Verdant Minerals Pty Ltd
ABN 33 122 131 622
T +61 8 8942 0385
F +61 8 8942 0318
E info@verdantminerals.com.au
www.verdantminerals.com.au
A 20/90 Frances Bay Drive, Stuart Park NT 0820
P GPO Box 775 Darwin NT 0801

Essential Services Commission
Level 1, 151 Pirie Street
Adelaide SA 5000

Via email: escosa@escosa.sa.gov.au

Re: Tarcoola to Darwin (TDR) rail infrastructure: Review of asset valuation methodologies for periodic revenue reviews

Verdant Minerals Pty Ltd (Verdant) appreciates the opportunity to provide comments in relation to the above review. Verdant confirms this submission is public.

Background

Verdant is a privately owned company based in the Northern Territory. Verdant is pursuing development of its Ammaroo Phosphate Project, located approximately 200km south-east of Tennant Creek and 95km from the TDR.

Verdant intends to utilise the TDR for the transport of product output and potentially for mine and processing inputs and has been actively engaged with the access provider during the project's various study phases.

Methodology

Verdant acknowledges that there are a range of methodologies available to determine asset valuation. In that regard, Verdant is committed to paying a fair rate of return for the infrastructure and services provided by the asset owner. This fair rate of return needs to be commensurate with the risk being assumed by the asset owner, whilst also representing a rate which would be the product of a competitive outcome in the event there was true competition for the provision of such monopoly rail infrastructure.

For Verdant to make an assessment of a fair return, it requires transparent access to information on the asset base. Without such information, Verdant can only speculate as to the value of the underlying asset base and what a fair return ought to be in the context of the terms and conditions of access being offered.

While the DORC methodology is commonly applied for valuation of below rail assets across Australia, this approach should not automatically be assumed to apply to the TDR on an ongoing basis. Rather, the specific circumstances of the TDR should be considered to determine the most appropriate methodology into the future. Verdant strongly encourages ESCOSA to undertake a detailed review and assessment of an appropriate valuation methodology as it applies to the TDR.

The TDR is unique in that it is one of the only major rail track assets in Australia which has been sold and acquired several times by various parties over the last 20-25 years. Other major rail assets (e.g. Hunter Valley Coal Network, Central Queensland Coal Network, Interstate Network, etc.) have been generally held by the same party for long periods, and having government owned origins. In each of the transactions for the TDR, the market value of the TDR has been significantly less than the prevailing DORC at the time. This is illustrated as follows:

	2003/04	2010/11	2022/23
DORC (opening)[1] ($m)	$2,301	$2,015	c.$1,550[2]
DORC (opening), Excl Contributed Assets ($m)	$992	$875	c.$730
Market Value ($m)	$2,329[3]	$334[4]	c.$400[5]

This highlights the major shortcoming in the DORC valuation methodology, such that the DORC value is incongruous, by a factor of multiple of times, to the owner's contributed capital. Consequently, while a rate of return calculated on a DORC basis may not be considered excessive, such an assessment would have a very different outcome if based on market value. Continuation of the current DORC methodology given this disparity is no longer valid in determining efficient costs for the TDR.

The DORC methodology is not appropriate in the TDR context, and Verdant submits that little merit exists in revaluing the DORC either as a once off or on a periodic basis. As stated above, DORC bears no resemblance to the actual value put on the asset by a buyer and seller. As such, enabling a DORC methodology would result in an unconscionable windfall gain for the TDR's owner, which when considered in the context of the monopoly infrastructure in question would continue to stifle the legitimate use of the TDR.

Merit exists for a market value methodology to be considered as, or part of, an appropriate valuation methodology for the TDR. Market value is the most accurate measure of contributed capital and value of the assets in providing services to access holders. Drawbacks associated with over-bidding are considerably less significant in the context of the differences between current DORC and market value.

1 ESCOSA, Tarcoola to Darwin Railway: 5 Year Review of Revenues 2013-14 to 2017-18, p. 51 (20220325-Rail-Tarcoola-DarwinRailwayRevenueReview -Final.pdf.aspx (escosa.sa.gov.au))

2 Indicative calculation on the basis of asset roll forward from 2017-18, notional $10m pa CAPEX and $47m pa depreciation.

3 Approximate construction cost of $1.6bn plus $729m for Tarcoola-Alice Springs line.

4 Paid by GWAN.

5 Based on the Aurizon purchase price of One Rail for $2.35bn. Assuming a $1.0bn valuation is ascribed to ECR, the bulk above and below rail business value is $1.35bn. Below rail portion of the bulk business revenue is ~30%, therefore the notional indicative value of the TDR on a revenue portion basis is c.$400m.

Verdant also submits that construction and development risks, which are no longer relevant, and future usage risks are already accounted for in the market price paid for the asset. The terms and conditions of access are such that a very high percentage of the access charges are treated as fixed costs, thereby providing the access provider with limited risk from a revenue and return perspective. If an asset valuation is amplified, this consequently contributes to a higher revenue ceiling and as such a higher threshold for excessive revenues being earned. As no competition exists for transporting services, customers have little option but to pay the access owner's sought price. A more reflective market asset base would encourage the asset owner to seek greater usage of the asset in order to increase its revenue and associated return.

Verdant considers that a hybrid approach may be appropriate in these circumstances, being the lesser of DORC and market value. Like the line-in-the-sand approach for the DORC methodology, the market value methodology can be applied in the same manner, with periodic adjustments allowed for each new market transaction (which are likely to be relatively infrequent) or adding new capital invested in the same way as the current asset base is adjusted.

Regulatory Risks

Verdant acknowledges that a material change in the asset valuation methodology has ramifications for all stakeholders, including existing access holders, access seekers and the asset owner. All stakeholders strive to have regulatory certainty upon which they are able to make critical investment decisions and have confidence in the cost base for business continuity – to do otherwise creates uncertainty and economic instability. The current regulatory regime only achieves this to a limited extent given the broad floor-ceiling pricing that may apply, the terms and conditions of access 'negotiated' between the parties and the limited oversight to determine if operating and maintenance costs are efficient. Given the relatively low number of customers, new or renewing access seekers tend to disproportionately bear the risk of increased costs under existing access arrangements.

Importantly however, mitigations can be put in place to enhance the fairness and regulatory risks of any such change. The requirement for change should not be hampered by perceived regulatory risks, but more importantly ensure that the most appropriate asset valuation is applied, and the correct balance is achieved between pricing, service, and terms and conditions. 'Regulatory certainty' should be considered on the basis of longer-term certainty over which pricing and access terms are applied. It should not be construed as a means to defer or avoid a regulatory change that would lead to a competitive market outcome.

Prospective vs Retrospective Application

Verdant submits that prospective application of any change in methodology is a more appropriate approach. Verdant supports the conclusions by NERA and the Commission's starting position in this regard. Prospective application allows both potential users and the asset owner to consider changes as part of future price setting, negotiations and investment decisions. Such an approach also limits the regulatory risk to the access provider to apply retrospective applications which it did not expect and would seek to account for in its rate of return in the future.

Both users and asset owners require reasonable certainty upon which access charges are determined and capital can be invested in the network. Verdant does not agree with the position held by the previous access provider that any change in methodology should only take effect after expiry of the certification of the state-based regime in 2030. A change in methodology applying from the start of the next 5 year review period (i.e. 1 July 2023) would provide administration alignment and be a logical juncture for commencement.

If you would like to discuss this submission, please contact me on the details provided below.

Callan Harding
Chief Financial Officer
Mobile: +61 437780282
Email: charding@verdantminerals.com.au