MINERALS COUNCIL OF AUSTRALIA
NT DIVISION

SUBMISSION TO THE 2015 DRAFT REPORT OF THE TARCOOLA-DARWIN RAILWAY: 10 YEAR REVIEW

JUNE 2015

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EXECUTIVE SUMMARY

The Minerals Council of Australia - Northern Territory Division ('MCA-NTD') welcomes the opportunity to make this submission on the Essential Services Commission of South Australia ('ECOSA') *2015 Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues* ('*2015 Draft Report*').

The Minerals Council of Australia (MCA) is the peak industry association that represents the corporate minerals companies in Australia. The members of the MCA are engaged in mineral processing, mining, exploration, or the provision of services to the industry and account for more than 85% of mineral industry output in Australia.

The MCA's strategic objective is to advocate public policy and operational practice for a world-class industry that is safe, profitable, innovative, environmentally responsible and attuned to community needs and expectations.

The MCA-NTD represents the interests of members operating, exploring and providing services to the industry in the NT. The minerals industry has a large and diverse presence across the NT which comprises close to 20% of the NT's gross domestic product whilst employing approximately 4,400 across mining operations for a range of mineral commodities including manganese, iron ore, lead, silver, zinc, gold, bauxite and uranium.

Members of the MCA-NTD are currently engaged in seeking rail transport solutions for their respective projects. As such MCA-NTD is well positioned to provide comment on behalf of its members on this review, together with other relevant regulatory issues which we encourage ESCOSA to consider, both in developing its final position for the review and longer term suggestions of improvements to the regulatory framework.

The MCA-NTD submission therefore seeks to highlight a number of fundamental issues which is contained within the *2015 Draft Report*.

Specifically, the MCA-NTD:

- Is of the view that the Tarcoola-Darwin Railway (TDR) is an asset of national significance, key to the economic prosperity of the Northern Territory;
- Believes there is a detrimental lack of transparency and also a presence of information asymmetry within the regulatory framework governing the TDR, together constraining the overall effectiveness of the regulatory regime. Consequently, the current framework is inadequate, has and will continue to jeopardise investment within the Northern Territory;
- Is of the view that developers are in the process of securing the required financing to begin project development, but are frustrated with both a lack of transparency and a lack of certainty around infrastructure pricing and capacity, altogether hampering, if not constraining, global capital investment within NT projects and infrastructure;
- Recommends a further and timely review of the Code be undertaken in light of recent movements within the regulatory environment and competition principles spheres;
- Recommends the regulator reconsider its assessment of relevant revenues as severe restraints do and have existed for inter-modal road freight;
- Recommends the regulator reassess the underlying DORC valuation, including to undertake a condition based assessment of the TDR, as well as providing consideration in altogether excluding government contributions; and

- Recommends the regulator reconsider its assessment of an appropriate weighted-average cost of capital.

MCA-NTD recognises the importance of the consultative regulatory process prescribed by ECOSA and welcomes any further opportunity to discuss the issues raised in our submission.

BRIEF HISTORY AND THE ECONOMIC IMPORTANCE OF THE TARCOOLA-DARWIN RAILWAY ('TDR') TO THE NORTHERN TERRITORY

Part of a $1.2b project built under a Build, Own, Operate and Transfer Back ('BOOT') scheme, the 2,244km Tarcoola-Darwin Railway ('TDR') was completed with the 2003 finalisation of the remaining 1,420km stretch of standard gauge railway between Alice Springs and Darwin. Operations subsequently began in 2004 under the Asia Pacific Transport Consortium ('APTC') which included Barclay Mowlem, John Holland, Macmahon Holdings, Genesee & Wyoming Australia and PGA, with also a related body corporate, FreightLink Pty Ltd ('FreightLink').[1]

As general cargo and containerised freight throughput increased along the corridor, mining development along the TDR also intensified, with manganese ore, iron ore and copper-gold concentrate among the commodities commencing to be hauled.

However due in part to excessive debt obligations of funding the railway's construction and failing to reach agreement with creditors on terms for sale of the business, FreightLink was placed into voluntary administration in 2008. Subsequently in 2010, Genesee & Wyoming Australia ('GWAN') – a subsidiary of the New York Stock Exchange listed Genesee & Wyoming ('GWR') – purchased the entire 1,420km Alice Springs-Darwin Railway ('ASDR') for AUD$334m, a substantial discount to the original build cost and the 2005 Depreciated Optimised Replace Cost ('DORC') valuation of $2,301.4m ($1,696.9m in nominal terms).

As a key piece of transport infrastructure within the Northern Territory ('NT'), the TDR is of significant economic importance at it also includes a rail causeway integration into the Port of Darwin ('PoD'). Located in the centre of Australia's northern coastline, the PoD is Australia's most northern deep water harbour and the closest port to Asia. Entirely owned by the NT Government, the port is a multi-user, mixed cargo and marine services port operated by the Darwin Port Corporation ('DPC').

Due to experiencing its own capital constraints, in 2014 the NT Government announced that it intended to undertake increased and sustained private sector investment within the port.[2] With the granting of a long-term lease the most likely outcome, a winning bidder is expected to be announced towards the end of 2015, where the long-term lease of the port has the potential to generate substantial capital inflow for the NT Government.

Nevertheless, the strength of offers that the NT Government could possibly receive will – in part – be based upon a number of underlying aspects, including volume throughput as well as the gesticulations of both downstream and upstream markets.

For instance, in 2013/2013, total throughput for all Australian ports totalled 991.57 million tonnes ('mt'). The PoD was one of the smaller contributors, with 2.8mt of throughput flowing through the port during that same period.[3] Yet of this, 91% of all throughout was bulk freight, with iron ore (1.67mt) and manganese (0.88mt) the main commodities[4].

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[1] FreightLink, 2008, FreightLink submission to Infrastructure Australia – Future infrastructure investment requirements along the Adelaide to Darwin freight corridor, 15 October 2008.
[2] Invest NT, 2014, *Investment opportunity – Port of Darwin*, 23rd December 2014, available at www.ntinvest.com.au
[3] Ports Australia, 2015, *Trade Statistics – Total Throughput (mass tonnes) for 2012/13*, available at www.portsaustralia.com.au
[4] Ports Australia, 2015, *Trade Statistics for 2012/13*, available at www.portsaustralia.com.au

The mining industry remains the largest contributor towards the NT's economy accounting for 19.5% of the area's Gross Domestic Product in the 2012/13 financial year.[5] As the TDR transports the lion's share of bulk exports into the PoD, the railroad remains of significant economic importance not just to the mining industry, but also to sale of the PoD and the entire economy of the NT.

As stated in a recent NT Government submission, the TDR [emphasis added]

> *…is a crucial and necessary link in a comprehensive national freight and passenger rail network.* ***It has been and continues to be the key to unlocking this region's economic growth potential.*** [6]

Such is the importance of Northern Australia to the national agenda that in 2013 the Australian Government released the *2030 Vision for Developing Northern Australia* paper. The paper outlined that the Commonwealth supports expediting investment in economic infrastructure, where projects would be

> *…able to complete for Commonwealth funding on a cost-benefit basis with other proposals elsewhere across the country…*[where]*…well targeted economic infrastructure can generate a virtuous cycle in which infrastructure improvements and economic growth can become mutually reinforcing.* [7]

Subsequently in 2014 the Australian Government released its *Green Paper on developing Northern Australia ('2014 Green Paper').* The *2014 Green Paper* constitutes part of the Government's pre-election commitment in formulating major policy directions to develop Northern Australia. Hence used as basis for the subsequent release of the June *2015 White Paper*, the aim of both is to establish a

> *…well-defined and timely policy platform for realising the full economic potential of the north, including a plan for implementing these policies over the next two, five, 10 and 20 years.* [8]

The *2014 Green Paper* indicated board policy directions across six broad areas including infrastructure; land; water; business, trade and investment, education, research and innovation; and governance so as to maximise the potential of Northern Australia. This included the:

- Better use of existing infrastructure;
- Better planning and understanding of infrastructure opportunities and benefits;
- Better collaboration across governments;
- Efficient service delivery; as well as
- Capable and sustainable local institutions.[9]

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[5] Department of Mines and Energy, *Annual Report 2013-2014,* pg. 7, 28th August 2014, available at www.nt.gov.au

[6] NT Government, 2014, Submission from the NT Government to the Standing Committee on Infrastructure and Communications inquiry into Infrastructure Planning and Procurement, pg.4, 30th April 2014, available at www.aph.gov.au

[7] Australian Government, 2013, *The Coalition's 2030 Vision for Developing Northern Australia,* pg. 24, June 2013, available at www.liberal.org.au

[8] Australian Government, *White Paper on Developing Northern Australia,* accessed 19th May 2015, available at www.northernaustralia.dpmc.gov.au

[9] Australian Government, 2014, *Green Paper on Developing Northern Australia*, page vii, 6th June 2014, available at www.northernaustralia.dpmc.gov.au

Importantly, the *2014 Green Paper* recognised the need for addressing hindrances to infrastructure development, as improvements would

> *…boost economic development in several contexts. It will reduce business costs, encourage new investment and make northern Australia more attractive to visit, live and work. It will support regional communities, help meet the needs of urban centres and be an enabler to industry growth.*[10]

This commitment to the development Northern Australia was further supported within the Australian Government's 2015 Budget announcement, where the Australian Government committed $5b towards the Northern Australia Infrastructure Facility.[11]

[10] Australian Government, 2014, *Green Paper on Developing Northern Australia*, page 44, 6th June 2014, available at www.northernaustralia.dpmc.gov.au
[11] Parliament of Australia, *Budget Review 2015-16 – Developing Northern Australia,* available at www.aph.gov.au

THE CODE, THE REGIME AND THE REGULATORY FRAMEWORK

Subject to the third-party, intra-state rail access regime ('Regime'), the governance of the TDR is established under the AustralAsia Railway (Third Party Access) Code ('Code'), a schedule to the *AustralAsia Railway (Third Party Access) Act 1999* ('ARA').

The Regime operates under a negotiate-arbitrate regulatory framework, which encourages both the access seeker and access provider to reach agreement on the pricing of access to the asset. However MCA-NTD considers that the success of the negotiate-arbitrate regulatory framework rests upon fundamental elements of transparency, adequate information and information symmetry.

The lack of these are hindrances and in the Productivity Commission's ('PC's') *2014 Submission to the Competition Policy Review*, the PC outlined a range of impediments that affected efficient market outcomes, including that a lack of effective competition, a lack of adequate information, and the presence of information asymmetry were detrimental.[12] MCA-NTD believes similar factors affect the efficient operation of the TDR, most particular the lack of adequate information and also the presence of information asymmetry between that of the access provider and access seeker. For instance, the PC stated that information asymmetry arises when [emphasis added]

> *…one party knows more about key aspects of a transaction than the other party. One possible consequence is 'adverse selection' —* ***a bias toward entering into a transaction that provides a lower quality or higher risk for the other party. Another potential problem is 'moral hazard', which is another form of risk transfer and occurs when a party exploits an information advantage and this affects the probability or magnitude of a payment from another party****.* [13]

In the negotiate-arbitrate regulatory framework of the TDR, MCA-NTD believes there is the potential of unequitable risk transfers between the access seeker and access providers based upon a lack of transparency, adequate information and information asymmetry. In the same vein, MCA-NTD believes that there are remedies to mitigate such impediments. For example, the availability of regulatory approved standard access agreements – similar to those presented by Australian Rail Track Corporation ('ARTC') and Aurizon Network ('AN') – would reduce protracted negotiations, limit information asymmetry and ensure that outcomes are not unfairly balanced towards that of network operator or access provider. Whilst MCA-NTD recognises costs would be incurred in establishing such agreements, MCA-NTD also believes that any costs would be small when compared to the costs involved in drafting, negotiating and implementing a multiple number of stand-alone agreements.

Yet this is only one remedy. The availability of adequate information would be dramatically improved if GWAN supplied a reasonable level of cost information so as to expedite the negotiate phase of the regulatory framework. Supplying such information could arguably increase the efficiency of the negotiations whilst simultaneously achieving a result that would more closely approximate an outcome that could be expected to be achieved in a competitive market for all parties concerned.

Case in point, in reviewing GWAN's website, two documents are available for access seekers to download and utilise in preparation of negotiations. The first is a 3 page "Access Application

[12] Productivity Commission (PC), 2014, *Submission to the Competition Policy Review,* 10th June 2014, available at www.pc.gov.au
[13] PC, 2014, pg. 5

Form"[14], with the second a "General Information Sheet", a 1 page document that contains 13 lines of text indicating that standard pricing components may include a combination of flag-fall and variable rates, a variable rate, or a fixed charge based on time, usage or operating parameters. Compare this to Queensland Rail. Its website contains information about applying for access, a summary of the entire access process, copies of the Conceptual Operating Plan and various Access Agreements, as well as all line diagrams, costing manuals and compliance reports.[15] Considering that GWR owns or leases 120 freight railroads worldwide, that employs approximately 7,700 staff and services close to 2,500 customers[16], and states in its 2014 Annual Report that it relies [emphasis added]

> *…**on information technology in all aspects of our business [where] the performance and reliability of our technology systems is critical to our ability to operate and complete safely and effectively**…*[17]

MCA-NTD remains a little perplexed as to why such limited information is available to access seekers and potential customers.

GWAN could argue that provision of increased information availability and transparency would breach confidentiality and jeopardise market competitiveness. MCA-NTD indeed recognises that it is an important characteristic in any public decision making process, especially where claims of confidentially are genuine or where competitive advantage is at risk of disclosure.[18]

However symmetry is required when competing interests of the access provider and access seeker are encountered, where such balance protects and respects the confidential business information of the access provider, yet also publicly publishes or releases relevant material that would assist the access seeker. Obviously the key term within this recognition is 'balance', and when historically assessing available information, a sense of balance is something which access holders and seekers within the NT have seen little of. As stated by the PC [emphasis added]

> *Access pricing inevitably involves information asymmetry between the access provider, the access seekers and the relevant regulatory authorities. Regulators will be unable to perfectly value the assets used to provide access. Short-run and long-run cost information will not be easily available and the access providers who are most likely to know relevant cost figures will often have little incentive to correctly provide this information to regulators.* [19]

For these reasons, due to a lack of transparency and the presence of information asymmetry, it can be argued that investment confidence in the mining and resources industry would be adversely affected. Specifically, due to uncertain access pricing arrangements, mine feasibility studies would need to take into account the possibility of increased transportation costs. With commodities and resources prices under sustained pressure, increasing costs could prove a bridge-to-far for current as well as new resource projects in securing necessary investment

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[14] GWR, *Operations – Railroads – Australia – Access Seekers*, available at www.gwrr.com/operations/railroads/australia/genesee_wyoming_australia/access_seekers
[15] Queensland Rail, *Network Services – Access and Regulation,* www.queenslandrail.com.au
[16] GWR, *About Us*, available at www.gwrr.com/about_us
[17] GWR, 2015, 2014 Annual Report, pg. 31, available at www.gwrr.com
[18]ACCC, 2011, Submission to the Productivity Commission's inquiry into the economic regulation of airport services, March 2011, available at www.accc.gov.au
[19] PC, 2000, *Achieving Better Regulation of Services,* pg. 83, 27th June 2000, available at www.pc.gov.au

support.[20] Yet as these projects fail to gain the required investment support, Governments will also receive less royalties and revenue, with communities and taxpayers required to pay more for vital infrastructure.

It could also be argued that without the transparency, the lack of information or the presence of information asymmetry, no arbitration of disputes has been required under the current regulatory framework for the TDR between 15th January 2004 to 30th June 2013 ('Review Period').

Hence, a lack of disputes could indicate that a negotiate-arbitrate regulatory framework has been successful. There are arguments for and against this view and MCA-NTD recognises that the Productivity Commission ('PC') discussed the issue in its *2013 National Access Regime - Inquiry Report*.[21] Yet the PC also indicated that information asymmetry is a source of market failure, and when combined with inadequate information, can distort market signals and lessen the degree of competition.[22]

However, the MCA-NTD strongly argues that a lack of disputes does not clearly indicate the success of a negotiate-arbitrate framework. For instance, access seekers could be unwilling or unable to test the dispute resolution process, wary that arbitration can involve significant costs and with many emerging and junior resource companies usually operating under pressures of slim margins, raising disputes could prove cost prohibitive. But once concepts of limited transparency and information asymmetry are thrown into the equation, access seekers could have their abilities further limited in accurately designating their foundations for the dispute under *Division 2 – Access Disputes and requests for arbitration* of the ARA. Hence the MCA-NTD is of the belief that without the right amount of regulatory oversight, a vertically integrated monopolist could exploit such impediments, exercising its monopoly power and further leveraging its market position. For instance, a vertically integrated operator could dictate the timing of investment to increase capacity.

Therefore, it is the view of the MCA-NTD that the true test of a successful dispute resolution framework – as well as the regulatory environment – is its impact upon investment, growth and productivity, which altogether combines to attract continued competition and development within the Northern Territory's resource, commodity and infrastructure sectors. More so the case when resource and infrastructure investment has waned in recent years.

Inappropriate regulation and investment

Mining and energy is the largest contributing sector to the NT economy, accounting for 19.5% of the area's Gross Domestic Product,[23] 3.9% of the total employment[24] and altogether combining towards a production value of $6.3bn in the 2012/13 financial year.[25] Of this, mining specific activities contributed $2.4bn,[26] with forecasted estimates indicating similar contributions into the immediate future.

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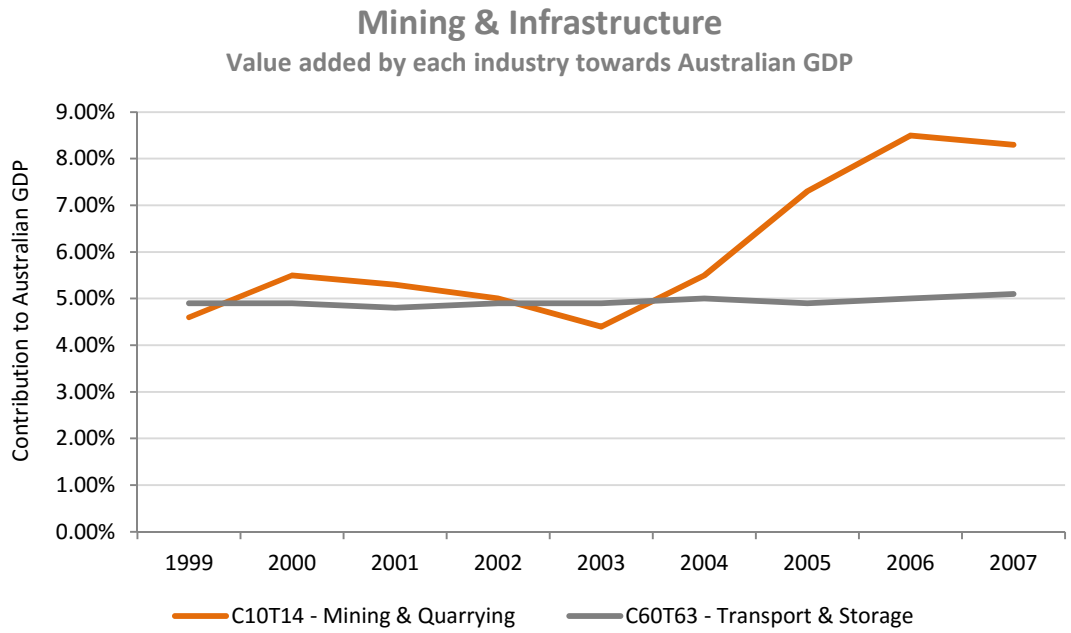
[20] AustralAsia Railway Corporation (ARC), 2014, *Annual Report 2013/2014,* 8th September 2014, available at www.aarail.com.au
[21] PC, 2013, *National Access Regime - Inquiry Report,* No. 66, 25th October 2013, available at www.pc.gov.au
[22] PC, 2014
[23] Department of Mines and Energy, *Annual Report 2013-2014,* pg. 7, 28th August 2014, available at www.nt.gov.au
[24] Department of Mines and Energy, *Annual Report 2013-2014,* pg. 9
[25] Department of Mines and Energy, *Annual Report 2013-2014,* pg. 11
[26] Department of Mines and Energy, *Annual Report 2013-2014,* pg. 11

The importance of infrastructure and mining is also of national significance, where since 1999 infrastructure has contributed approximately 5.0% year on year to Australia's Gross Domestic Product ('GDP'). Mining and quarrying have delivered similar benefits, but as the resources boom gained momentum, so did the industry's contribution.



Source: Organisation for Economic Co-Operation and Development, STAN Database, Value added by industry towards GDP, available at www.oecd.org

Nonetheless occasionally and erroneously infrastructure and commodities are often viewed in isolation. However both share a causative relationship that should not be ignored. Simply stated, commodities require infrastructure to be transported and traded, whilst equally, infrastructure requires the demand of commodities in order to be constructed, so that infrastructure owners and operators are able to earn a return on their investment. Yet to sustain both markets and provide returns to investors within both industries, a balancing of interest needs to be achieved.

As Australian Governments, both Commonwealth and State, have privatised assets since the 1990s, economic research has also long since shown that privatisation is no guarantee of productivity.[27] For instance, simply privatising a Government-owned business or corporation that retains vast economic inefficiencies and waste only creates privately owned firms of a similar ilk.[28] Effective regulation is therefore absolutely essential to ensure such productivity declines are not reverberated throughout downstream and upstream markets. More to the point, if productivity issues or adverse monopoly characteristics are not addressed, detrimental impacts could be felt not just through the entire supply chain, but also through other interrelated industries. As stated within an Australian Competition and Consumer Commission ('ACCC') submission towards the Senate Economics References Committee [emphasis added]

> *Assets with monopoly characteristics, however, are likely to raise competition concerns regardless of who acquires or operates the asset—that is, market structure cannot be used to address potential monopoly issues such as high pricing or poor service quality. In these*

[27] Kay, J.A. & Thompson, D., 1986, *Privatisation: A Policy in Search of Rationale,* The Economic Journal, Volume 86, No. 381, March 1985, pages 18-32, available at www.jstor.org
[28] King, S. & Pitchford, R., 1998, *Privatisation in Australia: Understanding the Incentives in Public and Private Firms,* The Australian Economic Review, Volume 31, No. 4, December 1998, pages 313-328

> *instances,* ***the ACCC is of the view that there needs to be sufficient regulatory oversight to ensure that competition in upstream or downstream markets is not hindered****.*
>
> ***Without an adequate regulatory regime (covering access and/or pricing), monopoly infrastructure service providers would be capable of earning monopoly profits or foreclosing competition. Benefits would therefore flow to investors, at the expense of users of the asset and, ultimately, end consumers. Inadequate economic regulation can also dampen investment in markets that depend on access to the monopoly asset, thereby denying at least some of the benefits the community could obtain from greater competition.***
>
> ***In the ACCC's experience, appropriate economic regulation will be more likely to promote competition by providing efficiency benefits and aligning operations and investments across supply chains related to the monopoly asset. In turn, this will improve national and state productivity and benefit those in the supply chain and consumers.*** *The ACCC notes, however, that the appropriate form of economic regulation and the mechanism used to implement the arrangements will depend on the type of market and the nature of the competition concerns relevant to the circumstances. This is not a 'one size fits all' exercise.*
>
> ***The ACCC's view is that access and pricing issues are best addressed through access undertakings under Part IIIA of the Act, which is the primary legislation governing Australia's National Access Regime. Part IIIA is designed to address concerns through a public assessment process in industries where an infrastructure asset with natural monopoly characteristics forms a bottleneck for firms operating in upstream or downstream markets.*** *The access undertaking provisions of Part IIIA are flexible and can be adapted to be made 'fit-for purpose' such that the level of access or price regulation can be tailored to the level of market power held by the acquirer or operator.* [29]

The Queensland Competition Authority ('QCA'), expressed similar views in its submission to the *2014 Competition Policy Review* (also referred to as the 'Harper Review'), where the QCA acknowledged [emphasis added]

> *…that poorly designed or implemented access regimes could lead to under-investment in infrastructure. The QCA agrees that,* ***as markets change, the nature and scope of access regulation should be reassessed to ensure efficient regulation.***

Additionally, the QCA also highlighted the impacts of unsound regulatory frameworks [emphasis added]

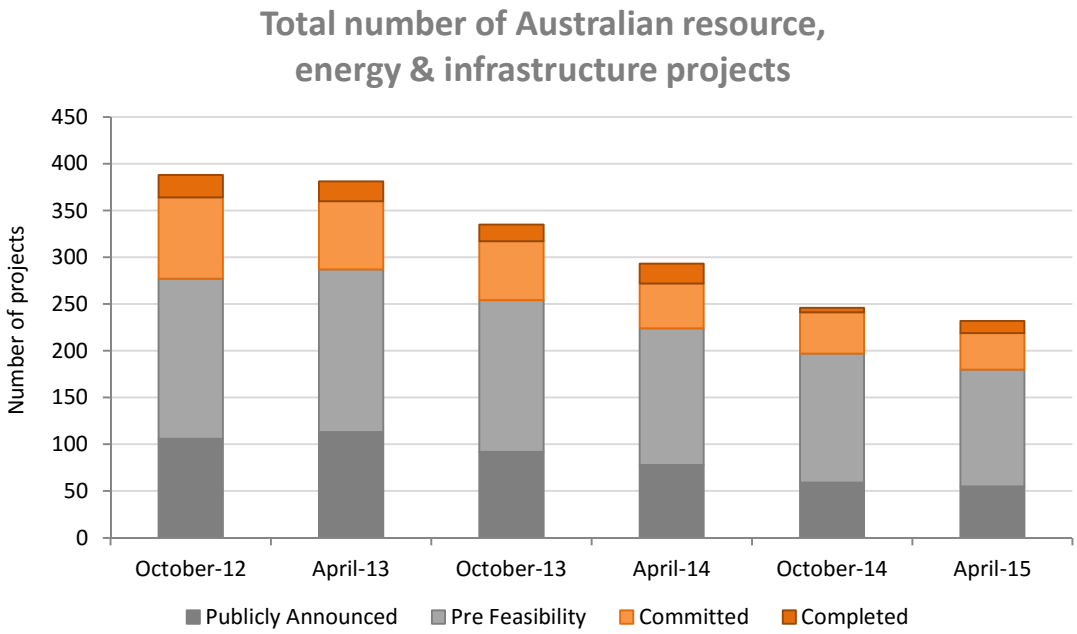
> *…the underlying market failure addressed by access regimes -* ***the capacity of natural monopoly owners to extract rents through aggressive pricing and restricting supply - continues to exist. While markets have evolved since 1995, misuse of monopoly power by owners of essential facilities can still damage competition in upstream and downstream markets. These risks are evident in many infrastructure sectors, such***

[29] ACCC, 2015, Privatisation of state and territory assets and new infrastructure – Submission to the Senate Economics References Committee, 29th January 2015, available at www.aph.gov.au

as rail, water, ports, telecommunications, electricity and gas. Access regulation, or the plausible threat of an access declaration, mitigates these risks. [30]

As such, poorly designed and unsound regulatory frameworks remain a large disincentive for investors to make continued and/or new investment.[31,32,33] Therefore when considering the current economic climate of resource, energy and infrastructure projects, the combination effectively delivers regulatory, economic and financial knockout punches to investment. Such has been the case for the 2014 closures of Territory Resources Frances Creek mine, Sherwin Iron's iron ore project within the Roper River region and Western Desert's Roper Bar project.

Unambiguously, in regards to new projects, the Australian Department of Industry has indicated that the total number of Australian resource, energy and infrastructure projects has been declining, and as is evident from the half-yearly Project Listing publications,[34] since the half-year ending October 2012, the total number of projects has decreased by approximately 40%.



Whilst such data indicates that the Australia resources boom began to wane from 2012, MCA-NTD believes the NT has yet to experience its own boom. Specifically, as per the NT Department of Mines and Energy:

- In the 24 months prior to June 2014, six mining development projects were likely, under construction or being commissioned;

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[30] QCA, 2014, *Competition Policy Review – Submission,* 17th November 2014, pg. iv, available at www.qca.org.au
[31] Brown, A.C., Stern, J., Tenenbaum, B.W. & Gencer, D., 2006, *Handbook for Evaluating Infrastructure Regulatory Systems,* pg. xii, World Bank Publications, available at www.worldbank.org
[32] ACCC, 2014, ACCC submission to the Independent Cost Benefit Analysis – Review of Regulation Telecommunications Regulatory Arrangements Paper (s.152EOA Review), 14th April 2014, available at www.accc.gov.au
[33] OECD, 2012, Measuring Regulatory Performance – The Economic Impact of Regulatory Policy: A literature review of Quantitative Evidence, 12th August 2012, available at www.oecd.org
[34] Department of Industry, *Office of the Chief Economist – Publications – Resources and major energy projects*, available at www.industry.gov.au/Office-of-the-Chief-Economist/Publications/Pages/Resources-and-energy-major-projects.aspx

- In the next 12 months after June 2014, a further six mining development projects were considered pending or considered likely; and
- Over the next 48 months post June 2014, an additional 15 mining development projects are being potentially considered.[35]

Because of the project pipeline, MCA-NTD understands that pending and potential developers are in the process of securing the required financing to begin project development, but are frustrated with both a lack of transparency and a lack of certainty around infrastructure pricing and capacity. As financial capital is a global in scope, Australian projects are at a substantial disadvantage to those projects than can offer certainty and transparency within other regions. Consequently, MCA-NTD is of the view that these deficiencies are hampering, if not constraining, investment within projects and infrastructure in the NT.

For these reasons alone, all possible and reasonable steps should be undertaken by governments, regulators, asset owners, operators and customers to enhance certainty and continue to drive continued economically justified and prudent investment into the various industries, not just within the Northern Territory, but across all of Australia.

As a result, the MCA-NTD recommends ECOSA to consider a number of questions in relation to the Regime, Code and the ARA. For instance, recognising that the Code was originally written in 1999 and applied to a vastly different environment, is the regulator able to establish the true effectiveness of the Code under conditions prevalent throughout the Review Period, today and into the foreseeable future? Under the code, what objective is the regulator ultimately attempting to seek and does that promote the efficient use of, operation and investment in significant infrastructure, thereby promoting effective competition in upstream or downstream markets? Further, does the objective of the Code continue to align itself with that of national regulatory momentum?

The *1995 COAG Competition Principles Agreement ('CPA')* aimed to deliver substantial reform within competition and regulatory streams conjoining to improve Australian productivity. In relation to the regulation of infrastructure, the agreement was undertaken to drive a more consistent national approach, where the agreement contained object clauses that sought to

> *…promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.*

And ensure that where regulated prices are set, that they

> *…generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services and include a return on investment commensurate with the regulatory and commercial risks involved;*
>
> *allow multi-part pricing and price discrimination when it aids efficiency;*
>
> *not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and*
>
> *provide incentives to reduce costs or otherwise improve productivity.*[36]

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[35] **NT Government, 2014, *Mining Developments in the Northern Territory,* June 2014, available at www.nt.gov.au**

[36] **COAG, 2005, *Competition Principles Agreement, 13th April 2007,* available at www.coag.gov.au/node/52**

In the same year under s.45A(1) of the Code, ECOSA conducted a review of the TDR Regime. Three particular issues were of key consideration within the issues paper published in November 2007. Subsequently and following on from and May 2008 Draft Decision, ECOSA issued its Final Decision in September 2008 and concluded that:

- In regards to *Guidelines No.1: Access Provider Referencing Pricing and Service Policies* – there was no need to impose and Australian Rail Track Corporation ('ARTC') reference tariff pricing;
- In regards to *Guidelines No.2: Arbitrator Pricing Requirements* – the value of the TDR via an asset roll forward approach, rather than periodic revaluations; and
- In regards to *Guidelines No.1: Regulatory Information Requirements* – it was not considered appropriate to make amendments to the Guidelines whilst taking into the ARTC undertaking or the *CIRA*. [37]

ECOSA also stated that as the Regime has been declared an effective access regime, suggestion is made that the

> *…objectives of the Code are aligned with those underlying clause 6 of the Competition Principles Agreement. In essence, the clause 6 principles:*
>
> - *identify the type of infrastructure services that should be subject to access regulation; and*
> - *establish principles that the regulatory framework should embody.* [38]

Yet it should be highlighted that clause 6 of the *CPA* is far more expansive than the two in-essence statements made by ECOSA. For instance, clause 6(c)(1) states that for a State or Territory access regime to confirm to the principles set out in this clause, services provided by means of significant infrastructure facilities where

> *…access to the service is necessary in order to permit effective competition in a downstream or upstream market; and*
>
> *…the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist* [39]

Hence some seven years later, MCA-NTD recommends that a review of the code is once again required. This is in light of the *2012 National Compact on Regulatory and Competition Reform*, the *2013 Review of the National Access Regime,* the *2014 Harper Review* and lately, the recent round of reviews namely the *2015 South Australian Rail Access Regime Review* and also the *2015 Western Australia Railways (Access) Code Review.* The World Bank provides support on this approach, indicating that [emphasis added]

> *…the best way to avoid getting stuck with poorly performing regulatory systems is to subject them to ongoing and periodic reviews* ***to make sure they are fully functional and reflective of social and economic realities, and help to achieve the government's***

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[37] ECOSA, 2008, *AustralAsia Railway (Third Party Access) Code: Guideline Review – Final Decision,* 30th September 2008, pg. 1, available at www.ecosa.sa.gov.au
[38] ECOSA, 2008, pg. 3
[39] Council of Australian Governments (COAG), 1995, *Competition Principles Agreement,* available at www.coag.gov.au/node/52

objectives for the sector. What is desperately needed are independent, objective, and fully informed analyses of existing regulatory systems. [40]

The World Bank goes on to highlight that the aim of the evaluation process is to improve the regulatory system, focussing on elements that would clearly lead to better outcomes for the sector, recognising both good and bad elements. However, this subtlety makes the assumption that the stakeholders are able to make fully informed decisions on the performance of the regulatory system. In the case of GWAN and the TDR, none of that is evident. To the knowledge of the MCA-NTD, nothing has been supplied to indicate the performance of GWAN in operating and maintaining the TDR in a way that reflects the prudent and efficient costs. For instance:

- How many train services were there during a month, quarter or year?
- Where these train services bulk minerals or freight?
- What were the percentage of services that reached their destination on time?
- Of those services that did not reach their destination on time, who or what was this attributable to?
- Why did these services experience delays?
- What were the above and below rail transit times?
- How many train cancellations were there?
- Of those services that were cancelled, who was this attributable to?
- How many safety incidents were there?
- How many gross tonne kilometres were haul and by what type?
- How many train paths were available?
- How many train paths were contracted?
- How many train paths were allocated to maintenance, planned or unplanned?
- What were percentage of train paths available were not used?

These are just some indicators, yet altogether are referred to as performance measures that generally indicate the overall state of the network. It is therefore this information that outside observers could use to assess GWAN's performance.

The World Bank's Evaluating Infrastructure Regulatory Systems handbook, then goes onto to indicate possible bad elements of regulatory systems, including:

- *Having no accounting system for calculating costs and tariffs;* [and]
- *Specifying a tariff-setting system for an initial five-year period and then providing little or no guidance as to the tariff-setting system that will be used in future tariff periods.* [41]

The World Bank handbook then outlines principles for the independent regulator model of regulatory governance as well as critical standards for effective infrastructure regulation. This includes:

[40] Brown, A.C., Stern, J., Tenenbaum, B.W. & Gencer, D., 2006, *Handbook for Evaluating Infrastructure Regulatory Systems,* pg. xii, World Bank Publications, available at www.worldbank.org
[41] Brown, A.C., Stern, J., Tenenbaum, B.W. & Gencer, D., 2006, pg. 46

Principles for the Independent Model of Regulatory Governance[42]	Critical Standard for Effective Infrastructure Regulation[43]
Independence	Legal Framework
Accountability	Legal Powers
Transparency and Public Participation	Property and Contract Rights
Predictability	Clarity of Roles in Regulation and Policy
Clarity of Roles	Clarity and Comprehensiveness of Regulatory Decisions
Completeness and Clarity in Rules	Predictability and Flexibility
Proportionality	Consumer Rights and Obligations
Requisite Powers	Proportionality
Appropriate Institutional Characteristics	Regulatory Independence
Integrity	Financing of Regulatory Agencies
	Regulatory Accountability
	Regulatory Processes and Transparency
	Public Participation
	Appellate Review of Regulatory Decisions
	Ethics

Troublingly, until issues within the current framework are addressed or until national alignment of the Code and ARA is achieved, the future economic productivity of the TDR will continue to be compromised, not just jeopardising GWAN's overall investment of $334m, but also the economic prosperity of the Northern Territory, as future resource and commodity investment within the state will continue to be hampered.

As a result, the MCA-NTD strongly believes that if the current issues within the regulatory framework are to be addressed, a firmer method of regulation should be implemented, be it the rate of return, price-cap or revenue cap form of price control regulation.

Accordingly, MCA-NTD recommends ECOSA consider undertaking a review of the regulatory framework whilst adhering to commonly accepted regulatory impact assessment guidelines.

Regime certification

As per Part IIIA of the *Competition and Consumer Act 2010 (Cth)* ('CCA'), certification of access regimes is undertaken on case by case basis. For a regime to be an effective regime though, a set of principles need to be obeyed. Established within Clause 6 of the *CPA*, the principles relate to negotiated access, regular reviews, reasonable endeavours, access terms, independent dispute resolution, binding decisions, principles for dispute resolution and the promotion of efficiency by pricing.

Yet when certified as effective regime on the 23rd March 2000, the TDR Regime was exempted from the additional Clause 6 principles as the TDR was considered an entrepreneurial Greenfields project. As per the *2000 Final Determination* by the National Competition Council ('NCC'), the consortium (at the time being APTC and FreightLink) intending to construct and upgrade the TDR were required to generate considerable demand if the project was to be profitable. Consequently, the NCC believed consortium was taking considerable risk and as it was proven, the consortium proved unsuccessful. As stated by the NCC [emphasis added]

[42] **Brown, A.C., Stern, J., Tenenbaum, B.W. & Gencer, D., 2006, pg. 59**
[43] **Brown, A.C., Stern, J., Tenenbaum, B.W. & Gencer, D., 2006, pg. 63**

> *…even though this risk has been substantially mitigated by Government contributions. In a number of ways, this* [the TDR] *differs from an* ***established infrastructure facility or a facility built to serve an established market****.*
>
> *Regulation of entrepreneurial greenfields projects needs to deal appropriately with the ex-ante risks facing the investor. Ignoring these risks will undermine the incentives to invest in new infrastructure projects. Therefore,* ***regulation needs to balance the interests of the access provider and access seekers. While on the one hand, access arrangements must not deter investment, on the other they must promote access and promote competition in related markets****.*
>
> ***The AustralAsia Railway Regime now incorporates a balanced approach to access. It provides a framework for access negotiations that gives investors sufficient certainty to proceed with the project, while ensuring access on terms and conditions that could be expected in a competitive market****.* [44]

Yet even though the TDR Regime was certified effective in 2000, under certain conditions and following a recommendation from the NCC, Ministers are afforded discretion to revoke or modify certification of the access regime. For example, such conditions include where there fundamental amendments have been made to the Regime or competition principles, or alternatively, where the practical application of the access regime is not as originally anticipated. MCA-NTD strongly believes the significant change has occurred to competition principles because of the recent reforms and reviews. In addition, MCA-NTD also believes that the practical application of the certification has changed and based on these events, recommends an evaluation of the TDR access regime.

[44] National Competition Council (NCC), 2000, *AustralAsia Railway Access Regime – Final Recommendation,* February 2000, available at www.ncc.gov.au

DETERMINATION OF RELEVANT REVENUE

TDR access pricing is dictated between a floor and ceiling band set according to the prudent forward looking costs of providing access to the infrastructure, where the

> *…floor price reflects the avoidable costs of providing access and the ceiling price reflects the standalone costs of providing access. The major difference between these two approaches relates to the allocation of fixed costs, largely the cost of the existing asset base.* [45]

In the case where competition exists towards the railway, the Code dictates that a "sustainable competitive price" approach – based upon competitive principles –be utilised to establish which type of freight should be included in testing whether excessive revenues have been earned.

Testing for the existence of excessive below rail revenues paid or payable by access holders is specifically undertaken by tests detailed within the ARA, identifying the relevant services, revenue and costs. In doing so, the first of the two tests determines whether impediments exist to transporting freight by other means; with a second test assessing the availability of other modes of transport as a competitive restraint. Specifically, as per the *Access Pricing Principles*:

> *(2) 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;*

[45] **ECOSA, 2015, *Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues*, pg. 31, 31st May 2015, available at www.ecosa.sa.gov.au**

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.* [46]

Upon application of the tests to the TDR Review Period, ECOSA's preliminary view is that

> *…with the exception of bulk freight services, effective competition has been provided in the freight services market during the period of this review by other transport sources, such as road.* [47]

In settling on this preliminary view, ECOSA outlined that as per the ARA, it assessed freight services against a range of criteria contained within Test 2(a). For ease of discussion, these are summarised in Table 1.

Table 1 - Test (2a): Preliminary views

Criteria	Aspect	ECOSA's preliminary view
Impediments	Regulatory	*…minimal regulatory impediments to the transport of freight by road.*[48]
	Technical	*…no particular technical impediments to the transport of freight by road, as road access is widespread and all freight types carried on the TDR are capable of being carried by road transport.*[49]
	Commercial	*…practical, commercial impediments to the carriage of bulk commodities over long distances using road transport…*[50]

GWAN's below-rail revenues stem from three separate services including bulk freight, inter-modal freight and passenger services. The MCA-NTD notes passenger services were not included in the review. But in relation to the freight services and based upon consideration of the regulatory, technical and commercial aspects, ECOSA stated that in relation to bulk freight, it did

> *…not pass the first test of facing sustainable price competition and below-rail revenues for bulk freight are therefore included in relevant revenue for the purposes of this review. For the Review Period, relevant revenues from bulk freight were $136.6m or 36 per cent of total gross revenues from access holders.* [51]

However, the MCA-NTD disagrees with ECOSA's assessment that inter-modal freight does pass the first test of facing sustainable price competition, as significant impediments do exist in transporting freight by road. As ECOSA indicated that the regulatory and technical aspects provided minimal to no impediment for road transport to compete with bulk freight, MCA-NTD therefore focuses upon these facets in greater detail below.

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[46] South Australian Legislation, 2015, *AustralAsia Railway (Third Party Access) Act 1999 ('ARA')*, version 30.3.2001, pg. 28, 9th November 2007, available at www.legislation.sa.gov.au

[47] ECOSA, 2015, *Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues,* pg. 17, 31st May 2015, available at www.ecosa.sa.gov.au

[48] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 19

[49] ibid

[50] ibid

[51] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 20

Regulatory impediments

The National Transport Commission ('NTC') (previously named the National Road Transport Commission 'NRTC') was established as an independent, inter-governmental agency designed to improve the safety, productivity and environmental performance of Australia's road transport system. In 2002, the role of the NRTC expanded to also include rail and intermodal systems so that the body could deliver an all-encompassing approach in improving land transport reform.

Yet even prior to the 1991 establishment of the NRTC, 1987 saw the formation of the Federal Interstate Registration Scheme ('FIRS'), a national based registration scheme for all heavy vehicles weighing more than 4.5 tonnes gross vehicle mass which engage solely in the interstate carriage of passengers or goods. To register heavy vehicles under the scheme, operators were required to not only submit an application for registration, but also complete a declaration indicating the safe and suitable use of the vehicle.

Recognising that over 95%[52] of Australia's road freight is carried by heavy vehicles and auxiliary to the FIRS, a National Heavy Vehicle Accreditation Scheme ('NHVAS') began operation in 1999, recognising operators that maintain robust safety management systems, with newly introduced benefits of accreditation allowing operators to operate at higher mass limits, programmed vehicle inspection exemptions and greater flexibility in shift rotations.

All of this is encompassed under a wide range of legalisation, including but not limited to the:

- *Road Traffic Act 1961 (SA) and Rules and Regulations;*
- *Interstate Road Transport Act 1985*;
- *Interstate Road Transport Charge Act 1985*;
- *National Transport Commission Act (Cwlth) 2003*;
- *Model Heavy Vehicle Charges Act 2007*; and
- *Interstate Road Transport Charge Regulations 2009*.

More recently as a result of a July 2009 Council of Australian Governments ('COAG') meeting, from the 1st January 2013 the newly formed National Heavy Vehicle Regulator ('NHVR') began to implement a national set of vehicle laws across Australia (except Western Australia). Known as the Heavy Vehicle National Law ('HVNL'), the rules apply to heavy vehicles over 4.5 tonnes gross vehicle mass, where State and Territory police as well as NHVR officers are authorised to enforce offences. At the same time the HVNL was passed, four new regulations were also incorporated under the national law. This included the:

- *Heavy Vehicle (Fatigue Management) National Regulation*;
- *Heavy Vehicle (General) National Regulation*;
- *Heavy Vehicle (Mass, Dimension and Loading) National Regulation*; and
- *Heavy Vehicle (Vehicle Standards) National Regulation*.[53]

The NHVR also manages the NHVAS and Performance Based Standards ('PBS'), yet this still remains entirely separate to the State and Territory administered matters of registration, inspections, licensing and dangerous goods contained within State and Territory legislature. For instance, in South Australia there exists the *South Australian Road Traffic Act 1961* and the *South Australian Statutes Amendment (Road Transport Compliance and Enforcement) Act 2006*. As way

[52] BITRE, 2014, *Freightline 1 – Australian freight transport overview,* May 2014, available at www.bitre.gov.au

[53] National Heavy Vehicle Regulator (NVHR), *Laws & Policies – Heavy Vehicle National Law and regulations,* available at www.nhvr.gov.au/law-policies/heavy-vehicle-national-law-and-regulations

of a further example, the NT Government – Department of Transport ('NT-DoT') issues motor vehicle registry information bulletins. As per *V33 – Innovative Vehicle Combinations*, the Department via the bulletins aims to enhance innovative vehicle combinations operating on NT roads in addition to that prescribed by other regulatory bodies. Particularly [emphasis added]

> ***In view of the work undertaken by the NTC, the following NT innovative vehicle policy has been developed to facilitate the operation of innovative high productivity vehicles which may or may not comply with all PBS measures.*** [54]

Most recently, reflecting issues for action contained within the *2012 National Land Freight Strategy*[55], and as per the *2014 Competition Policy Review* (also referred to as the 'Harper Review'), the *2015 Harper Review – Final Report* indicated that [emphasis added]

> ***More effective institutional arrangements are needed to promote efficient investment in and usage of roads, and to put road transport on a similar footing with other infrastructure sectors. Lack of proper road pricing leads to inefficient road investment and distorts choices between transport modes, particularly between road and rail freight.*** [56]

As a result, the Harper Review Panel ultimately recommended [emphasis added]

> *… reforming road transport by* ***introducing cost-reflective road pricing in a revenue-neutral way and linked to road construction, maintenance and safety so that road investment decisions are more responsive to the needs and preferences of road users.*** [57]

Heavier regulatory reforms have had substantial impacts upon the road transport industry, where in referencing a 2014 BITRE report on infrastructure, transport and productivity,[58] road freight shares of both single trailer articulated and other trucks had decreased by more than half from 1995 to 2007 on routes such as the Stuart Highway. Recognising that heavy vehicles have regained most of this freight share, such data does not indicate the impacts of the heavier forms of regulation enacted towards the end of the period, nor the impending impacts of cost reflective road pricing.

Consequently, significant regulatory impediments have and will continue to exist for the transportation of freight by road and therefore the MCA-NTD strongly disagrees with ECOSA stance that such obstacles are minimal.

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[54] NT Government, Department of Transport, 2014, *MVR Information Bulletin V33 – Innovative Vehicle Combinations,* 22nd August 2014, available at www.mvr.nt.gov.au
[55] Transport and Infrastructure Council, 2013, *National Land Freight Strategy,* May 2013, available at www.transportinfrastructurecouncil.gov.au
[56] Commonwealth of Australia, 2015, *Competition Policy Review – Final Report,* pg. 38, 31st March 2015, available at www.competitionpolicyreview.gov.au
[57] ibid
[58] BITRE, 2014, *Infrastructure, transport and productivity – Information sheet,* July 2014, available at www.bitre.gov.au

Technical impediments

In relation to technical impediments, ECOSA states that

> *…there are no particular technical impediments to the transport of freight by road, as road access is widespread and all freight types carried on the Tarcoola-Darwin rail are capable of being carried by road transport.* [59]

Technical impediments are partially covered within the rules and regulations aspect for road transport. For example, as per the earlier example of the NT-DoT V33 bulletin, operator applications need to indicate what variation of road train combination the operator intends to utilise. More relevantly, as per the *Heavy Vehicle (Mass, Dimension and Loading) National Regulation,* the NHVR outlines specific technical requirements that heavy vehicles must abide by including size, mass, warning signs, load projection and axle groupings.[60] Specifications outside of these requirements could incur significant penalties.

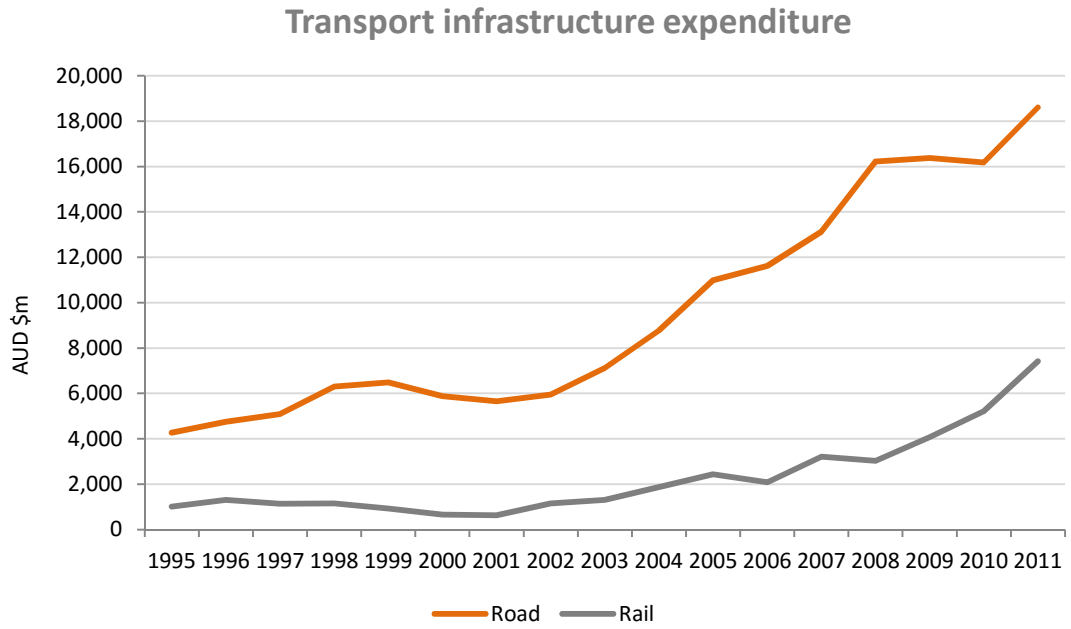
MCA-NTD also believes access to road is not as widespread as initially determined by the regulator. For instance, as per the Road Report Website as at the 14th June 2015, 52 restrictions and 3 impassable incidents existed on the NT road network.[61] This is despite national road investment increasing by 435% since 1995. However despite the extraordinary amount of expenditure, as late as 2014, the Local Government Association of the Northern Territory indicated that of the 14,000kms of road in the NT, 11,385km was unsealed of which 7,000km was unformed, dramatically limiting the ability of Government to undertake flood mitigation measures. When including NT highways, the situation improves slightly, but only 9,000km of the 36,000km is sealed and still subject to flooding issues throughout the NT's notorious wet seasons, such as the extended closure of the Barkly Highway in 2009.[62,63] Furthermore, bridges have been a constant focus for the NT Government, which has been on an ongoing program to increase the higher mass limits of all bridges. As recently as February 2015, the NT Government announced that will be upgrading six bridges under the first tranche of the Australian Government's $300m Bridges Renewal Programme.[64]

It could therefore be safely assumed that if road restrictions exist under an environment that has seen extensive road infrastructure investment, considerably more restrictions would be been experienced throughout the Review Period, hindering road access substantially more.

With indications that 90% of the contestable land-based intermodal freight market between Adelaide and Darwin has historically been captured by FreightLink then subsequently GWAN,[65,66], just because road transport is capable of carrying all freight types between Adelaide and Darwin, does not automatically provide validation that road transport can provide road transport, is competitive, or nor is it economically efficient to do so. In addition, unless there are vast technological improvements in the road freight environment, MCA-NTD believes that road

[59] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 19
[60] NHVR, 2014, *Heavy Vehicle (Mass, Dimension and Loading) National Regulation,* 29th September 2014, available at www.legislation.gld.gov.au
[61] NT Government, Road Report Website, 2015, available at www.ntlis.nt.gov.au/roadreport
[62] Economic Development Advisory Panel, 2013, *Recommendations for the Northern Territory Government's Economic Development Strategy,* 3rd October 2013, available at www.nt.gov.au
[63] NT Government, 2014, Submission from the NT Government to the Standing Committee on Infrastructure and Communications inquiry into Infrastructure Planning and Procurement, 30th April 2014, available at www.aph.gov.au
[64] Minister of Infrastructure and Regional Development, 2015, *Australian Government renewing six bridges across NT*, 27th February 2015, available at www.minister.infrastructure.gov.au
[65] FreightLink, 2008
[66] ARC, 2014, Annual Report 2013/2014

will become a competitor of even less significance in transporting freight across vast distances, especially with the advent of heavier regulations, increased congestion, driver shortages, increasing rail competition, harmonisation of national transport and investment strategies, costs and technical requirements.



Source: Organisation for Economic Co-Operation and Development, STAN Database, Transport infrastructure investment and maintenance spending, available at www.oecd.org

Recommendations

In working through the *2015 Draft Report*, ECOSA's preliminary view is that Test(2b) only applies to inter-modal freight since it passes the Test 2(a). However, MCA-NTD believes ECOSA have erred in the application of the Test and the Pricing Principles as outlined in the Code and ARA. MCA-NTD is therefore of the view that revenues derived from inter-modal freight are relevant, and recommends that consideration should be given to include inter-modal freight revenues in determining whether excessive revenues have been earned throughout the review period.

DETERMINATION OF RELEVANT COSTS

To assist ECOSA in making its draft determination, GWAN provided the regulator with three different allocation methodologies. This included (1) a cost allocation approach on the basis of revenues; (2) a cost allocation approach on the basis of estimated cost drivers; and (3) the allocation of costs between those customers that were subject to a sustainable competitive price and those that were not on the basis of a thousands of gross tonne-kilometres (KGTKs) usage measure.

In assessing the various allocation approaches, ECOSA determined that allocation methods (2) and (3) were considered reasonable and therefore were prepared to accept both for the purpose of the *2015 Draft Report*.

When combined with avoidable costs, ECOSA's preliminary decision was that total costs would range between $197.2m and $408.9m. Putting aside the issue of the wide – if not extreme – disparity between the upper and lower bounds of the relevant cost range, MCA-NTD expresses concern towards a number of facets associated the underlying metrics of the cost estimates themselves.

Asset base

In determining both a return of capital (depreciation allowance) and a return on capital for the upper and lower bound asset values, a Depreciated Optimised Replace Cost ('DORC') methodology has been utilised, entirely consistent with the *Access Pricing Principles* of the ARA.

DORC is essentially a notional concept of cost, seeking to quantify what it would cost a new entrant or the incumbent owner to replace the existing network. Alternatively, the methodology evaluates the current cost of forming the asset which provides the same service, then modifies the cost to reflect the condition of the asset. Like all valuation methodologies, DORC has been recognised to retain its own set of benefits and drawbacks. For instance, one advantage of DORC is that it does ensure obsolete assets are not included in the capital base. Another benefit is that DORC allows for ease of comparison by valuing assets at their current costs. Yet MCA-NTD believes any advantages – perceived or otherwise – are outweighed by DORC's significant shortcomings.[67]

For instance, regulators have expressed reservations to the subjectivity of DORC valuations,[68,69,70] with concerns being directed towards regulated entities yielding windfall gains.[71] Even the consultants retained to undertake the original DORC valuation have expressed that the methodology contains considerable subjectivity and engineering judgement.[72] This is even more so when desktop studies take the place of actual site visitations and inspections. MCA-NTD is therefore of the view that the DORC valuation methodology is a flawed concept that exhibits an

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[67] BHP, 1999, *Submission to the Productivity Commission Inquiry into the National Access Regime,* pg. 32, 5th January 1999, available at www.pc.gov.au

[68] Essential Services Commission, 2009, *Review of Victorian Ports Regulation – Final Report,* 26th June 2009, available at www.esc.vic.gov.au

[69] QCA, 1999, Queensland Rail – Draft Undertaking Asset Valulation, Depreciation and Rate of Return – Issues Paper, May 1999, available at www.qca.org.au

[70] ACCC, 2008, *Draft Decision Access Undertaking – Interstate Rail Network Australian Rail Track Corporation*, 9th April 2008, available at www.accc.gov.au

[71] QCA, 2015, A preliminary view: Regulatory economics assessment of the proposed Western System asset valuation approaches, 8th April 2015, www.qca.org.au

[72] Independent Pricing and Regulatory Tribunal (IPART), 2001, *Valuation of Certain Assets of the Rail Access Corporation – Final Report,* 14th May 2001, available at www.artc.com.au

absence of theoretical intelligibility as it leads to an overpricing of services as well as an underutilisation of infrastructure assets.

As part of the QCA's review of Queensland Rail's DORC asset valuation of the West Moreton Network, PWC was retained to by Queensland Rail to analyse and comment upon the methodology. In reference to the approach, PWC noted that

> *…the valuation should be constructed from forward-looking benchmarks and information, and historic patterns of asset accounting and development costs are irrelevant... A DORC valuation should focus on the remaining service potential of the assets. The 'estimated life' of assets for regulatory purposes should not be based on the accounting treatment of these assets. Regulators over the last two decades have recognised that accounting treatment may be an unreliable proxy for setting the asset value for regulatory purposes. A DORC valuation should reflect the modern equivalent asset value for delivering the same service requirements.*[73]

In any case, if ECOSA deems the DORC methodology to be the most prudent approach, the valuation method requires an assessment of the underlying condition of the asset which indicates the remaining service potential of the asset. In other words, the modern equivalent asset value.

This is because after the initial rail infrastructure investment, asset condition usually declines to a steady state phase, reflecting required maintenance but also indicating limited asset requirement expenditure. However once within the steady state phase, both maintenance and renewal expenditure is required so as to sustain the asset and meet desired levels of service performance. This phase continues until the asset nears the end of its economic life, where at the time, the asset is permitted to deteriorate.

10 years since commencement of operations upon the TDR, it could be reasonably assumed that the state of the asset is not new and within a steady state phase. However as no maintenance costs have been provided, nor any asset condition report, difficulties are encountered into externally assessing the overall state of the TDR without site visitations. MCA-NTD therefore refers to information contained within the 2014 Bureau of Infrastructure, Transport and Regional Economics ('BITRE') *Trainline 2 Statistical Report*.

Based upon information supplied to the BITRE by GWAN, the report indicates track quality indices ('TQI') for the Darwin to Tennant Creek segment of the TDR, where the index is a statistical measure calculated from the standard deviations of a number of different track geometry parameters including gauge, twist, vertical and horizontal irregularities across 100m sections. Higher track indices reflect lower track quality and troublingly, track indices for each of the three segments have increased since GWAN purchased the TDR in 2010.[74]

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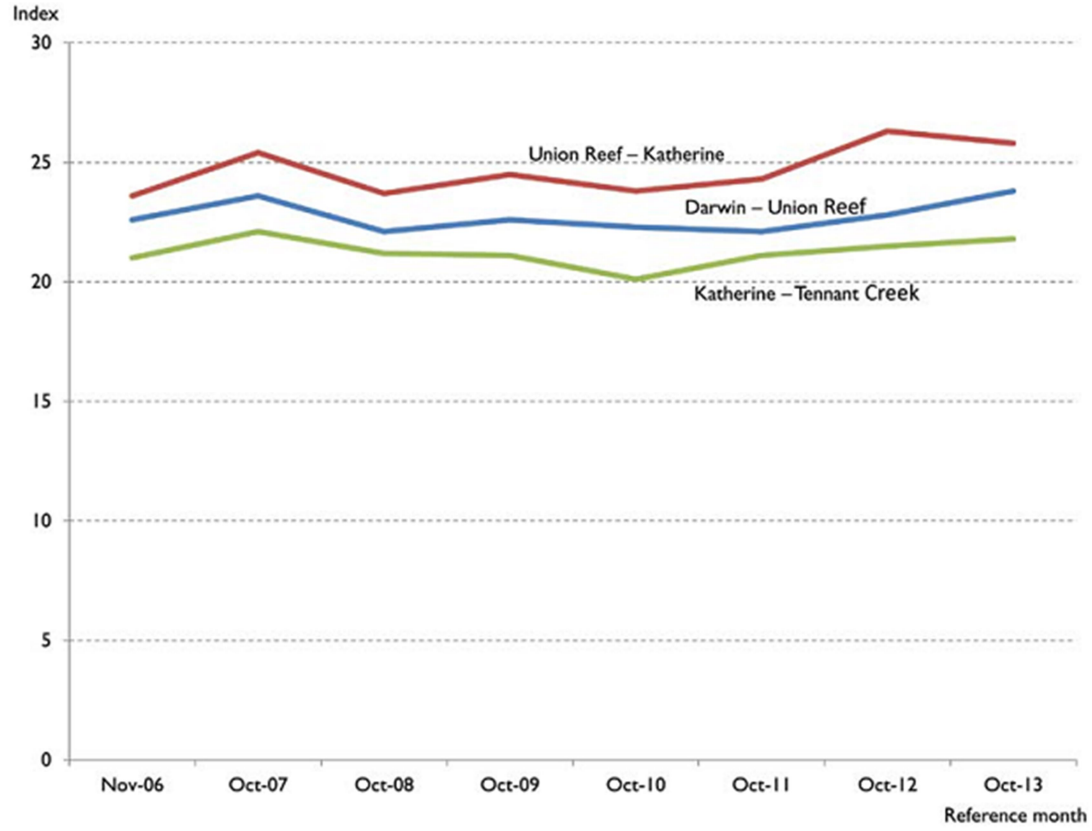
[73] PWC, 2015, *Asset valuation of the West Moreton Network,* pg. 6, 4th May 2015, available at www.qca.org.au

[74] BITRE, 2014, *2014 Trainline 2 Statistical Report,* 11th November 2014, pg. 87, available at www.bitre.gov.au

Figure 38 Genesee & Wyoming Australia track quality index, Darwin – Tennant Creek



Note: Lower indices indicate higher track quality.
Source: Track quality indices provided by Genesee & Wyoming Australia.

Further, per the Engineers Australia, *2010 Northern Territory Infrastructure Report Card*, commentary indicates that derailment can partially be an indicator of the state or quality of a rail network, where the report states that

> *…the quality of the rail network is partially reflected in the number of derailments. The Territory's rail network experienced 13 derailments between January 2001 and June 2009. Converting this figure to derailments per million km travelled, the Territory's level of derailments per distance travelled is the second highest of all Australian States and Territories.* [75]

Hence, when combined with the total new asset capital expenditure totalling $25.5m[76] for the 10 years of the Review Period, serious questions could be raised as to how much investment and asset renewal expenditure has been spent on the TDR since commencement of operation, especially since the asset could be considered to be within a steady state maintenance phase.

In addition, the MCA-NTD believes that the asset valuation and the price for which the asset was purchased needs further consideration. Pointedly, it is the submission's view that it is inappropriate for GWAN to be able to earn a return on an asset valuation where that valuation substantially exceeds the purchase price of the asset. More to the point, the MCA-NTD believes

[75] Engineers Australia, 2010, *2010 Northern Territory Infrastructure Report Card – Part 2: Transport,* pg. 28, November 2010, available at www.engineersaustralia.org.au
[76] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 36

GWAN is earning a free-kick on an asset which it only paid $334m for. MCA-NTD recognises there is no modest treatment in recognising government contributions or subsidies. However, treatment entirely depends upon the particular circumstances of how those assets where constructed or acquired. In the case of the TDR, GWAN purchased the assets – of which there were substantial government contributions – at a substantial discount approximately six years after their construction. Simply, it did not purchase the asset at full cost. In this light, MCA-NTD believes there could be two ways in recognising such contributions, where firstly, some form of offsetting account or mechanism could be utilised in the regulatory accounts, or alternatively, the regulator exclude amounts reflecting contributed assets altogether. In relation to the second approach, MCA-NTD notes that for regulated entities, capital contributions and gifted assets are excluded from regulated asset values.[77]

MCA-NTD therefore recommends the regulator consider:

1. Undertaking a site-orientated, condition based assessment of the TDR so as to determine its true and accurate condition. If upon completion the report indicates that the condition of the TDR is below that of what would be expected of an asset within a steady state condition required to desired levels of service performance, then MCA-NTD is of the opinion that the DORC should be decreased in value, with relevant assets optimised;
2. Supplying minimal information for the DORC valuation, including each of the asset classes, the modern engineering equivalent and optimised replacement cost of each asset class, as well as the valuation life, average life expired and depreciated optimised replacement cost; and
3. Implementation of one of the two proposed approaches so as to exclude government contributions from the underlying DORC valuation.

Lastly and again based upon limited information on hand, in regards to new asset capital expenditure, spending would seem reasonable. This is founded upon the understanding that GWAN has operated six to seven intermodal services per week between Adelaide and Darwin, plus 24 bulk train services per week between mine sites and the Port of Darwin.[78] However, MCA-NTD cannot make comment upon whether new asset capital expenditure throughout the Review Period was economically justified or prudent.

Operating costs

In relation to GWAN's operating costs, ECOSA simply states

> *GWAN has provided annual operating cost information for the Review Period, which totals $146.3m ($125.6m in nominal terms).* [79]

Of the total avoidable costs before allocation, operating costs accounted for ~95%. Once allocated and depending upon the allocation method and its respective workings, allocated operating costs account for between 9% and 20% of total costs for bulk freight services provided on the TDR throughout the Review Period.

Yet, no indication has been provided by ECOSA to specify what level of analysis has been undertaken to determine whether the costs provided by GWAN were reasonable and are

[77] ESC, 2014, *Regulatory Asset Valuation and Pricing*, 5th February 2014, available at www.esc.vic.gov.au
[78] ARC, 2014, Annual Report 2013/2014
[79] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 30

prudent. For instance, has ECOSA undertaken any benchmarking of the operating costs? Have GWAN delivered against any expected maintenance scope? Has such scope seemed prudent against forecasted railings? If actual railings differed from those forecasted, has the maintenance expenditure also been adjusted?

As way of example, due to the newly built Arrium port at Whyalla, from March 2013 the rail haulage task for Arrium Southern Iron switched from the PoD. Hauling close to 13 million tonnes per annum ('mtpa'), the Arrium haul counts as one of GWAN's largest where train configurations consist of four, 4,300 horse power AC locomotives with in-line refuelling, hauling 166 covered wagons comprising a total gross weight of approximately 15,000 tonnes.[80] Whilst towards the end of the Review Period, MCA-NTD would expect that a portion of the variable maintenance effort in the previous review period, as well as that in the current, would be taken into consideration.

Yet without any true transparency, stakeholders are only able to assess what costs drivers and expense line items operating costs are comprised of, as represented by Table 3-2 of the *2015 Draft Report* that outlines the specific line items in GWAN's regulatory accounts.[81] With such limited information, stakeholders encounter difficulties in providing insightful comment in comparing these costs to the definition of operating costs as per the ARA. Specifically, the *Access Pricing Principles* define operating costs as

> *…the on-going operational costs of providing the freight service, including the labour and material costs that are causally related to the provision of the freight service, including:*
>
> *— train crew labour costs;*
> *— rollingstock maintenance costs;*
> *— fuel costs; and*
> *— terminal handling costs…* [82]

Therefore in assessing Table 3-2, MCA-NTD assumes operating costs includes:

- Linehaul & operating costs;
- Linehaul costs;
- Track maintenance; and
- Other operating costs.

However of concern to MCA-NTD is that inability of GWAN to provide precise figures to the expense line items within Table 3-2. Pointedly, ECOSA indicated that [emphasis added}

> *GWAN's information systems have been built around a 'whole of line' approach to the operation of the Railway, and therefore* ***precise figures to populate the table above are not available.*** *GWAN submitted the estimated figures based on its best estimate, supported by RBB Economics.* [83]

Given the complexity of today's IT systems, it should be relatively straightforward for costs – be they maintenance related or other – to be tied to a program of works where such work is physically undertaken on specific track segments or allocated to an appropriate cost element.

[80] GWAN, 2013, *Mining South Australia 2013 Presentation*, November 2013, available at www.slideshare.net
[81] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 29
[82] South Australian Legislation, 2015, *ARA*, pg. 30
[83] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 30

However as no insight is provided into the composition of these line items, it is near impossible for stakeholders to access and comment upon the reasonableness of claims. No doubt GWAN would also incur costs associated with train control, asset management, business management, business support as well corporate overhead costs covering the IT, safety and finance functions of the organisation.

In any case, given the expanse of GWR and that GWAN has been operating the TDR for close to five full years, MCA-NTD is surprised of the limited ability of GWAN's information systems, ultimately impeding the precision that is usually required to indicate whether a network provider is undertaking prudent economic activity in the provision of a safe, efficient and effective operating environment. Further, when compared to other networks, the TDR is not as large nor considered as complex to operate and it would be fair and reasonable to expect GWAN undertaking its own efficiency gains in maintaining and operating the network thereby improving its operating ratio, especially given it would able to leverage of approaches and procedures from its parent firm, GWR.

Weighted average cost of capital

In relation to GWAN's return on capital, ECOSA has indicated that

> *…for the purposes of initial testing of relevant revenue outcomes, the Commission has adopted a pre-tax, real rate of return of 5.25 per cent as the lower bound of a reasonable range.* [84]

In arriving at its preliminary position, ECOSA also indicated it assessed a range of recent regulatory WACC determinations as evident by Table 3-3 of the *2015 Draft Report* [emphasis added]

> *…it recognises that the commercial rate of return (i.e., that used for pricing purposes) contemplated under clause 50(5)(c) of the Code is likely to be higher than the lower bound. However,* ***the rationale for the selection of a comparatively low commercial rate of return is that, if excessive revenues are not evident at this point, they will not be evident anywhere within or above the reasonable range****, including at the point estimate of the commercial rate of return (wherever that may lie).* [85]

However, MCA-NTD believes the regulator needs to go further. Pointedly, rather than utilising a rudimentary rationale of picking the lowest WACC from Table 3-3 and stating that if this WACC does not produce excessive returns then no excessive returns will be evident, the regulator should undertake a more comprehensive WACC analysis over the Review Period, taking into account market conditions as well as key commercial and regulatory risks that GWAN has been exposed to. This detailed assessment would focus upon the attributes which comprise the regulated WACC, establishing a view on:

- The firm's credit rating;
- The risk-free rate including the underlying asset and the appropriate term;
- The market risk premium;
- The firm's equity beta which include the asset and debt beta's; and
- Any applicable debt transaction or interest rate swap costs.

[84] ECOSA, 2015, Draft Report of the Tarcoola-Darwin Railway: 10-year Review of Revenues, pg. 35
[85] ibid

As ECOSA has chosen to reference the WACC of Aurizon Network ('AN') from the QCA's current regulatory review process, MCA-NTD would like to highlight some of the obvious differences between the respective operations of AN and that of GWAN, where most of these differences impact upon a firm's asset and equity beta's.

Regulatory revenue framework

The floor-and-ceiling price framework essentially allows the network service providers to set access tariffs anywhere between the two limits, where the ceiling price is defined as the

> *... amount equal to the costs associated with the operation of the required railway infrastructure needed by the access seeker for the provision of the freight service involving the transportation of freight on the railway between one point (point A) and another point (point B), calculated assuming the access seeker is the sole user of that required railway infrastructure and calculated in a manner consistent with section 2(2)(d) and (7)(a).* [86]

and where the floor price is incremental (avoidable) below rail costs if a network service provider did not provide access. In other words, tariffs are required to be set between a total cost (maximum amount) and an incremental cost (minimum amount).

Alternatively, network pricing under a revenue cap principally places a frontier on the overall revenue that a regulated business is allowed to earn across a term of one year, where prices are calculated by dividing the total allowable revenue by volumes (be they contracted or forecasted). If actual revenue is greater than allowed revenue in any one year, the regulated business has to return excess revenues back to its customers. Alternatively, if actual revenue is lower than allowed revenue in any one year, the regulated business has the right to receive additional revenue from the customers.

But a fundamental difference between the two approaches is that revenue caps protect regulated business from a majority of the significant impacts associated with volume risks, where if volumes drop off due to subdued economic activity, revenues are still protected. Instead in the case of the floor-and-ceiling pricing framework, apart from initiating take-or-pay arrangements, little can be done by regulated business to protect total revenues.

Additionally, MCA-NTD believes that the large variation evident between the floor and ceiling price limits provides no genuine guidance towards the economically efficient pricing outcomes for the TDR, doing little to promote the prudent operation as well as effective utilisation of the railway. Specifically, in addition to the Code exhibiting a flawed pricing methodology of floor and ceiling prices and allowing the operator the ability to extract monopoly rents from access holders and future access seekers, little insight is provided into how access prices correlate to rail performance; limited transparency is provided into the prudency and reasonableness of costs; next to no insight is provided into how and why such costs have been considered reasonable; and ultimately to protect its monopoly based position, the railway operator has and will continue to make confidentiality claims over information so as to impede the required transparency within the consultative process.

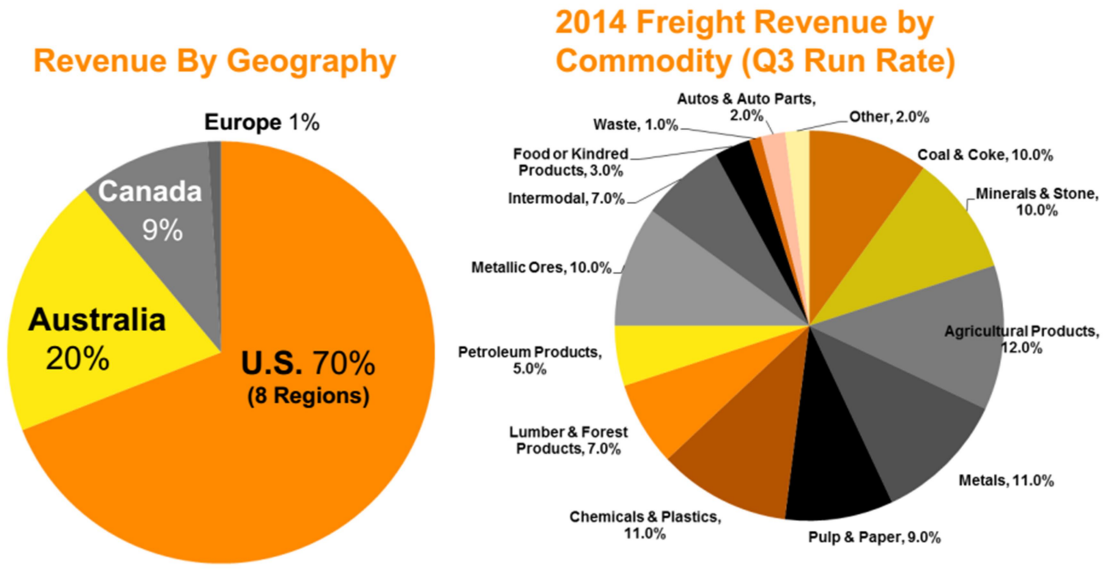
[86] South Australian Legislation, 2015, *AustralAsia Railway (Third Party Access) Act 1999 ('ARA')*, version 30.3.2001, pg. 28, 9th November 2007, available at www.legislation.sa.gov.au

Commodity revenue base

MCA-NTDs view is that the systematic risk of a single commodity railroad is expected to be closely correlated to the systematic risk of the industry it serves. For example, the Central Queensland Coal Network ('CQCN') owned and maintained by AN, a rail transport business whose revenue is nearly wholly derived from the haulage of coal primarily bound for export markets. If international coal markets stagnated, or prices fell even further than they are today, many coal producers who have been experiencing operating margin pressures could potentially cease operations altogether. As a result, even though AN has entered into take-or-pay contracts to mitigate against such risks, take-or-pay arrangements do little to protect AN if coal producers face insolvency.

GWAN and GWR are within a different scenario. This is reflected by GWR's total revenue diversity, where the graphic below indicates how widespread the GWR's 2014 freight revenue was, with GWAN comprising approximately 20% of the GWR's total revenue base.

Figure 1 - GWR Revenue Diversity (2014)[87]



Specifically in relation to Australia, GWAN earned revenues from hauling agricultural products, metallic ores, minerals and tones, intermodal freight and petroleum products. Table 2 highlights GWAN's earnings for each of these commodity types as per GWR's, United States Securities and Exchange Commission Form 8-K lodgement as at 31st December 2014.[88]

[87] GWR, 2015, Review of Canadian Short Line – Funding Needs and Opportunities Presentation, 26th February 2015

[88] United States Securities and Exchange Commission (SEC), Genesee & Wyoming Inc. – Form 8-K, 10 February 2015, available at www.sec.gov

Table 2 - Australian Freight Revenues by Commodity type

Commodity Group	31st December 2014		31st December 2013	
	Freight revenues	Carloads	Freight revenues	Carloads
Agricultural products	32,003	54,184	40,405	61,757
Metallic ores	109,439	56,542	109,326	52,135
Minerals & stone	8,921	53,407	10,144	56,762
Intermodal	91,895	63,475	97,888	65,148
Petroleum products	1,447	286	1,730	296
Totals	243,705	227,894	259,393	236,098

Therefore, as GWAN's revenue is base is significantly more diversified, it retains a greater ability to protect its revenues throughout subdued market conditions, further indicating that revenues are relatively more stable.

Recommendations

Determination of an appropriate regulated WACC is not a straightforward exercise. Whilst many of the elements that comprise WACC are grounded firmly in technical fundamentals, the WACC's asset beta is open to a fair degree of subjectivity. As financial markets rise and fall and economic conditions change, WACCs can vary within months, let alone a decade. In addition, WACCs can be profoundly different for regulated entities in the same industry.

Hence critical issues exist in ECOSA's approach of initially testing GWAN's appropriate commercial return. In this light, MCA-NTD considers that the approach and the WACC utilised by ECOSA is inappropriate. Rather than choosing the lowest WACC from a range based upon a view which indicates that if excessive revenues are not earned under that value, then no excessive revenues would be earned under higher WACC values, ECOSA should undertake a comprehensive analysis of the financial and economic elements applicable to GWAN across the Review Period. Once completed, MCA-NTD further recommends that ECOSA then review the post-tax WACC range of between 12.9 to 16.6%.

In any case, even if ECOSA stands by its initial approach and continues to reference the AN WACC, questions are immediately raised as to its relevancy to the Review Period. Specifically, the AN WACC is intended to be applicable throughout AN's regulatory period beginning the 1st July 2014 through to the 30th June 2018, whilst the TDR Review Period is for the era between the 15th January 2004 to the 30th June 2013.

MCA-NTD therefore recommends consideration be given to utilisation of at least two, post-tax WACC's that more appropriately reflect GWAN's business and operating risks throughout the 10 year Review Period.