ARTC

11 Sir Donald Bradman Drive
Keswick Terminal, SA 5035

PO Box 10343 Gouger Street
Adelaide, SA 5000

P. 08 8217 4366
F. 08 8217 4578
E. info@artc.com.au
W. artc.com.au

28 May 2019

NSW Rail Access Undertaking – Review of rate of return and Mine Life

Independent Pricing and Regulatory Tribunal

PO Box K35

Haymarket Post Shop NSW 1240

Bu website: www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>

Dear IPART,

Re: NSW Rail Access Undertaking – Review of rate of return and Mine Life

Thank you for the opportunity to comment on IPART's draft decision re the NSW Rail Access Undertaking (NSWRAU) – Review of rate of return and Mine Life.

ARTC hold voluntary access undertakings with the Australian Competition and Consumer Commission for both its Interstate and Hunter Valley Coal Networks. Some of its assets in NSW remain subject to IPART coverage; whilst formally all of the assets covered by the voluntary ACCC undertakings remain covered by state legislation and the NSWRAU should those ACCC undertakings lapse for any reason. ARTC is therefore an interested stakeholder in this Draft Decision.

The Executive Summary highlights that there are two draft decision and a draft recommendation, being:

Draft Decisions

1. The rate of return to apply from 1 July 2019 is 5.8% per annum on a real, post-tax basis;
2. The remaining mine life from 1 July 2019 used to determine depreciation should be 21 years, resulting in a terminal date of 2040.

Draft Recommendation

1. The NSW Government should ask IPART to undertake a review of the NSWRAU.

In respect of these decisions and recommendation, ARTC makes the following points:

Rate of Return

ARTC supports the rate of return defined by IPART in the Draft Decision and the detailed analysis provided which supports that decision. In particular, ARTC strongly supports the consistency of parameter assumptions and how they interact with each other. IPART's approach in balancing long term and spot market rates to removal volatility in rate determinations and provide greater temporal stability is a positive approach to regulatory rate of return determinations.

ARTC has previously stated (via IPART's 2017 WACC Review) its belief that this balanced approach could be further improved via the addition of forward expectations into the formula. ARTC continues to believe that an approach which balances historical, spot and future expectations would provide the most balanced approach with benefits for both owners and users of infrastructure. However, in the absence of the inclusion of future expectations from the model, the IPART approach is the next most optimal formula.

Remaining Mine Life (RML)

ARTC understands the RML dilemma IPART has faced in this review, where the economic life assumptions need to reflect a demand rather than supply focus given the announced potential closures of domestic power stations in the Hunter Valley in the medium term and the uncertainties of demand and recovery of depreciation beyond that point.

RML assessments need to consider supply as well as demand perspectives. From the supply side, the life of a mine is a function of the licenses held by a Producer to extract the coal and the ratio of reserves to production that will determine the time to deplete the available reserves.

Typically, the RML calculation has focussed on the assumed life of a mine to deplete its reserves and therefore assumed that all licenses held by the Producer will be extended in perpetuity until the resource is depleted.

From a license perspective, ARTC believes that the assumption of perpetual extension is no longer appropriate, as there is no certainty such extensions will be granted. The assumed life of a mine for regulatory depreciation purposes should therefore be limited to the term of its current licenses. The lack of license certainty is reflected in recent decisions by the NSW Environmental Court and ensures a network owner is not accepting mine licensing risk in the stranding risk of its assets.

In respect of reserves depletion, ARTC also has concerns that the RML equation assumes mines continue production until all reserves are depleted notwithstanding the presence of studies which highlight this is not the case. In addition, the equation assesses Proven and Probable reserves as being equally certain of production; which assumption fails to reflect the confidence interval which underpins the reserves assessments. This assumption ensures that network owners are accepting an element of reserves risk in the RML calculation.

ARTC would therefore recommend that the supply side assessment of RML should be limited to the existing license term of each mine and that the relevant confidence interval in assessing reserves be accounted for in the equation. Such an approach would have provided a relevant supply side comparison to the demand side RML date of 2032 and assisted IPART in its deliberations.

ARTC acknowledges IPART's approach to providing a pragmatic solution to mitigate the price impact on consumers to ensure the viability of continuing services. In this instance, the objective assessment of RML yielded a price increase considered unsustainable which, by its own nature, triggers an increase in stranding risk. IPART's pragmatic approach to balance the medium to long term demand and supply stranding risk, against a short-term price risk is therefore appropriate for this unique circumstance. ARTC assumes that in the reverse scenario, where an RML assessment leads to a significant increase in RML and a large fall in revenue, that such a pragmatic approach of balancing owner and user interests would be similarly applied.

ARTC would, however, recommend a review of the RML formula in future assessments to ensure that the reserves and license risks of continuing mine production are allocated appropriately to those in a position to best manage such risks.

NSWRAU Review

ARTC appreciates that the NSWRAU was legislated in 1999 and has neither been reviewed nor amended since that time. A review of the NSWRAU is therefore warranted to ensure it is fit for purpose.

At the same time as this Draft Decision is subject to review, other jurisdictions are undertaking similar processes:

- The Queensland Competition Authority is undertaking a review of its Declaration of Rail Assets;
- The WA Treasury is reviewing the WA Rail Access Regime;
- ESCOSA has released draft guidelines on the rail guidelines for the Tarcoola to Darwin railway.

In addition, ARTC is engaging with the ACCC and stakeholders on the renewal of its Interstate Access Undertaking and is required to engage with stakeholders on the 2022 renewal of its Hunter Valley Access Undertaking in the second half of 2019.

This list highlights the disjointed regulatory framework which applies to rail assets in Australia, with a combination of state and federal regimes and where each competition regulatory review is undertaken in isolation from each other.

The Productivity Commission (PC) were recently tasked by the Transport and Infrastructure Committee of the Council of Australian Governments to review long-run economic impacts of transport regulatory reforms agreed by COAG in 2008-09 relating to heavy vehicle safety and productivity, rail safety and maritime safety and to make recommendations for further reforms towards a more integrated national market for transport services. This does not directly include review of economic regulatory frameworks; however clearly the economic regulation of rail (and roads) would benefit from a review on the benefits of greater national integration.

ARTC would therefore strongly support an enquiry by the PC of greater national integration of rail economic regulation, which would incorporate the proposed NSWRAU review and provide greater integration benefits to the rail industry than a further (isolated) review of a state specific regulatory instrument.

Thank you for the opportunity to comment on the Draft Decision. If you have any questions in respect of this submission, please don't hesitate to contact me on jteubner@artc.com.au or [redacted]

Yours sincerely

[redacted]

Jonathan Teubner
Manager Economic Regulatory Development