Alice to Darwin Rail Project

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Introduction The Alice to Darwin Rail Project represents a landmark in project financing, particularly in the Australian environment which has its own unique legal and economic context. Having said this, the approach pioneered by governments and the private sector to implement this project is translatable and provides a broad template for the solution of large greenfield public infrastructure procurement by the private sector.

Although the implementation pre-dates the formal embracing by Australian Governments of public/private sector partnering (as developed from United Kingdom precedents), the nature of the undertaking in this case led to a unique structure and risk sharing profile.

This comes about due to the fact that the three Governments concerned had several aims in connecting Darwin in north Australia to the southern and eastern States. The line is being constructed through some of the most inhospitable and poorly populated country in Australia. It passes through an established freight corridor which has experienced prolonged levels of high growth but, relative to the quantum of infrastructure required, the existing freight levels are not high. However, it marries the aim of Governments to promote future economic growth and transport efficiency to private sector carriage of risk. Within its structure, as the long term government aims are achieved, it also allows for the gradual transfer of risk out of Government hands and Government financial reporting.

Due to the number of parties involved and the novel nature of the process, the procurement was lengthy and the documentation extensive. Ultimately this reflected the range of issues that needed to be overcome and in this instance the significant prior experience of Governments and the private sector in the Australian BOOT market was essential.

The Project

Historical Background

The construction of a railway line connecting Darwin in Australia's remote north with Adelaide and the east-west transnational rail system in the south, has been under consideration since the early 1900s. An 830 km railway line was constructed from Tarcoola on the east-west line to Alice Springs in central Australia early in the last century. Freight carried on this line and destined for Darwin has had to be unloaded at Alice Springs and loaded onto road transport for the remaining part of the journey.

The Northern Territory and South Australian Governments, with the support of the Federal Government established the AustralAsia Railway Corporation ("the Corporation") in 1997 to coordinate and oversee the delivery of a railway line to extend the existing rail line through to Darwin, to be known as the AustralAsia Railway Project.

The following year, the Corporation commenced a tender process to award a concession to the successful private sector Consortium to construct the new line and to operate it for 50 years prior to reversion to Government ownership. The three Governments had also undertaken to provide significant capital works funding to the successful bidder.

In July 1999, the Asia Pacific Transport Consortium ("APTC"), advised Macquarie Bank Limited, was announced as preferred bidder. Following this announcement, APTC appointed a Joint Lead Arranger bank group comprising ANZ Investment Bank, RBS (Australia) Limited, ABN AMRO and SG (Australia) Limited (the ‘Senior Financiers’) to underwrite senior debt funding for the project.

These negotiations culminated with Financial Close in April 2001, with construction commencing shortly afterwards.

Participants

APTC comprises Kellogg Brown & Root (part of the Halliburton group), John Holland Group (part of the Leighton Group), Barclay Mowlem Construction Ltd., Macmahon Holdings, ARG, and S.A.N.T. Holding Pty Ltd.

Construction & Engineering will be undertaken by a joint venture comprising Brown & Root, Barclay Mowlem, John Holland Group Pty Ltd, and Macmahon Holdings Limited

Brown & Root Pty Ltd is the owner of the local firm, Kinhill Pty Ltd, the Australian arm of one of the world’s largest and most diversified engineering and construction firms.

Barclay Mowlem Construction Ltd is a large multidisciplined engineering and construction company operating throughout Australia, Papua New Guinea and South-East Asia, with particular expertise in rail construction.

John Holland, since its foundation in 1949, has been a leader in engineering and construction projects throughout Australia and across South-East Asia, particularly in civil engineering.

Macmahon is one of the largest civil engineering and contract mining companies in Australia, and operates throughout Australia, New Zealand, Malaysia and Indonesia.

Rail Operation will be undertaken by Australian Railroad Group Pty Ltd (ARG), a joint venture between Genesee and Wyoming and Wesfarmers.

SANT (Management) will be responsible for Logistics Management and is owned by the Gunn family who are specialists in providing logistics services to industry in the form of supply chain management, warehousing and distribution services, and line haul and forwarding services.

In addition to the Sponsors, at financial close there were the following equity participants:

- Colonial First State Investments
- National Australia Asset Management Ltd
- Northern Territory Government
- Northern and Central Aboriginal Land Councils

Components of Construction

The project involves the construction and operation of a new line from Alice Springs to Darwin under a 50 year (from completion of construction) BOOT contract between APTC and the Corporation including the construction of the fit out works associated with the terminal facilities at the Port in Darwin.

The Federal Government and the Governments of South Australia and Northern Territory have provided the 53 year lease of the existing Tarcoola to Alice Springs railway line. Other components include a 50 year lease over the integrated intermodal container terminal at the East Arm Port in Darwin (the “Port”); and the operation of the railways and the new container terminal facilities at Darwin.

Main project features are:

- 1,420km single track with passing loops;

- Maximum operating speed of 115kph; and
- 120 bridges with a total combined length of 8km.
- Freight terminals/handling facilities at Darwin (Berrimah Road), Katherine, Tennant Creek and Alice Springs.
- A maintenance depot at the Berrimah Road freight terminal in Darwin..

The railway will be constructed on multiple fronts over a three-year period, which will minimise disruption by the tropical wet season (December to March) and optimise project logistics. The key construction targets include track laying at the average rate of 1.6 km per day, per work front, and a daily sleeper production rate of 4,000 from two plants located in Katherine and Tennant Creek.

The Freight Task

The project is aiming to capture a share of the existing corridor market between Adelaide and Darwin. This is referred to as the 'domestic market'. This market potential has undergone thorough review by various consultants acting for the Corporation, APTC and the financiers.

On this corridor freight forwarders have a choice between rail and road for transport north to Alice Springs, and road only for the larger volume of freight destined for Darwin. The previous Government-run rail service to Alice Springs has been pared back and is perceived as a poor fit to freight forwarders' requirement resulting in price discounting in order to retain market share.

APTC's business plan and economics enable a permanent discount to road prices, with an additional discount in the earlier years to stimulate the shift from road to rail. Another key factor is that of road safety, with freight forwarders keen to reduce their exposure to the ultimate risk on current road haulage practices that operate at the limit of legal and physical constraints. Road hauliers on the Adelaide to Darwin route operate in a very competitive environment, with vehicles at the top end of productivity and on low operating margins.

Additional benefits are expected to come from the integration of the railway with the expanded port facilities at Darwin. Darwin's proximity to Asian export markets allows greater flexibility and speed to exporters than traditional shipping methods involving large cargo vessels connecting the southern and south-eastern Australian cities to the major Asian ports.

Important components for deriving the estimates for the rail freight task are:

1. Growth within the import-led Northern Territory economy is the key driver to this Corridor's freight market. Within the 5 years to 1997/98 Northern Territory's GDP grew by an annual average of 5.6%, compared to the national average of 4.1%. The South Australia Centre for Economic Studies forecasts a conservative growth rate for the Northern Territory economy "of at least 4.0 to 4.5 per cent over the next decade" (prior to any East Timor considerations), well in excess of the Australian national average.
2. Diversion rates from road to rail for the contestable road freight market have been assessed dependent upon length of line haul. This is consistent with the national experience where shorter routes, that make up the bulk of the freight market, are more suited to road freight, and longer haul is more suited to rail. In their Base Case, the Senior Financiers adopted diversion rates from 15% for short sectors (such as Darwin to Katherine) to 75% for the longest haul length, between Adelaide and Darwin.
3. At the start of operations is expected that there will be a ramp-up period over which freight volumes will increase from levels currently transported between Adelaide and Alice Springs to include freight captured from road transport. During this period APTC plan to offer discounted freight rates in order to attract business away from road freight. Because of the adverse impact on Project cash flows of both ramping up volumes and discounted pricing, a key issue for the banks was the Project's debt servicing capacity over this period, given the uncertainty of the rate of ramp up in the absence of existing haulage contracts.

Landbridge

As well as the traffic intended for domestic consumption identified above, APTC have identified an additional market for exporters and importers between southern and south-eastern states (via the Railway) and Asian markets. The Senior Financiers viewed this business, known as “landbridge”, as equity upside, and excluded it entirely from the bankable freight market for the project.

The Policy background

The project has been procured via a unique partnership between two Governments (with the support of the Federal Government) and the private sector. These Governments have seen the completion of the north-south link as integral to future economic development of the region. The Commonwealth Government also views the project as one of national significance and provided a portion of the funding for the Government Works portion of the construction as well as facilitating negotiations on issues such as the Access Regime for the completed rail link.

Although not procured directly under a Public Private Partnership policy, the complexity of the project, its level of commercial viability, especially as a start-up business, and its long-term importance to national development resulted in a very close partnership between the public and private sectors and a unique contractual basis for risk sharing, financing and benefiting from the returns of the venture.

The Concession Deed is the key document government the relationship between the private sector and Corporation, and as well as general issues related to construction and operating obligations and rights, encapsulates mechanisms for dealing with regulatory and legal considerations such as third party access to the corridor, Aboriginal land rights, corridor occupation rights, environmental management and heritage/sacred site issues.

The Access Regime was established to comply with the Trade Practices Act which establishes the basis of which competitive environments in Australian commerce and industry. Access regimes in general deal with the delicate balance of ensuring that privately provided public infrastructure is available for general use, but at the same time seek to ensure that private sector capital investment and returns on that investment are sustainable. The Tarcoola to Darwin Access Regime is enshrined in South Australia and Northern Territory legislation and was declared effective by the Federal Government prior to financial close. It provides mechanisms for pricing and regulation of that pricing that have given the finance community confidence that, while APTC may not operate as a monopoly on the line, an appropriate return on capital can be earned through a combination of selling track access and direct freight haulage.

Under the Concession Deed, the Corporation indemnifies APTC against loss or claims arising from pre-existing environmental contamination and is responsible for managing the remediation of such problems. An Environmental Management Plan is in place as agreed between APTC and the Corporation which lays down strict guidelines for the management of future migratory and on-site contamination where the bulk of the responsibility lies with the project.

The corridor land is owned by a combination of Aboriginal Land Councils and the Crown. The Corporation is the beneficiary of a number of Head Leases and in turn sub-leases to APTC. The Corporation has warranted the efficacy of the leases under the Concession Deed.

In relation to indigenous land rights, Australia legally recognises valid claims over land of valid significance to the indigenous people. Practically this can result in a range of outcomes including rights of access and use, restrictions on third party use to outright possession. Above a nominal threshold, the Corporation has indemnified APTC for loss associated with any resulting disruption to the project which could ultimately result in the termination of the Concession Deed and the payment of a forfeiture amount to retire the financing.

In relation to sacred site, heritage and artefact risks, the Corporation has identified a number of potential sites, issued clearances and indemnified in respect of these. These arrangements are subject to APTC completing defined Pre-Construction activities.

The Contractual/Legal structure

The structural considerations were complicated by the phasing in of the new Federal Government Revised Business Taxation scheme. The ramifications extended to thin capitalisation issues, the new Goods and Services Taxation system, tax consolidation and clarifications on debt/equity distinction and the treatment of leases/hire purchase arrangements.

Major Entities:

APT is the joint venture ‘Nominee’ and acts as agent for the UJV in entering into contracts. APT enters into the operating contract with Freightlink, wholly owns the borrowing entity Asia Pacific Transport Finance (‘APTF’), is signatory to the Concession Deed with the Corporation; is the beneficiary of the site sub-leases (has the contractual rights of occupation of the corridor); is the ultimate owner or lessee of the project assets, including rolling stock; and enters into the Design and Construct (‘D&C’) Contract with the D&C Joint Venture.

APTF is established for several reasons. First, the US market is commonly used to a clean skin vehicle, which assists during the off shore syndication. Additionally, it is a requirement for offshore syndications to qualify for relief from withholding tax that the debt notes be issued by a company.

The D&C Joint Venture (called ADRail) has been formed by the four lead contractors who are also equity investors: Brown and Root Construction, Barclay Mowlem Construction, John Holland Pty. Ltd. and Macmahon Contractors Pty. Ltd. ADRail is jointly funded by the Corporation and APTF for the construction of the line between Alice Springs and Darwin and separately for the construction of the Port Works in Darwin. Fifteen year parent guarantees have been provided by the parent companies including Halliburton Company and Leighton Holdings Ltd.

FreightLink is the operating company which commenced roles associated with management of the existing line form Tarcoola to Alice Springs at financial close. FreightLink is essentially owned by the same entities as the UJV and the ownership is stapled. FreightLink is a largely a non asset owning and break even vehicle with project tax being paid at the level of the Joint Venturers. FreightLink subcontracts functions other than its core management obligations to specialist entities. These include SANT as logistics and terminal manager, the BJB Joint Venture for operational below rail maintenance, and Rail operations are subcontracted to ASR (a subsidiary of ARG) and port operations to P&O. The BJB Joint Venture has been formed by Brown & Root, Barclay Mowlem and John Holland. ASR is the south Australian rail freight operator and is partly owned by Genesee & Wyoming.

Key Project Documents:

The project is purported to involve 300 executed documents. The major components of the key documents are discussed below:

The key equity document is the Joint Venture Agreement between the equity Sponsors. In most cases there are two ultimate UJV Participants for each Sponsor. This is to permit convenient sell down from initial equity positions to the minimum requirements of the finance documents and the Concession Deed when applicable. As well as regulating the UJV parent obligations and cross charges, it authorises the Nominee and FreightLink to enter into their various contractual relationships and encapsulates the equity subscription timing and parameters (overlaying the Equity Subscription Agreement).

The core document behind the project is the Concession Deed to which the Corporation and APTC are the prime signatories. The governments of South Australia and the Northern Territory are also signatories primarily in their role as guarantors for the two Governments. The Concession Deed incorporates the obligations with respect to the construction of both the Government Works and the private sector works as well as the operating period and encapsulates the project risk sharing arrangements. In the case of a right of termination by APTC, an Early Termination Payment must be paid by the Corporation which effectively retires the project debt and some return to equity. The overall project also involves the joint development of the Port of Darwin which is relevant to the Land Bridge task, but APTC’s obligations in relation to this are largely independent of the rail construction and operation obligations. MAE protections for the project extend to amendments and repeal of the access Regime, support of competitive projects and discriminatory changes in law which provide for a variety of Corporation remedies, which can extend to financial compensation for a change in State Law.

The Debt Financiers' Tripartite overlays the Concession Deed and the Finance Documents. The parties to it include the Corporation, APTC, Freightlink and the senior and mezzanine lenders. Apart from standard provisions concerning the priority of Banks' security and rights of enforcement subject to notifying the Corporation, of principal interest are the Senior Financiers' rights to remedy project defaults under the Concession Deed. Where Termination Events are capable of remedy where APTC and the Security Trustee are entitled to cure periods with an obligation to diligently pursue a cure. These periods are extendable so long as the remedy continues to be diligently pursued or the extension is required due to Force Majeure or inclement weather.

The Operating Agreement: The Operating Agreement sets out the relationship between the Nominee, APTC and FreightLink. Subcontracted obligations are back-to-backed through to the subcontractors who operate under KPI regimes that impact upon their levels of payment. The Senior Financiers have the benefit of Consent Deeds to the operating contracts which establishes their security, right of cure and other provisions enabling them to protect their interest.

The D&C Contract: The D&C Contract is a fixed price, turnkey for the design, construction, procurement of operating equipment (not including such things as rolling stock) and commissioning/testing of the railway and ancillary below rail infrastructure. The contract backs through the construction obligations of the UJV arising in the Concession Deed. The design development obligations are encapsulated in the Design Brief and the contract itself contains mechanisms to involve the Principals, future Operators and (through the D&C Consent Deed) the Senior Financiers to ensure fitness for purpose and consistency between the constructed product and the operating phase operational requirements and costs. The Senior Financiers have the benefit of the D&C Consent Deed establishing and acknowledging the Senior Financiers' rights of security, cure and assignment.

The Government Works Agreement

The signatories to this document are the Northern Territory and South Australian Governments and an intermediate entity called Asia Pacific Contracting. This latter entity enters into the D&C Contract with the D&C Joint Venture and the Nominee for the practical implementation of the works. The Government Works are those which are funded by the Governments which are largely preliminary civil works which are required to be completed and funded to set levels prior to thew drawing of mezzanine and senior debt. There is a separate schedule of payment of the Government funding and the certification of the work prior to any stage of funding is subject to sign off by the Independent Certifier and the Banks' Independent Engineer. The latter is to ensure that the Senior Financiers see no impediment to their funding being drawn arising from the earlier stages of the works.

The Rolling Stock Acquisition and Rolling Stock Maintenance Protocols

As an operating business, APTC needs to acquire locomotives and wagons on time and sufficient in quantity and capability for the initiation of operations following Completion of construction, and also on a staged basis as the freight task of the project builds up over time. The Senior Financiers make available an initial loan of AUD80m to fund the first stage of rolling stock. Any cost overruns at this stage are to be funded by equity. The Rolling Stock Acquisition Protocol is an agreement between the banks and the project governing the terms of procurement and the funding of it. It extends to scenarios involving leasing and hook and pull arrangements to give APTC economic flexibility. In particular it deals with the necessary timing of the procurement processes, the technical acceptability of various types of rolling stock, and the risk carriage that is to be carried by the suppliers. The Rolling Stock Maintenance Protocol carries out a similar function for the maintenance of the acquired rolling stock and also puts in place procedures to ensure that the forecast maintenance costing is in line with the specifications of the acquired assets.

The Independent Certifier's Deed

This is an agreement covering the role of the Independent Certifier between the Government works and D&C contractors, the project, the various financiers, the Corporation and the certifier. Particular roles are to monitor construction in compliance with the Concession Deed, certify progress payments under the Government Works Agreement and certify Completion of construction for all parties.IJ