

AUSTRALIAN RAIL TRACK CORPORATION LTD
APPLICATION TO VARY THE HUNTER VALLEY COAL NETWORK ACCESS UNDERTAKING
(VARIED ON 17 OCTOBER 2012) TO PROVIDE FOR THE INCORPORATION OF GAP TO
TURRAWAN SEGMENTS IN THE NETWORK

SUPPORTING DOCUMENTATION



24 MARCH 2014

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1. Executive Summary

Terms used in this supporting document are as per the definitions in ARTC's Hunter Valley Coal Network Access Undertaking accepted by the ACCC on 29 June 2011 (2011 HVAU) and varied on 17 October 2012 (2012 HVAU) unless otherwise obvious from the context.

1.1 Background & Context: Relevant development of ARTC's 2011 HVAU

In June 2011, the 2011 HVAU lodged by ARTC was accepted by the ACCC. This followed previous versions lodged with the ACCC in April 2009, September 2010 and April 2011 that were subject to a substantial level of consultation and ACCC review. The Network contemplated under the 2011 HVAU was as prescribed at Schedule E of the 2011 HVAU and, in broad terms, included:

- Newcastle Ports to Bengalla (via Newcastle coal lines only) including entry and exit roads to the ports to and from coal facilities south of Newcastle (referred to as Pricing Zone 1);
- Muswellbrook to Ulan (referred to as Pricing Zone 2); and
- Muswellbrook to Gap (referred to as Pricing Zone 3).

The Network prescribed in the 2011 HVAU has not been altered.

In October 2012 the ACCC accepted an application by ARTC to vary the 2011 HVAU to, in broad terms, establish the Initial Indicative Service and Initial Indicative Access Charge to apply in existing Pricing Zones under the 2011 HVAU. The access undertaking incorporating these variations is the 2012 HVAU.

1.2 Application to vary the 2012 HVAU to incorporate Gap to Turrawan Segments

In seeking coverage of the Hunter Valley coal network under the Competition and Consumer Act 2010 (CCA Act) ARTC has sought to include those parts of the Hunter Valley rail network on which coal is substantively carried to the extent that that network is managed by ARTC, and can be covered under the CCA Act.

During most of the ACCC consultation and acceptance period for the 2011 HVAU, ARTC did not manage the Hunter Valley rail network beyond Gap to the extent needed to contemplate coverage under the CCA Act. At that time, this part of the network was controlled by the Country Rail Infrastructure Authority (CRIA) and was covered, for the purposes of economic regulation, under the

NSW Rail Access Undertaking (NSWRAU). Since that time, ARTC has commenced a lease of certain parts of the CRIA network north of Gap and is now in a position to seek coverage for this part of the network under the CCA Act. Under this lease, ARTC is required to apply to the ACCC for coverage of relevant parts of its network under the CCA Act. Until such coverage is approved, the provisions of the NSWRAU will continue to apply. The rail infrastructure between Gap and Turrawan is required in order to meet the needs of Gunnedah Basin coal mines north of Gap.

This application seeks to vary the 2012 HVAU to incorporate Segments between Gap and Turrawan (Additional Segments) in the Network, prescribed at Schedule E of the varied access undertaking as:

- Gap (416.000 km) to Watermark (447.1 km);
- Watermark (447.1 km) to Gunnedah (480.075 km);
- Gunnedah (480.075 km) to Boggabri (521.455 km); and
- Boggabri (521.455 km) to Turrawan (548.485 km).

The Additional Segments service the Gunnedah Basin coal mines Gunnedah, Boggabri and Narrabri, and proposed developments at Watermark and Maules Creek.

This application represents a revision to an earlier application to vary the HVAU to incorporate the Additional Segments made on 28 June 2013 and subsequently withdrawn on 20 January 2014 (Initial Application). This application has been submitted following extensive consultation with relevant stakeholders (both directly and through the ACCC's consultation process) as well as with the ACCC following both formal and informal information requests and the release of a position paper (Position Paper). ARTC considers that it has addressed the issues and concerns raised by the ACCC during its assessment of the Initial Application. ARTC has elected not to duplicate the information provided in the Initial Application in this application and supporting documents. Instead ARTC will provide detail in relation to the amendments made to the Initial Application following stakeholder consultation and ACCC review.

This variation seeks to incorporate the Additional Segments into the Network and be subject to the provisions in the HVAU on and from 1 January 2014. These provisions include:

- Section 4 Pricing Principles;
- Section 13.1 Network Performance Indicator Reporting;
- Clause 5.4 of Annexure A Calculation of TOP Rebate and Ad-Hoc Charge Rebate;
- Schedule 2 of Annexure A System Wide True Up Test; and

- Schedule 3 of Annexure A Charges

ARTC has sought these provisions to become operative from this date in order to align to the 2014 calendar year, consistent with timing for a range of ARTC's obligations under the 2012 HVAU including pricing, contractual entitlements and performance reporting.

Key elements of this application include:

- extension of the existing Pricing Zone 3 under the 2012 HVAU to incorporate the Additional Segments into the Network;
- the operation of provisions in the HVAU applicable to the Additional Segments on and from 1 January 2014;
- adjustments to an asset valuation with respect to the Additional Segments prepared in accordance with the 2012 HVAU and treated consistently with previous asset valuations accepted under the 2011 HVAU that has been reviewed by the ACCC in light of stakeholder submissions;
- Initial Indicative Access Charges for Initial Indicative Services applicable to the extended Pricing Zone 3 for the 2014 calendar year; and
- the provision of additional information to relevant Access Holders under section 4.20 of the HVAU to assist with pricing transparency.

Extension of the existing Pricing Zone 3 will result in a number of advantages and efficiencies as all obligations provided under the 2012 HVAU will be applicable to the extended Pricing Zone 3 including:

- the loss capitalisation mechanism incorporated in the 2012 HVAU;
- the remaining mine life approved under the 2012 HVAU;
- Network KPI reporting; and
- the system-wide true-up test.

Further detail in relation to these key elements is provided in section 4 of this supporting document.

2. Relevant Development of ARTC's Hunter Valley Access Undertaking

2.1 2011 HVAU

In June 2011, the 2011 HVAU lodged by ARTC was accepted by the ACCC. This followed previous versions lodged with the ACCC in April 2009, September 2010 and April 2011 that were subject to a substantial level of consultation and ACCC review. The Network contemplated under the 2011 HVAU was as prescribed at Schedule E of the 2011 HVAU and, in broad terms, included:

- Newcastle Ports to Bengalla (via Newcastle coal lines only) including entry and exit roads to the ports to and from coal facilities south on Newcastle (referred to as Pricing Zone 1);
- Muswellbrook to Ulan (referred to as Pricing Zone 2); and
- Muswellbrook to Gap (referred to as Pricing Zone 3).

2.2 2012 HVAU

In October 2012 the ACCC accepted an application by ARTC to vary the 2011 HVAU to, in broad terms, establish the Initial Indicative Service and Initial Indicative Access Charges to apply in existing Pricing Zones under the 2011 HVAU. The access undertaking incorporating these variations is the "2012 HVAU".

A related outcome of the variation included the establishment and publication of Charges to apply to non-Indicative Services in each Pricing Zone.

This variation had no impact on the definition of the Network covered in the 2011 HVAU.

ARTC negotiated access pricing for coal services to apply to sections of the Hunter Valley rail network north of Gap, which did not fall within the definition of Network under the 2012 HVAU. These negotiations were covered by the provisions of the NSWRAU. Access pricing was negotiated with respect to existing coal train configurations operating north of Gap that are identical to the Initial Indicative Services prescribed under the 2012 HVAU, as well as non-Indicative Services.

3. Additional Segments

In seeking coverage of the Hunter Valley coal network under the CCA Act it has always been ARTC's intention to include those parts of the Hunter Valley rail network on which coal is substantively carried to the extent that that network is managed by ARTC, and can be covered under the CCA Act.

During most of the ACCC consultation and acceptance period for the 2011 HVAU, ARTC did not manage the Hunter Valley rail network beyond Gap to the extent needed to contemplate coverage under the CCA Act. At that time, this part of the network was controlled by CRIA and was covered, for the purposes of economic regulation, under the NSWRAU. Since that time, ARTC has commenced a lease of certain parts of the CRIA network north of Gap and is now in a position to seek coverage for this part of the network under the CCA Act. Under this lease, ARTC is required to apply to the ACCC for coverage of relevant parts of its network under the CCA Act. Until such coverage is approved, the provisions of the NSWRAU will continue to apply. The Additional Segments are required to meet the needs of Gunnedah Basin coal mines north of Gap.

This application seeks to vary the 2012 HVAU to incorporate the following Segments between Gap and Turrawan in the Network, prescribed at Schedule E of the varied access undertaking as:

- Gap (416.0 km) to Watermark (447.1 km);
- Watermark (447.1 km) to Gunnedah (480.1 km);
- Gunnedah (480.1 km) to Boggabri (521.5 km); and
- Boggabri (521.5 km) to Turrawan (548.5 km).

The Additional Segments service the Gunnedah Basin coal mines Gunnedah, Boggabri and Narrabri, and proposed developments at Watermark and Maules Creek. An illustrative map showing the Network included in the Additional Segments is provided at Annexure 1 to Schedule B of the varied 2012 HVAU (Annex 2 to this application).

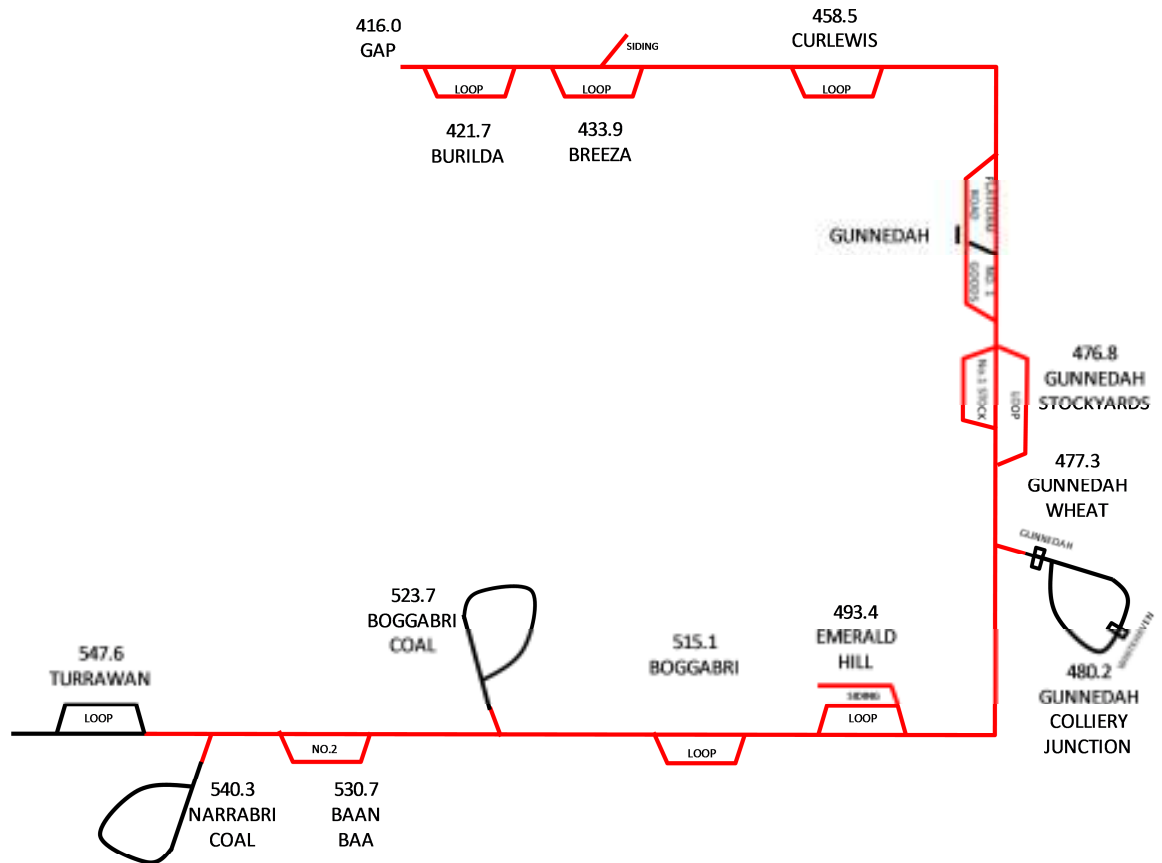
Since the Initial Application, and following further consultation with the ACCC and analysis by ARTC, the assets included for valuation on a DORC basis as part of the Additional Segments have been adjusted to:

- remove assets used for non-coal traffic only;
- remove assets not considered necessary for stand-alone coal operations; and
- remove an asset not owned by ARTC.

Assets removed from the valuation since the Initial Application include 6 sidings and a junction to the extent the asset is not owned by ARTC. Further details are provided at section 4.

The extent of the Network north of Gap now included in the valuation is schematically described at Figure 1 below.

Figure 1



In making this application, ARTC proposes to incorporate the Additional Segments in the existing Pricing Zone 3 under the 2012 HVAU. The alternative would have been to create an additional pricing zone. ARTC considers that incorporating the Additional Segments in the existing Pricing Zone 3 under the 2012 HVAU is appropriate for a number of reasons, including:

- All coal trains emanating from the Additional Segments are also operated over the entirety of the existing Pricing Zone 3.
- The infrastructure configuration and capacity in the Additional Segments are similar to that for the existing Pricing Zone 3.

- Network management arrangements on the Additional Segments are the same as the arrangements on the existing Pricing Zone 3.
- Access Holders accessing the Additional Segments, and the commercial arrangements under which access is provided, are similar to that in the existing Pricing Zone 3.
- Both the existing Pricing Zone 3 Segments and the Additional Segments¹ are currently expected to be unconstrained.

ARTC also considers that a number of advantages and efficiencies will arise from incorporating the Additional Segments into the existing Pricing Zone 3 under the 2012 HVAU, including:

- A single Charge for the Initial Indicative Service, Interim Service and other non-Indicative Services will apply with respect to the extended Pricing Zone 3 under the varied 2012 HVAU, making for simpler and more efficient pricing arrangements.
- A single application of the RAB and RAB Floor Limit roll-forward, loss capitalisation, Pricing Limits and Unders & Overs accounting will apply to Segments in the extended Pricing Zone 3 under the varied 2012 HVAU.
- A single application of the system wide true-up test will apply to the extended Pricing Zone 3 under the varied 2012 HVAU.

ARTC does not envisage any significant adverse outcomes arising from the incorporation of the Additional Segments into the existing Pricing Zone 3 under the 2012 HVAU.

¹ The NSW Independent Pricing and Regulatory Tribunal recently determined that revenue for that part of the network between Gap and Turravan was less than 80% of ceiling under the NSWRAU for the 2011/12 financial year.

4. Key elements of ARTC's proposal to vary the 2012 HVAU

4.1 Timing considerations in relation to the proposed variation

4.1.1 Date of effect of the variation

In the Initial Application, ARTC sought to incorporate the Additional Segments in the Network effective on and from 1 January 2014. ARTC has sought the variation to be effective from this date in order to align with the 2014 calendar year, consistent with timing for a range of ARTC's obligations under the HVAU including pricing, contractual entitlements, annual compliance assessment and performance reporting.

At the time of the Initial Application, ARTC recognised that the proposed effective date for the variation may be contingent upon the date of approval of the variation if such approval was not given by 1 January 2014.

In its Position Paper (page 15), the ACCC advised that it considered it unlikely that the Initial Application would be accepted for inclusion in the scope of the HVAU by 1 January 2014. It advised that ARTC needed to consider how this transition would be managed in order to ensure certainty for Access Holders. As this application is being submitted after 1 January 2014, and following further consultation with the ACCC, ARTC now proposes to amend the 2012 HVAU, at section 2.2(a)(iii), so that the provisions of the varied 2012 HVAU that are applicable to the Additional Segments will take effect from 1 January 2014.

4.1.2 Asset valuation

In the Initial Application, ARTC proposed a valuation of the assets forming the Gap to Turrawan Segments as at 1 January 2013, representing the time at which the valuation was being carried out. ARTC considers this approach to be reasonable in the circumstances given that the 2012 HVAU requires assets to be valued on the basis of replacement by commercially efficient application of best known currently available technology based on existing capacity and performance characteristics of assets². This approach is also consistent with that adopted in relation to previous valuations accepted by the ACCC under the 2011 HVAU in relation to the Dartbrook to Gap Segments and Leased PWCS Coal Loop Assets where the date of valuation is ahead of regulatory approval.

² 2012 HVAU Section 4.4(a)(ii)

For the purposes of forecasting Initial Indicative Access Charges to apply to the Gap to Turrawan Segments for the 2014 calendar year, ARTC has rolled forward this asset valuation to 1 January 2014 in accordance with the roll forward principles of the NSWRAU which is the applicable access undertaking. Details of the roll forward were incorporated in confidential financial modelling underpinning the forecasts provided to the ACCC. Consistent with the approach taken with respect to the initial annual compliance assessment under the 2011 HVAU (for the second half of 2011), the ACCC will be able to consider whether the roll forward complies with the varied 2012 HVAU as part of the 2014 calendar year compliance assessment.

In the Position Paper (p28), the ACCC provided a preliminary view that this proposed roll-forward of the 1 January 2013 asset valuation is likely to be appropriate given ARTC has advised that producers have endorsed capital expenditure through the Rail Capacity Group (RCG).

4.1.3 Application of Charges

In the Initial Application, ARTC considered that it was appropriate for Initial Indicative Access Charges applicable to the 2014 calendar to be approved by the ACCC as part of the variation. ARTC understood that, in normal circumstances, Initial Indicative Access Charges for the 2014 calendar year would be finalised as part of the process for finalising Indicative Access Charges contemplated under Section 4.20 of the 2012 HVAU. ARTC also understood that Charges for non-Indicative Services applicable to the 2014 calendar year would be finalised at around the same time.

In order to inform stakeholders, and to enable consideration by the ACCC, ARTC submitted forecast Initial Indicative Access Charges applicable to the 2014 calendar year. These charges were based on expected volumes and costs for the 2014 calendar year for the Additional Segments at the time of the Initial Application. ARTC provided confidential financial modelling underpinning these forecasts to the ACCC.

ARTC recognised that the forecasted volumes and costs in the 2014 calendar year may differ from variations proposed by Access Holders in accordance with section 4.20(a) of the 2012 HVAU. Consequently once 2014 volumes were finalised and ARTC had consulted on the Initial Indicative Access Charge for the extended Pricing Zone 3 with Access Holders, and prior to the Initial Application being approved by the ACCC, ARTC intended to submit a finalised 2014 Initial Indicative Charge for Pricing Zone 3 for the ACCC's approval.

As the process required under section 4.20 of the 2012 HVAU has now been completed, the 2014 Initial Indicative Access Charge for Pricing Zone 3 has now been finalised and published by ARTC. ARTC is now obliged to offer the Initial Indicative Access Charge for Pricing Zone 3 to relevant Access Holders and Applicants during 2014 in accordance with the 2012 HVAU.

ARTC submits this charge as set out in Table 2 of section 4.3.2 below for approval by the ACCC.

4.2 Proposed 2012 HVAU amendments

A description of each amendment to the 2012 HVAU proposed by ARTC in order to, in ARTC's view, give effect to the incorporation of the Additional Segments in the Network is provided at Figure 4 of Attachment A to this application.

It should be noted that, for reasons of efficiency, ARTC has also sought to adjust the definition of some other Network Segments in order to incorporate some updated segment numbering as part of this application to vary the 2012 HVAU. This nature of these adjustments is administrative only.

In accordance with the ACCC's preliminary views expressed in the Position Paper (page 33), ARTC has now incorporated amendments at section 4.20(d) of the 2012 HVAU in order to provide greater transparency around the expected losses to be capitalised in a pricing year. These amendments are detailed at section 4.3.5 below.

4.3 Other elements of the proposed variation

With respect to a number of provisions, no amendments are proposed in relation to the incorporation of the Additional Segments. In such cases, relevant provisions as they apply to Segments in the existing Pricing Zone 3 under the 2012 HVAU will simply extend to the Additional Segments by virtue of the inclusion of the Additional Segments into Pricing Zone 3. In order to inform stakeholders of other impacts of the proposed variation, some of the key existing elements of the 2012 HVAU that would apply to the Additional Segments are described below.

As indicated earlier, as this application represents a revision to the Initial Application and has been submitted following extensive consultation with relevant stakeholders (both directly and through the ACCC's consultation process) as well as with the ACCC, ARTC has elected not to duplicate the information provided in the Initial Application in this application and supporting documents. Instead

ARTC will provide detail in relation to the amendments made to the Initial Application following stakeholder consultation and ACCC review.

4.3.1 Asset Valuation (Section 4.4(a))

Under Section 4.4(a)(ii) of the 2012 HVAU, assets that have not been ascribed a regulatory asset value in accordance with the NSWRAU in force at the time immediately preceding the Commencement Date are initially valued using the depreciated optimised replacement cost (DORC) method of valuing assets, and approved by the ACCC. The optimised replacement cost means the cost of replacement by commercially efficient application of best known currently available technology based on existing capacity and performance characteristics of the assets.

ARTC submitted a DORC valuation to the ACCC as part of the Initial Application. Following further consultation with the ACCC and relevant stakeholders, as well as the release of the ACCC's preliminary views as expressed in the Position Paper in relation to the proposed DORC valuation, ARTC has now proposed a number of amendments to the initial DORC valuation in this application.

ARTC has also recently engaged in recent direct consultation with relevant Access Holders (key existing Gunnedah Basin coal producers) in relation to several remaining areas of concern including:

- remaining asset life assumptions for assets to be replaced as part of the planned 30 tonne axle load capacity investment program over the next few years;
- replacement cost and mark-up assumptions for certain assets;
- the magnitude of proposed financing costs; and
- maintenance adjustments in relation to non-MEERA assets.

ARTC has agreed further amendments to the asset valuation underpinning the Initial Application that satisfy the remaining concerns of those relevant Access Holders, and proposes these amendments in this application.

The ACCC's preliminary view and amendments now proposed in relation to the DORC valuation by ARTC in this application are shown in Table 1 below. Table 1 also incorporates additional adjustments made by ARTC in response to ACCC issues identified during consultation prior to release of the Position Paper.

Table 1

Position Paper Section	ACCC Issue	ARTC Response to the ACCC preliminary view
Extending the coverage of the HVAU to include Segments from Gap to Turrawan		
<p>5.4.1.1</p>	<p>The inclusion of assets that are not required for hauling coal is not likely to be appropriate.</p> <ul style="list-style-type: none"> • 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. • 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. 	<p>In this application, ARTC proposes to remove from the DORC any assets (ballast, earthworks, sleepers, rail and signalling) that would no longer be required if the three sidings used solely by non-coal trains and one privately owned and maintained junction (to the extent it is privately owned and maintained).</p> <p>These assets include:</p> <ul style="list-style-type: none"> • Gunnedah stockyards siding; • Gunnedah colliery junction (reduced to 100m) • Boggabri siding 1 • Bann Baa siding 1 <p>Following further consultation and review, ARTC also proposes to remove the following additional assets from the DORC in this application:</p> <ul style="list-style-type: none"> • Curlewis siding 1 • Curlewis siding 2 • Boggabri siding 2 <p>Following further consultation and review, ARTC proposes to retain in the DORC the following sidings used for maintenance and above rail activities in this application:</p> <ul style="list-style-type: none"> • Breeza siding • Gunnedah passing loop

		<ul style="list-style-type: none"> • Gunnedah stockyards siding • Emerald Hill siding • Bann Baa siding 2 <p>ARTC's reasons for retaining these assets are provided In its response to the Position Paper.</p> <p>ARTC has determined that the impact on ORC and DORC of removal of earthworks, track and relevant signalling assets for the excluded loops and sidings is -\$11.17m and -\$3.42m respectively.</p>										
<p>5.4.1.3</p>	<p>Financing Costs (interest During Construction)</p> <p>The inclusion of financing costs may be appropriate in principle but 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'.</p> <p>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</p>	<p>In ARTC's response to the Position Paper, ARTC advised that its consultants Evans & Peck have confirmed that financing costs have not been included in proposed mark ups.</p> <p>In its response to the Position Paper, ARTC sought to identify, from publicly available information, a number of comparable rail network construction projects to use as a benchmarks for construction time frame, in order to guide its consideration of what might be appropriate for the Gap to Turrawan assets. ARTC provided the results in its response.</p> <p>Based on the available benchmarks and having regard for the scope (146km) and nature (brownfield country) of the Gap to Turrawan construction project, ARTC proposed a construction time frame of:</p> <p>Pre-construction – 1 year</p> <p>Construction – 3 years</p> <p>In ARTC's response to the Position Paper, ARTC also provided the results of an indicative internal engineering assessment of a hypothetical Gap to Turrawan replacement project based on similar assumptions to that proposed by ARTC. ARTC did not consider that this additional internal advice warranted any increase to the above proposal of 4 years above resulting from available benchmarks.</p> <p>Based on the internal assessment above, ARTC also estimated and proposed a spend profile for the Gap to Turrawan construction as follows:</p> <table border="1" data-bbox="968 1269 1432 1383"> <tr> <td>Year</td> <td>1</td> <td>2</td> <td>3</td> <td>4</td> </tr> <tr> <td>Spend</td> <td>12%</td> <td>35%</td> <td>31%</td> <td>22%</td> </tr> </table>	Year	1	2	3	4	Spend	12%	35%	31%	22%
Year	1	2	3	4								
Spend	12%	35%	31%	22%								

		<p>In all other respects, ARTC proposed that the basis of calculation of financing costs would be consistent with that used to determine financing costs in relation to other HV capital projects, as approved by the ACCC for annual compliance assessment.</p> <p>Using an indicative DORC estimate of around \$302m (\$604m ORC) at the time, ARTC estimated that the financing costs determined on the proposed basis for the Gap to Turrawan replacement would be \$56.8m.</p> <p>Following further consultation with the ACCC and relevant stakeholders, and as part of a package of adjustments put forward and accepted by relevant stakeholders, ARTC now proposes in this application to adopt a more conservative position with respect to project time frame and spend profile than that supported above by available internal and external benchmarks. The proposed settings are set out below.</p> <p>Pre-construction – 9 months</p> <p>Construction – 2 years and 3 months</p> <table border="1" data-bbox="968 711 1341 824"> <tr> <td>Year</td> <td>1</td> <td>2</td> <td>3</td> </tr> <tr> <td>Spend</td> <td>10%</td> <td>19%</td> <td>71%</td> </tr> </table> <p>Based on ARTC’s revised DORC valuation and settings now proposed in this application, the proposed equivalent financing cost would be now \$26.94m. This represents around 9.06% of the proposed DORC valuation, significantly less than the 18.8% proposed in ARTC’s response to the Position Paper.</p> <p>It should be noted that this adjustment is proposed on the basis that:</p> <ul style="list-style-type: none"> it is applied in the specific circumstances of the DORC for the Additional Segments and this application only; and does not represent a precedent for future valuations or applications made by ARTC. 	Year	1	2	3	Spend	10%	19%	71%
Year	1	2	3							
Spend	10%	19%	71%							
5.4.2	The magnitude of the mark-ups on direct costs (as a means of calculating indirect costs) is not likely to be appropriate as they	During the ACCC’s assessment, ARTC provided, where it could, available internal and external benchmarks in								

<p>appear to be high compared to relevant benchmark costs.</p> <ul style="list-style-type: none"> The 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. MJA Report³ Section 5.10.4 Ballast, rail and sleepers <p>‘In undertaking our review we have grouped together ballast, rail and sleepers to produce a single overall combined cost. This is because track laying costs often includes the combined cost of installing these assets. Our review shows that the Evans & Peck’s combined cost of ballast, rail and sleepers is around 15% above a comparable benchmark prepared by CMT Solutions⁷⁹. The CMT Solutions benchmark includes a mark-up with similar components but critically the client cost mark-up component is set at 15%.</p> <p>We estimate that a 15% lower replacement of cost of ballast, sleepers and rail (pre adjustment for useful lives) reduces the DORC value by \$10.0 million. However, we note that the ARTC has provided us with information that suggests that the mark-up for client costs is closer to 20%. We have not been able to verify the validity of this figure with closer examination of supporting</p>	<p>relation to both the proposed mark ups and direct costs used in the Gap to Turrawan valuation.</p> <p>ARTC recognised that the ACCC had concluded ARTC’s DORC values and mark ups are too high in relation to certain assets being ballast, rail and sleepers (combined) and signalling, based on benchmark information provided to the ACCC by MJA and CMT solutions.</p> <p>As neither the MJA report nor the Position Paper provided any detail of the benchmarks nor any information underpinning those benchmarks it is difficult for ARTC to undertake a proper comparison with those benchmarks and identify any reasons for differences (which is a common problem with benchmarking) or where any adjustments to its proposals may be reasonable.</p> <p>ARTC recognised that determining reasonable mark ups for hypothetical construction projects is difficult and sensitive to the specific circumstances of the project. ARTC does not question the credibility of any benchmarks that may have been provided to the ACCC, but considers that advice to be one view of what might be considered appropriate against the view proposed by ARTC.</p> <p>As such, ARTC did not see any sound reasoning upon which it could base any adjustment to its proposals other than that the current proposals are higher than an alternative presented to the ACCC.</p> <p>Following further consultation with the ACCC and relevant stakeholders, and as part of a package of adjustments put forward and accepted by relevant stakeholders, ARTC now proposes in this application to reduce the proposed mark up for signalling assets from 115% to 102%, and for track assets including ballast, rail and sleepers to align to the ACCC’s consultant’s benchmarks.</p> <p>The adjustment to the DORC for track assets was undertaken by adjusting the mark-ups on these assets to reflect a 15% reduction of the prices, excluding the client cost mark-ups. This was reflected in an overall reduction of the mark-ups from 100% to 74%.</p> <p>It should be noted that these adjustments are proposed on the basis that:</p> <ul style="list-style-type: none"> they are applied in the specific circumstances of the DORC valuation for the Additional Segments and this application only; and
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³ Marsden Jacob Associates, Review of ARTC’s valuation for the Gap to Turrawan Segment of the Hunter Valley rail network, 30 November 2013, p55.

	<p>data. If the client cost mark-up component is set at 20%, we estimate that the impact on the DORC is only \$7.4 million. Therefore, it is reasonable to assume that the DORC impact lies between \$7.4 and \$10.0 million.</p> <p>We further note that the comparable cost for ballast, rail and sleepers used in the Dartbrook to Gap (adjusted for inflation⁸⁰) is lower than the CMT Solutions benchmark cost. However, unlike the confidential benchmark, the Dartbrook to Gap valuation appears to be based on cost information from the mid-2000s adjusted for inflation. Additionally, the mark-ups used in our confidential benchmark are closer to the Evans & Peck mark-ups than those used in the Dartbrook to Gap valuation.</p> <ul style="list-style-type: none"> • MJA Report⁴ Section 5.10.6 Signalling ‘The signalling costs of just over \$900,000 per kilometre for the Gap to Turrawan appear high compared to some other valuations (e.g. Dartbrook to Gap valuation). However, signalling systems are a function of the rail segment in terms of factors such as overall rail traffic volumes, peak load traffic and number of connections of the main line to passing loops, lanes and sidings. Our review has examined that the unit cost rates for the key signalling components appear reasonable, although we believe that the mark-ups are slightly high overall. If we adjust for a lower mark-up of 102% (instead of 115%) for signalling, we estimate that this results in a lower signalling replacement cost (pre-adjustment for useful lives) of \$7.8 million and a reduction in the DORC value by \$6.3 million.’ 	<ul style="list-style-type: none"> • they do not represent a precedent for future valuations or applications made by ARTC. <p>ARTC has determined that this will result in a reduction to the DORC proposed in the Initial Application of \$13.6m.</p>
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⁴ Op Cit, p56.

<p>5.4.3.3</p>	<p>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.</p> <ul style="list-style-type: none"> 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. 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. 	<p>In this application, and as a result of consultation with the ACCC and relevant stakeholders, ARTC proposes to include the present value of cost savings associated with the operation and maintenance of a modern asset (as compared to the existing asset) in the DORC valuation.</p> <p>In ARTC's response to the ACCC's formal information request, ARTC indicated that due to the planned investments in the Additional Segments to deliver 30Tal capacity, and any alignment of remaining asset lives of relevant assets to the time of replacement and disposal of these asset the impact of including the present value of cost savings associated with a modern asset (as compared to the existing asset) in the DORC valuation is likely to be substantially muted. As noted in ARTC's response at Item 5.4.4 below, and following further consultation with relevant stakeholders, ARTC now proposes to align the remaining asset lives of relevant assets to the time of replacement and disposal of these assets under the planned 30Tal capacity investment program.</p> <p>ARTC has identified that the only affected assets that require consideration in relation to cost savings are the existing non-60kg rail and turnouts to be upgraded for 30Tal operations which are planned to be replaced over the period 2014-2018. In both cases the remaining life assumptions are aligned to the planned replacement date under the 30Tal project (refer Item 5.4.4 below). In relation to other key assets, ARTC considers that the impact on DORC of any savings will be insignificant for the following reasons.</p> <p>Sleepers – All existing mainline non-MEERA (timber/steel) sleepers have been replaced as part of the 30Tal investment in 2013. Under the HVAU, these existing assets will be deemed to have only been in place for 6 months from valuation date. Given this, ARTC expects the DORC impact of any maintenance savings to be minor particularly given that revenue associated with mines serviced by the Additional Segments is likely to be unconstrained in 2013, and loss capitalisation will not become applicable until 1 January 2014 under this application.</p> <p>Ballast, Earthworks, Signalling, Bridges – ARTC Hunter Valley maintenance engineers have advised that any difference in operating cost between non-MEERA and MEERA assets will not be significant.</p> <p>Turnouts – All non-MEERA turnouts other than those planned to be replaced under the planned 30Tal project are life expired in the DORC valuation and as such have no value. Consistent with the remaining life assumption, no maintenance savings will accrue.</p>
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		<p>In relation to the rail assets, ARTC has undertaken the following assessment.</p> <p>Under the 30Tal capacity investment program, the existing mainline non-60kg (MEERA) rail assets will be progressively replaced between 2014 and 2016-17. Aligned to dates of replacement, ARTC has adjusted the remaining life assumption for these turnouts to between 1.5 and 4 years from 1 January 2013 (refer Item 5.4.4 below).</p> <p>For these assets ARTC has determined an average unit annual maintenance saving for each length (track km) of rail for each year until the replacement of the rail. The annual maintenance saving contemplates the annual forecast cost of specific rail maintenance activities for each relevant year, applied to the impact on the cost of carrying out those activities where MEERA assets are assumed, based on the advice of experienced ARTC Hunter Valley maintenance engineers. The present value of these savings for each length of rail using Rate of Return as the discount factor is then applied (deducted) from the DORC for each length of rail.</p> <p>Other than the above assets to be replaced under the 30Tal project, there are some other non-MEERA rail assets included in the DORC valuation (e.g. rail in loops and sidings). ARTC Hunter Valley engineers have indicated that whilst such assets are not planned to be replaced under the 30Tal project, these assets may be replaced over the next 10 or so years on an as needed basis (e.g. wear and tear).</p> <p>For these assets ARTC has determined an average unit annual maintenance saving for each length (track km) of rail for each year assuming replacement an average remaining life of 10 years (2023) for these assets. This is consistent with the remaining life assumption in the DORC valuation. The annual maintenance saving contemplates the annual forecast cost of specific rail maintenance activities over the 10 year period, applied to the impact on the cost of carrying out those activities where MEERA assets are assumed, based on the advice of experienced ARTC Hunter Valley maintenance engineers. The present value of these savings for each length of rail using Rate of Return as the discount factor is then applied (deducted) from the DORC for each length of rail.</p> <p>The planned replacement of non-MEERA rail assets is shown below.</p>
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Rail Replacement Schedule (kms)											
<i>Line Sector</i>	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
966		9.7		21.3	0.0						1.7
988		6.8		9.3	14.8						3.8
967		4.6		0.0	36.4						4.0
968		4.2		0.0	14.1						8.6
Total		25.3	0.0	30.6	65.2	0.0	0.0	0.0	0.0	0.0	18.1

In relation to the **turnout** assets that are planned to be replaced under the 30Tal project, ARTC has undertaken the following assessment.

Under the 30Tal capacity investment program, a number of existing non-MEERA turnouts will be replaced over the next few years. Aligned to dates of replacement, ARTC has adjusted the remaining life assumption for these turnouts to between 1.5 and 5 years from 1 January 2013 (refer Item 5.4.4 below).

For these assets ARTC has determined an average unit annual maintenance saving for each turnout for each year until the replacement of the turnout. The annual maintenance saving is contemplates the annual forecast cost of specific turnout maintenance activities for each relevant year, applied to the impact on the cost of carrying out those activities where MEERA assets are assumed, based on the advice of experienced ARTC Hunter Valley maintenance engineers. The present value of these savings for each turnout using Rate of Return as the discount factor is then applied (deducted) from the DORC for each turnout.

The planned replacement of non-MEERA turnout assets under the 30Tal project is shown below.

Turnout Replacement Schedule (# of turnouts)						
<i>Line Sector</i>	2013	2014	2015	2016	2017	2018
966	0		0	1	0	
988	0		2	1	0	
967	2		2	1	1	
968	4		0	0	0	
Total	6		4	3	1	

The total amount deducted from the DORC for maintenance adjustments for the above non-MEERA assets is \$0.985m.

ARTC has provided calculations underpinning these cost adjustments to the ACCC on a confidential basis.

		<p>ARTC considers that this will achieve the desired internal consistency where the assumed remaining useful life underpins both the depreciation calculation and the calculation of the present value of any material cost savings, as sought by the ACCC</p> <p>Despite now proposing to treat any cost savings on a basis proposed by the ACCC, ARTC remains concerned in relation to the practical application of the approach sought by the ACCC. For example, material cost savings have been determined on the basis of a planned investment program that may not eventuate as planned. Where the maintenance cost savings have been 'locked in' to this valuation, any adjustment that may be necessary if the investments do not occur as planned remains uncertain.</p>
<p>5.4.4</p>	<p>Several remaining asset life assumptions underpinning the proposed DORC valuation are unlikely to be appropriate.</p> <ul style="list-style-type: none"> • 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. • 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. • 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. 	<p>In this application, ARTC proposes to adjust the DORC valuation to reflect the MJA position as sought by the ACCC. ARTC has determined that the impact on DORC is +\$1.18m.</p> <p>ARTC presumes that this reference in the Position Paper relates to the "economic life" of certain signalling assets rather than remaining life. In this application, ARTC proposes to reduce the economic life of all signalling and telecommunications assets back to 30 years with the exception of certain "civil" asset types such as buildings that are used to support the signalling equipment, and included in the signalling asset classification. ARTC believes that these assets are likely to be more permanent than the signalling equipment itself which is more likely to be prone to technical obsolescence. ARTC proposes to retain an economic life of 40 years for such assets. ARTC estimates that the impact on the DORC is -\$6.66m.</p> <p>In this application, ARTC proposes to adjust the installation date for 1 in 4 steel to 1993 to result in a weighted remaining life (3 x timber installed 1990 life expired/1 x steel installed 2000, 37 year remaining life) of 10 years. ARTC has determined that the impact on the DORC is -\$0.3m.</p>

<ul style="list-style-type: none"> 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. 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). 	<p>ARTC notes that the ACCC, in the preliminary view expressed in the Position Paper, does not appear to have explicitly sought ARTC to make any adjustments to the remaining life of assets that are planned to be replaced soon (under the planned 30Tal capacity investment program).</p> <p>ARTC wishes to make it clear that the DORC valuation of the Additional Segments has a valuation date of 1 January 2013 and, as at that date, the existing capacity and performance of the Additional Segments was aligned to 25Tal operations. ARTC considers this to be consistent with the requirements of section 4.4(a) of the 2012 HVAU. ARTC has not taken into account any future investment program, nor future capacity and performance of the Additional Segments, in the proposed DORC valuation. ARTC believes that the ACCC has acknowledged this in the Position Paper.</p> <p>ARTC is not proposing to alter this assumption.</p> <p>Nevertheless, in order to address the ongoing concerns expressed by relevant stakeholders in relation to assets that are planned to be replaced over the next few years under the planned 30Tal capacity investment program, ARTC has consulted further with the ACCC and relevant stakeholders and, as part of a package of adjustments put forward and accepted by relevant stakeholders, ARTC now proposes in this application to adjust the remaining lives of relevant assets planned to be replaced over the next few years under the planned 30Tal capacity investment program, to align to the time of replacement and disposal of these assets. In broad terms, the remaining lives of relevant assets have been adjusted as follows:</p> <p>Rail – reduced to between 1.5 and 4 years from 1 January 2013 to align to replacement in between 2014 and 2016/7.</p> <p>Sleepers - reduced to 0.5 years to align to replacement in 2013.</p> <p>Turnouts – set to between 1.5 and 5 years from 1 January 2013 to align to replacement between 2014 and 2017/8.</p> <p>These adjustments will have the effect of reducing the proposed DORC value as at 1 January 2013 and the initial RAB and RAB Floor Limit values for the Additional Segments under the HVAU. Under the HVAU, these assets will be depreciated from 1 January 2013 on the basis of the approved remaining mine life.</p> <p>It should be noted that these adjustments are proposed on the basis that they:</p>
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	<p>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.</p>	<ul style="list-style-type: none"> • are applied in the specific circumstances of the DORC valuation for assets in the Additional Assets relevant to the planned 30Tal capacity investment program and this application only; • are not taken to represent a change in the assumptions made by ARTC in relation to the capacity and performance of the Additional Segments as at 1 January 2013 to that proposed by ARTC in the Initial Application; and • do not represent a precedent for future valuations or applications made by ARTC. <p>ARTC has determined that this will result in a reduction to the DORC proposed in the Initial Application of \$10.1m.</p> <p>Further to this reduction to the DORC, these adjustments will have the effect of substantially reducing the value of planned disposals under the 30Tal project, to be expensed and included in the cost base in the year of disposal. This will address concerns expressed by relevant stakeholders in relation to the significant cost burden resulting from disposal of assets with assumed remaining lives as incorporated in the DORC proposed in the Initial Application. As part of this adjustment accepted by relevant stakeholders, any benefit that can be derived by ARTC from the sale or alternate use of disposed assets (now assumed to be life expired) under the 30Tal project will not be included in the regulatory cost base at the applicable point in time.</p>
<p>5.4.5</p>	<p>The modelling underpinning the proposed DORC valuation contains a number of errors and is unlikely to be appropriate.</p> <ul style="list-style-type: none"> • 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. • Ballast costs have been double counted for one section of the rail segment. 	<p>In this application, ARTC proposes to correct the error to include the 47kg rail in the model. ARTC estimates that the impact on DORC is +\$0.54m.</p> <p>In this application, ARTC proposes to correct the error in the model for the misspecification of sleepers. ARTC estimates that the impact on DORC is +\$8.09m.</p> <p>In this application, ARTC proposes to correct the error in the model for the double count of ballast. ARTC estimates that the impact on DORC is -\$3.66m.</p>

Proposals in relation to Other Issues not explicitly addressed in the Position Paper		
Response to ACCC informal information request 27 September	The existing asset is described as a timber sleeper and yet an optimisation factor of 100% is applied. This appears inconsistent with the way that it is done for other timber sleepers where the optimisation factor is 40%. The optimisation factor for this asset has been adjusted to 40%. ARTC estimates that the impact on ORC is - 3.4m. There is no impact on DORC as this asset is fully depreciated.	The optimisation factor for this asset has been adjusted to 40%. ARTC estimates that the impact on ORC is - \$3.34m. There is no impact on DORC as this asset is fully depreciated.
Response to ACCC informal information request 24 October.	Do all the passing loops, sidings and passing lanes currently have concrete sleepers?	<p>Asset data initially sourced for this valuation in relation to Gap to Turrawan loops and sidings was incomplete and largely inconclusive. At the time it was considered reasonable to make broader assumptions in relation to the specific assets based on anecdotal advice provided at the time. These assumptions were largely predicated on an expectation of assets existing after substantial investments in loops made in recent times.</p> <p>ARTC has undertaken a closer assessment of the key loop/siding assets (rail & sleepers) which now reveals assets in place as follows:</p> <ul style="list-style-type: none"> in relation to sleepers around 50% are concrete (predominantly installed as part of recent new loop and extension works), 25% older timber and 25% 1 in 4 steel configuration. in relation to 47kg rail assumed for all loops and sidings, closer assessment reveals that only 40% is 47kg rail, whereas 37% is 53 kg rail and 22% is 60kgHH rail. <p>In this application, ARTC proposes to incorporate the mix of asset types as identified. The impact on DORC is reflected in the adjustment determined for the removal of certain sidings and loops as described earlier in this table.</p>
Error in initial asset valuation recently detected.	The initial asset valuation excluded a number of turnouts on the basis that these were considered as not being required for coal operations. Some excluded turnouts have recently been identified as providing access to coal balloon loops.	Turnouts providing access to coal balloon loops at Gunnedah, Boggabri and Narrabri were inadvertently excluded from the initial asset valuation. These have now been re-instated. ARTC has determined that the impact of ORC is +\$1.13m. There is no impact on DORC as these assets are fully depreciated.

As a result of all of the amendments to the DORC valuation proposed in this application, the DORC and ORC valuation with respect to each of the Additional Segments is shown at Table 2 below.

Table 2

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

* Financing cost has been allocated to each of the Additional Segments on the basis of the ORC Valuation.

** Route km = track distance between Gap and Turrawan. Excludes loop and siding track.

The ORC and DORC values for each line segment in Table 2 also include the Network Control Centre allocation, which has been apportioned on a train kilometre basis to each line segment. The total Network Control Centre ORC included in Table 2 is \$0.689m and the corresponding amount included DORC value is \$0.547m.

These amendments represent a reduction in the ORC and DORC for the Additional Segments proposed in the Initial Application of \$42.334m and \$28.983m respectively, and are offset in part by the inclusion of \$26.942m of financing costs.

ARTC now considers that the revised DORC for the Additional Segments now addresses the relevant ACCC concerns expressed in the Position Paper, and is supported by key relevant stakeholders.

Key revisions to the DORC for the Additional Segments are summarised as follows:

- a more detailed review of the optimal infrastructure required for stand-alone coal operations has resulted in the removal of assets considered required only for non-coal, not required for stand-alone coal operations, or not owned by ARTC;
- financing costs (interest during construction) has been included based on the regulated cost of capital and conservative settings for construction time frame and spend profile;
- asset replacement mark-ups are reduced to align to ACCC proposed benchmarks;

- the present value of material future operating cost savings arising from utilising MEERA assets has been incorporated such that consistency between assumptions relating to remaining asset life and future cost savings is achieved;
- remaining asset life assumptions have been adjusted to reflect ACCC proposals and, in the case of assets to be disposed as a result of recent and planned 30Tal investments, to align to the time of disposal, on a one-off basis to address relevant stakeholder concerns about being required to pay substantial disposals expenditure in the near future;
- a number of identified modelling errors in the DORC proposed as part of the Initial Application have been rectified; and
- a number of assumptions in relation to asset type, quantity and condition due to quality of available data have been improved.

In order to provide further context in relation to the DORC valuation for the Additional Segments now proposed in this application, Table 3 below provides a comparison of the DORC (or Initial RAB Floor Limit) as at 1 January 2013 against corresponding RAB Floor Limits as at 1 January 2013 for other relevant parts of the Network, initially valued at different points in time. The comparison is provided on a per track kilometre basis (including loop and double/triple track length) to appropriately mitigate the effects of multiple track. An estimate of the RAB Floor Limit including the planned 30Tal capacity investment expenditure is also provided.

Table 3

Network	Initially valued	1 January 2013 RAB Floor Limit per track km (\$m)
Ports to Dartbrook	1999	3.06
Dartbrook to Gap (pre 30Tal investment)	2008	1.81
Gap to Turravan (pre 30Tal investment)	2013	2.24
Dartbrook to Turravan (post 30Tal investment)	NA	2.53*

*Expected value around 2017

Table 3 shows that the RAB Floor Limit, which is relevant to the recovery of capital costs from users is comparable around the Network. Once parts of the Network servicing the lower Hunter Valley and Gunnedah Basin have similar capability (30Tal) the value of the Network servicing the lower Hunter Valley will be around 20% higher.

A comparison on a track kilometre basis may result in a slight under-estimate in the lower Hunter Valley where an assumption that the replacement a double/triple track network would be double or triple (as applicable) that of a single track network is implied. As some assets are shared, this cost relationship may be exaggerated. On the other hand, it might be expected that the lower Hunter Valley estimate may be higher, where there may be a higher prevalence of new assets.

In any event, where the capability of the Network in the lower Hunter Valley is still slightly better than that in the Gunnedah Basin (longer trains are permitted), it is ARTC's view that the above comparison provides evidence that the quantum of the DORC valuation for the Additional Segments will result in an efficient and equitable outcome for Hunter Valley coal users.

4.3.2 Initial Indicative Services and Access Charges (Section 4.17)

The incorporation of the Additional Segments in Pricing Zone 3 means that the Initial Indicative Service and Initial Indicative Access Charge prescribed for the extended Pricing Zone 3 under the varied 2012 HVAU will apply to all Segments in the extended Pricing Zone 3, including the Additional Segments.

ARTC considers that the Initial Indicative Service prescribed for the existing Pricing Zone 3 under the 2012 HVAU was determined with respect to HVCCC coal chain modelling that had regard for the Hunter Valley coal chain operations beyond the ARTC Network at the time. As such, ARTC does not consider that the incorporation of Additional Segments in Pricing Zone 3 will impact the specification of the Initial Indicative Service for the extended Pricing Zone 3 under the varied 2012 HVAU.

Access Holders utilising the Additional Segments all utilise the entirety of the Segments forming the existing Pricing Zone 3 under the 2012 HVAU. As such, ARTC does not consider that the specification of an Indicative Access Charge to apply to all Segments in the extended Pricing Zone 3 to have any significant allocation or equity impacts.

As the process required under s4.20 of the 2012 HVAU has now been completed the 2014 Initial Indicative Access Charge for Pricing Zone 3 has now been finalised and published by ARTC. ARTC is now obliged to offer the 2014 Initial Indicative Access Charge for Pricing Zone 3 to relevant Access Holders and Applicants during 2014. ARTC submits the 2014 Initial Indicative Access Charge as set out in Table 4 below.

Table 4**2014 Initial Indicative Service and Access Charge (effective from 1 January 2014)**

Segments	Non-TOP \$/kgtkm (ex GST)	TOP \$/kgtkm (ex GST)	Initial Indicative Service Characteristics
In Pricing Zone 3*			
Initial Indicative Service 1	1.496	9.635	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

*Pricing Zone 3 contains Segments as specified at Schedule E (including Segments for the extended Pricing Zone 3)

Further information in relation to the development of 2014 Initial Indicative Access Charges for the extended Pricing Zone 3 was provided to relevant Access Holders in accordance with requirements under section 4.20 of the 2012 HVAU. This information was based on best available forecasts at the time, and ARTC's proposal in relation to the DORC for Additional Segments forming part of the Initial Application. ARTC will provide confidential financial modelling underpinning the 2014 Initial Indicative Access Charges to the ACCC, based on similar forecasts and ARTC's proposal in relation to the DORC for the Additional Segments in this application. Adjustment to the most recent modelling have no impact in 2014 Initial Indicative Access Charges for the extended Pricing Zone 3 finalised under section 4.20 of the HVAU, but will impact on the forecast of any amount to be capitalised in extended Pricing Zone 3 in 2014.

4.3.3 Interim Services and Charges for Services having the characteristics of Interim Services (Section 4.19)

The 2012 HVAU only contemplates specification and approval by the ACCC of Initial Indicative Access Charges.

Interim Services are not considered to represent efficient utilisation of Capacity and Coal Chain Capacity and are subject to price differentiation in accordance with Section 4.15 of the 2012 HVAU, similar to other 'non-indicative' charges.

ARTC expects that relevant Access Holders will predominantly utilise Initial Indicative Services in the extended Pricing Zone 3 in the 2014 calendar year.

The incorporation of the Additional Segments in Pricing Zone 3 means that Charges for Services having the characteristics of an Interim Service in the extended Pricing Zone 3 under the varied 2012 HVAU will apply to all Segments in the extended Pricing Zone 3, including the Additional Segments.

ARTC does not consider that the incorporation of the Additional Segments in Pricing Zone 3 will be problematic in terms of Service or Charge specification under the varied 2012 HVAU for the following reasons:

- The Interim Service in Pricing Zone 3 currently operates on the Additional Segments.
- Access Holders in utilising the Additional Segments in Pricing Zone 3 all utilise the entirety of the Segments forming the existing Pricing Zone 3 under the 2012 HVAU;.
- ARTC's determination of the 2014 Charge for Services having the characteristics of an Interim Service in the extended Pricing Zone 3 under the 2012 HVAU had regard to differentiation in accordance with Section 4.15(a) of the 2012 HVAU and in accordance with committed principles prescribed in ARTC's 2012 Initial Indicative Service and Access Charge variation application.
- Further information in relation to the development of the Charge for Services having the characteristics of an Interim Service for the extended Pricing Zone 3 was provided to relevant stakeholders in accordance with requirements under section 4.20 of the 2012 HVAU. ARTC will provide confidential financial modelling underpinning the Charge for Services having the characteristics of an Interim Service to the ACCC, on the same basis as described in section 4.3.2.

2014 Charges for Services having the characteristics of an Interim Service in the extended Pricing Zone 3 are published on the ACCC website.⁵

4.3.4 Non-Indicative Services and Access Charges (Section 4.15)

For clarity, references to non-Indicative Services and Charges for non-Indicative Services do not apply to Interim Services or Charges for Services having the characteristics of an Interim Service in the extended Pricing Zone 3 under the varied 2012 HVAU as contemplated in Section 4.3.3.

⁵ <http://www.artc.com.au/Content.aspx?p=229>

Non-Indicative Services and Charges for non-Indicative Services are not specified in the varied 2012 HVAU.

Having said this, the incorporation of the Additional Segments in Pricing Zone 3 means that Charges for non-Indicative Services in the extended Pricing Zone 3 under the varied 2012 HVAU will apply to all Segments in the extended Pricing Zone 3, including the Additional Segments.

ARTC does not consider that the incorporation of the Additional Segments in Pricing Zone 3 will be problematic in terms of Service or Charge specification under the varied 2012 HVAU, for similar reasons as described above for Interim Services and Charges for Interim Services.

ARTC's determination of the Charge for non-Indicative Services in the extended Pricing Zone 3 under the 2012 HVAU has had regard to differentiation in accordance with Section 4.15(a) of the 2012 HVAU and in accordance with committed principles prescribed in ARTC's 2012 Initial Indicative Service and Access Charge variation application.

ARTC will provide confidential modelling demonstrating the extent of differentiation inherent in the Charges for non-Indicative Services to the ACCC, on the same basis as described in section 4.3.2.

2014 Charges for non-Indicative Services in the extended Pricing Zone 3 are published on the ACCC website.⁶

4.3.5 Process for finalising Indicative Access Charges (Section 4.20)

As Access Holders utilising the Additional Segments all utilise the entirety of the Segments forming the existing Pricing Zone 3 under the 2012 HVAU, ARTC does not consider that the incorporation of the Gap to Turrawan Segments in Pricing Zone 3 will have any significant impact on the application of Section 4.20 of the varied 2012 HVAU.

In the Position Paper (page 33) the ACCC's preliminary view indicated that the provision of an estimate of the likely losses to be capitalised to Access Holders during the annual process for finalisation of the Initial and Interim Indicative Access Charges in accordance with section 4.20 of the 2012 HVAU would improve transparency around the charges that Access Holders in Pricing

⁶ <http://www.artc.com.au/Content.aspx?p=229>

Zone 3 are likely to face over time, given that ARTC has discretion to set charges at a level that does not recover the Economic Cost in Pricing Zone 3 in the short term. The ACCC further indicated that one way that this could be achieved would be through an amendment to section 4.20(d) of the 2012 HVAU.

To address the ACCC's concern in this regard, ARTC proposes to amend section 4.20(d) to provide Access Holders in Pricing Zone 3 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 section 4.20(d). The provision of starting and ending RAB values enables an Access Holder in Pricing Zone 3 to determine an estimate of any amount to be capitalised for that year. That is, Access Holders will be able to determine the amount to be capitalised by subtracting the starting RAB from the end RAB. If the subtraction result is positive that amount has been capitalised. Where the subtraction result is zero or negative no amount is being capitalised and prior year capitalised amounts are being recovered.

To inform relevant stakeholders, Table 5 below provides the relevant information for extended Pricing Zone 3 for 2014.

Table 5

	Pricing Zone 3 (\$m)
2014 RAB _{start}	648.0
2014 RAB _{end}	696.5

4.3.6 Drafting amendments

In the Position paper (page 34), the ACCC advised a preliminary view that draft amendments proposed in the Initial Application were appropriate.

4.3.7 Impact on other provisions of the 2012 HVAU

For the reasons expressed in the supporting document provided as part of the Initial Application, ARTC does not consider that the variation proposed in this application will have any material impact on the operation of the following sections of the 2012 HVAU:

- Section 4.4(a) – RAB Roll Forward

- Section 4.6 Cost Allocation
- Section 4.7 – Remaining Mine Life
- Section 4.9 – Unders & Overs Accounting
- Section 4.10 – Annual Compliance Assessment
- Section 4.14 – Indicative Access Services and Charges
- Section 4.15 – Charges for non-Coal Access Rights
- Section 4.21 – Provision of forecast information and coal volumes
- Section 9.2 – Additional Capacity – Rail Capacity Group
- Section 9.8 – Additional Capacity - Endorsement of project development stages
- Annexure A – Indicative Access Holder Agreement
 - No adjustment to Tier 1 or 2 provisions is required
 - Existing Access Holder Agreements for Access Holders utilising the Additional Segments already contemplate the relevant parts of the Network they utilise and commercial arrangements for the Additional Segments
 - Some relatively minor outcomes highlighted in the Initial Application include Network Path Capability (Schedule 2) – refer Initial Application.