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19 December 2007

Attention: Mr Luke Wilson  
AustralAsia Access Code Guideline Review  
Essential Services Commission of South Australia  
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Dear Sirs,

### Review of the AustralAsia Railway (Third Party Access) Guidelines

This submission is made by Asia Pacific Transport Pty Ltd (in its capacity as agent of the Asia Pacific Transport unincorporated joint venture) (APT), in response to ESCOSA's invitation for public comment on its review of the AustralAsia Railway (Third Party Access) Code (Code), pursuant to the *AustralAsia Railway (Third Party Access) Code: Guideline Review Issues Paper dated November 2007 (Issues Paper)*<sup>1</sup>.

For the purposes of the Code and the Issues Paper, APT is the relevant access provider to the Railway.

APT notes that ESCOSA is required by the Code to undertake a public consultation process when considering the adoption or variation of one of the four previously published guidelines (Guidelines) applying to the access regime to the Railway<sup>2</sup>.

<sup>1</sup> Terms and expressions defined in the Issues Paper have the same meaning in this submission.

<sup>2</sup> For completeness, the Guidelines are: *Rail Industry (Tarcoola-Darwin) Guideline No. 1: Access provider Reference Pricing and Service Policies (Guideline No. 1)*; *Rail Industry (Tarcoola-Darwin) Guideline No. 2: Arbitrator Pricing Requirements (Guideline No. 2)*; *Rail Industry (Tarcoola-Darwin) Guideline No. 3: Regulatory Information Requirements (Guideline No. 3)*; and *Rail Industry (Tarcoola-Darwin) Guideline No. 4: Compliance Systems and Reporting (Guideline No. 4)*.

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This submission is made for the purposes of providing ESCOSA with information that APT considers relevant to the review of the Guidelines, and any resulting decision by ESCOSA to vary or revoke the Guidelines, or to develop and publish or substitute new guidelines for access to the Railway.

## 1. **Background to Operation of Railway**

1.1 APT presently has the benefit of concessional rights to operate the Railway, under the AustralAsia Railway Project Concession Deed between APT, The AustralAsia Railway Corporation (**Corporation**) and the SA and NT Governments (**Concession Deed**). APT has appointed its related body corporate Freight Link Pty Ltd (**FreightLink**) as the Railway operator, and FreightLink has operated continuously since commencement of commercial Railway operations in January 2004.

1.2 Broadly, the Concession Deed provides for the grant to APT of the concession to build, operate and then transfer back to the Corporation the Railway after 50 years, being the period of the concession. Under that arrangement, APT's obligations include, amongst other things, the financing, operation, maintenance and repair of the Railway, with all operational risk borne by APT/FreightLink during the period of the concession.

1.3 Commercial operations are now into the 4th year of the 50 year concession period. Since commencement, key achievements have included:

- (a) the conversion from road transport to rail transport on the Railway of around 90% of general freight business between Adelaide and Darwin;
- (b) 3 major bulk minerals haulage agreements being secured for the transport of materials north to the Port of Darwin; and
- (c) a number of significant business opportunities for bulk minerals haulage emerging, as a result of further mineral deposits being developed (or evaluated) in proximity to the Railway, under the present mineral resources and commodity prices 'boom'.<sup>3</sup>

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<sup>3</sup> The bulk haulage of minerals extracted from the Prominent Hill mine site, due to commence in 2008, will involve a road haulage element approximately 116km from the mine site to the Railway. The Railway is therefore considered to be proximate to resources projects located some physical distance apart.



1.4 Given significant Railway start-up costs, commercial operations are not yet profitable for APT/FreightLink; a position that is not expected to change until later in the concession period. It is not feasible to gauge, accurately, when the operation of the Railway will become profitable, or when there will be an appropriate return on investment to APT. That is dependent upon a number of factors, including whether, and the extent to which, further freight business is attracted to the Railway, and whether a greater percentage of existing road freight traffic to destinations along the Railway, is converted from road to rail.

1.5 The rapid growth of freight tasks on the Railway in the short period since commencement in 2004, has largely been due to APT's flexible and innovative approach to attracting business from road to the Railway, within the parameters of the pricing structure under the Code and the Guidelines.

## 2. **Executive Summary**

### 2.1 **Railway Operations under the Current Regulatory Regime**

- (a) Commercial operations on the Railway must still be considered to be at an early developmental stage, and still in the initial growth phase.
- (b) Conditions for continued business growth in the early stages of the concession period are best served if there is a stable and consistent regulatory regime within which the access provider and all access seekers operate. APT/FreightLink's business strategies will need to remain innovative and flexible in order to continue the growth phase.
- (c) The regulatory framework within which the Railway is required to operate (particularly the reference pricing guidelines for access seekers):
  - (i) provides a sufficiently certain regime within which the access provider and access seekers may negotiate access to the Railway; and
  - (ii) allows APT to be flexible and innovative in structuring its proposals for the provision of access to access seekers.
- (d) Changes to the regulatory regime so early into the concession period (particularly changes that increase regulation):
  - (i) risk destabilising present levels of certainty in negotiations for access to the Railway; and



- (ii) may result in the access provider having less flexibility and resulting in a less innovative approach in attracting business to the Railway.

## 2.2 **Asset Roll Forward (Issues Paper, Section 4.1)**

- (a) APT is **supportive** of a proposal for Guideline No. 2 to be varied by the inclusion of a mechanism for the January 2004 DORC valuation to be rolled forward over time (where appropriate, including adjustments over time for depreciation, additions to and disposals from the Railway and inflation). APT's support is, however, conditional on any such variation not adversely impacting its ability to achieve appropriate returns on investment over the 50 year concession period under the Concession Deed.
- (b) Alternatively, APT is **supportive** of the adoption of a new DORC valuation (or valuations) over time, in substitution for the January 2004 DORC valuation.

## 2.3 **Reference Pricing (Issues Paper, Section 4.2)**

- (a) APT is **not supportive** of any proposal to vary the existing reference pricing model to increase levels of regulation or to make provision for more detailed direction regarding reference pricing disclosures under Guideline No. 1.
- (b) APT does not consider there are compelling reasons, at this point in time, to change the level of existing regulation regarding reference pricing.
- (c) APT does not consider that ESCOSA's original modelling underlying the current reference pricing requirements have been superseded by the emergence of bulk minerals freight on the Railway.
- (d) APT does not agree with the proposition that bulk minerals traffic is necessarily less likely to have sustainable competitive modes of transport available to it.

## 2.4 **ARTC undertaking and CIRA (Issues Paper, Section 4.3)**

- (a) APT is **supportive** of the high level principal of consistency between access regimes that govern the Railway and the ARTC system under the ARTC undertaking.
- (b) APT considers that the existing provisions in Guideline No. 1 and 2 regarding consistency with the ARTC undertaking are generally adequate, and that no further level of regulation is presently necessary.



- (c) APT is **not supportive** of principles of consistency regarding reference pricing between the Railway and the ARTC system.
- (d) APT is **not supportive** of the proposition that the emergence of bulk minerals traffic on the Railway is a relevant consideration in an investigation regarding the merits of promoting consistency between the Railway and the ARTC system.
- (e) Although APT is not averse to 'nationally significant railways' adopting a similar and consistent system of access regulation (except in so far as reference pricing is concerned), APT considers that there are not compelling reasons why ESCOSA should take into account matters relevant to CIRA, when reviewing the Guidelines.
- (f) APT does not consider the Guidelines need be impacted by any of the CIRA implications.

APT submits that the following matters be taken into account as part of ESCOSA's review of the Guidelines.

### 3. **Asset Roll Forward**

- 3.1 In response to Section 4.1 of the Issues paper (regarding a proposed variation to the asset roll forward provisions of Guideline No. 2, in terms of how the depreciated optimised replacement cost (**DORC**) valuation methodology may be used in the future), APT's position is as follows.
- 3.2 Under Guideline No. 2, DORC methodology is used by ESCOSA as a basis for determining (in arbitration) the ceiling price that may be charged by the access provider for access to the Railway, having regard to a financial return on Railway assets (including government contributed assets and other forms of government financial assistance). DORC methodology requires that a reasonable minimum scope of railway infrastructure assets be identified and the replacement cost estimated (to yield the optimised replacement cost), to which is then applied a depreciation estimate based upon an independent assessment of the percentage of Railway asset life already consumed. It is acknowledged that a different valuation methodology is used for determining (arbitrated) access prices in the absence of sustainable competitive prices (involving valuation of railway infrastructure assets exclusive of government contributed assets).
- 3.3 In other words, the ceiling price may not be a rate of return that exceeds the applicable DORC depreciated value of the Railway infrastructure assets. Importantly, the DORC methodology applies a value – and a depreciation methodology - that is determined at a



certain point in time, (which for present purposes is January 2004, being the commencement of commercial operations on the Railway), and which is then applied forward.

3.4 ESCOSA notes that:

- (a) Guideline No. 2 is silent on how the DORC valuation (meaning the valuation as at January 2004) is to be rolled forward over time;
- (b) a new DORC valuation could be required on future occasions; and
- (c) there is merit in adding roll forward provisions to Guideline No. 2.

3.5 APT is concerned that the application of a roll forward provision to the DORC valuation without provision for future amendments and significant structure around the "inflation" mechanism (to take into account changes to the cost of labour materials and construction, especially in cases where those costs are higher than inflation):

- (a) may not accurately reflect the value of Railway assets over time; and
- (b) may result in an artificially low value of Railway assets,

which would then, following application of the Pricing Schedule in the Code, have a downward impact on the ceiling price to be applied.

3.6 APT understands that adherence to the DORC valuation without adequate roll forward provisions (or provisions for revised DORC valuations) would, over time, fail to take into account the value of any upgrades, enhancements, improvements or additions to the Railway that were funded by the access provider (or its related parties or stakeholders) subsequent to the DORC valuation. Such upgrades, enhancements, improvements or additions to the Railway could include:

- (a) the construction of additional passing/loading loops funded by the access provider (or its related parties or stakeholders) in circumstances where there is no contemporaneous cost contribution by an access seeker<sup>4</sup>;

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<sup>4</sup> Relevantly, in the first 4 calendar years of operating the Railway, the APT/FreightLink consortium has constructed an additional two passing/loading loops and one holding track, of which all have been funded solely by the consortium. Given the forecast increase in the



- (b) track maintenance costs/repair & replacement costs following extreme weather events;
  - (c) general replacement of rail, sleepers and ballast to accommodate additional Railway traffic over time; and
  - (d) upgrades to bridges to accommodate higher axle loads.
- 1.1 Importantly, APT is concerned that the application of the roll forward provisions to the DORC valuation could impact APT's ability to realise a positive (or appropriate<sup>5</sup>) return on investment at the end of the 50 year concession period. The concession arrangement is such that a positive return on investment for APT's stakeholders will only be achieved later in the concession period.
- 3.7 APT is concerned that the application of an inaccurate DORC valuation that does not, at the relevant time, accurately reflect the value of the Railway assets (taking into account all relevant expenditure on those assets subsequent to the DORC valuation) could have a downward impact on the ceiling price to be applied.
- 3.8 If this were to occur later in the concession period, the resulting implementation of a lowered ceiling price would detrimentally affect the ability for APT stakeholders to achieve a positive (or an appropriate) return on investment in the Railway project, across the concession period.
- 3.9 APT therefore:
- (a) supports the proposition that a new DORC valuation could be required over time<sup>6</sup>;
  - (b) considers that a new DORC valuation will become necessary over time, in order to accurately reflect the future value of Railway assets, taking into account relevant factors affecting use of the Railway assets subsequent to the January 2004 DORC valuation;
  - (c) agrees with ESCOSA's observation that there is merit in adding roll forward provisions to Guideline No. 2<sup>7</sup>, provided

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freight task and the number of trains operated on the Railway, APT reasonably anticipates the construction of further passing loops either at its sole expenditure or with some level of cost contribution from access seekers (that is, without further cost contribution from Government entities).

<sup>5</sup> An appropriate return on investment will be one that, in APT's view, recognises losses and/or poor returns on investment in prior years of operation under the concession arrangement.

<sup>6</sup> Issues Paper, page 13;



however that any such variation does not adversely impact APT's ability to achieve a positive (or an appropriate) return on investment over the 50 year concession period under the Concession Deed;

- (d) notes ESCOSA's observation that roll forward provisions involve adjustments over time for depreciation, additions, disposals and, inflation, and is supportive of Guideline No. 2 being varied in conjunction with those principles; and
- (e) considers that the objective of any amendment to Guideline No. 2 to incorporate roll forward provisions should be such that the application of the DORC valuation methodology at any point in time:
  - (i) is based on updated data that determines an accurate value of Railway infrastructure assets at the relevant time;
  - (ii) takes into account all relevant factors affecting the use of the Railway assets subsequent to any previous DORC valuation;
  - (iii) is not based upon outdated data that may have a resulting (inaccurate) impact on ceiling pricing calculations under the Code;
  - (iv) does not result in an artificially lowered ceiling price (upon application of the arbitration processes under the Code); and
  - (v) does not inequitably impact upon the access provider's ability to achieve a positive (or an appropriate) return on investment during the concession period currently in place for the operation of the Railway.

#### 4. Reference Prices

4.1 In response to Section 4.2 of the Issues Paper (dealing with ESCOSA's current approach to reference pricing under the Code, and whether a more detailed method is required), APT's position is as follows.

4.2 This aspect of the Issues Paper arises because of the emergence of new sources of 'bulk traffic' on the Railway, principally being haulage of minerals from points along the Railway. It is implicit from the Issues Paper that the emergence of this line of business has been unexpected, and that it was not (at least directly) in

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<sup>7</sup> Ibid, page 13;





contemplation when the access pricing models were developed. It is clear from the Code and Guideline No. 1 that the access pricing regime has been modelled more directly on 'traditional' (non bulk minerals) freight and passengers.

- 4.3 Presently, the access provider and access seekers are guided by the Code provisions regarding access pricing in alternate scenarios, where there is:
- (a) a sustainable competitive pricing model (ie; pricing is influenced by the availability to access seekers of alternate, commercially viable transport modes other than the Railway); and
  - (b) no sustainable competitive pricing model (ie; where there is no such alternate transport model).
- 4.4 Relevantly, APT operates within Clause 9.1(e) of the Code, under which the access provider is obliged to provide, upon application by an access seeker:
- "...relevant prices and costs associated with railway infrastructure services provided by the access provider, prepared by the access provider for reference purposes in accordance with guidelines developed and published by the regulator" (meaning Guideline No. 1)*
- 4.5 Guideline No. 1 then provides that 'reference prices' (ie; access prices under the Code that are proposed or offered to an access seeker) are to be provided by the access provider with a statement to the effect that they are *"neither maxima nor minima, and that actual prices are to be subject to negotiation and not restricted by [these] Reference Prices"*<sup>8</sup>.
- 4.6 The Issues Paper outlines a number of matters that were considered for inclusion as potential guides to reference pricing (but ultimately not implemented) when Guideline No. 1 was developed<sup>9</sup>. These were not considered appropriate for inclusion because of the potential constraining influence they could have on pricing negotiations between the access provider and an access seeker.
- 4.7 The effect of this is that the reference pricing model exists in a less regulated manner than was originally contemplated, in order to promote flexible pricing negotiations between the access provider and access seekers. The fact that arbitration has not been needed to resolve an access pricing dispute under the Code is, in APT's view, evidence that the present reference pricing model:

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<sup>8</sup> *Guideline No. 1, page 5.*

<sup>9</sup> *Ibid, page 14.*



- (a) is appropriately and equitably applied by the access provider;
- (b) provides a sufficient and meaningful level of disclosure of pricing and access information to access seekers; and
- (c) is adequately understood by access seekers,

without the need for the additional levels of regulation originally proposed for inclusion in Guideline No. 1<sup>10</sup>.

- 4.8 Given the emergence of bulk minerals traffic on the Railway, ESCOSA queries whether current reference pricing requirements in Guideline No. 1 (based on the sustainable competitive pricing model) may not be suitable for freight for which there is not clearly sustainable alternate transport modes available (such as bulk minerals).
- 4.9 The Issues Paper notes that bulk traffic is "*less likely*" to have sustainable competitive modes than other forms of freight, and that a more detailed reference pricing model might be warranted. In other words, the proposition in the Issues Paper is whether Guideline No. 1 should:
- (a) be varied to incorporate a more prescriptive regime for reference pricing (by the incorporation of some or all of the guidance principles previously considered for inclusion - but not ultimately included in - Guideline No. 1);
  - (b) set out more meaningful information for access seekers (especially those seeking access for which there is no, or where there is less likely to be a, sustainable competitive pricing model); and
  - (c) be more prescriptive in the application of reference pricing to all forms of freight (but clearly with an increased focus on freight for which there is no sustainable competitive pricing model, including in ESCOSA's view, bulk minerals traffic).
- 4.10 APT's position is as follows:
- (a) It is **not supportive** of any proposal to vary the existing reference pricing model to increase levels of regulation, or to make provision for more detailed direction regarding reference pricing disclosures under Guideline No. 1. APT does not consider there are compelling reasons, at this point in time, to change the level of existing regulation.

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<sup>10</sup> Ibid, page 14.



- (b) APT does not consider that:
- (i) ESCOSA's original reasoning underlying the current reference pricing requirements have been superseded by the emergence of bulk minerals freight on the Railway; or
  - (ii) a new methodology for reference pricing is necessary, in response to the bulk minerals traffic on the Railway,

but that current reference pricing models and the regulatory regime (generally) are adequate for bulk minerals traffic. This is supported by the fact that the current regulatory regime has seen the emergence of 3 bulk minerals freight agreements within the first 4 years of commercial operation of the Railway.

- 4.11 It should not be assumed, without further analysis, that bulk traffic on the Railway (such as bulk minerals) is freight for which there is no sustainable competitive pricing model. Even if it is the case that there are *less likely* to be sustainable competitive transport modes in some instances, those modes do exist and (in APT's experience) are being taken into consideration by access seekers.
- 4.12 Relevantly, APT's view is that road transportation of freight on the Stuart Highway in South Australia and the Northern Territory is (in the case of the significant majority of rail freight tasks) a prime example of a sustainable competitive transport mode, and one where alternate comparative pricing can be readily determined. The Stuart Highway is uniquely positioned in that regard, because:
- (a) it is a premium interstate road system;
  - (b) it is situated (approximately) parallel to the Railway over the entire route from Tarcoola to Darwin; and
  - (c) is configured to support a high gross mass tonnage of freight on triple and quadruple road trains (being highly efficient and world-competitive road haulage configurations).

In those circumstances, it is uniquely positioned as a directly sustainable competitive transport mode.

- 4.13 Since the emergence of the bulk traffic business, bulk minerals access seekers have modelled alternate transport modes on the basis of both rail transport on the Railway **and** road transport on the



Stuart Highway<sup>11</sup>. In those instances, the access seekers have viewed road transport as:

- (a) being an available, alternate transport mode for which there are no (or no significant) barriers to entry, given the close proximity of the road infrastructure to the Railway and associated infrastructure;
- (b) commercially viable to the mining project; and
- (c) not necessarily an inconvenient mode of transport to the mining project, when compared to rail transport (given tonnages to be transported, and given that the road system is specifically configured to support high volumes of freight traffic).

4.14 That is, access seekers have taken the view that transportation of bulk minerals is a freight task for which there is actually a sustainable competitive pricing model, and that APT/FreightLink has had to win those freight tasks on to the Railway and away from road transportation, on the basis of cost competitiveness with road transportation.

4.15 The current reference pricing regime under the Code and Guideline No. 1 is a robust and flexible system that promotes negotiation for access to the Railway on a fair and equitable basis.

4.16 It is in the interests of the access provider and access seekers to retain the maximum degree of flexibility in the pricing negotiations. Increased regulation of the reference pricing regime by the implementation of some or all of the guidance matters formerly considered for inclusion (but not ultimately included) in Guideline No. 1, could have the opposite effect of:

- (a) disadvantaging access seekers in some situations; and/or
- (b) dissuading investment in new projects based on preliminary feasibility studies,

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<sup>11</sup>

In the case of one of the 3 bulk minerals freight agreements concluded in the first 4 years of commercial operations, the agreement with the Railway operator was negotiated with both a road (ie; Stuart Highway) and Railway transport logistics solution, in which the road transport solution was initially considered the more competitive, appropriate and therefore preferable transport logistics solution.



due to a potentially less flexible and more rigid regulatory structure.

- 4.17 In terms of bulk minerals, access pricing differs greatly depending on the mineral to be transported on the Railway. The formulation of a more prescriptive access pricing regime based upon a particular type (or types) of mineral could be disadvantageous to an access seeker subsequently seeking access to the Railway for the transportation of a different type of mineral.
- 4.18 To date, APT has had no indication from access seekers (including in relation to the transportation of bulk minerals) that the reference pricing regime has disadvantaged any party from obtaining the required pricing information in order to seek access to the Railway, or from negotiations, in good faith, for access to the Railway.

## 5. **ARTC undertaking and CIRA**

- 5.1 In response to Section 4.3 of the Issues Paper (dealing with interface issues with access regimes on other railway systems), APT's position is as follows.
- 5.2 In broad terms, APT supports the principal of consistency between access regimes that govern the Railway and the ARTC system under the ACCC undertaking.
- 5.3 APT considers that the existing provisions in Guideline No. 1 and 2 regarding consistency with the ARTC undertaking are an adequate level of regulation. Despite this, APT is **not supportive** of principles of consistency regarding reference pricing between the Railway and the ARTC system. APT considers that the reference pricing model for the Railway should remain sufficiently flexible to take into account access issues that are specific to the Railway, and which are not impacted by the ARTC system. There is a risk that reference pricing could be adversely impacted (from the access provider's perspective) by matters that are relevant to the ARTC system but generally not relevant to the Railway.
- 5.4 APT is not supportive of the proposition that the emergence of bulk minerals traffic on the Railway is a relevant consideration in an investigation regarding the merits of promoting consistency between the Railway and the ARTC system.
- 5.5 At present, the majority of bulk minerals traffic is transported (or is scheduled to be transported) north to Darwin from points along the Railway north of Tarcoola, so there will be no interface with the ARTC system. It is acknowledged that some bulk minerals traffic is transported (and is scheduled to be transported) south, and this does involve in interface with the ARTC system.
- 5.6 ATP notes the broad objectives of the February 2006 Competition and Infrastructure Reform Agreement, in terms of a consistent



national approach to the economic regulation of significant railway infrastructure.

5.7 While APT is not averse to 'nationally significant railways' adopting a similar and consistent system of access regulation (except in so far as reference pricing is concerned), APT:

- (a) notes that the Code is grandfathered from the requirements of CIRA; and
- (b) considers that there are not compelling reasons, at this point in time, why ESCOSA needs to take into account matters relevant to CIRA in reviewing the Guidelines for the purposes of the Issues Paper (or otherwise).

5.8 Therefore, APT does not consider that the Guidelines need be impacted by any of the CIRA implications, because the existing provisions of the Guidelines regarding alignment of the access regimes of the Railway and other nationally significant railway infrastructure, is adequate.

APT trusts that this submission to ESCOSA in response to its invitation for public comment in respect of its review of the Guidelines, has been instructive.

Yours faithfully

**ASIA PACIFIC TRANSPORT PTY LTD**

per



John Fullerton  
Chief Executive Officer

CC: Ms Vanessa Loughlin – Asia Pacific Transport Pty Ltd