Hunter Rail Access Task Force (HRATF) submission on the IPART Draft Report on Rate of Return and Mine Life for the NSW Rail Access Undertaking

10 July 2024

1 Introduction

IPART have published the Draft Report for the periodic review of the rate-of-return and mine life for the NSW Rail Access Undertaking. The rate-of-return finding applies to all rail networks, while the mine life conclusion is solely focused on the small section of the Hunter Valley Coal Network (HVCN) which is not owned by ARTC.

Hunter Rail Access Task Force (HRATF) is comprised of the users of HVCN. HRATF have some concerns with the analysis and the conclusions of the Draft Report.

2 Rate-of-Return Review

HRATF recognise that the rate-of-return review mainly represents an uncontroversial update of market data using the standard IPART methodology. The Draft Report does not attempt a broader review of the IPART WACC methodology. This is a reasonable approach for the purposes of the NSW Rail Access Undertaking.

Given this, HRATF are surprised that IPART have materially changed the articulation of the reasons for the choice of the gearing ratio. In previous review, IPART adopted 45% debt to 55% equity ratio for the NSW rail networks. This is a substantially lower level of debt ratio than is typically used for regulated entities and is less than used for the ARTC (while the ACCC have not formally considered ARTC WACC since 2017, their previous assumption was 60% debt) or Aurizon Undertakings (which has 55% debt in UT5).

In its report for the 2019-2024 Rate-of-Return and Mine Life Review, IPART simply referenced the market comparators. At the time, IPART justified its 45% gearing by simply noting that the median gearing ratios were 48% for coal mining, 47% for electricity generation and 38% for rail transport. The median of all three industries is a gearing ratio of 45%.

In the DRAFT report, IPART now explicitly link the gearing ratio to the coal sector risk in response to the TAHE's submission, which refers to a 2016 report by the Competition Economists Group for Aurizon Network (Debt risk premium of coal transporters). That report argued for a 'coal' premium being priced in by debt investors who were supposedly concerned about Aurizon's ability to recover its fixed and sunk investments.

In the Draft Report, IPART acknowledges that the 'coal' premium should be recognised and says that it recognises it by setting a low debt ratio. In other words, IPART implies that a benchmark coal rail company would not be able to achieve BBB rating if it were to gear up to the same level as other infrastructure businesses with similar revenue cap regulations.

In HRATF view, this new rationalisation is not based on any underlying research or market analysis. Such analysis would require a much more fundamental review of the rate-of-return approach than the periodic review. This new rationalisation comes across as a throw-away comment and opinion. While it does not result in any change to the gearing ratio, if it is left in the Report, it will create an analytical precedent.

Apart from the apparent lack of evidence for the 'coal' premium, IPART's argument is also internally inconsistent. The rate-of-return determination applies to all rail networks in NSW. The total RAB for the coal sectors covered by the NSW Rail Access Undertaking is less than \$20m—a very small fraction of the total asset base of the NSW rail networks. It would make no sense to select a gearing ratio on the basis of the 'coal' premium and then apply it to all other networks.

While there may be a number of justifications for the 45% gearing for the NSW rail networks, none of them are relevant or specific to the coal network. We believe it is important that IPART address both the logical inconsistency and the lack of evidence in its reference to the 'coal' premium

3 Mine life review

IPART have previously argued that instead of using Mine Life for depreciation, they should apply the Asset Life. As we understand it, the distinction that IPART see between these two concepts appears to relate to the ability to recognise demand side factors. In the case of the few HVCN segments covered by the NSW Rail Access Undertaking, the distinction allows IPART to focus on the expected life of the NSW coal power plants, which are the main users of those segments. Given the announcements of the likely coal power plant closures, IPART proposes to reduce the Remaining Mine Life from 16 to 5 years. This has a very significant effect on the depreciation allowance and would lead to an about 19% increase in access charges.

IPART's key argument is that while the mine life of the mines supplying the power plants will not be affected, since the segments cannot be used to transport coal from those mines to Newcastle, the asset life of the segments is reduced.

While the conclusion with respect to the carriage of coal to the NSW power plants is reasonable, HRATF have a number of concerns with the analysis.

First, the Draft Report continues to define the remaining depreciation period as 'Mine Life' even though IPART explicitly state that it is not. While this may appear to be semantics, HRATF would ask IPART to clarify its definitions to avoid setting a precedent for a fairly arbitrary approach to Mine Life.

Second, the Draft Report dismisses the significance of the northwards movement of coal on the segments in question, which allows the mines located south of Newcastle to deliver to the port. Such movements currently account for around 40% of the volume on the segments. IPART appears to exclude those volumes through a semantic argument: that since the mines are not located in the Hunter Valley, they are not relevant for the HVCN. HRATF strongly opposes this argument, since the coal is carried on HVCN regardless of where the mine is located.

In HRATF view, if the northwards movement of coal to Newcastle was properly included, the change in Mine Life may not be justified. At the very least, IPART needs to consider explicitly whether the 40% of the current volume which comes from the southern mines could continue to sustain the segments in question beyond the 5-year period.