

INDEPENDENT PRICING AND REGULATORY TRIBUNAL

RAIL ACCESS REVIEW OF RATE OF RETURN
AND REMAINING MINE LIFE

Tribunal Members

Dr Michael Keating AC, Chairman
Mr James Cox, Chief Executive and Full-Time Member
Ms Sibylle Krieger, Part-Time Member

Held at Level 8,
1 Market Street, Sydney

On Wednesday, 1 April 2009, at 3pm .1/4/09 1
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1 THE CHAIRMAN: Ladies and gentlemen, I would like to begin
2 by welcoming you all to this public hearing which has been
3 conducted by IPART as part of its review of the rate of
4 return and remaining mine life to apply to the
5 Hunter Valley coal network from 1 July this year. The New
6 South Wales Rail Access Undertaking requires IPART to
7 review both the greater return and the estimates of
8 remaining mine life every five years.

9
10 Before proceeding further today, however, I should begin
11 by introducing my fellow Tribunal members and perhaps
12 myself also because I wasn't here the last time this review
13 was undertaken. I am Michael Keating, Chairman of IPART.
14 On my left is Jim Cox who is the chief executive and
15 full-time member of the Tribunal and on my right is
16 Ms Sibylle Krieger who is a part-time member of the
17 Tribunal.

18
19 Also representing IPART here today is Eric Groom who
20 is IPART's principal adviser, Aaron Murray - who is here -
21 who is the program manager for this inquiry and also in
22 attendance is Mr Mike Smart from LECG who is a consultant
23 appointed by IPART to assist with the making of a decision
24 on the remaining mine life component of the review.

25
26 As I am sure you will appreciate, the purpose of
27 today's hearing is to hear from stakeholders their views
28 regarding the appropriate rate of return for the remaining
29 mine life of the Hunter Valley coal network. ARTC has
30 already provided us with a proposal on these two matters.
31 RailCorp has not put forward a proposal but has stated that
32 it is prepared to accept the rate of return and the
33 remaining mine life as determined by IPART.

34
35 IPART has already released two papers as part of its
36 review: a discussion paper on the rate of return and a
37 report from LECG on the remaining mine life. IPART
38 released these two papers to facilitate discussion at
39 today's hearing. We are also seeking written submissions
40 by 9 April, which is just over a week away. The written
41 submissions received on these two papers from ARTC's
42 proposal, as well as the outcomes from today's discussions,
43 will be considered by the Tribunal members when making
44 their draft decision on 9 May.

45
46 The process for today's hearing is set out in the
47 circulated agenda. Each part will commence with an

1 introduction by a member of IPART's Secretariat and I will
2 then go around the table and ask roundtable participants to
3 present their position.

4
5 In doing that, I would like to ask that your comments
6 be kept reasonably brief, say 10 minutes for each topic -
7 some may want a bit more, some may want a bit less - and
8 one of the rules of the game is that speakers are not
9 interrupted during their presentation. I will then ask for
10 any questions or comments and after the roundtable
11 participants have had their opportunity to speak and
12 comment and the Tribunal members also have an opportunity
13 to ask questions, I will then invite comments from any
14 other stakeholders in the rest of the room, if you want to
15 make any comments.

16
17 As you will have noticed, today's hearing is being
18 transcribed, so to assist the transcribers in recording the
19 discussion please identify yourself at the start of your
20 presentation or question. The transcript will be available
21 on IPART's website early next week.

22
23 Before we proceed further with this hearing, I would
24 like to remind the stakeholders of the context surrounding
25 IPART's review. As you are probably all aware, ARTC is
26 currently undertaking consultations on the development of a
27 Hunter Valley access undertaking which it is to submit to
28 the ACCC for approval in the near future. I understand
29 that it is ARTC's current intention that this new
30 undertaking would replace the existing New South Wales rail
31 access undertaking for those parts of the Hunter Valley
32 coal network of which ARTC is the rail infrastructure
33 owner.

34
35 That process and the potential outcome of that process
36 is not something that IPART wishes to discuss today.
37 Stakeholders should be aware that if the new undertaking is
38 approved, the ongoing need for the current undertaking will
39 need to be considered. Therefore, this decision may well
40 be IPART's last on the rate of return and remaining mine
41 life of the Hunter Valley coal network and it's also highly
42 likely that this decision will not be in effect for the
43 full five years for that part of the network leased to
44 ARTC.

45
46 The second contextual matter I wish to mention is the
47 capacity of the Hunter Valley coal network and its key role

1 in exporting coal through the port of Newcastle. ARTC is
2 planning on spending around \$1 billion on capital projects
3 over the next ten years as part of broader plans to enhance
4 coal supply and chain capacity in the Hunter. While
5 expansion of the system is under way, the near-to-medium
6 term outlook for coal exports must have been affected by
7 the global financial crisis and the marked decline in
8 economic growth in the Asian countries which dominate the
9 export market for coal.

10
11 We will now move on to the agenda items. Aaron Murray
12 from our Secretariat will provide a quick introductory
13 presentation on some of the rate of return issues before we
14 turn to hear from the stakeholders here today.

15
16 MR MURRAY: As the Chairman said, I will just provide a
17 very brief introduction on some of the key rate of return
18 issues for discussion today. In its last review in 2004,
19 IPART set a rate of return of 7.3 per cent. This was on a
20 pre-tax real basis. The WACC range identified as part of
21 the review was 5.5 to 8 per cent. IPART set a rate of
22 return above the midpoint of that range and in making that
23 decision, it was guided by the stakeholders' views at the
24 last public hearing in particular that they were willing to
25 accept a rate of return of between 7.1 and 7.5 per cent.

26
27 For this review IPART proposes to continue to use a
28 pre-tax real WACC formulation and a statutory tax rate to
29 determine the rate of return. In ARTC's proposal, which
30 was provided back in November 2008, it identified a range
31 of 8.8 to 10.5 per cent and argued that it should be
32 provided with a rate of return of at least the 75th
33 percentile within that range and that equated to I think
34 10 per cent real pre-tax.

35
36 Turning to the rate of return, some of the key issues
37 identified by ARTC in its proposal included the increased
38 risk associated with the substantial forecast capital
39 program, approximately \$1 billion over the next 10 years,
40 the impact of the global financial crisis upon finance
41 markets, the commercial and operating environment in the
42 Hunter Valley and also the consequences of regulatory
43 errors being asymmetric.

44
45 IPART has also identified many similar issues as key
46 issues for stakeholder comment and in particular is it
47 appropriate to set a rate of return above the midpoint in

1 the range? Are the costs of setting a WACC too low greater
2 than setting a WACC too high? Finally, is there any
3 particular need for IPART to amend its market based rate of
4 return to take account of specific issues, such as the
5 global financial crisis, the large capital program,
6 asymmetric risks for assets and if it should, how should it
7 take this into account?

8
9 IPART's issues paper on the rate of return also
10 identified a number of key parameters or specific issues
11 for stakeholder comment. They included the debt margin,
12 the expected inflation rate and there was a separate IPART
13 discussion paper which set out an alternative approach or
14 similar return approaches for forecasting inflation and the
15 appropriate capital structure and equity beta.

16
17 I will repeat the key issues for discussion which are
18 included in the agenda today. What is the WACC range that
19 is acceptable to stakeholders? Is it appropriate to set a
20 rate of return above the midpoint in that range. Are the
21 costs of setting a WACC too low greater than setting a WACC
22 too high, taking into account ARTC's proposed capital
23 program over the coming years? Finally, should the global
24 financial crisis change the way regulators estimate the
25 WACC and if it should, how should this be done? Finally,
26 should any adjustments be temporary?

27
28 THE CHAIRMAN: Thank you very much, Aaron. I suspect,
29 in the absence of volunteers, we might start with ARTC, as
30 you are the principal proponent.

31
32 MR ORMSBY: Thank you, Chairman. In my opening statement
33 I will provide some brief overview comments and then I am
34 going to hand over to Mark Christensen who is from
35 Synergies Consulting who is completing some work on behalf
36 of ARTC in relation to this exercise.

37
38 ARTC has approached this review by submitting a robust
39 and defensible range of parameters reflecting a reasonable
40 rate of return for a business with this risk profile,
41 embarking on a significant capital investment program in a
42 difficult financial and economic environment. In doing
43 this we've sought to be pragmatic, recognising this rate of
44 return will only apply for a reasonably short period of
45 time and operation under the existing IPART framework. To
46 this end, we have not pursued a certain position in
47 relation to some of the WACC parameters. These parameters

1 will be reviewed again by the ACCC under a longer-term
2 framework where ARTC's approach and position may be
3 different.

4
5 The approach taken by Synergies on behalf of ARTC was
6 to undertake an assessment of the most appropriate rate of
7 return for the business today in the current market
8 environment, using current market data and referencing
9 relevant regulatory precedent. It is not focused on
10 IPART's previous decision or whether the parameters
11 determined at that time were appropriate. The rate of
12 return is being reviewed in what is a highly uncertain and
13 difficult market environment.

14
15 The most significant issue is the uncertain outlook
16 for the export coal industry following the global economic
17 downturn and the fact that ARTC is looking to significantly
18 increase the size of its regulated asset base in this
19 environment. By 2014, ARTC estimates that the
20 Hunter Valley coal network regulatory asset base will
21 increase to around 2.5 billion from around 680 million
22 currently.

23
24 ARTC estimates that around 63 per cent of the
25 Hunter Valley coal network regulated asset base will be
26 constrained in 2014. This doesn't include ARTC's
27 unconstrained investments on the north coast. The size of
28 the investment north of Muswellbrook means that there is no
29 certainty that this part of the Hunter Valley coal network
30 will become constrained over the next five years. The coal
31 traffic using this part of the Hunter Valley coal network
32 also operates over a significant portion of the RIC network
33 - that is, the Rail Infrastructure Corporation network -
34 north of the Gap where ARTC has no control over pricing or
35 investment.

36
37 The assets ARTC is constructing have very long
38 economic lives and, hence, a long capital recovery period.
39 The investment horizon is much longer than the horizon of
40 many market participants and well exceeds the horizon of
41 any demand forecasts. Further, some of this expansion will
42 be servicing a number of more distant mines. The
43 systematic risk of these particular mines is likely to be
44 higher than the systematic risk of established mines that
45 are located closer to the port. Apart from being
46 relatively new developments, given that the mines are
47 located much further from the port, they are at a relative

1 cost disadvantage compared to their competitors who are
2 located close to the port, given they face higher transport
3 costs. As a consequence, these mines are likely to be more
4 vulnerable to a significant down turn in demand.

5
6 It is also noted that any mine, whether it be a small
7 producer or a large diversified multinational, can be
8 placed into care or maintenance or closed altogether as
9 demand conditions deteriorate. This has already been
10 witnessed in Australia in response to the recent commodity
11 market down turn.

12
13 The nature and extent of the global financial crisis
14 was yet to become fully evident when the Synergies report
15 was prepared. As a consequence, the implications of the
16 crisis were not considered for any of the parameters. As
17 other participants in the Hunter Valley would be aware,
18 apart from the impact of the collapse in commodity prices,
19 the global financial crisis is making it particularly
20 difficult to raise funding. This is significant for ARTC
21 given the size of its capital program.

22
23 Synergies' analysis is based on the standard
24 regulatory approach which is to determine the rate of
25 return based on an efficient benchmark firm. We note that
26 in its issues paper IPART makes reference to potential
27 equity being provided by government in funding ARTC's
28 capital program. This is considered by ARTC to be
29 completely irrelevant in this context, although, in any
30 case, if the government is contributing funds to a
31 commercial business it owns there is an expectation that it
32 will earn a commercial rate of return for its shareholders
33 which are, ultimately, the taxpayers. An overview of our
34 proposed position will now be provided by Synergies.

35
36 MR CHRISTENSEN: Thank you, Simon. My name is
37 Mark Christensen. I am wanting to speak to just a couple
38 of the parameters - one being the asset beta, the other
39 being the debt margin - and then I will go on and talk
40 about the effect of the global financial crisis and where
41 the point of estimate for WACC should lie within a
42 particular range.

43
44 Firstly, with the asset beta, how we went about
45 deriving a reasonable range for the asset beta was that we
46 considered drivers of systematic risk. We did a
47 first-principles analysis and considered the nature of the

1 customers, the product, the types of contracts, the form of
2 regulation, the market power and the operating leverage.
3 We also considered US rail firms. With the US rail firms
4 the average asset beta was 0.83, but combining these two
5 observations we came up with a reasonable range - or a
6 range we believed to be reasonable - of 0.5 to 0.6.
7
8 Also, we considered coal companies in coming up with a
9 range of asset betas, not that ARTC have the same asset
10 beta as a coal company, but the demand for coal does flow
11 through from the demand for ARTC's service to some extent.
12 Coal companies had an asset beta of 1.33 on average which
13 was twice the top end of the range that we're proposing of
14 this 0.5 to 0.6.
15
16 Additionally, we considered recent regulatory
17 decisions from rail networks, excluding the TPI decision,
18 and their asset betas were in the range of 0.5 to 0.65.
19 We believe that the range of asset beta we came up with -
20 0.5 to 0.6 - is quite a reasonable range based on any
21 comparative evidence that we could find.
22
23 With respect to the cost of debt, we believe the
24 appropriate rating is a BBB rating for ARTC and this is the
25 standard approach in setting your debt margin. What we did
26 in coming up with the cost of debt for a BBB firm was that
27 we looked at Bloomberg data. Because of the illiquidity of
28 the Bloomberg data we can't get 10-year cost of debt, so we
29 had to use eight-year cost of debt. We used the standard
30 adjustment for comparative eight-year BBB cost of debt,
31 which was eight-year cost of debt and adjusting it.
32
33 In the issues paper IPART sought to consider debt
34 margins on utility bond issues for AAA rated credit wrap
35 debt issues. We questioned the appropriateness of this,
36 the relevance of it, in that debt margins on AAA rated
37 credit wrapped issues don't reflect the cost of debt for a
38 BBB firm and the only way it could ever reflect the cost of
39 debt to a BBB debt is if you add back the cost of the
40 credit default swap to the AAA margin.
41
42 With the implications of the global financial crisis,
43 firstly with the risk-free rate how we believe that the
44 global financial crisis could impact upon some of these
45 parameters, the most significant impact of the crisis has
46 been on the Commonwealth Government bond yields, so
47 these yields currently are at historically low levels, which

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1 reflects the impact of non-risk factors on returns of
2 sovereign government debt. Historically there's been an
3 argument for this convenience bias. We don't pick up on
4 that, we don't believe in that convenience bias but what we
5 do realise is that that's blown out to about an additional
6 60 basis points. So if you did want to consider the
7 effects of the global financial crisis, an adjustment of 60
8 basis points we believe could be made to the risk-free rate
9 of return.
10
11 With the market-risk premium Synergies has proposed a
12 market-risk premium of between 6 and 7 per cent and this is
13 based on a long-term historic average as being a reasonable
14 predictor of a forward-looking market-risk premium. If we
15 consider just Bloomberg data to derive a forward-looking
16 market-risk premium, the current forecast market-risk
17 premium is about 10 to 12 per cent from Bloomberg. So
18 still using our historic data, the 6 to 7 per cent
19 market-risk premium we believe is reasonable and even the
20 upper end of that range is most probable.
21
22 The required return on equity: overall what we did is
23 we took a holistic view and looked at what is a reasonable
24 rate of return on equity in today's economic climate and in
25 today's economic climate firms are raising capital with a
26 PE of about 7. This implies cost of equity of about
27 14 per cent and that's on an average equity beta of 1;
28 we're suggesting a cost equity of below this and our equity
29 beta, or ARTC's equity beta would be in the range of
30 somewhere from 1 to 1.33, so our claim we believe is a
31 conservative claim.
32
33 With inflation it's expected that our approach to
34 inflation is to use the forecast of the Reserve Bank for
35 the next two years and then the mid of the 2 to 3 per cent
36 band and if we were to update the estimate of inflation
37 today, that estimate, based on that approach, would be
38 2.4 per cent.
39
40 So we come up with a range for the WACC. Where within
41 that range for the WACC should ARTC sit? We believe they
42 should be sitting to the higher end of the range and
43 there's two main reasons for that. One being the
44 asymmetric consequence of regulatory error, in that
45 underinvestment from too low a WACC is worse than the
46 consequences of the WACC being set too high.
47

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1 The second one is the stranding risk where ARTC has
2 undertaken this huge capital expansion of trebling their
3 RAB. With asymmetric risk it's not reflected in the WACC.
4 Normally it's not reflected in the WACC, it's not captured
5 in the beta, so how you can adjust for it then is by
6 adjusting the WACC in some way or trying to maybe quantify
7 it and put it into cash flows, but the difficulty of
8 quantifying it: what number do you come up with? So what
9 we do know is taking a figure, a WACC that's at the 75th
10 percentile is reasonable considering the stranding risk
11 that ARTC is faced with.

12
13 Do you have any questions? Can I say that?

14
15 THE CHAIRMAN: We'll come back to that.

16
17 MR CHRISTENSEN: Okay.

18
19 THE CHAIRMAN: You have finished ARTC?

20
21 MR ANDREWS: Geoff Andrews rather than George Andrews
22 from the Minerals Council. The New South Wales Minerals
23 Council is representing the Hunter Rail Access Task Force,
24 which is an associated body comprising all 14 Hunter Valley
25 coal producers using the Hunter Valley coal rail network. The
26 current coal rail by those produces around 100 million
27 tonnes per annum, with the vast majority of those being
28 exported through the Port of Newcastle. There's potential
29 for a very large investment in new mine capacity in the
30 infrastructure chain and consequent growth in exports from
31 the Hunter Valley in coming years.

32
33 Currently 97 per cent of the coal tracked in the
34 Hunter Valley network pays the full economic cost of the
35 track infrastructure and this is expected to increase to
36 100 per cent when production from the Gunnedah basin
37 expands. Minerals Council will make a detailed submission
38 on the rate of return and the IPART discussion paper
39 following the round table. The submission will be based on
40 work by our expert consultants ACIL Tasman and also some
41 work by Wood McKenzie in relation to the demand for and
42 economic competitiveness of Hunter Valley coal in world
43 markets. We, unfortunately, have not been able to get the
44 ACIL Tasman people here today to sort of talk at a more
45 technical level. However, they have given us the material
46 that we're talking about today.

47
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1 Talking about the WACC range: the ARTC range is 8.84
2 per cent to 10.53 per cent based on time variant parameters
3 being a risk-free rate and the debt margin that prevailed
4 in November 2008. It also reflected values for other
5 parameters: market-risk premium, proportion of franking
6 credits attributed value by shareholders, the asset beta
7 and the effective tax rate, which we believe result in an
8 ROR which is too high. The Minerals Council's proposed
9 range, and I emphasise this is subject to our final
10 analysis, completion of our report and review of our report
11 by our members, is expected to be around 4.7 to
12 6.8 per cent and that is based on time variant parameters
13 applying more recently and we believe there are strong
14 arguments for setting a rate that is in effect at or
15 towards the bottom end of that range and certainly not
16 above the 50th percentile. The precise proposals will be
17 confirmed in our submission.

18
19 In relation to the individual WACC parameters, the
20 Australian energy regulator's approach of aligning the term
21 for Commonwealth Government securities and bonds for the
22 regulatory period of five years is important and should be
23 used for determining any central estimates or at least the
24 lower bound estimates for the risk-free rate and the debt
25 margin. As the AER indicates, using a longer period
26 recompenses ARTC for risks it's not actually facing. The
27 AER review of the cost of capital parameters was undertaken
28 in conjunction with the ACCC. When approving the WACC
29 parameters included in the ARTC's interstate access
30 agreement the ACCC was careful to note that this review was
31 being undertaken. Accordingly it's very likely that the
32 ACCC will adapt AER's recommendations in its future
33 regulatory reviews. The Minerals Council believes that to
34 avoid overcompensating service suppliers and to ensure
35 consistency with future regulatory reviews of ARTC's Hunter
36 Valley network, IPART's approach to the WACC parameters
37 should be consistent with the AER recommendations.

38
39 The Minerals Council also believes it's not
40 appropriate to select an estimate above a midpoint of the
41 overall WACC range. This is in fact more generous than
42 selecting an equity or asset beta towards the upper end of
43 the range and combining it with midpoint estimates of upper
44 parameters, such as the market-risk premium. For example,
45 the Queensland Competition Authority selected an equity
46 beta towards the upper end of the range of estimates for
47 that particular parameter only. The Minerals Council

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1 believes that for many of the parameters a single point
2 estimate is appropriate. Parameters such as the risk-free
3 rate, the debt margin, market-risk premium. These should
4 be based on the AER approach. I won't go through the
5 detailed numbers that we have for each parameter but they
6 will be provided in our submission.
7

8 On the question of treatment of asymmetric risk, the
9 Minerals Council believes that the asymmetric risk should
10 not be considered in choosing the WACC for the Hunter
11 Valley coal network for a number of reasons. Firstly, the
12 risk of asset stranding is low. ARTC's assumption about
13 more remote mines closing first is not necessarily true, as
14 rail transport costs are a relatively small proportion of
15 FOB costs and can be outweighed by other positive cost
16 factors that might favour some mines over others, factors
17 such as grades, ratios, et cetera. Even with the
18 significant escalation in mining costs during the past two
19 years there is scope for the mines to take a considerable
20 price decrease before mine closures would be contemplated.
21 Moreover, Hunter coal is good quality, it's mined
22 efficiently and it uses efficient rail infrastructure and
23 it is located close to many major Asian markets and it is
24 strongly competitive in world terms. In the event of a
25 major downturn in demand for coal Australia and the Hunter
26 are likely to be among the least affected.
27

28 The production of coal in Australia and the Hunter,
29 while occupying a large share of the world seaborne coal
30 trade is only a very small proportion, less than 5 per cent
31 of world production. This means that provided Australia
32 remains at the low end of the world cost curve, then
33 continued expansion is expected. The reserves in the west
34 of the Hunter Valley are very substantial and require very
35 substantial investment by the mining companies to develop.
36 By comparison, the amount of rail infrastructure required
37 to support the mines is relatively small and it does not
38 make a significant difference to the total cost of
39 extracting the coal.
40

41 Decisions to develop or to continue to develop new
42 mines are being made by the mining companies in full
43 knowledge of the current global economic position. The
44 downturn may mean that plans for more marginal mines will
45 be deferred. This in itself makes it less likely that the
46 new mines will be closed down after they have been
47 developed. The mining companies will be examining the

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1 economics of new mines very carefully and ARTC will be able
2 to probe its customers about mine prospects before
3 committing to extension of the rail infrastructure.
4

5 The second reason why we don't think there should be
6 any compensation for asymmetric risk is that ARTC is able
7 to mitigate any stranding risk that might be there.
8 Stranding risk can be mitigated or avoided altogether by
9 requiring capital contributions from new mines requesting
10 extensions to the network or by the agreement of long-term
11 take or pay contracts.
12

13 ARTC's draft Hunter Valley access undertaking proposes
14 a 15-year minimum access contract term, with a large take
15 or pay component of access prices covering ARTC's new
16 investment and other fixed costs. Under this contract ARTC
17 is not obliged to commit to new capital investment projects
18 unless it has contractual access commitments covering the
19 extra capacity resulting from the capital investment. This
20 lowers the risk to ARTC because the contract term is longer
21 than the five or less years of most access contracts that
22 have been under the current undertaking and there is a take
23 or pay component unlike the current contracts.
24

25 Thirdly, ARTC is protected under the regulatory
26 regime. The regulatory regime itself provides protection
27 for ARTC's revenues through the revenue cap and the unders
28 and overs regime. ARTC claims that it has revenue
29 certainty only for the duration of the regulatory period
30 and not beyond. In our view this is not the case. The
31 rules for determining ceiling revenues are well defined and
32 will continue to be so even if regulatory jurisdiction
33 passes the ACCC. Moreover, the ACCC has made it clear that
34 it does not favour revaluing existing assets which also
35 reduces ARTC's revenue risk. Relatively short depreciation
36 lives allow accelerated depreciation to be recovered in
37 line with the expected life of mines rather than the
38 economic lives of the rail assets involved. Most line
39 sectors serve many mines and the routes are
40 interchangeable, which reduces the risk of revenue being
41 under-recovered. Where a sector serves only one or a few
42 mines the ARTC is able to request upfront capacity payments
43 from miners before making new investments.
44

45 Finally, even if there were deemed to be an asymmetric
46 risk, appropriate treatment can be provided for under the
47 regulatory regime. A number of regulators - the ACCC, the

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1 Essential Services Commission of South Australia, the
2 Queensland Competition Authority - have agreed that
3 asymmetric or truncated reserves can be adjusted for via
4 the cash flows, with the addition of a self-insurance
5 premium to operating costs which ensure that the rate of
6 supply for cash flows which reflect the true expected
7 outcomes as required by the capping. However, we do note
8 that the burden of evidence require that the regulated
9 entity is heavy in that case. In particular, the regulated
10 businesses needs to demonstrate that it is resolved to
11 self-insure for the identified events and will not make any
12 future claims to recover the costs in the event of an
13 adverse event occurring.

14
15 I would like to make some brief remarks too about the
16 cost setting the WACC too low being greater than the risk
17 or the costs of setting it too high.

18
19 The Minerals Council does not believe that the cost of
20 setting a WACC too low will be greater than setting it too
21 high. Firstly, overinvestment can be costly too. In a
22 report of the Essential Service Commissioner of Victoria
23 and also the report by National Economic Research
24 Associates suggested that both underinvestment and
25 overinvestment are costly and it is not at all clear which
26 is preferable. If overinvestment gives rise to capacity
27 that will not be utilised by reasonably anticipated future
28 demand, the resources dedicated to overbuilding that asset
29 could presumably have been better utilised elsewhere. For
30 example, in the provision of alternative infrastructure
31 services for which the consumer welfare associated with
32 their provision may be equal or greater.

33
34 Secondly, we believe that the risk of underinvestment
35 in ARTC's Hunter Valley network is low. We understand that
36 under the Commonwealth Government's package ARTC is to
37 receive a \$1.2 billion equity injection to help finance a
38 \$1.6 billion program for track upgrades and investment,
39 including \$580 million received from the government for the
40 Hunter Valley network. That's the extent of our remarks.

41
42 THE CHAIRMAN: Thank you. Does anyone wish to
43 comment on any of that at this stage?

44
45 MR ORMSBY: No.

46
47 THE CHAIRMAN: I would just like to make a couple of

1 observations myself. First, you referred to the IPART
2 discussion paper and equity - the return on equity - we
3 agree with that. They can always include the return on
4 equity; through our observation of WACCs, I'm not quite
5 sure how that confusion emerged. I just want to set the
6 record straight on that; we of course agree. You have to
7 get a return in equity from whatever the source of the
8 equity is.

9
10 The next question I'd like to ask is: I just want to
11 get a better understanding of what proportion of the asset
12 base is constrained. In our discussion paper we show a
13 chart, figure 4.1 in fact, which shows that just over
14 80 per cent of ARTC's regulated asset base was constrained
15 in 2007/8. I understood the Minerals Council to talk in
16 terms of 98 per cent under constraint.

17
18 MR ANDREWS: Yes, the --

19
20 CHAIRMAN: But I thought ARTC said something about
21 60-odd per cent. I'm just trying to understand what's the
22 right figure.

23
24 MR ORMSBY: The Minerals Council, I believe, were
25 referring to the volume of tonnes, not the asset base in
26 '07, so that was the reference to the value of the asset.
27 80 per cent sounds about right but that includes the
28 addition of the sectors, which is part of a current
29 submission to IPART which hasn't been approved or accepted.

30
31 THE CHAIRMAN: Can you speak up a bit or into the
32 microphone because I'm having trouble hearing you.

33
34 MR ORMSBY: The 80 per cent is part of ARTC's current
35 submission in relation to '07/'08 ceiling tests. That
36 hasn't been approved except to endorse it yet and that
37 includes a Ulan to Bengalla section, which may well be
38 constrained for the first time. Our reference to 63
39 per cent was in the year 2014 and it includes a significant
40 investment that we will be undertaken between
41 Muswellbrook and Werris Creek, which is not constrained
42 and may well still remain unconstrained in 2014.

43
44 THE CHAIRMAN: Thank you for that. My next question is
45 to the Minerals Council.

46
47 You refer to the fact that the ACCC is likely to adopt

1 the AER's methodology in terms of setting a WACC and
2 therefore IPART should be consistent with that methodology.
3 I think we'd agree that regulators shouldn't change their
4 methodology unless there's very good reason. So that, to
5 my mind, raises a question of whether we should depart from
6 our previous methodology rather than trying to anticipate
7 another regulator's methodology. I have to say also that
8 we at this stage haven't been persuaded that some elements
9 of the AER's methodology is correct. I will give you an
10 example: inflation rate where we put out the paper and I'd
11 have to say that I personally, having been at one time in
12 my career an official forecaster, I personally don't regard
13 official forecasts as an unbiased estimate of the future
14 inflation. At this stage I remain to be persuaded that we
15 aren't better off pursuing the work that we've undertaken
16 using a market-based forecast of inflation.
17
18 It is not obvious to me that we should try and
19 anticipate what the ACCC will do, or even what will
20 eventually come out, as distinct from adopting or
21 continuing our own methodology with the changes regarding
22 inflation, for example. We are also about to put out a
23 paper on debt margins that may influence that.
24
25 Just while I am directing questions to the
26 NSW Minerals Council, I wasn't part of the last
27 determination by IPART regarding the rate for this purpose,
28 but my understanding is that all parties at that time
29 agreed that we should fix a rate of return which is above
30 the 50 per cent point.
31
32 At that time, as I have been informed, the coal
33 companies took the view that the risk of - for want of a
34 better phrase - underinvestment or insufficient return
35 provoking underinvestment was a more significant risk than
36 the risk of overinvestment from a too-high rate of return.
37 While I appreciate you've given reasons, you're now arguing
38 for something less than the midpoint of the range, I am
39 intrigued as to why you changed your view, if I'm correct.
40
41 MR ANDREWS: Yes, we have changed our view. I guess
42 we're reflecting current circumstances.
43
44 THE CHAIRMAN: Do you want to enlarge on that?
45
46 MR ANDREWS: We have more information about the risk of
47 underinvestment or potential risk of underinvestment.

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1 We see that that's less of a risk. We see a lot more plans
2 for investment. We see that ARTC is going to be adequately
3 recompensed for that investment through the assets charges.
4 We don't see that they will have a problem financing the
5 investments they're going to make.
6
7 MR ORMSBY: We would at 4.8 per cent.
8
9 MR COX: Can I come in here? I do remember when we were
10 talking about this issue five years ago both parties, both
11 the mining industry and ARTC, were more or less happy with
12 a rate of return of about 7.3 per cent, plus or minus a
13 bit, which we said corresponded to a range of 5.5 per cent
14 to 8 per cent, or something of that order of magnitude.
15
16 If you were to update that for market movements you
17 would move up a bit, but probably not all that much.
18 I have two observations. Firstly, given the limited life
19 our decision has, there's a lot to be said for sticking to
20 the status quo and update it unless there are strong
21 reasons to the contrary. My second observation is that
22 both parties have changed their position as to where they
23 were five years ago in 2004. I would really like to
24 understand why. What actually has changed between 2004
25 and now from the point of view of both markets? That is
26 probably the crucial decision that we have to make.
27
28 MR CHRISTENSEN: Could I have a go at trying to answer
29 some of that?
30
31 MR COX: Yes.
32
33 MR CHRISTENSEN: There are two approaches in calculating
34 the WACC. One may have been to go back to the past and try
35 and see what has changed from the past to the present and
36 try to look at some sort of reason for this incremental
37 change, or, alternatively, we go to the market today using
38 market data today, using appropriate methodologies and
39 calculating the one today. That is what we've done.
40 We have calculated asset betas today using monthly data
41 over a five-year period.
42
43 In no way have we gone on to try and explain, say,
44 movements in asset beta over time because asset beta is
45 non-stationary. If I calculated an asset beta last month
46 and calculate it this month, using appropriate methodology,
47 it is a different beta. Asset betas change because of a

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1 variety of reasons. What we've done is we've gone out and
2 used market information today to calculate risk factors to
3 September using available observed market data. We haven't
4 tried to explain reasons for incremental changes because we
5 just didn't think that was an appropriate methodology.
6

7 MR COX: From my point of view, the changes are quite
8 substantial. It would assist me to understand why you
9 think they're necessary.
10

11 MR ORMSBY: In putting this forward, there are two primary
12 changes that we're dealing with and to some extent one of
13 them relates to the point in time and that is the current
14 credit availability and challenge in raising financing.
15 Clearly, we're in a different environment in that regard to
16 where we were five years ago.
17

18 The second aspect that has changed from ARTC's
19 perspective is the quantum of investment and the location
20 of some of that investment. When we sat here five years
21 ago our investment plan did not contemplate anywhere near
22 the size of investment that we are making to address
23 capacity at the request of the industry and it did not
24 contemplate the size of investment that we would be making
25 between Muswellbrook and Werris Creek. They are the two
26 obvious factors that have changed.
27

28 MS KRIEGER: Could I ask a question about that? The
29 difficulty in getting finance translates into the debt
30 margin. Does it translate into anything else?
31

32 MR CHRISTENSEN: As to raising funds, we've looked at the
33 holistic view of what would it cost to raise equity funds
34 today. We did that when we checked our cost of equity
35 using the capitalised pricing model parameters and it also
36 reflects in the debt margin as well. It reflects both in
37 equity and debt to give the overall effect.
38

39 MR COX: Do the Minerals Council want to add to why
40 things have changed since 2004? Have you answered that
41 sufficiently in response to my question?
42

43 MR ANDREWS: We will give you some detailed material on
44 this in our submission. There are a couple of factors.
45 One is that we're seeing a lower risk and it's mentioned
46 over here that the market has changed. One of them is a
47 lower risk-free rate. That is coming out of the current

1 environment. The second one is that we are seeing a
2 considerably higher gamma than was used before.
3

4 The third one is we see the effective tax rate that
5 ARTC will be subject to, because of its very large
6 investment program, will be far below the current corporate
7 tax rate, somewhere in the range of 10 to 20 per cent.
8 There are several significant factors in there that are
9 moving our rate determination down from the previous one
10 and we will have all the detail in our submission.
11

12 THE CHAIRMAN: I open it up to the floor.
13

14 (No response from the floor)
15

16 THE CHAIRMAN: Are there any final comments on the rate
17 of return from either party? We have probably exhausted it
18 for the time being. We might now move to the second topic,
19 which is remaining mine life. Aaron.
20

21 MR MURRAY: This is a very brief introduction to the
22 issues here. In 1999 IPART set the remaining mine life at
23 40 years. In that last decision it reaffirmed that
24 original estimate and set the remaining life at 35 years.
25 This reflected the stakeholders' views at the hearing.
26 They largely accepted that 35 years was an appropriate
27 estimate. Not altering that current estimate implies a
28 remaining mine life of 30 years from 1 July 2009, the
29 commencement of this current review.
30

31 ARTC in their proposal has proposed a shortening of
32 the remaining mine life to 22.8 years and that was based on
33 the work undertaken by Booz & Co. They identified a number
34 of mine life estimates based on several options and the
35 range of those estimates was 22.5 to 25.5 years.
36

37 As mentioned, Mike Smart is here today. Mike has
38 prepared a draft report for the Tribunal and it raises a
39 number of issues for stakeholder comment. Those comments
40 are due on 9 April. Mike is also here today if anyone
41 wants to ask about any specific issues regarding his
42 report.
43

44 Just briefly, I will repeat the key issues identified
45 in the agenda for today. What are the reasons to depart
46 from the existing estimate of mine life: ie, 30 years from
47 1 July 2009? What would be the benefits of altering the

1 existing estimate of remaining mine life? How would any
2 change affect ARTC and/or its customers? The
3 appropriateness of Booz & Co's methodology, including its
4 approach to modelling coal chain bottlenecks and
5 prospective mines? And finally, the treatment of lines
6 which have recently joined the constrained group.
7 Thank you.

8
9 MR ORMSBY: I will perhaps give a quicker statement on
10 this one. I won't call on Synergies. In reviewing mine
11 life, we undertook an assessment that was done in
12 accordance with the provisions of the New South Wales rail
13 access undertaking and the previous practice under IPART
14 and we applied a single mine life to the whole of the
15 Hunter Valley coal field.

16
17 It is probably worth noting that under our
18 Hunter Valley access undertaking proposed to go to the
19 ACCC, we take a quite different approach. We introduced
20 the concept of pricing zones between Newcastle and
21 Muswellbrook, Muswellbrook and Ulan, Muswellbrook and
22 the Gap and in that process we intend to recognise the
23 different investment characteristics and risks in the
24 Upper Hunter Valley.

25
26 The proposed new undertaking proposes an expansion of
27 the current network for which a wrap has been determined to
28 include data put to the Gap. Nonetheless, in this exercise
29 we've sought to include all mines used in the Hunter Valley
30 coal network managed by ARTC.

31
32 We have largely adopted an approach that's consistent
33 with that used in the last two assessments. While there
34 were some drawbacks identified last time around,
35 we understand that the previous approach was accepted by
36 stakeholders and by IPART and in seeking to adopt a
37 consistent approach, we've undertaken the following.
38 We have assessed a similar but updated set of mines and
39 we've considered mines currently in operation or expected
40 to be in operation over the 2009 to 2014 time frame as a
41 relevant representation of coal mines utilising the Hunter
42 Valley sectors, in accordance with the New South Wales rail
43 access undertaking. We have included, as in previous
44 assessments, those mines beyond the Hunter Valley coal
45 network managed by ARTC, but utilising the Hunter Valley
46 coal network managed by ARTC.

47

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1 We tested the impact of prospective mines that may
2 commence beyond 2014, as was the case in previous
3 assessments. With respect to mine life this time around,
4 there are two key differences to the previous approach.
5 Firstly, we considered incorporating a forecast of
6 production levels over the life of a mine. Previous
7 assessments based production weighting on production levels
8 in a single year - the current year only - and failed to
9 reflect the realities of changes over time. Previously, it
10 was identified by the Minerals Council as a serious
11 drawback under the previous assessments. ARTC agrees that
12 this should be recognised.

13
14 For reference purposes, we've based our production
15 forecasts on those provided directly to us by producers
16 around the year 2008, the most recent forecast we have from
17 producers.

18
19 The second key difference is that we've considered and
20 incorporated forecasted supply chain constraints over 2009
21 to 2014. We have considered demand forecasts in the
22 context of any coal chain capacity constraints that may
23 arise. In proposing a mine life, we considered the impact
24 of supply chain constraints incorporated in the first five
25 years in the 2009 to 2014 period. We assume that beyond
26 the five-year period there would have been sufficient
27 investment by service providers to avoid a supply chain
28 constraint.

29
30 As was previously mentioned, we considered a number of
31 options. We included with and without coal chain capacity
32 constraint, we included with and without prospective mines
33 and the main purpose for this was to provide a degree of
34 sensitivity around the outcomes.

35
36 In summary, we believe this represents an approach
37 that is consistent with but actually improves on the
38 approach used in 1999 and 2004. In 2004, ARTC considered
39 the Booz estimate at that time, which was 27.5 years,
40 suffered from some drawbacks that could result in
41 underestimation and overestimation. These drawbacks were
42 that mine life was predicated on a continuing production
43 level of 70 to 80 million tonnes per annum and at the time
44 increased coal chain capacity was intended to deliver
45 capacity over 100 million tonnes. Effectively, that would
46 have overestimated mine life.

47

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1 The approach did not incorporate a ramp-up of
2 production for new mines which was underestimated. It did
3 not contemplate proving of resources, which again provided
4 an underestimate, and it didn't contemplate the impact of
5 coal pricing, depending on whether the price provided an
6 underestimate or overestimate, and it didn't contemplate
7 climate change, emissions trading or alternative base load
8 energy developments on a global scale, which would provide
9 an overestimate.

10
11 Taking all things into account, ARTC considers that
12 its current approach addresses many of the previous
13 drawbacks that it could reasonably address with some
14 certainty and as such represents a more robust and accurate
15 estimate of average mine life of coal mines utilising the
16 Hunter Valley coal network managed by ARTC.

17
18 ARTC also contends that this work and ARTC's proposal
19 of an average mine life of around 23 years to apply from
20 1 July 2009 provides a stronger confirmation than the
21 previous Booz & Co estimate of 27.5 years that was
22 reasonable in 2004.

23
24 MR ANDREWS: The Minerals Council will make a detailed
25 submission on remaining mine life and the LECG issues paper
26 following the roundtable, as we will on ROR. The
27 submission will be based on work by our expert consultants,
28 Wood McKenzie, in relation to the resources and the
29 forecast production of Hunter Valley coal over the medium
30 to longer term.

31
32 Commenting specifically on the estimates of remaining
33 mine life that ARTC has proposed, their remaining mine life
34 of 22.8 years is based on major growth in production
35 levels, whereas previously that has been a flat production
36 level assumed. Our proposed remaining mine life is at
37 least 30 years, even based on the reserve data quoted in
38 the ARTC Booz & Co submission. Firstly, that submission
39 excluded prospective mines at Caroon, Maules Creek and
40 Watermark and if they were included it would add three
41 years to the average RML, bringing it up from 22 to
42 25.6 years.

43
44 We also believe that it's not appropriate to assume,
45 as ARTC Booz have done, a production rate beyond the
46 maximum capacity at the current port terminals at PWCS and
47 NCIG. A future production rate of no more than the planned

1 future capacity at PWCS and NCIG, which is potentially
2 211 million tonnes from 2013 onwards, should be used rather
3 than ARTC Booz's assumed production of 240 to 260 million
4 tonnes from 2013 and on.

5
6 The difference between 211 and 240 to 260 would add
7 another five years to the average remaining mine life and
8 that alone takes the 25 up to 30-odd years, or a bit over
9 30 years. We also don't think it is appropriate to assume
10 a production rate beyond the track capacity that will
11 result from ARTC's investment in the five-year regulatory
12 period. This capacity is not clear from the ARTC further
13 submission or from ARTC's response to IPART's query on the
14 matter in January. It could be that the capacity resulting
15 from that investment will be lower than the potential
16 short-term capacity.

17
18 Finally it's possible that the actual production will
19 be less again than the infrastructure capacity, at least in
20 the short to medium term, with a consequent further
21 extension of average mine life beyond 30 years and there's
22 certainly forecasts out there that would be lower than that
23 capacity.

24
25 In addition, the Minerals Council view is that the
26 prospective market reserves for Hunter mines and
27 prospective mines are understated in published data and the
28 assessment used by our ARTC views. Our submission will
29 address this issue. From a demand point of view we believe
30 that demand for Hunter Valley coal will be sustained in the
31 medium to longer term by worldwide demand for coal and
32 the economic competitiveness of Hunter Valley coal in world
33 markets. We believe there's no need to shorten the
34 remaining mine life to allow for any stranding risks but
35 that's what we see the ARTC proposal doing.

36
37 The final point I make is we will comment in detail on
38 IPART's other questions and the LECG report, methodology
39 and issues in our submission.

40
41 THE CHAIRMAN: Thank you. I'd like to go back to the
42 ARTC. You describe your estimates now as being consistent
43 with past methodology. Am I right in thinking when you say
44 that it's consistent with the methodology which was used
45 back in 1999, which was the first time around, that when in
46 2004, as I understand it, there was general agreement to
47 say instead of I think it was 40 years, from memory, back

1 in 1999, five years had passed, therefore the remaining
2 mine life is 35 years. If we were to pursue that
3 argument, the remaining mine life now is 30 years, so
4 that's one view of the consistency, consistent with what we
5 did in 2004, but you're basically saying you want to go
6 back and rework the 1999 estimate, having regard to today's
7 conditions; is that --

8
9 MR EDWARDS: Glen Edwards from ARTC. In 2004 I think
10 both the Minerals Council, ARTC at the time had some concerns
11 with the approach that was used by Booz, because Booz did
12 in fact undertake a review in 2004, for different reasons
13 they had concerns. From memory the New South Wales
14 Minerals Council submission saw 40 years whereas ours saw
15 something less than 27, which was the Booz estimate, so I
16 don't think either party was particularly satisfied with
17 the estimate. 35 came about last year as a result of the
18 position we agreed to get it to at the end of the day. So
19 I don't think we necessarily assume that everybody thought
20 that 35 was the appropriate level but when you have got two
21 parties so widely apart, there needs to be some conclusion
22 drawn.

23
24 THE CHAIRMAN: I gathered from my reading of the past is
25 that there was a fair amount of agreement to come to 35,
26 the logic being it was five years after the --

27
28 MR EDWARDS: I'm not sure that was the basis but yes.

29
30 THE CHAIRMAN: Just pursuing this a little bit further:
31 having regard to the likely limited time for determination
32 that it will run, is it appropriate for us to go into a
33 huge amount of detail? I take your contention that it's
34 consistent with the conceptual approach back in 1999 but is
35 it appropriate for us to, for want of a better phrase,
36 reopen that and do it again when this thing might only run
37 for a limited amount of time?

38
39 MR ORMSBY: I understand the point. I won't answer it
40 here but we will take that on board when putting forward
41 the final submission. I'm not necessarily disagreeing with
42 that but we'll take it on board.

43
44 MR COX: I guess my comment is to ARTC. I would be
45 interested in any views you had on the things said by the
46 Minerals Council, either today or later in their
47 submission, I would be interested to see your response to

1 those views.

2
3 MR EDWARDS: I think we'd probably prefer to look at those
4 in our submission. Perhaps one thing we could mention is I
5 think Geoff mentioned that we used production levels
6 somewhere in the order of 240, 260 million tonnes based on
7 the forecasts of production that we provided, I think the
8 highest it gets to is about 211 million tonnes.

9
10 MR ANDREWS: The graph in your submission says 240-260.

11
12 MR EDWARDS: That shows capacity, not necessarily the
13 forward production.

14
15 MR ANDREWS: I think I said it's unclear and I think it
16 would be good to have that forecast provided because that's
17 a key element of working out what the remaining mine lives
18 are and that's why we asked for it in January.

19
20 MR EDWARDS: We're obviously trying to respect the
21 confidentiality when information received is provided.

22
23 MR ANDREWS: Yes. The other comment I'd make about this
24 is when you go to individual companies they will all give
25 you a forecast which will reflect their hopes and
26 aspirations and when you put them all together you tend to
27 get larger numbers than what will actually happen in
28 practice. So that, you know, all that has to be tempered
29 by an assessment of what will really happen to look at what
30 the demand is as well as what the supply capability is and
31 that's one of the things that Wood McKenzie is doing for us
32 and they have been out in the field and looking at what
33 demand is versus what the supply capacity is.

34
35 MS KRIEGER: I say to ARTC: is there a fundamental
36 inconsistency between the higher production levels which
37 you assume and which underpin the shortened mine life on
38 the one hand and on the other hand the risk of
39 underutilisation, or stranding which you referred to, which
40 you say pushes you towards the top end of the WACC
41 spectrum?

42
43 MR EDWARDS: No. The higher levels of production will
44 naturally bring down the life of the mine, which creates
45 the stranding risk because the investments are longer term
46 than 22 years and a life longer than that.

47

1 MR ORMSBY: The higher production level is in large part
2 driven by significant volumes in outer mines which
3 exacerbates the stranding risk.

4
5 MS KRIEGER: To put it another way: you have focused very
6 much on production within the next five-year period for
7 some purposes but you have looked at an investment spectrum
8 much longer than that for assessment of your investment
9 risk.

10
11 MR ORMSBY: Yes. As I understand, the rail arrangements
12 focused around the five-year cycle - our assumption is
13 that's why you have a five-year review, given the
14 circumstances that may prevail five years from now.

15
16 THE CHAIRMAN: Just to pursue my colleague's questioning:
17 you must be more confident of achieving your revenue target
18 if you believe there will be loss of production, five
19 years. At the end of the day that might influence where we
20 are in the range of your WACC.

21
22 MR EDWARDS: I think we're reasonably confident of the
23 next five years. As I said our investments - when an
24 investor comes to where we might get funding come from,
25 they will be looking over a lot longer term than five years
26 as we must and whilst we can say there is going to be a lot
27 of production growth in line with what the industry is
28 seeking over the next five years, because our assets are
29 much longer term than that, an investor will look over much
30 longer timetables than five years and decide whether to
31 invest and where the best use of its funds might be.

32
33 MR SMART: I have just a few questions. Mike Smart from
34 LECG.

35
36 The first question for ARTC is: in your calculation,
37 or in Booz's calculation of the remaining mine life Booz
38 has excluded some of these large mines out near Gunnedah,
39 Maules Creek and Watermark. Why did you leave them out
40 in calculating the margin?

41
42 MR EDWARDS: Firstly, it was consistent with previous
43 practice. The New South Wales undertaking talks about the
44 remaining mine life of mines utilising the network. I
45 guess it remains a matter of conjecture as to how far out
46 you are prepared to look for what might be out there.

47

1 I guess the second element is in relation to those
2 particular mines and the certainty with which they are
3 actually going to occur and equally the quality information
4 available about the rate of production levels that might
5 apply to those mines and if you get those terribly wrong,
6 because of the size of those mines that can significantly
7 distort the outcome.

8
9 MR SMART: Is it a question of the timing of when the
10 mines will come onstream or whether or not they will come
11 onstream.

12
13 MR EDWARDS: If you're going to look out 15, 20 years and
14 that sort of thing, for volume - I'm not talking about
15 these mines particularly beyond that - there's a lot of
16 other risks that needs to come into the equation as well,
17 things like climate change, demand for coal and those sorts
18 of things that have to be factored in as well, so it does
19 create a much more complex outcome taking those into
20 account and that's probably some of the reasons why in
21 previous assessments undertaken in '99 and 2004 they
22 basically looked at using the five-year time frame and
23 taking it all - production forecasts in that period of time
24 rather than going out beyond because - knowing that in five
25 years time you will have an opportunity to look at those
26 additional mines and the impact that may have then when
27 you can become more certain about whether they'll actually
28 come onstream and what their production might be.

29
30 MR SMART: The idea being that you might consider
31 lengthening the mine life in five years time if --

32
33 MR EDWARDS: Our understanding of the objective of the
34 regime in having a five-year review is just to do that, to
35 update itself in that five-year period as to what the best
36 estimate might be at that time.

37
38 MR SMART: Thank you.

39
40 MR ORMSBY: It's also worth, I think, thinking about the
41 stage, as Mike mentioned, five years out they may have
42 exploration licences but they're not constructing, there
43 are still a series of approvals that most of those mines
44 have put in place, some of them still have to have
45 infrastructure in place, so I think there has to be a fair
46 amount of uncertainty around these mines. You have got to
47 draw a line somewhere and five years has been previously

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1 selected.
2
3 MR ANDREWS: There is an inconsistency there. If you
4 assume increasing production over a long term, it's got to
5 come from somewhere, it's got to come from new mines. You
6 say you can't assume that they're in because they're not
7 yet committed, then you can't assume that growth in
8 production over the long term either because it's got to
9 come from new mines.
10
11 MR EDWARDS: We've only assumed production levels in
12 the five years. I think again, based on the forecasts we were
13 given and the mines that we've used in this assessment, the
14 production level does peter out beyond that five-year time
15 frame.
16
17 MR ANDREWS: The natural way of things is that new
18 resources are developed to take over from depleting mines
19 and there are a lot of new resources.
20
21 MR EDWARDS: We'd all hoped that would be the case. It's
22 not certain and there are a lot of other things out there,
23 including things like climate change, that might change
24 things going forward.
25
26 MR SMART: Second question: Booz has looked at two
27 possible scenarios in estimating mine lifes. One in which
28 the rail infrastructure constraints are binding and the
29 other one in which these rail infrastructure constraints
30 are ignored. Bringing in those rail infrastructure
31 constraints has an extremely small effect on the remaining
32 mine life of 0.3 years, I think, which seems rather
33 unexpected, given that there is such a high priority placed
34 at the moment on putting new investment into expanding the
35 rail capacity. One way of looking at it would be to say:
36 if it makes such a small difference, why is everybody so
37 focused on investing in track capacity? And it makes one
38 wonder, I think, whether Booz has done this part of the
39 calculation correctly.
40
41 MR EDWARDS: Okay. That's something that intrigued us
42 too, I might add. As I said, we relied on production of
43 forecast information from the industry and I guess the best
44 conclusion we can draw from that outcome is that the
45 forecasts that were provided as to production, not
46 necessarily demand but production, by the industry may have
47 had, in their own minds, factored in the level of capacity

1 that was available in the network and hence there would be
2 a natural levelling between the production and the capacity
3 over that five-year period. Beyond the five years, as
4 Simon said, we've assumed, which we think is fairly well
5 aligned with the industry position, that there will be
6 sufficient investment in the network such that demand is
7 met. In those first five years there may have been a
8 tempering in those production forecasts back a little bit
9 to reflect the fact that the capacity is in the network and
10 hence you are going to get very little difference between
11 production we are being told about and what the capacity
12 might be of the network. That's probably the best response
13 that we have come to this at stage.
14
15 MR SMART: I think it would be helpful if you could
16 provide more detail as to how Booz did that constraint
17 calculation, just so that we can test it for ourselves.
18
19 MR EDWARDS: Sure.
20
21 MR SMART: At the moment it's a bit of a black box.
22
23 MR EDWARDS: That's why we've still got a submission to
24 put in.
25
26 MR SMART: One last question: this last question is posed
27 to both the Minerals Council and to ARTC, so I will put it
28 to the Minerals Council first. To some extent adjusting
29 the mine life is a bit of a zero-sum gain in the long term
30 because ultimately you can only recoup the regulated asset
31 base once through access charges over the lifetime of the
32 assets. So given that, with a long-term perspective, why
33 is it so important to change the mine life now?
34
35 MR ANDREWS: We don't want it changed, we don't want it
36 shortened and the reason being that you have higher
37 depreciation rates which means higher access charges. Yes,
38 it's a zero sum gain but not - it's not a zero sum gain.
39
40 MR EDWARDS: Our view on that would be any change that
41 brings in a more accurate and reliable assessment of
42 estimated mine life than might have been undertaken
43 previously has got to be of some benefit to everybody.
44
45 MR SMART: Is that right, though? Surely what's
46 important is that it's accurate in the end.
47

1 MR EDWARDS: The best estimate you can use should give
2 you a reasonable balance between the issues of over and
3 underinvestment in the network, so we would see that as
4 having to be some sort of improvement and, as I say, it is
5 something that we feel is perhaps provided for in the
6 undertaking. That's why they have five-year reviews. If
7 they intended to set it at 40 and just keep going, marking
8 it down five years every time, why would there be a need to
9 have five-year reviews? Surely this sort of change might
10 have been contemplated if it could be improved on over
11 time.

12
13 MR ANDREWS: The comment I'd make on that is that
14 remaining mine life should reflect what the situation
15 really is. It shouldn't be artificially shortened. The
16 remaining mine life should reflect what the situation
17 actually is. If you artificially shorten it, current users
18 are going to pay more than future users, you know. There's
19 an inequity thrown up by that.

20
21 MR SMART: So far nobody's commented on one of the
22 questions that was in the issues paper and in this list of
23 questions and that is: how should the mine life treatment
24 apply to lines such as the Ulan line which is joining the
25 constraint for the first time? It does throw up some
26 rather special issues and I was just wondering what the
27 parties felt should be done about that.

28
29 MR ANDREWS: You have got a position on that for the ACC,
30 haven't you?

31
32 MR EDWARDS: We'd probably prefer to leave our position
33 to the paper on the 9th on that. Perhaps a broad comment
34 might be that we do see some merit in it. It seems to have
35 some alignment with the approach that we are proposing to
36 put forward to the ACCC which we have titled - it's a new
37 approach but it's called lost capitalisation where an
38 investor is compensated over the long term for investments
39 that might initially not recover full economic cost. We
40 think that's something that would be very useful in the
41 Hunter Valley because it does provide fairly strong
42 incentive to invest ahead of demand, knowing that you are
43 going perhaps make losses but not recover your full return
44 in those early years but you might be compensated in later
45 years, assuming the market can afford it, so we do see some
46 merit in that perspective. That's a fairly broad comment
47 about it.

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1
2 MR ORMSBY: We actually do welcome the debate and the
3 discussion on open mike there. I don't think it is any
4 secret ARTC has been concerned about this concept that
5 under a regulated framework once you forego return on
6 depreciation that's it, you can never get it back even
7 though you have actually invested the money. It seems
8 logical that you should be able to recover that return of
9 depreciation some time in the future if it made investment
10 and if the market conditions would allow - make it
11 affordable.

12
13 MR ANDREWS: I would just make the comment that I
14 thought your question was heading towards depreciation by
15 one segment or groups of segments and I think the direction
16 of that is where we will head over time. I'm not sure it's
17 necessary here as opposed to having just one average mine
18 life.

19
20 MR SMART: Yes.

21
22 THE CHAIRMAN: Are there any questions or comments on
23 mine life from the audience?

24
25 (No response from floor)

26
27 THE CHAIRMAN: If there is not, unless people at the table
28 want to make a further comment, I am going to bring the
29 proceedings to a close. First of all, I would like to
30 thank you all again for your contributions today. I don't
31 think there's a lot I can say in reply because what's quite
32 evident is that the devil is in the detail in this one and
33 in several significant cases we're still to get the detail.
34 It wouldn't serve any useful purpose for me to comment on
35 the proceedings today.

36
37 The only thing I would say is that, if you like, one
38 general issue is how far, if at all, we should seek to
39 change from continuing what has previously been
40 established, especially in the context that this
41 determination isn't going to run very long and that a new
42 regulatory body is likely to want to set its own course.
43 I imagine it might be guided by the past, but at the end of
44 the day it will make its own determination according to its
45 own norms.

46
47 I suppose there is an issue for us - which I've

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1 already raised - as to how far we should seek change. Let
2 me just say that I think for those who want us to change,
3 you will have to make a case. The ball is in the court of
4 the proponents of change rather than in defence of the
5 status quo.
6

7 We do look forward to your written submissions in
8 which you flagged you would pick up some of the things that
9 have been raised today. On that basis, we expect to get
10 our draft decision out in early May, so that on the basis
11 of comment after that we can make our final decision before
12 the end of June. Thank you again for your participation
13 today. This hearing is closed.
14

15 AT 4.22PM THE TRIBUNAL ADJOURNED ACCORDINGLY
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