

Tarcoola - Darwin Railway - Ten Year Review of Revenues

PURPOSE OF THIS REVIEW

Under the terms of the *AustralAsia Railway (Third Party Access) Act 1999*, the Essential Services Commission of South Australia (**Commission**) is required to undertake a review of the revenues received from the provision of access to the Tarcoola – Darwin Railway (**the Review**).

The purpose of the Review is to determine if excessive revenues have been earned by the operators of the Tarcoola - Railway (**the Railway**) for the provision of non-competitive railway infrastructure services since the Railway commenced operations in 2004. The Review must be in respect of the period ending on 30 June 2013 in the tenth year of operations of the Railway.

If the Commission determines that excessive profits for those services had been earned (if revenues exceed costs, including a reasonable cost of capital), the Railway operator, GWA (North) Pty Ltd¹ (**GWAN**), and the Commission will seek to agree a “remedial plan” to ensure that revenues for the next five years are not excessive. Failure to agree would result in the Commission making a price determination to ensure that the future over-recovery of revenues does not occur.

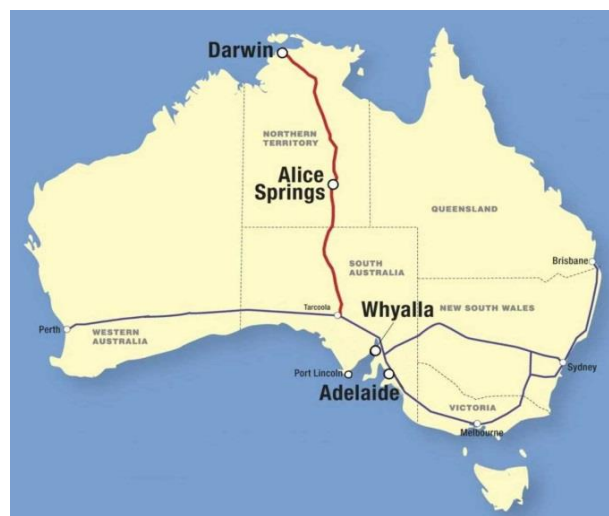
This Issues Paper invites comments on a threshold question for this Review: what Railway services have been subject to sustainable competition during the first ten years of operation? In addition, this Paper briefly outlines the scope and principles that the Commission intends to apply in this Review and requests any information, or evidence, that any party wishes to provide to the Commission, for it to take into account in this Review.

BACKGROUND

Description of the Railway

The Tarcoola – Darwin railway connects Darwin's East Arm Port to Australia's interstate standard gauge rail network. The Railway is a single track railway that comprises both an older section of line between Tarcoola and Alice Springs² and the more recently constructed section of line between Alice Springs and Darwin. Construction of this new section commenced in 2001 and the first train from Adelaide arrived in Darwin on 17 January 2004.

Figure 1: Tarcoola to Darwin Railway (shown in red)



Source: GWA (North) Pty Ltd.

The Railway is a standard gauge line of approximately 2,244 km in length and consists of an 824 km section from Tarcoola to Alice Springs and the newer 1,420 km section from Alice Springs to Darwin.

The final construction price paid for the new section of line (between Alice Springs and Darwin) was approximately \$1.2 billion (in July 2003 prices).

¹ GWA (North) Pty Ltd is a wholly owned subsidiary of Genesee & Wyoming Inc.

² The line between Tarcoola and Alice Springs was built during the 1980s and replaced several older sections of line (along different routes) completed during the 1920s and which had their origins in the 1870s.

Original commercial and legal structure

The AustralAsia Railway Corporation (**AARC**) was established in 1997 to build the Darwin to Alice Springs section of the Railway. In accordance with an inter-governmental agreement between the Northern (**NT**) Territory and South Australian (**SA**) Governments, the AARC consists of representatives drawn from both SA and NT governments with the Chair appointed by the NT Minister responsible for the Railway.

In 2000, AARC awarded the contract to design, construct and operate the Railway under a build, own, operate and transfer back (**BOOT**) arrangement to the Asia Pacific Transport Consortium (**APT**).³ Ownership of the Railway is scheduled to be transferred back to AARC in 2054 – that is, after 50 years of operation.

APT won the original 50-year concession rights to operate the Railway in accordance with the AustralAsia Railway Project Concession Deed, between APT, AARC and the Governments of South Australia and the Northern Territory.

In turn, APT awarded the contract to build, own and operate the Railway to Freight Link Pty Ltd (**FreightLink**); a related body corporate of APT.

Financial contributions

While the Railway is owned and operated privately under the terms of the concession described above, the Federal Government and the Governments of the Northern Territory and South Australia contributed initial funding⁴ as follows:

- ▲ the Federal Government, \$165 million
- ▲ Northern Territory, \$165 million, and
- ▲ South Australia, \$150 million.

In total, the three governments contributed approximately \$555 million⁵ towards the cost of construction.

In comparison, at the time of the commencement of the operation of the Railway, it is estimated that the value of private capital invested in the Railway was \$731.6 million⁶ (in prices of July 2003).

In total, the entire line from Tarcoola to Darwin is valued at \$1,697 million⁷ (in prices of July 2003) and consists of the following amounts:

- ▲ the section of line from Alice Springs to Darwin is valued at \$1,159 million—which includes government-funded construction of \$427.5 million and private capital investment of \$731.6 million.
- ▲ the section of line from Tarcoola to Alice Springs⁸ is valued at \$538 million.

Other Government contributions

As noted above, the principal government support for the project was provided in the form of capital contributions from each government. In addition to these capital contributions, the Federal and NT Governments also contributed various ‘physical’ assets. In particular:

- ▲ the Federal Government contributed an asset in the form of the existing Tarcoola to Alice Springs railway,⁹ and
- ▲ the NT Government contributed sub-leases in respect of the railway corridor located within the Northern Territory.¹⁰

Although, the three contributing governments do not require a financial return on the capital invested for their asset contributions at any time during the concession period, they do require the contributed ‘physical’ assets to be returned to them at the expiry of the concession along with the transfer of all project-funded assets.

Receivership and sale

In November 2008, the previous operator of the Railway at the time, FreightLink, was placed into voluntary administration. In June 2010, GWAN paid \$334 million for FreightLink’s assets which included the concession over the Railway and, in so doing, obtained the right to operate the Railway for the remainder of the 50-year concession period.

³ At the time, the APT consortium partners were Kellogg Brown & Root, John Holland Group, Carillion plc, Macmahon Holdings, and Australian Railroad Group (ARG). ARG was a partnership between Wesfarmers and Genesee & Wyoming.

⁴ AustralAsia Railway Corporation, *Annual Report 2002-03*, p11, available at <http://www.aarail.com.au/wp-content/uploads/2012/08/anreport02-03.pdf>.

⁵ Subsequent to the above grants, additional government funding of approximately \$76m was also provided to support APT.

⁶ Essential Services Commission of South Australia, *Rail Industry (Tarcoola - Darwin) Guideline No.2*, September 2008, p12, available at <http://www.escosa.sa.gov.au/library/080818-TarcoolaArbitratorPricingRequirements-GuidelineNo2.pdf>.

⁷ Essential Services Commission of South Australia, *Rail Industry (Tarcoola - Darwin) Guideline No.2*, September 2008, p12.

⁸ Ownership of the Tarcoola to Alice Springs section of the Railway resides with the Australian Rail Track Corporation (ARTC). However, it is also subject to a 50 year lease to AARC and forms a part of the concession to GWAN.

⁹ The asset is to be returned to the ARTC upon the expiry, or early termination, of the concession period.

¹⁰ These leases revert to the NT Government upon expiry, or early termination, of the concession period.

LEGISLATIVE FRAMEWORK

The Commission is an independent economic regulator of the water, electricity, gas, ports and rail industries in South Australia and is established under the *Essential Services Commission Act 2002 (ESC Act)*. It is the regulator of the Tarcoola – Darwin Railway as required by the *AustralAsia Railway (Third Party Access) Act (SA) 1999 (Act)*.

In broad terms, the Act creates a regulatory regime to facilitate third party access to the Tarcoola – Darwin Railway as well as prescribing a process to review the revenues earned by the operator of the Railway. The Act is mirrored by Northern Territory legislation, the *AustralAsia Railway Third Party Access Act 1999 (NT)*. The relevant provisions of both Acts are identical.

The *AustralAsia Railway (Third Party Access) Code (Code)*, a schedule to the Act, provides for third party access to the Railway and encourages commercial negotiations between the access provider and access seekers.

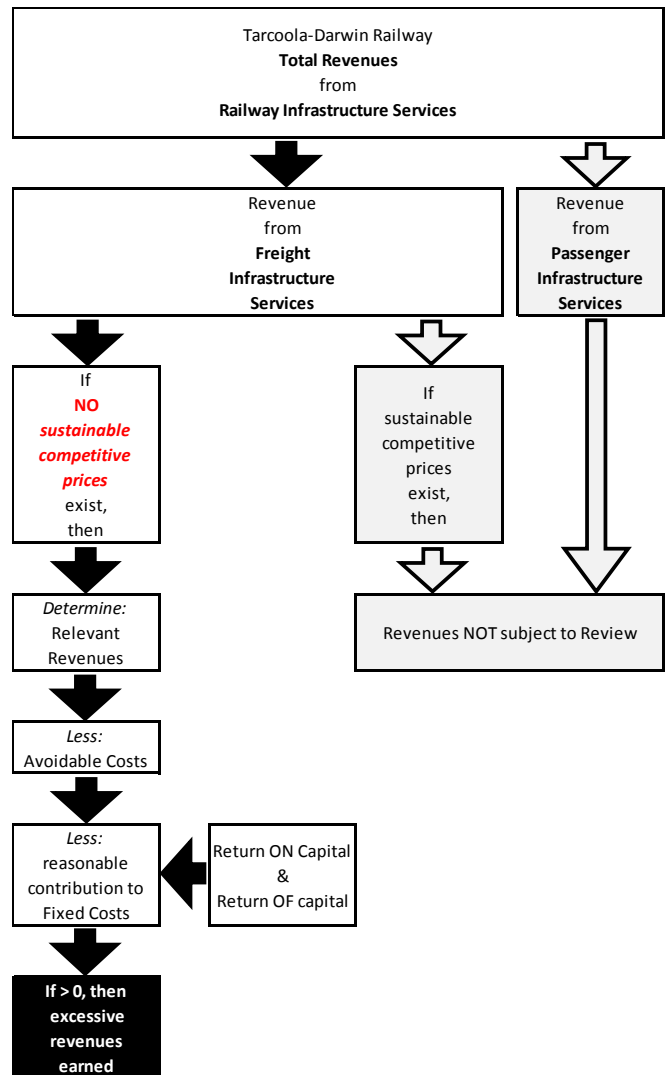
Clause 5 of the Code authorises the Commission to exercise and perform the powers and functions of the regulator under the Code for the purposes of both the law of South Australia and the law of the Northern Territory. The Code applies to the whole of the railway between Tarcoola and Darwin, pursuant to a joint ministerial notice published in January 2004.

The Act requires the Commission to undertake a review of the revenues received by the access provider (originally Freightlink and then GWAN) from access seekers for the provision of access to the Tarcoola – Darwin Railway. The Act also requires that the Review be in respect of the period from the date upon which the Railway commenced operating until 30 June in the tenth year of operations; that is, 30 June 2013.

The Review, which is to be conducted under Section 50(4) of the Act, will only assess revenues from railway infrastructure services; revenue from above-rail services (e.g. the provision of rolling stock) is excluded. The Act also specifies that revenues from passenger infrastructure services and any infrastructure services where “sustainable competitive prices” exist are outside the scope of the Review. The remaining revenues, which are the subject of this Review, are referred to in the Code as the “relevant revenues”.

The *relevant revenues* and costs that are the subject of this Review will need to be segregated from the total revenues and costs of the Railway. The process proposed is outlined in the following diagram.

Figure 2: Process for assessing relevant revenues



The *relevant revenues* are to be reviewed by the Commission with the aim of determining whether they are excessive having regard to the following factors:

- ▲ The efficient costs of providing railway infrastructure services to the relevant access holders, including an appropriate commercial return on the required railway infrastructure.
- ▲ The investment in the railway infrastructure facilities by the access provider or any other person.

The review mechanism set out in Section 50 does not alter, nor affect, any access contract entered into during the past 10 years. The potential outcomes of the Review may only impact future revenues to the extent that past revenues were excessive.

THRESHOLD ISSUE:

What Railway infrastructure services are subject to sustainable competitive prices?

The first issue that the Commission must resolve is to determine which Tarcoola – Darwin freight infrastructure services are subject to a sustainable competitive price. As noted above, only those services which are NOT subject to a *sustainable competitive price* are to be included as Relevant Revenues for the purposes of this Review.

The Schedule to the Act provides some guidance on this matter and defines sustainable competitive prices as follows:

A sustainable competitive price will exist in relation to the transportation of a particular type of freight where it can be demonstrated that-

- a) *there are no regulatory, technical or other practical impediments to transport of the freight by a mode of transport other than the railway or combination of such alternative modes; and*
- b) *the availability or potential availability of modes of transport other than the railway is an effective constraint on the price of transporting such freight on the railway having regard to the following factors:*
 - i. *the number and size of participants in the market;*
 - ii. *the type and volume of freight involved and any unequal backhaul loadings;*
 - iii. *whether there are any regulatory, technical or other practical barriers to entry;*
 - iv. *the extent of product differentiation in the market, including the differences in the ancillary services and convenience offered by different modes of transport;*
 - v. *the dynamic characteristics of the market including any fluctuations in demand for transportation services;*
 - vi. *the costs and service characteristics of transporting freight by different modes of transport (including the time for delivery of the freight, rail rolling stock or other vehicle axle loadings, length and speed of trains, and any infrastructure upgrade requirements);*
 - vii. *contractual terms (such as duration and frequency of service, whether for a specific volume or at call);*
 - viii. *congestion and bottleneck inefficiencies caused by constraining points on the road, railway or other relevant infrastructure;*
 - ix. *the safety requirements the different modes of transport are required to meet;*
 - x. *the direct and indirect costs of environmental impacts of the different modes of transport; and*
 - xi. *any other relevant matters.*

The types of freight infrastructure services that are provided via the Railway include:

- ▲ domestic intermodal freight (consumer goods freight and the like)
- ▲ bulk minerals freight (including iron ore, copper and manganese).

CALL FOR SUBMISSIONS

The Commission invites comments from interested parties, particularly those that have been directly involved in the use of the Railway or transportation that may compete with the Railway, on services that have been subject to sustainable competition over the past 10 years.

The Commission also invites interested parties to provide, to the Commission, any information or evidence that may be of relevance to this Review. The Commission will have regard to all relevant information in preparing its Draft Report. A further round of public consultation on that report will occur in 2015 (refer to the project timetable below).

PROCESS FOR MAKING SUBMISSIONS

The Commission invites written submissions from all members of the community on this Issues Paper by Friday 19 December 2014.¹¹

Responses to this paper should be directed to:

Tarcoola – Darwin Railway: Ten year review of revenues

It is preferred that submissions are sent electronically to: escosa@escosa.sa.gov.au. Alternatively, submissions can be sent to:

Essential Services Commission of South Australia
GPO Box 2605
Adelaide SA 5001

¹¹ It is Commission policy to make all submissions publicly available via its website (www.escosa.sa.gov.au)—except where a submission, either, wholly or partly, contains confidential or commercially sensitive information and is provided on a confidential basis and appropriate prior notice is given.

The Commission may also exercise its discretion not to publish any submission based on length or content (for example, if it contains material that is defamatory, offensive or in breach of any law).

NEXT STEPS AND TIMETABLE FOR THIS REVIEW

It is expected that the Commission will release its Draft Report by mid-2015.

STAGE	TIMING
Draft Report released	April to June 2015
Public Consultation	4-6 weeks
Final Report released	By August 2015

FURTHER INFORMATION

Any queries relating to this Issues Paper should be directed to:

Con Carellas
Manager Market Analysis
Telephone: (08) 8463 4444
Freecall: 1800 633 592 (SA and mobiles only)
E-mail: con.carellas@escosa.sa.gov.au
Website: www.escosa.sa.gov.au

MORE INFORMATION – RAIL INDUSTRY ACTIVITIES

If you would like to keep up to date with the Commission's industry activities and the release of papers for consultation, subscribe at <http://www.escosa.sa.gov.au/subscribe.aspx>.



The Essential Services Commission of South Australia is an independent economic regulator of water, electricity, gas, ports and rail industries in South Australia. The Commission's primary objective is the protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.

THE ESSENTIAL SERVICES COMMISSION OF SOUTH AUSTRALIA
Level 1, 151 Pirie Street Adelaide SA 5000 | GPO Box 2605 Adelaide SA 5001
T 08 8463 4444 | E escosa@escosa.sa.gov.au | W www.escosa.sa.gov.au