

RAIL INFRASTRUCTURE CORPORATION

VALUATION OF CERTAIN ASSETS

INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES

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June 2001

EXECUTIVE SUMMARY

In August 1999 the Premier requested the Tribunal to assist the Minister for Transport by valuing certain assets owned by Rail Access Corporation. In formulating its recommendations to the Minister, the Tribunal has considered:

- a report by independent consultants, Booz-Allen and Hamilton, appointed to assist in undertaking the valuation
- comments on the consultant's report by stakeholders including Rail Infrastructure Corporation (formerly Rail Access Corporation), Minerals Council and FreightCorp.

The asset value (calculated on the basis of depreciated optimised replacement cost) recommended by the Tribunal is \$349.5m as at 1 July 1999.

The basis of the Tribunal's decision is:

- Booz-Allen and Hamilton's methodologies for the assessment of
 - depreciation
 - optimisation
 - replacement costs
- exclusion of rail infrastructure assets not commissioned by July 1999 to meet demand in the period to 2004. This affects both the optimised replacement cost and depreciation
- inclusion of financing costs (capitalised interest) as recommended by Booz-Allen and Hamilton in their letter accompanying their final report.

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1 INTRODUCTION

The Tribunal was requested in August 1999 to value certain assets of Rail Access Corporation for the purposes of the definition of 'Rate of Return' included in the New South Wales (Rail) Access Regime (Regime). The request was made under section 9(1)(b) of the *Independent Pricing and Regulatory Tribunal Act 1992*. The terms of reference of this Review are contained in Appendix 1.

Since the commencement of the review, Rail Access Corporation has combined with Rail Services Corporation to form Rail Infrastructure Corporation (RIC).

The Tribunal engaged an independent consultant, Booz-Allen Hamilton (BAH), to assist with the review. BAH's report is attached.

There was extensive consultation with key stakeholders throughout the review.

The consultancy has taken longer than expected because of the quality of asset information kept by RIC, numerous revisions by RIC to the data supplied and lack of agreement between the parties (including RIC, Minerals Council and FreightCorp) on the methodology to be adopted and the subsequent valuation. Driven by conflicting commercial interests, no consensus has been reached. BAH's final report reflects the consultant's findings after due consideration of the views of those stakeholders. The Tribunal notes BAH's comment that 'considerable subjectivity and engineering judgement'¹ was exercised in undertaking the valuation.

BAH's valuation is substantially below RIC's own valuation (29 per cent) but substantially higher than what the Mineral's Council and FreightCorp consider fair and reasonable.

The Tribunal has accepted BAH's valuation of the Hunter Valley Rail Infrastructure assets with one exception. This is:

- The Tribunal recommends the exclusion of assets, which had not been commissioned as at July 1999. The Tribunal proposes that the asset base be adjusted on an annual basis for the capital expenditure required to provide an optimised rail network for those operators subject to the price ceiling test². Commencing in 2004, the Regime requires that the DORC value be revised every five years. Such revisions could review the appropriateness of the assets added in the preceding five years. Allowing the asset base to be adjusted each year subject to five yearly revisions will reduce distortions to future investment decisions. The Regime also permits disaffected parties to resort to arbitration at any time.

The effect of this amendment is to reduce the depreciated optimised replacement cost valuation proposed by BAH by \$7.3m to \$349.5m.

¹ Booz-Allen Hamilton, *Final Report - Valuation of Certain Assets of the Rail Access Corporation*, 14 May 2001, piii.

² NSW Government, *NSW Rail Access Regime, Schedule 3* NSW Government Gazette No. 22, 19 February 1999

2 BACKGROUND

The New South Wales Rail Access Regime was established in August 1996. The Regime is based on negotiation and arbitration of access prices between the Rail Infrastructure Corporation (RIC) and operators. Negotiations are bound by floor and ceiling prices. Ceiling prices reflect full economic costs of the sectors required by access seekers. Floor prices reflect direct costs only.

On 21 October 1998, the Premier requested that the Tribunal examine specific aspects of the pricing principles of the regime. The Tribunal's Final Report recommended depreciated optimised replacement cost (DORC) as the appropriate asset valuation methodology required to determine ceiling prices.³ It was also recommended that an independent consultant be commissioned to undertake a DORC valuation of RIC's rail assets.

In August 1999, the Premier requested that IPART carry out the DORC valuation of RIC's Hunter coal network. This request included an understanding that consultants would be appointed to carry out the valuation. BAH were appointed. Their final report was received on May 14, 2001. Only the Hunter coal network was to be valued as this is the only section of the network where full cost recovery is currently viable.

RIC's access prices have been based on an interim DORC since 1 July 1999. These prices are to be adjusted retrospectively (with an allowance for interest) if the independent DORC valuation is lower than the interim valuation.

Tables 2.1 to 2.3 compare the final DORC values from the BAH report with the interim DORC and RIC's own revised DORC.

Table 2.1 Final DORC Values

	Current costs			1 July 1999 costs ¹		
	ORC (\$M)	DORC (\$M)	Discount (%)	ORC (\$M)	DORC (\$M)	Discount (%)
Track	405.6	240.1	40.8	398.1	235.7	40.8
Sigs and Comms	117.0	57.3	51.0	114.8	56.3	50.0
Structures	129.9	65.6	49.5	127.5	64.4	49.5
Total	652.6	363.5	44.3	640.5	356.8	44.3

1. Current costs adjusted downwards by 1.85 per cent to obtain equivalent 1 July 1999 costs.

Table 2.2 Comparisons with RIC Interim Values

	RIC ORC (\$M)	BAH ORC (\$M)	% Diff	RIC DORC ¹ (\$M)	BAH DORC (\$M)	% Diff
Track	393	398.1	+1	291	235.7	-19
Sigs and Comms	92	114.8	+25	62	56.3	-9
Structures	239	127.5	-47	164	64.4	-61
Total	724	640.5	-12	517	356.8	-31

1. Discount from ORC based on condition as an interim measure.

³ *Aspects of the NSW Rail Access Regime, Final Report*, Independent Pricing and Regulatory Tribunal, 28 April 1999, p 39.

Table 2.3 Comparisons with RIC Revised Values

	RIC ORC (\$M)	BAH ORC (\$M)	% Diff	RIC DORC ¹ (\$M)	BAH DORC (\$M)	% Diff
Track ²	413.2	398.1	-4	305.7	235.7	-23
Sigs and Comms	125.7	114.8	-9	93.0	56.3	-39
Structures	138.6	127.5	-8	102.6	64.4	-37
Total	677.5	640.5	-5	501.3	356.8	-29

1. Discount from ORC of 26 per cent based on mine life.

2. Includes assets RIC identified as additional assets ie culverts, formation and drainage, weighbridges.

If assets not commissioned by 1999 to serve demand to 2004 are excluded, then the final ORC assessed by BAH as \$640.5m would reduce by \$12.6m to \$627.9m. However, because BAH have applied depreciation uniformly across each asset class by sector then the final DORC figure would not reduce by \$12.6m but by approximately \$7.3m from \$356.8 to \$349.5m.

The figure for capitalised interest included by Booz-Allen Hamilton is \$13.8m. RIC's figures exclude capitalised interest. Because of the late addition by BAH of capitalised interest, the Tribunal has been unable to obtain a comparable figure from RIC for its calculation of capitalised interest. Therefore the difference between RIC's calculation of the DORC (including capitalised interest) and BAH's is understated in the table above.

3 KEY ISSUES

In this section, the key points of contention in relation to the final DORC valuation are described and recommendations are made. BAH's final DORC is 29 per cent lower than RIC's own revised DORC. RIC claim that adopting this lower DORC will have severe implications for their ability to continue investment in the Hunter network and argue that some aspects of BAH's methodology are flawed.

NSW Treasury share RIC's concerns.

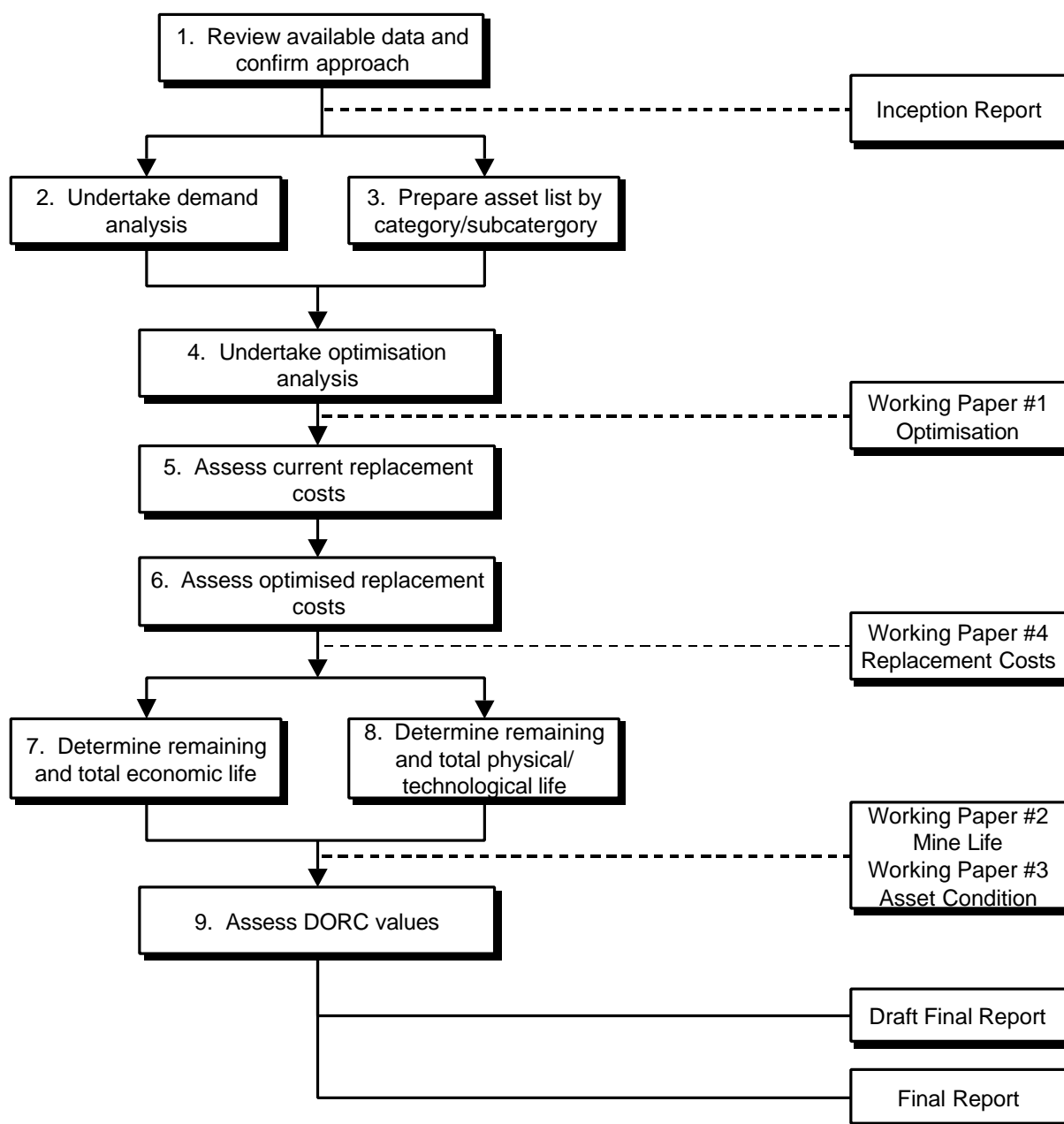
On the other hand, the operators (represented by the NSW Minerals Council and FreightCorp) contend that the consultants have overstated the valuation. They claim that the unit rates adopted are greater than those applied in Queensland by the Queensland Regulatory Commission and greater than those quoted in a recent report, prepared by the same consultants, on the Australian Rail Track Corporation Standard Gauge Rail Network DORC. FreightCorp also claim that internal documents dating back to before the break up of StateRail support these lower unit rates and that such figures remain valid today. They also dispute the validity of including capitalised interest.

3.1 General approach

The approach adopted by BAH is illustrated below⁴. Working papers and drafts of the final report were circulated to stakeholders for comment as part of the process.

⁴ Booz-Allen Hamilton, *Final Report - Valuation of Certain Assets of the Rail Access Corporation*, May 2001, p 2.

Figure 3.1 Study approach



The consultants made a number of assumptions in valuing the assets. The most critical of these was that the assigned value represents the cost of replicating the existing stock of assets in their current physical condition if the system was optimised for those operators subject to the price ceiling test. No regard was had for past amounts paid by operators or the basis for future payments.

There are minor dollar differences between RIC's and BAH's valuation of a new optimised rail network. This is despite RIC's view that the valuation should include all assets, whether they are associated with coal traffic or not.

The major difference arises in the approach to assessing the current (depreciated) value of the assets. This is reflected in Table 2.3.

3.2 Depreciation methodology

3.2.1 Mine life versus asset condition

BAH methodology

In their report BAH have used asset condition and an assessment of life consumed as the basis for determining accumulated depreciation. BAH reason that both the remaining physical life and the future earnings potential from the Hunter mines influences the economic value of the assets. They judge that, for the Hunter coal network, remaining physical life is the driver of value as they consider it is the shorter of the two.⁵ In making this judgement BAH considered that if a competitive market existed, asset condition would be key in determining the service potential of the assets. They acknowledge that maintenance works can extend the potential life of the assets however they consider that it is not appropriate to include the value of future major periodic maintenance (MPM) in the DORC or to consider its impact on extending asset life. This is because MPM is directly funded by the industry under the Regime on a year-by-year basis.

RIC's arguments and proposed alternative

RIC strongly contest that using asset condition as a basis for accumulated depreciation is appropriate and support their argument with comments provided by four consultants⁶. NSW Treasury support RIC's concerns.

An important argument is that appropriate maintenance programmes extend the total asset life. While individual components may be nearing the end of their life, a programme of continual maintenance means that various components that make up the whole will be at different stages of their individual life at any one time. With an appropriate maintenance programme the assets could be maintained in working condition in perpetuity. For this reason RIC consider that assessments based on the standard lives of asset components should not be conducted in isolation and extrapolated to apply to a whole sector.

An alternative method of depreciation is advocated by RIC. That is, depreciation based on the economic life of the assets in terms of their dependence on mine life rather than physical condition. The closure of the mines at some future date means that the assets could not generate substantial revenue after that time. Likewise, significant revenue could only be generated in the past once the majority of the mines had begun operating and once most of the existing assets had been constructed. The economic life of the assets therefore reflects mine life and it is argued depreciation should be calculated on that basis. Despite support from RIC and some of their economic consultants for this approach there are difficulties in applying it because of uncertainties in determining opening and closing dates of the mines.

RIC argue that since the Tribunal has already estimated a closure date,⁷ and that this is to be reviewed every 5 years, depreciation can be adjusted after each review in line with the revised estimates. It is suggested this would alleviate any errors associated with the current prediction of mine closure dates.

⁵ Booz-Allen & Hamilton, *Valuation of Certain Assets of the Rail Access Corporation*, 2001, p 14.

⁶ PricewaterhouseCoopers, KPMG Consulting, n/e/r/a and Network Economics Consulting Group in Rail Infrastructure Corporation, Submission to IPART on the Booz.Allen & Hamilton Revised Draft Final Report: *Valuation of Certain Assets of the Rail Access Corporation*, Appendix 6.

⁷ IPART, *Aspects of the NSW Rail Access Regime Final Report*, 1999, p 45.

There is also argument about the appropriate starting date. The Tribunal, in its 1999 report, and BAH have suggested a reasonable start date is based on the average age of existing mines. If this method is adopted the start date would be 1974. RIC prefer 1984 as the start date as this was when large capital works programs, designed to provide for coal traffic, were completed and effectively made the networks 'as new'⁸. Adoption of BAH's estimated start and closing dates would result in a level of accumulated depreciation similar to the accumulated depreciation in their final DORC based on asset condition.

Determining an appropriate rate of depreciation using either asset condition or mine life is difficult. However, these are the approaches generally considered by stakeholders as most appropriate for application to the Hunter coal rail network.

Determining the opening asset condition is probably less subjective than estimating mine life. Nor does it rely upon assumptions concerning what may have been paid in the past, or may be paid in the future, to maintain the track. It is an estimate at a point in time of the minimum cost of providing replacement assets of a similar age and in a similar condition to supply a defined service.

Departure from the independent consultant's methodology appears unwarranted especially given the limitations of the alternative. However, it raises the issue of consistency between the approach adopted for the opening valuation compared to any subsequent revisions.

3.2.2 Compatibility between using asset life for current value and mine life going forward

BAH have estimated accumulated depreciation based on asset condition to determine a DORC. In 1999, the Tribunal recommended that ongoing depreciation be based on an estimate of remaining mine life. This recommendation is now a Regime clause. RIC have expressed a preference for consistency between accumulated and ongoing depreciation methods.

PricewaterhouseCoopers were requested by RIC to comment on the BAH methodology. They argue that using differing methodologies for accumulated and ongoing depreciation creates greater potential for the DORC value to become inaccurate and not replicate investment value. They support using mine life to estimate depreciation but are concerned that there is potential to use inconsistent mine life end points.

The Tribunal, in its 1999 report, recommended the consultant consider several methodologies when determining a starting point for depreciation. This recommendation is reflected in the Terms of Reference for the consultants. It is clear that the Tribunal did not intend to limit the consultant to using an accumulated depreciation method based on mine life and hence, accepted the possibility of using different methods for determining an initial DORC and for ongoing depreciation.

⁸ Rail Infrastructure Corporation, Submission to IPART on the Booz-Allen & Hamilton Revised Draft Final Report: *Valuation of Certain Assets of the Rail Access Corporation*, p 14.

BAH have argued that this initial valuation is a line in the sand. It is a starting point for determining access charges in the future. This line in the sand approach has implications for consistency between methods used to determine the DORC and methods used to move forward. BAH argue that they are determining a single starting point. From that point on, there is a need for consistency in the methods applied. However, there is no requirement for consistency between the methods used to set that point and the methods used to move forward from that point. The argument also applies retrospectively. That is, BAH argue that their line in the sand approach means that there is no need to consider past charges or monopoly rents in setting the DORC.

3.2.3 Adjustment to DORC to determine 1 July 1999 value

BAH determined a 1 July 1999 DORC value by adjusting their estimate downward by 1.85 per cent. This is because their estimate was based on 2000 data and the value is to be applied retrospectively from 1 July 1999. RIC do not support this approach. They consider that the assumptions applied in valuing the assets (eg assessing the condition of the assets) produce approximations that would have a plus/minus tolerance greater than the CPI discount factor used to convert the costs.

While recognising the extent of assumptions made in making the valuation, the Tribunal supports certainty and accuracy wherever possible and has therefore adopted BAH's adjustment.

3.3 Optimisation

There is general agreement between RIC and BAH about optimisation of the network. Areas of difference are highlighted in the sections below.

3.3.1 Exclusion of some assets

RIC are concerned that particular assets are not included in the optimised network. These include drainage and culvert assets, future expenditure on 'existing corridor formation' and weighbridges. Inclusion of these assets is estimated by RIC to increase the ORC by \$17m.

BAH have not explicitly allowed for drainage and culverts but have accepted a track replacement cost at the top end of what they consider a reasonable range. This is to allow for these and other miscellaneous assets that are difficult to account for.

3.3.2 Inclusion of assets specific to coal requirements

RIC question BAH's interpretation of the Terms of Reference in relation to the scope of optimisation. There is some ambiguity as to whether assets serving category 1 and 2 mines include all assets in the network that meet the needs of all operators or only the assets required by coal trains subject to the price ceiling. RIC believe the broader definition is consistent with the Regime and IPART's Terms of Reference. Adopting this definition would result in an increase in the ORC as BAH specifically excluded some assets that are not considered essential for category 1 and 2 mines.

The interpretation is also important for new investments. FreightCorp has disputed whether charges to coal operators should include new investments not required for coal train operations.

Given that the valuation is to be based on stand alone costs⁹ and is to be used to set a ceiling price that only some coal operators will pay, then it is reasonable to take the reference to all operators to be a reference to all coal operators subject to the ceiling price.

The BAH interpretation of the current terms of reference is consistent with this approach.

3.3.3 Design load

RIC is concerned that a design load of 25tal¹⁰ rather than 30tal has been assumed for an optimised network. BAH have made this assumption in order to reduce the complexity of their valuation and to eliminate the need for ongoing adjustments, which they think using a design load of 30tal would require.

Much of the existing coal traffic operates at 30tal and the track structure has been improved to cope with the higher axle loads. However, it is not an optimised track structure and incurs greater operation and maintenance expense than otherwise.

If the valuation included an optimised network with a design load of 30tal then the actual operations and maintenance costs would need to be adjusted down each year. The consultants have made a pragmatic decision to base the valuation on a design load of 25tal on the assumption that there will be no such annual adjustment.

3.3.4 Allowance for demand growth to 2004

The Tribunal, in its 1999 report, supported 'the use of an allowance of a 5 year demand growth forecast within the DORC valuation'¹¹. BAH have therefore determined the optimised network based on the likely future level of demand in 2004. They have included existing and potential future assets in their assessment of an optimised network for this period.

RIC interprets the Tribunal's support for an allowance for growth as applying to existing assets. That is, any existing asset that is required to meet capacity at any time between 1999 and 2004 should form part of the initial DORC. They suggest that assets not built and commissioned as at 1 July 1999 should be excluded. New assets should be included at the time they are built at their efficient actual cost. RIC believes this is more equitable as the assets will not earn a rate of return until they are built and actual, rather than forecast, assets will be valued.

⁹ NSW Rail Access Regime, Schedule 3, clause (i) and IPART, *Aspects of the NSW Rail Access Regime, Final Report*, April 1999, Recommendation 7, p 27.

¹⁰ tonnes axle load.

¹¹ IPART, *Aspects of the NSW Rail Access Regime Final Report*, April 1999, p 37.

There are a number of factors that will affect demand for coal and therefore capacity requirements of the Hunter coal network over the next few years. They include exchange rates, environmental policies and growth of the Australian and Asian economies. Recent events would suggest most factors favour increased coal production in the medium term. BAH's 2004 optimised network may be unduly conservative though accurate predictions are difficult. In any case, there are many reasons why assets, currently not foreseen may be required to be built over the next five years. If this required expenditure is not added to the DORC as assets are built and commissioned, perverse incentives may exist for RIC to delay appropriate expenditure.

A danger in allowing RIC to add expenditure throughout the five-year regulatory period is that there are limited checks and balances to ensure only necessary and efficient expenditure is included. Arbitration is the only avenue for access seekers to resolve any disputes about expenditure added to the DORC. Inefficient expenditure should be addressed at the five yearly DORC review however there is no mechanism for retrospectively compensating access seekers for being overcharged during the previous regulatory period.

On balance, the Tribunal considers it is important to provide sufficient incentive for efficient investment. Allowing for the addition of efficient capital expenditure to the DORC during the regulatory period should provide adequate compensation for RIC's investment. If negotiations fail between the parties then they can resort to arbitration.

BAH's figures include \$12.6m¹² for assets yet to be constructed to serve load growth to 2004.

3.4 Replacement Costs

3.4.1 Greenfields and Brownfields

The consultant's brief required Booz·Allen & Hamilton to value the assets on both a greenfields and brownfields basis. They have only valued the network assets on a greenfields basis. They believe the difference between greenfields and brownfields would be minimal because the Terms of Reference require that the valuation exclude land, tunnels, cuttings, embankments and other formation works vested in RAC on its establishment in 1996.

RIC argue that a brownfields assessment is more appropriate and suggest that if only a greenfields assessment is possible, it is reasonable to apply unit rates at the higher end of the range in the valuation.

¹² Figure supplied to IPART by Booz-Allen Hamilton, 28 May 2001.

3.4.2 Review of ORC estimates by asset categories

RIC generally agrees with the construction methods, production rates and resulting unit rates applied to the track assets proposed by BAH. However there are some areas of disagreement where RIC think there has been insufficient allocation for overheads or for which the full scope of works has not been allowed. The areas of difference are summarised in Table 3.1.

Table 3.1 ORC Summary

Optimised network asset	BAH draft	RIC revised
Track	365,748,081	365,748,081
Fences	13,139,331	13,139,331
Level Crossings	2,181,600	7,901,202
Sound Barriers	9,146,208	9,146,208
Bridges	124,897,642	138,636,382
Signals (including OCC)	87,300,000	94,644,810
Communications	25,200,000	31,088,370
Total	627,612,862	660,304,384
Additional Assets		
Culverts	0	7,825,966
Formation and Drainage	0	5,400,000
Weighbridges	0	4,000,000
Financing costs	43,100,000	-
Grand Total	670,712,862	677,530,350

Note: The Booz-Allen & Hamilton figures are the original 2000 figures ie not adjusted for 1 July 1999.

Source: RIC, Submission to IPART on the Booz-Allen & Hamilton Revised Draft Final Report: *Valuation of Certain Assets of the Rail Access Corporation*.

Overall, BAH's assumptions and estimates of replacement costs do not appear unreasonable. RIC argue that higher costs should be allowed for in some instances but the Minerals Council and Freightcorp argue just as strongly that costs are too high.

3.5 Financing costs

In a letter dated 24 April 2001, BAH raised the issue of including financing costs in the RIC DORC valuation. They amended their final report, after consulting with stakeholders, to include an allowance for financing costs of 4 per cent in the ORC. This results in an increase in the ORC¹³ of \$25.1m and a \$14m increase in the DORC. They believe this is consistent with the other greenfields construction assumptions they have adopted.

¹³ Booz-Allen Hamilton, *Final Report - Valuation of Certain Assets of the Rail Access Corporation*, May 2001, p 58.

The reasoning for including financing costs is that major rail infrastructure construction projects are likely to be spread over a number of years as the project moves from initial design through to completion and commencement of operations. BAH believe allowing for capitalised interest is consistent with greenfields assumptions. The Queensland Competition Authority (QCA) also took this view in its recent determination of Queensland Rail's below rail DORC value.

Both the Minerals Council and FreightCorp have questioned the addition of capitalised interest. RIC does not capitalise interest in its financial accounts and past charges to operators have included interest in the year incurred. In addition, the operators have queried the inclusion of capitalised interest when they believe that the consultants have already been generous in their valuation of the assets.

RIC support the inclusion of capitalised interest but contend that the amount included is understated. RIC questions the rate adopted and the period to which it is applied. These queries relate to whether the rate should be RIC's weighted average cost of capital or borrowing costs alone, and whether the consultants have allowed sufficient lead-time for the period of asset construction.

The Tribunal queried the consultant as to whether the construction costs already included an allowance for capitalised interest. Contractors undertaking work for RIC would already include funding costs in their charges. However, BAH indicated that they had only allowed funding costs between the period of payments to contractors and the final commissioning of plant by RIC.

In their valuation, BAH have endeavoured to draw a line in the sand. They have been required to hypothecate what would be a reasonable starting asset value rather than work with actual costs and actual depreciation. On this basis, considering whether financing costs have already been recouped in past charges is irrelevant in determining the ORC. In the future, whether capitalised interest is allowed on any new capital expenditure will depend on whether it is actually capitalised or expensed.

APPENDIX 1 TERMS OF REFERENCE

1. The Independent Pricing and Regulatory Tribunal (IPART) is requested, under section 9(1)(b) of the *Independent Pricing and Regulatory Tribunal Act 1992*, to value certain assets of Rail Access Corporation as at 1 July 1999 for the purposes of the definition of 'Rate of Return' in paragraph (iii) of schedule 3 to the New South Wales Access Regime (**Regime**).
2. The assets to be valued are all assets for the line sectors serving Category 1 and Category 2 mines as described in section 3.5 of IPART's Final Report 'Aspects of the NSW Rail Access Regime' (Review report No 99-4, 28 April 1999) (**IPART's Final Report**) other than cuttings, embankments and tunnels (including lighting and ventilation) and land.
3. In valuing the assets, IPART must use a depreciated optimised replacement cost (**DORC**) methodology and must otherwise conduct the valuation in accordance with recommendations 9, 10 and 11 of IPART's Final Report.
4. IPART must consider whether different optimum configurations for different combinations of mines might affect the DORC valuation and, if any such effect might be material, IPART must provide different valuations for different combinations of mines to the extent necessary to satisfy the pricing principles underlying the Regime.
5. IPART may have regard to any other matters that it considers are relevant to the valuation.

APPENDIX 2 RECOMMENDATIONS 9, 10 & 11 FROM 1999 IPART REPORT

Recommendation 9 – Appointment of an independent body to manage the asset valuation consultant

For the purposes of the NSW Rail Access Regime, the Government should appoint an independent body to manage the consultant selection process and then provide subsequent management of the asset valuation consultancy.

Recommendation 10 – Asset valuation methodology

For the purposes of the NSW Rail Access Regime, the assets owned by the Rail Access Corporation (other than Corridor Formation Assets and land) should be valued using a depreciated optimised replacement cost methodology (DORC) applied retrospectively from 1 July 1999. Prior to the finalisation of the independent consultant's DORC valuation, RAC should utilise their interim DORC value for ceiling test access prices. Should the final DORC value be lower than the interim DORC value, RAC should provide customers with a refund including interest for the relevant holding period.

Recommendation 11 – Process for completing the asset valuation

For the purposes of the NSW Rail Access Regime, the DORC asset value should be determined by an independent consultant. A draft DORC valuation should be published which invites stakeholder comment which must be considered by the consultant prior to establishing a final value.

It is suggested that the opening (1999) asset valuation be a constant and that the five yearly revisions (required under the regime) to the asset value take this as a given.

APPENDIX 3 QUEENSLAND COMPETITION AUTHORITY

The QCA released a report on its draft decision on Queensland Rail's draft undertaking in December 2000. A chapter in the QCA's report deals with asset valuation and depreciation. The key similarities and differences between the asset valuation methodology supported by the QCA and the DORC valuation proposed for RIC are highlighted in the following points.

- The QCA adopted a DORC valuation for Queensland Rail's assets.¹⁴
- The QCA valued all assets including land.¹⁵
- The QCA has made an allowance for a limited brownfields optimisation.¹⁶
- The QCA considers that the valuation should allow for costs associated with financing construction.¹⁷

The QCA considers that asset lives should be measured in terms of their physical lives and that depreciation should be charged on the basis of asset consumption. In those instances where an asset's condition is inconsistent with its age the asset valuation should be adjusted accordingly.¹⁸

The key areas of difference to Boozé·Allen & Hamilton's valuation are that all assets including land have been included in the valuation and that QCA has made an allowance for brownfields optimisation.

¹⁴ Queensland Competition Authority, *Draft decision of Queensland Rail's Draft Undertaking*, Chapter 13, p 144.

¹⁵ Queensland Competition Authority, *Draft decision of Queensland Rail's Draft Undertaking*, Chapter 13, p 144.

¹⁶ Queensland Competition Authority, *Draft decision of Queensland Rail's Draft Undertaking*, Chapter 13, p 181.

¹⁷ Queensland Competition Authority, *Draft decision of Queensland Rail's Draft Undertaking*, Chapter 13, p 151.

¹⁸ Queensland Competition Authority, *Draft decision of Queensland Rail's Draft Undertaking*, Chapter 13, p 163.

