2008 IAU, which is likely to increase the remaining life of some track assets under a full DORC revaluation.

However, the ACCC notes that under the perpetual RAB model in the 2008 IAU, ARTC did not earn any revenue for depreciation of any expansion capex in the RAB over the term of the 2008 IAU. Under the full DORC revaluation, these assets will be linearly depreciated. Additionally, a DORC revaluation will make adjustments for depreciation and optimisation, including adjusting for any redundant assets, over-design and over-capacity.[39]

As set out in the ACCC's issues paper, the ACCC considers the best alternative to doing a full DORC revaluation is to do a RAB roll forward with reference to ARTC's proposed RAB value in its 2018 IAU application. Due to the lack of information in respect of capex projects, the ACCC would need to consider an alternative approach to determine what historic capex is considered prudent and included in the RAB under a RAB roll forward. For example, a possible alternative approach would be to calculate and apply a benchmark to all capex projects that the ACCC has insufficient information on, to determine what proportion of capex is considered prudent and can be included in the RAB for the replacement IAU. Such a benchmark could be calculated based on a weighted average of cost-benefit analyses in respect of particular capex projects, which ARTC provided to the ACCC during the assessment of the 2018 IAU.[40]

However, as set out in the ACCC's issues paper, the ACCC considers that such a process is likely to be complex and may require the ACCC to make assumptions where there are information gaps. The ACCC continues to be unsure what adjustments will need to be made and what assumptions will need to be made to support those adjustments. The ACCC is concerned that where there are information gaps, it will need to make a number of assumptions that may not be robust.[41] Given this complexity, the ACCC considers a RAB roll forward does not promote clarity and certainty in the operation of the replacement IAU, which is not in the legitimate business interests of ARTC or in the interests of those seeking access to the Interstate network (sections 44ZZA(3)(e), (a) and (c)).

[39] ACCC, *Issues paper: Valuation approach for the Interstate network*, 12 September 2019, p. 20.

[40] Ibid, p. 18.

[41] Ibid.

Similarly, to identify and remove replacement expenditures, including corridor capital, and including gifted funds used for replacement expenditures, the ACCC will need to make complex adjustments to ARTC's financial model. This is particularly complicated where projects involved some costs related to expansion and some costs that should be considered replacement expenditure under the 2008 IAU perpetual RAB model. The ACCC is concerned such a process is likely to be complex and may require the ACCC to make assumptions where there are information gaps. At this stage, the ACCC continues to be unsure what adjustments will need to be made and what assumptions will need to be made to support those adjustments. The ACCC is concerned that where there are information gaps, it will need to make a number of assumptions that may not be robust.[42] Given this complexity and uncertainty, the ACCC considers a RAB roll forward does not promote clarity and certainty in the operation of the replacement IAU, which is not in the legitimate business interests of ARTC or in the interests of those seeking access to the Interstate network (sections 44ZZA(3)(e), (a) and (c)).

Potential for windfall gains to ARTC

The ACCC notes PN's concern that a full DORC revaluation will result in a significant windfall gain to ARTC due to the increase in construction costs over the period since the RAB was last valued. In particular, that ARTC's Inland Rail study could be used as a benchmark to justify a three-fold increase in the RAB value.[43]

The ACCC notes that PN is comparing the RAB value under a full DORC revaluation with the opening RAB value set in the 2008 IAU. The ACCC considers this is the incorrect reference point for the purpose of determining which valuation approach is most appropriate in setting the RAB in the replacement IAU. Rather, the RAB under a full DORC revaluation should be considered against the RAB under a roll forward. The ACCC notes that under either a full DORC revaluation or a RAB roll forward, the RAB will grow in nominal terms due to indexation, but notes PN's suggestion that inputs for the construction of rail have increased in real terms since the opening RAB in the 2008 IAU was set. In addition, the ACCC makes the following points:

- Under the perpetual RAB model in the 2008 IAU, ARTC did not earn any revenue for depreciation of any expansion capex in the RAB over the term of the 2008 IAU. Under the full DORC revaluation, these assets will be linearly depreciated, having a deflationary effect on the value of the RAB compared with the 2008 IAU RAB value.
- Under the 'optimisation' step of the DORC revaluation, the RAB will be adjusted for depreciation and redundant assets, including over-design and over-capex.

Additionally, as the ACCC will manage the valuation process, including engaging a consultant with rail engineering and economics expertise, the ACCC will ensure that the consultant applies a transparent and robust framework to determine the value of assets that are included in the RAB, and will ensure any benchmark analysis undertaken is appropriate.

Alternative RAB roll forward approach proposal

As an alternative to the RAB roll forward approach detailed in the ACCC's issues paper, PN set out how it considers the ACCC can undertake a RAB roll forward, by taking the 2008 IAU RAB value and making adjustments for:[44]

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42 Ibid, p. 20.

43 Pacific National, *ACCC Issues Paper, 'The most appropriate method for valuing ARTC's Regulated Asset Base for the Defined Interstate Rail Network?'*, 15 October 2019, p. 9.

44 Ibid, pp. 12–3.

- new Segments, subject to particular conditions, where the values are determined by DORC valuations
- disposals over the term of the 2008 IAU
- expenditure for which ARTC can demonstrate resulted in a significant uplift in rail freight volume being hauled across the Interstate network, improved rolling stock operational performance and / or is supported by an independent business case.

PN considers that all other expenditure spent by ARTC over the term of the 2008 IAU should be excluded from the RAB.

During, and following, the assessment of the 2018 IAU, the ACCC sought information from ARTC in order to assess what expenditure spent by ARTC over the term of the 2008 IAU should be rolled into the RAB under the requirements in the 2008 IAU.[45] In particular:

- ARTC proposed to roll in 104 capex projects at a cost of $2.8 billion into the RAB. In order to assess prudency of these capex projects, the ACCC sought evidence of actual capex incurred, decision documents for each project delivery phase, approval by ARTC's Business and Investment Committee and Board, cost-benefit analyses and evidence of effective engagement with industry including customer endorsement.[46]
- Based on ACCC analysis, ARTC sought to roll in approximately $1.5 billion of replacement expenditure into the RAB. Similarly, ARTC sought to roll in $340.5 million of corridor capital into the RAB. The ACCC considers that under the 2008 IAU perpetual RAB model, replacement expenditure, including corridor capital, should have been expensed rather than capitalised.[47]

During the assessment of the 2018 IAU, ARTC was not able to provide information in relation to 77 of the 104 capex projects undertaken over the term of the 2008 IAU.[48] While the ACCC notes that ARTC has provided additional information to the ACCC, consistent with the ACCC's requests in the 2018 IAU draft decision, the information provided is insufficient for the ACCC to assess the substantial majority of ARTC's proposed capex for inclusion in the RAB.

The ACCC understands that there were a number of reasons why ARTC has not provided the information requested by the ACCC, including that 'there was no requirement within the IAU for the ACCC to assess cost efficiency or capital prudency on an annual basis.'[49] The ACCC understands that some of this information may not exist, given ARTC's statement that it did not maintain records due to there being no requirement in the 2008 IAU to provide data to the ACCC on an annual basis to assess cost efficiency or capital prudency.

The ACCC notes PN's proposal that any expenditure, which ARTC cannot provide sufficient documentation in support of, be excluded from the RAB. Given the extent of projects for which the ACCC has no information about, and the quality of information provided to the ACCC so far on the remaining projects, the ACCC considers that under PN's proposal the majority of ARTC's proposed capex for inclusion in the RAB would be excluded. The ACCC considers this is unlikely to be appropriate.

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45 The ACCC issued two formal information requests to ARTC in May and September 2018, and sought further information from ARTC informally in May 2019.

46 ACCC, *Draft decision: Australian Rail Track Corporation's 2018 Interstate Access Undertaking*, 20 December 2019, pp. 72–83.

47 Ibid, pp. 83–5; 86–9.

48 Ibid, pp. 74; 79.

49 ARTC, *ARTC Public Response to ACCC information request dated 20 September 2018*, 30 October 2018, p. 2.

The ACCC considers it is likely that some of ARTC's proposed capex would have been incurred prudently, even though ARTC has been unable to provide documentation for those projects that demonstrates prudency. In particular, the ACCC notes ARTC's statement repeated above that it did not maintain records demonstrating cost efficiency and capex prudency because there was no requirement under the 2008 IAU to do so.[50] However, under PN's proposal, the majority of capex would be excluded from the RAB, including capex, which may have been incurred on a prudent basis. This will result in an inefficiently low RAB value, which does not promote the economically efficient operation of, use of and investment in the Interstate network (section 44ZZA(3)(aa)). Additionally, this will result in ARTC not earning a return on prudent investments it made over the term of the 2008 IAU, which is not in ARTC's legitimate business interests (section 44ZZA(3)(a)).

The ACCC notes PN's additional proposal that the RAB should be valued based on the discounted value of future cash flows, determined by existing Access Charges.[51] The ACCC notes that use of the DORC methodology is specifically required under the 2008 IAU[52], and that under the Part IIIA undertaking framework, ARTC would need to propose a change in the valuation methodology in a future IAU application for the ACCC to assess such a proposal.

Future IAU applications

The ACCC agrees with Qube's statement that following the full DORC revaluation for the replacement IAU, the RAB roll forward methodology should be applied in future IAU applications.[53]

Additionally, the ACCC expects that ARTC will maintain accurate and detailed records of its expenditure. In particular, the ACCC expects that the replacement IAU clearly set out the process for the annual RAB roll forward, including what sorts of information ARTC will provide to the ACCC on an annual basis, in order for the ACCC to undertake a prudency assessment for inclusion of capex in the RAB, and assess ARTC's annual RAB roll forward. The ACCC considers this is essential for promoting transparency and accountability in the RAB roll forward process, and ensuring ARTC maintains records of all relevant projects over the term of the replacement IAU.

Further, the ACCC expects that the replacement IAU should set out clear and transparent capitalisation rules in respect of what expenditures will be treated as capital and consequently rolled into the RAB, and what expenditures will be expensed. Additionally, how ARTC will treat grants (or gifted funds), including what supporting documents ARTC will provide to the ACCC to demonstrate it should earn a commercial return on that expenditure.

The ACCC considers this will promote clarity and certainty in the operation of the IAU, which is additionally in the legitimate business interests of ARTC and the interests of those seeking access to the Interstate network (sections 44ZZA(3)(e), (a) and (c)).

3.2. Access Charges

Stakeholder submissions

Several stakeholders made comments about the impact of the RAB valuation on Access Charges on the Interstate network.

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50 Ibid.

51 Pacific National, *ACCC Issues Paper, 'The most appropriate method for valuing ARTC's Regulated Asset Base for the Defined Interstate Rail Network?'*, 15 October 2019, p. 15.

52 Section 4.4(d) of the 2008 IAU.

53 Qube Logistics, *Re: ARTC IAU – RAB Valuation Method*, 1 October 2019, p. 1.

Bowmans Rail requests that:[54]

> *…once the full DORC assessments have been completed that there is further Stakeholder review on what impacts these valuations could have if any on future access charges.*

GWA reiterates ARTC's commitment that Access Charges will be independent of the RAB[55], noting that:[56]

> *…ARTC has committed to the Standing Offer tabled with customers regardless of the outcome of valuation method for the setting of the RAB in the replacement of the IAU, on which GWA will continue discussions with ARTC.*

Qube raises concerns about the impact of a RAB revaluation on Access Charges, if ARTC proposes a similar banded negotiate-arbitrate model in a future IAU application, noting:[57]

> *Qube is concerned that the valuation of the RAB when combined with a banded negotiate-arbitrate model creates the potential for rail access pricing to increase significantly when compared to present access pricing; thus, contributing to a worsening of rail freight competitiveness versus road freight.*
>
> *However, it is understood that further consultation with industry in relation to any proposed access pricing methodology, will be conducted by the ACCC prior to approval of an IAU. Thus, Qube is satisfied for now with the proposed ACCC approach and will await a future opportunity to comment on pricing in greater detail.*

Similarly, SSR notes ARTC's commitment that Access Charges would be independent of the RAB[58], however raises concerns about Access Charges in future IAU applications:[59]

> *While the standing offer may be applicable for the next IAU period, there are always concerns over the ability of ARTC to 'hike-up' prices closer to the ceiling in future IAU applications. Rail freight operates in highly competitive markets against road transport and coastal shipping, and even small increases in track access can have significantly detrimental effect on the cost per tonne of rail freight transportation.*

SSR specifically notes that:[60]

> *Lack of commitment around access rates for train types such as 'ad hoc grain' will have a significant impact on regional grain customers and rail services especially during this severe drought, if these train types are removed from the standing offer come 1st July 2020.*

SCT Logistics considers that the DORC assessment should calculate the floor and ceiling such that passenger and freight services are differentiated, and consequently these services are appropriately priced.[61]

SCT Logistics also notes that it may be more appropriate to wait until a future IAU application to revalue the RAB, stating:[62]

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54 Bowmans Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, p. 1.

55 ARTC, *ARTC proposal to ACCC re Methodology for Revaluation of the Interstate Network*, 23 August 2019, p. 4.

56 Genesse & Wyoming Australia, *Submission – Valuation approach for the Interstate Network*, 4 October 2019, p. 1.

57 Qube Logistics, *Re: ARTC IAU – RAB Valuation Method*, 1 October 2019, p. 2.

58 ARTC, *ARTC proposal to ACCC re Methodology for Revaluation of the Interstate Network*, 23 August 2019, p. 4.

59 Southern Shorthaul Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, p. 1.

60 Ibid, p. 2.

61 SCT Logistics, *Issues Paper – Valuation approach for the Interstate Network*, 3 October 2019, p. 2.

Whilst we understand the regulatory process and the fact that the value will be utilised to determine the floor and ceiling, we also acknowledge the ARTC's undertaking to not change their published standing offer irrespective of the outcome of the RAB valuation. Therefore, after consideration of these two points we ask ourselves is the ACCC able to get comfortable, outside of a valuation, by comparing the standing offer published rates, existing floor and ceiling rate, anticipated floor and ceiling rates from a high and low valuation range threshold. Our view is that this should be able to be achieved and if so this extra regulatory cost and timing may be better dealt with when the proposed new IAU comes to its next expiry in 5 years' time. By doing this the 5 years of RAB roll forward and regulatory burden, for no real benefit can be avoided.

PN submits that given prices will not be set based on either the current or proposed valuations, it raises questions about how prices will be set in the future:[63]

To help facilitate ACCC and rail industry stakeholder consideration of the pricing framework to be included in the Replacement IAU, we commissioned NERA Economic Consulting to report on the regulatory rail freight pricing frameworks that exist across the European Union… The NERA report highlights, that across Europe, rail freight tariffs are priced to recover the marginal cost of rail access unless it can be shown that the freight commodity or rail corridor can operate commercially by paying more than this. This approach has been adopted to formalise European government's commitment to promoting rail freight. While this approach may not be directly applicable to Australia because of the size of the rail passenger market in Europe, a similar recognition of the wider benefits of rail freight in the pricing of the interstate network in Australia is clearly required.

While Arc Infrastructure considers that Access Charges should be informed by the full DORC revaluation in a future IAU application:[64]

Arc notes that ARTC have undertaken to leave access prices unchanged whilst the valuation issue is being determined, and during the DORC revaluation process in the event the DORC revaluation proceeds. This is an appropriate position which provides certainty in access pricing in the short term to ARTC's customers. In the mid to long term, Arc believes that the future RAB based on the DORC revaluation should inform access pricing.

ACCC view

The ACCC acknowledges the concerns raised by Bowmans Rail, GWA, Qube, SSR and PN relating to ARTC's future Access Charges. The ACCC notes that it has not yet made a decision on ARTC's proposed Access Charges, and that the ACCC will take into account the submissions made to the ACCC's issues paper as part of the formal assessment process, once ARTC submits its replacement IAU application. Stakeholders will have also have the opportunity to submit again as part of that formal assessment process.

The ACCC encourages ARTC to consider the concerns raised by stakeholders in submissions to the ACCC's issues paper prior to drafting the replacement IAU and submitting it for ACCC assessment.

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62 Ibid, p. 3.

63 Pacific National, *ACCC Issues Paper, 'The most appropriate method for valuing ARTC's Regulated Asset Base for the Defined Interstate Rail Network?'*, 15 October 2019, pp. 15–6.

64 Arc Infrastructure, *Response to the ACCC Issues Paper – Valuation approach for the ARTC Interstate Network*, 4 October 2019, p. 5.

The ACCC notes SCT's request that the floor and ceiling calculations from the full DORC revaluation differentiate between passenger and freight services. The ACCC notes that the floor and ceiling calculations arising from the full DORC revaluation will not differentiate between users. That is, ARTC's compliance against the ceiling test in the 2008 IAU will be calculated based on the total revenue from the group of users that use a Segment, against that Segment Floor and Ceiling Limit.[65]

However, it is open to ARTC to propose Access Charges in its replacement IAU that differentiate between services with different characteristics.

While ARTC has committed to set Access Charges in its replacement IAU application independent of the RAB valuation approach and RAB value[66], the RAB value could potentially have an effect on Access Charges in future regulatory periods.

In assessing ARTC's proposed Access Charges in the replacement IAU, and in future regulatory periods, the ACCC will have regard to where ARTC's revenue sits between the Floor and Ceiling Limits[67], as well as the relevant matters under section 44ZZA(3), including:

- regulated access prices should be set so as to generate expected revenue for a regulated services that is at least sufficient to meet the efficient costs of providing access to the regulated service (section 44ZZCA(a)(i))
- access price structures should allow multi-part pricing and price discrimination when it aids efficiency (section 44ZZCA(b)(i)
- assessing whether ARTC's proposed Access Charges:
    - promote the economic efficient operation of, use of and investment in the Interstate network (section 44ZZA(3)(aa))
    - are in ARTC's legitimate business interests (section 44ZZA(3)(a))
    - are in the interests of those seeking access to the Interstate network (section 44ZZA(3)(c)).

The ACCC notes SCT's suggestion that, given ARTC has committed to setting Access Charges independent of the valuation of the RAB, that the most appropriate RAB valuation approach may be better dealt with as part of an IAU in five years' time, rather than the replacement IAU. ARTC has stated that the Inland Rail project is likely to be completed in 2025, and will have a significant impact on the provision and competitiveness of services on the Interstate network.[68] The ACCC understands that ARTC may seek to roll in new Segments associated with Inland Rail, as part of a future IAU application. The ACCC considers it is preferable to resolve outstanding issues with the RAB valuation from the 2008 IAU term and establish clear rules and expectations around record keeping, annual reporting and capitalisation rules, prior to the introduction of Inland Rail. The ACCC considers this will promote clarity and certainty in the operation of the Interstate network (section 44ZZA(3)(e)).

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[65] Section 4.4(a) of the 2008 IAU.

[66] ARTC, ARTC proposal to ACCC re Methodology for Revaluation of the Interstate Network, 23 August 2019, p. 4.

[67] Under section 4.4(a) of the 2008 IAU, revenue earned from Access Charges must be above the Floor Limit (unless agreed by ARTC) and below the Ceiling Limit.

[68] ARTC, *2018 Interstate Rail Network Access Undertaking – Explanatory Guide*, 6 March 2018, p. 21.

3.3. Valuation process

Stakeholder submissions

The ACCC's preliminary view as set out in its issues paper was that if the Interstate network is revalued using the DORC methodology, the ACCC, rather than ARTC, should manage the revaluation process, including engaging a consultant with rail engineering and economics expertise. In submissions to the issues paper, stakeholders have not raised any concerns with the ACCC's preliminary view.

Qube[69], GWA[70], Bowmans Rail[71], SSR[72], SCT Logistics[73], and PN[74] all express their support for the ACCC's preliminary view.

PN states that:[75]

> *…the ACCC should engage suitably experienced engineering and accounting firms to undertake the task rather than rely on ARTC and/or any ARTC appointed engineering and accounting consultants.*

Arc Infrastructure considers that given the significance of the valuation, the ACCC and ARTC should jointly facilitate the process of undertaking the valuation:[76]

> *Arc suggests that it would be prudent for ARTC and the ACCC to confer and select a suitably qualified and independent consultant to undertake the valuation. Arc agrees that the setting of the RAB is significant, and as such ARTC and the ACCC should facilitate the process jointly.*

Bowmans Rail express a similar view, noting that while the ACCC should manage the process, it is important to ensure ARTC has some ownership of the outcome of this process:[77]

> *…we think that is appropriate after the ARTC have input into the scope for the appointment so that ARTC have some ownership in the outcome. We would like to see the ARTC are involved in the governance throughput* [sic] *the selection and delivery of the project as a key stakeholder and our representative to ensure ownership of the outcome.*

SCT Logistics submits that ARTC should be engaged throughout the process to ensure there are no misinterpretations at the end of the process:[78]

> *We would see it imperative that the following principles be considered as part of the brief/scope… Engagement with ARTC throughout the process to ensure that there are no expectation gaps or misinterpretation to the outcome delivered on completion.*

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69 Qube Logistics, *Re: ARTC IAU – RAB Valuation Method*, 1 October 2019, p. 2.

70 Genesee & Wyoming Australia, *Submission – Valuation approach for the Interstate Network*, 4 October 2019, p. 1.

71 Bowmans Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, p. 2.

72 Southern Shorthaul Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, p. 2.

73 SCT Logistics, *Issue Paper – Valuation approach for the Interstate Network*, 3 October 2019, p.3.

74 Pacific National, *ACCC Issues Paper, 'The most appropriate method for valuing ARTC's Regulated Asset Base for the Defined Interstate Rail Network?'*, 15 October 2019, p. 14.

75 Ibid.

76 Arc Infrastructure, *Response to the ACCC Issues Paper – Valuation approach for the ARTC Interstate Network*, 4 October 2019, p. 6.

77 Bowmans Rail, *Submission to ACCC's issues paper on RAB valuation*, 4 October 2019, p. 2.

78 SCT Logistics, *Issue Paper – Valuation approach for the Interstate Network*, 3 October 2019, p.3.

ACCC view

Considering the submissions to the issues paper are largely supportive of the ACCC managing the valuation process, the ACCC's view is consistent with the preliminary view expressed in the issues paper.

The ACCC considers that the valuation process represents just one aspect of the broader replacement IAU process, and that ARTC has ownership over the decision to submit a replacement IAU for the ACCC's assessment. Therefore, it is critical that ARTC endorses the outcome of this valuation process. The views expressed by Arc Infrastructure, Bowmans Rail and SCT Logistics in submissions reflect this concern.

However, the ACCC also considers that to preserve the integrity of the valuation, it is critical that the terms of engagement of a consultant remain independent. Allowing ARTC to provide input into the request for quote would compromise the independence of this process, which could potentially have an impact on the economic efficiency of the outcome of the valuation process.

However, once a consultant is engaged to undertake the valuation, the consultant will be required to work closely with ARTC staff to acquire the information necessary to carry out the valuation. This means that the ACCC will need ARTC to be engaged and involved throughout the valuation process.

The ACCC considers that this balancing act of ensuring ARTC's involvement in the process, and preserving the independence of the process, represents the approach most consistent with the statutory criteria for assessing a Part IIIA access undertaking. Specifically, ensuring ARTC is involved in the valuation process is consistent with ARTC's legitimate business interests (section 44ZZA(3)(a)) and maintaining the independence of the valuation process promotes the economically efficient operation of, use of and investment in the Interstate Network, which is also in the interests of those seeking access to the Interstate network (sections 44ZZA(3)(aa) and (c)).

4. Next steps

4.1. Expiry of the 2008 IAU

The 2008 IAU is currently due to expire on 30 June 2020.

On 29 July 2019, ARTC applied to vary its 2008 IAU to extend the period for which the 2008 IAU is in operation–from 29 February 2020 to 30 June 2020. On 26 September 2019, the ACCC issued a notice to extend the period of the 2008 IAU until 30 June 2020.

In ARTC's 29 July 2019 application, it stated that:[79]

> *This extension is requested to ensure enough time for ARTC to resolve the outstanding asset valuation methodology issues with the ACCC and then* [submit] *a renewed IAU consistent with the issues raised by the ACCC in their Draft Decision on the withdrawn 2018 IAU published on 20 December 2018 and ensuring the renewal IAU is approved and commences from 1 July 2020.*

4.2. Valuation of the RAB

The ACCC now seeks a public commitment from ARTC that it will constructively engage with the ACCC and its consultant, so the consultant can undertake its assessment. Further, once the valuation is completed, that ARTC will adopt the ACCC's RAB value in the financial model that accompanies its replacement IAU application and will accept the RAB value as a basis in future IAU applications, with appropriate RAB roll forward mechanisms in place. Once ARTC provides this public commitment, the ACCC will engage a consultant with rail engineering and economics expertise to undertake the valuation.

As flagged in the ACCC's issues paper, the ACCC expects this process is likely to take at least 6 months to finalise.[80] When available, the ACCC will publish the consultant's draft report and provide stakeholders the opportunity to make a submission to the ACCC on the draft report.

4.3. Replacement IAU

The ACCC considers there is likely to be a number of proposals in ARTC's replacement IAU, which the ACCC will not be able to form a view on until the RAB valuation is undertaken. In particular, proposals relating to Access Charges and an annual reporting framework. This is because the ACCC's assessment is likely to be impacted by where ARTC's revenue is sitting against its Floor and Ceiling Limits, which cannot be calculated until the RAB value is known. As such, the ACCC encourages ARTC to submit its replacement IAU for ACCC assessment once the RAB valuation is complete.

Given the above and the outstanding issues to be addressed from the assessment of the 2018 IAU, the ACCC considers the timeframe for assessing the replacement IAU prior to the current expiry date of the 2008 IAU on 30 June 2020, is extremely tight. As such, the ACCC encourages ARTC to consider submitting another application to extend the term of the 2008 IAU to ensure there is regulatory certainty over the terms of access to the Interstate network during the assessment of the replacement IAU. The length of a further extension required will become clear once the DORC consultant has been engaged.

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79 ARTC, Australian Rail Track Corporation Ltd, *RE: 2008 Interstate Access Undertaking Extension Application to the ACCC*, 29 July 2019, p. 1.

80 ACCC, *Issues paper: Valuation approach for the Interstate network*, 12 September 2019, p. 21.

The ACCC encourages ARTC and stakeholders to constructively engage with each other to resolve other key issues of concern, prior to ARTC formally submitting its replacement IAU application. This approach will reduce the number of unresolved issues in ARTC's replacement IAU application, and accelerate the ACCC's formal assessment process.

5. Legal framework

As ARTC has not yet formally submitted the replacement IAU to the ACCC for assessment under section 44ZZA(1) of the Act, the ACCC undertook consultation and formed its approach in preparation for the formal assessment process under section 44ZZBD of the Act. The approach taken to value the RAB will be a key input in ARTC's replacement IAU application and the ACCC will likely have regard to submissions received in response to the issues paper in the formal assessment process. As such, in considering submissions to the issues paper and forming view on the valuation approach, the ACCC has had regard to the matters set out in section 44ZZA(3) of the Act, as it would in assessing a formal application under section 44ZZA(1) of the Act.

Section 44ZZA(3) of the Act provides that the ACCC may accept an access undertaking if it thinks it appropriate to do so, having regard to the following matters:

- the objects of Part IIIA of the Act, which are to:
  - promote the economically efficient operation of, use of and investment in the infrastructure by which the 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, 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
- access price structures should:
  - allow multi-part pricing and price discrimination when it aids efficiency, and
  - not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operations is higher, and
- access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.