Attachment 1

Investigation into the better alignment of TasRail and Tasports

FINAL REPORT

December 2014

Department of Treasury and Finance

Tasmania
Explore the possibilities

Government of Tasmania 2014

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PART A: EXECUTIVE SUMMARY

Overview

On 29 September 2014, the Treasurer, Hon Peter Gutwein MP, and the Minister for Infrastructure, Hon Rene Hidding MP, issued Terms of Reference for an investigation into the better alignment of the operations and investment strategies of Tasmanian Ports Corporation Pty Ltd and Tasmanian Railway Pty Ltd.

The investigation is consistent with the Government's key objective of improving efficiency and the allocation of scarce Government resources, including reducing unnecessary duplication and costs in the Government Business portfolio. The intent of the review is to investigate whether a better alignment of the businesses might achieve cost savings and improve service delivery for businesses, producers and exporters.

This report to Government contains advice on the potential for benefits to be realised, key legal issues, key risks to be managed, cost savings that might be realised and a possible implementation approach to better aligning the businesses.

The overall benefit of aligning both businesses is likely to be modest. Nevertheless, it is feasible and can be pursued without significant legal impediments if implemented under an approach that includes enabling legislation being passed through the Tasmanian Parliament. This would facilitate the transfer of assets, rights, liabilities and employees between the businesses, as well as to establish a clear mandate for the reforms and provide certain protections to Directors and Shareholders.

The Terms of Reference require that possible alignment options be identified. Feasible options other than the status quo are those in which the two existing businesses are established as related entities under the *Corporations Act 2001 or Government Business Enterprises Act 1995* – that is, either under a subsidiary business model or a fully integrated single business.

If an alignment is progressed, the benefits that may accrue are most likely to be realised under a full integration model, where the two existing businesses would be merged into a single supply chain business.

An alignment would be best progressed by a Transition Board. The Transition Board would be responsible for managing the integration timeframe and all transitional issues, such as establishing a new corporate structure for the integrated business, appointing the senior management team, managing integration costs and managing resourcing, operational and compliance matters. Some or all of the members of the Transition Board, particularly the Chair, should form the first Board of the new company.

The principal benefits from an alignment that could reasonably be expected to accrue are an improvement in the coordination of commercial arrangements from a customer perspective, particularly for bulk freight customers, and an improvement in strategic asset planning, particularly in relation to the Burnie port.

The cost savings that might be delivered are forecast to be positive but modest, in the range of $2 million to $4 million per annum. Implementation costs, which would accrue in the first year or two of restructuring, are estimated to be in the range from $1.5 million to $5 million. However, experience in implementing structural reform of Government businesses suggests that this estimate should be treated with caution and that higher implementation costs may well accrue.

The cost savings have been identified as being of lesser significance compared to the strategic benefits and are of such a magnitude that the financial, business and implementation risks would make a restructure on a purely financial basis inadvisable.

The financial position of an integrated ports and rail business would be unlikely to significantly increase its ability to fund capital works compared to the status quo and returns to Government in the form of dividends, tax equivalent payments and guarantee fees would be slightly lower from an integrated business compared to the status quo.

In the context of the broader issues facing the Tasmanian freight system, in particular the ongoing challenges relating to distance from markets and obtaining adequate sea freight services at appropriate prices, a closer alignment or integration of ports and rail does not have the capacity to significantly resolve key freight policy challenges. However, in the areas outlined above, modest improvements could be expected.

A critical consideration is whether structural reform of the rail and ports businesses might impact on key private sector freight service providers, in particular critical Bass Strait sea freight providers. While the assessment indicates that there are unlikely to be competition law complications associated with any of the options identified, it is yet to be established whether the perception amongst key freight industry participants of any change will be positive and what impact, if any, pursuing integration might have on the commercial investment decisions of these key participants.

Should the Government wish to proceed with the alignment of both businesses, it would be prudent for a Transition Board to engage with key stakeholders as part of the implementation phase. This would primarily target third parties in the freight industry and the purpose would be to address any unintended adverse consequences that may arise in the most sensitive parts of the freight system, which otherwise has the potential to outweigh the modest benefits of the alignment that have been identified.

The Terms of Reference require a final report to be completed by March 2015. This report discharges that obligation and is intended to inform the Government sufficiently for it to identify a preferred way forward.

Policy context

Freight environment

As a small island state, the efficiency, effectiveness and optimisation of Tasmania's freight system is of critical importance to the strength of Tasmania's economy and, ultimately, the standard of living of Tasmanians. Given the combined challenges of the distance from markets for Tasmania's export industries and the relatively short length of Tasmania's land based freight corridors, it is unsurprising that Tasmania's freight system has been the subject of a range of reviews and proposed policy solutions.

Significant attention has been given to resolving key constraints on freight-dependent economic activity, in particular Bass Strait and international shipping arrangements. Given Tasmania's island economy, connecting to other markets will always be the most critical challenge for freight policy. For instance, the Government is implementing its election commitment to commit significant resources, if required, to establish interim international shipping arrangements.

Further, the Government is developing an integrated Freight Strategy that will consider all parts of the freight services supply chain and the long term infrastructure requirements of the freight system.

This investigation into the better alignment of the operations and investment strategies of Tasports and TasRail is thus occurring within a broader policy context, where broader challenges are being examined. The investigation is being completed consistent with its Terms of Reference, but is also cognisant of the possible impacts of any alignment options on the ability of Government to address its broader freight policy challenges.

Government business oversight

The investigation is also being undertaken within the context of the Government's Fiscal Strategy, outlined in the 2014-15 State Budget. Strategic Action 4 of the Fiscal Strategy requires Government businesses to deliver services to Tasmanians at the lowest sustainable cost, while also providing an appropriate financial return to the Government.

The Budget Papers note that the Government owns businesses for a range of reasons, including the need to ensure the continued provision of important or essential services to the Tasmanian community, as well as to enable the funding of large scale infrastructure to support economic development or to deliver on particular policy objectives. It is vital that these services are delivered at the lowest sustainable cost and in an efficient and effective manner, while also providing an appropriate financial return to the Government.

This investigation is one of a number of actions being undertaken to ensure the ongoing efficiency of the Government business portfolio.

Summary of findings

Key objectives

Key objectives that might be delivered through a better alignment of the operations and investment strategies of Tasports and TasRail were identified, to provide a framework for assessing the potential alignment. The key objectives were identified as:

- facilitating business investment;
- improved infrastructure planning;
- improved utilisation and productivity of infrastructure; and
- improved business performance, funding capacity and productivity.

Alignment options

Three theoretical models for aligning both businesses were established for purpose of assessing the potential benefits, costs and issues of any alignment. The three models represent an increasing scale of integration and, therefore, facilitate an assessment of the relative merits of an alignment to a lesser or greater extent.

Table 1: Alignment options

Level of integration	Alignment option	
	Model	Description
Low	Combined board model	The Boards of management of the two businesses are integrated to provide strategic governance and oversight of the businesses. Each business continues as a separate corporate entity and the entities are not related parties.
Medium	Shared services model	A parent company that provides executive and corporate services, business development, property and procurement, project management, engineering and IT services to both businesses operating as separate subsidiaries.
High	Full integration model	The two businesses are merged into a single supply-chain public utility corporation.

Legal constraints

Each theoretical alignment option was initially tested for compliance with relevant legal obligations, including Directors' duties under the Corporations Act, competition law requirements and national access and pricing regimes. Where an option was inconsistent with these legal obligations, it was not assessed further as it would not be feasible to implement the option. This is the case with the Combined Board model, which would put the Directors and Shareholders at risk of breaching the Corporations Act. The remaining two models, the shared services model and the full integration model were assessed as being compliant with relevant legal obligations and the risk of significant legal constraints arising were assessed as low.

Table 2: Assessment of potential for legal constraints to arise for each option

Legislation	Potential for constraints to arise		
	Combined Board	Shared services model	Full integration model
Corporations Act	**High** • Duties of directors limited to consideration of each business in isolation. • Significant risk to directors and Shareholders of breaching obligations. • Option not considered further, owing to significant constraints.	**Low** • Directors can consider interests of both entities. • Directors' and shareholders' obligations clear and consistent with Act.	**Low** • Directors can consider interests of both entities. • Directors' and shareholders' obligations clear and consistent with Act.
Competition and Consumer Act	**Not applicable** • Not pursued in light of Corporations Law constraints.	**Low** • Unlikely to substantially lessen competition in the Tasmanian market. • Anti-competitive contract and cartel provisions do not apply.	**Low** • Section 50 of the Act would apply in principle. Risk can be mitigated through legislation to support asset transfers to the new business. • Unlikely to substantially lessen competition in the Tasmanian market.

Legislation	Potential for constraints to arise		
	Combined Board	Shared services model	Full integration model
National Access Regime and National Competition Policy	**Not applicable** • Not pursued in light of Corporations Law constraints.	**Low** • No impediments under the Tasmanian Railway Network Declaration or the National Competition Policy.	**Low** • No impediments under the Tasmanian Railway Network Declaration or the National Competition Policy. • May declare port services for price regulation under *Economic Regulator Act 2009* if required for business confidence in arrangements.

Strategic opportunities

Each feasible alignment option has been assessed in terms of its potential ability to realise the strategic opportunities. In summary, the full integration model has a stronger potential to realise strategic opportunities than the shared services model. Despite this, overall there are limited instances where the alignment of the businesses would realise the strategic opportunities to the extent that they provide additional measurable benefits compared to the status quo. The majority of potential strategic opportunities that may be realised are intangible, such as the potential benefits to new mining ventures from having one rail and ports business to deal with and the potential productivity benefits that may arise from better strategic planning.

While the assessment concludes that the potential for specific strategic opportunities to be realised is low in many cases, this does not imply that there are no benefits. Instead, it reflects that the ability of an aligned model to achieve those benefits is not significantly greater than the status quo. Further, it may be that some potential benefits may exist that have not been identified.

Table 3: Potential for each option to realise strategic opportunities

Strategic opportunity	Potential to realise the strategic opportunity	
	Shared services model	Full integration model
Coordinated business development	**Low** • Little to no impact on the procurement of freight services for containerised freight. • Lower potential for improved freight coordination for new bulk commodity exporters. • Other parts of the freight supply chain will remain unchanged. • Overall, unlikely to have a substantial impact on the key constraints to businesses development.	**Medium** • Little to no impact on the procurement of freight services for containerised freight. • Higher potential for improved freight coordination for new bulk commodity exporters, for land based transport and storage. • Other parts of the freight supply chain will remain unchanged. • Overall, may have a positive impact for bulk freight related business development.
Improved infrastructure capacity utilisation and productivity	**Low** • Limited ability to influence the overall freight task in Tasmania. • Unlikely to be any competitive advantages that would facilitate a transfer from road to rail. • Separation of port and rail operations and logistics unlikely to result in productivity improvements. • Limited potential for significant asset rationalisation in the medium term.	**Low** • Limited ability to influence the overall freight task in Tasmania. • Unlikely to be any competitive advantages that would facilitate a transfer from road to rail. • Potential for productivity improvements, however, this will not necessarily improve infrastructure utilisation. • Limited potential for significant asset rationalisation in the medium term.

Strategic opportunity	Potential to realise the strategic opportunity	
	Shared services model	Full integration model
Better long term strategic planning	**Medium** • Effective working relationships will be institutionalised. • Alignment of commercial expectations and directors' duties. • Continued risk of information asymmetry.	**High** • Effective working relationships will be institutionalised. • Alignment of commercial expectations and directors' duties. • Broader freight perspective and availability of information.
Increased infrastructure funding	**Low** • Tasmanian Government fiscal constraints. • Avenues already exist to coordinate Australian Government infrastructure funding requests but these provide little flexibility. • Tripartite infrastructure funding negotiations have worked effectively to date.	**Low** • Tasmanian Government fiscal constraints. • Avenues already exist to coordinate Australian Government infrastructure funding requests but these provide little flexibility. • Tripartite infrastructure funding negotiations have worked effectively to date.
Enhanced business flexibility	**Low** • Potential to enhance strategic use of existing assets. • Strategic options limited by separation of rail and port operations into separate subsidiaries.	**Medium** • Potential to enhance strategic use of existing assets. • Difficult to assess the full extent of available business options and their likely impact.

Risks and issues

Each feasible alignment option has been assessed in terms of the potential for each risk and issue to materialise under those options. The majority of the risks and issues are intangible and are difficult to fully predict. In most cases, the risks are seen as low to medium and the full integration model is assessed as presenting higher risks than the shared services model, primarily in relation to the risk of the loss of business confidence by private sector freight operators and industrial relations risk.

Table 4: Potential for risks and issues to materialise under each option

<table>
<tr><th rowspan="2">Risks and issues</th><th colspan="2">Potential for risks and issues to materialise</th></tr>
<tr><th>Shared services model</th><th>Full integration model</th></tr>
<tr><td>Additional operating and trading risks</td><td>Low
Operational risks likely to remain unchanged.
Seasonal volume risks likely to remain unchanged.
Exposure to bulk freight volumes likely to remain unchanged.</td><td>Low
Operational risks likely to remain unchanged.
Seasonal volume risks likely to remain unchanged.
Exposure to bulk freight volumes likely to remain unchanged.</td></tr>
<tr><td>Loss of business confidence by private sector freight operators</td><td>Low
Separation of rail and ports operations and logistics into separate subsidiaries may alleviate market concerns.</td><td>Medium
Potential perception of anti-competitive behaviour.
Potential that concerns will not be alleviated by transparent pricing and access regimes.
Potential for private sector opposition to aligned business, irrespective of prior consultation.</td></tr>
</table>

Risks and issues	Potential for risks and issues to materialise	
	Shared services model	Full integration model
Cultural and internal business risks	**Low** • No obvious differences in business culture or workforce demographics. • Potential loss of internal business knowledge.	**Low** • No obvious differences in business culture or workforce demographics. • Potential loss of internal business knowledge.
Industrial relations	**Low** • Industrial relations environment likely to remain largely unchanged.	**Medium** • Costly conditions of employment may expand within the integrated business. • Potential concentration of union membership, impacting on industrial relations outcomes.
Implementation risks	**Medium** • Unrealistic expectations about implementation timeframes. • Implementation costs may be higher than expected. • Business integration will distract from core operations. • Incentives for key employees to leave the business. • Potential need to resecure Australian Government funding. • Mitigation measures are available via appropriate governance arrangements.	**Medium** • Unrealistic expectations about implementation timeframes. • Implementation costs may be higher than expected. • Business integration will distract from core operations. • Incentives for key employees to leave the business. • Potential need to resecure Australian Government funding. • Mitigation measures are available via appropriate governance arrangements.

Operating cost savings and integration costs

The assessment of operating cost savings has concluded that there are potential annual operating cost savings from the integration of the businesses, which in general relate to the savings created by merging the corporate functions of both businesses and the removal of the functions that are duplicated as a result. However, this would be the case for the alignment of any two businesses and does not necessarily imply that the alignment is worth pursuing, as a strategic case must also be made.

The integration will also result in a number of one-off costs, particularly in relation to redundancy costs and business establishment costs, possibly including information technology integration costs, depending on the strategy pursued for corporate IT systems.

Table 5: Estimated operating cost savings and integration costs

$000	Ongoing (per annum)		One-off (capital or immediate expense)	
	Low	High	Low	High
Board and committee fees	300	360	-	-
Duplicated executive, middle management and corporate	2 600	3 800	-	-
Redundancies	-	-	(620)	(1 900)
Aligned conditions of employment	(960)	(640)	-	-
Purchasing power	190	190	-	-
Accommodation	90	140	-	-
Lease termination			0	(360)
IT licensing	0	350		
IT avoided capital	-	-	0	930
IT capital expenditure	-	-	0	(1 490)
Business establishment	-	-	(1 000)	(2 000)
TOTAL	**2 220**	**4 200**	**(1 620)**	**(4 820)**

Financial Performance and Strength of an aligned business

The forecast financial performance and strength of an aligned business was determined by applying the estimated cost savings and integration costs to the combined corporate plan forecasts of both businesses. The key findings from the analysis of the financial forecasts of an aligned business include:

- the alignment of both businesses will consolidate their net losses over the planning period. An aligned business will make substantial net losses and the expected future profits from Tasports, from the end of the corporate planning period, will be forgone by the alignment of both businesses;
- an aligned business will be unable to produce sufficient revenues to recover operating expenses and capital costs and, therefore, will not be in a position to fully fund the replacement of infrastructure assets at the end of their useful lives;
- the alignment will have an immaterial impact on State's equity in the business, compared to the status quo;
- the alignment will not have a material impact on Total State Sector finances, compared to the status quo;
- total capital expenditure requirements of an aligned business will remain unchanged compared to the status quo, unless an aligned business reprioritises capital expenditure and/or rationalises assets;
- the borrowing capacity of an aligned business is unlikely to increase, compared to the status quo;
- returns to Government from an aligned business will decrease compared to the status quo, because the operating losses and accumulated tax losses of TasRail will more than offset the profits of Tasports (in the final years of the planning period); and
- the potential operating efficiencies and cost savings of an aligned business may potentially offset any increases in funding to TasRail that may be required if Australian Government rail funding is not committed.

The estimated key financial measures for an aligned business are outlined on the following page.

Table 6: Forecast key financial performance and strength measures

$'000	2014-15	2015-16	2016-17	2017-18
Financial Performance				
EBITDAM	31 229	37 930	38 514	43 339
EBITDA	1 152	8 276	13 473	18 815
EBIT	(17 918)	(12 383)	(7 676)	(2 740)
Profit Before Tax (before impairment)	(21 512)	(14 822)	(9 507)	(4 571)
Profit Before Tax	(55 180)	(40 322)	(33 507)	(28 571)
Percentage change in PBT (to status quo)	*(5.4%)*	*10.2%*	*12.0%*	*13.8%*
Financial Strength				
Total Assets	402 613	413 846	412 454	414 139
Total Liabilities	103 072	82 211	73 543	72 836
Total Debt	51 443	34 584	27 334	27 334
Total Equity	299 541	331 635	338 911	341 303
Percentage change in equity (to status quo)	*(0.9%)*	*1.4%*	*1.4%*	*1.4%*
Cash flow				
Capital expenditure	81 155	42 750	38 019	37 770
Key Financial Ratios				
Debt to capital	14.7%	9.4%	7.5%	7.4%
FFO/Total Debt	(4.7%)	16.9%	42.6%	62.1%
EBIT Interest coverage	(5.0)	(5.1)	(4.2)	(1.5)
EBITDA Interest coverage	0.3	3.4	7.4	10.3
Return on Assets	(9.6%)	(6.8%)	(5.7%)	(4.8%)
Return on Equity	(12.9%)	(8.5%)	(6.9%)	(5.9%)
Returns to Government				
Dividends	-	-	-	-
Income Tax Equivalents	-	-	-	-
Guarantee Fees	548	440	361	361
Total Returns to Government	548	440	361	361
Change relative to 2014-15 Budget	*(59.1%)*	*(61.2%)*	*0.0%*	*(92.4%)*

PART B: BACKGROUND

Terms of Reference

In the 2014-15 State Budget, the Government announced that it would investigate options to more closely integrate the operations of TasRail and Tasports to assess whether improved strategic and operational benefits can be delivered.

The Government subsequently agreed to the Terms of Reference for a review into the potential alignment of both businesses. This included the provision of a Final Report to Government by March 2015. This report has been prepared to fulfil that requirement.

The Terms of Reference are provided at Appendix A.

Approach to the investigation

In accordance with the Terms of Reference, a Steering Committee was established to oversee the investigation, provide strategic guidance throughout the process and endorse the Final Report to Government. The Steering Committee met monthly to consider relevant matters.

The following approach was adopted for assessing the alignment options:

1. identify key objectives;
2. identify alignment options for assessment;
3. assess legal constraints;
4. identify potential strategic opportunities;
5. identify potential risks and issues;
6. establish methodology for financial assessment;
7. assess the potential for alignment options to achieve strategic opportunities;
8. assess potential for risks and issues to materialise;
9. assess potential operating costs savings and implementation costs;
10. assess financial forecasts for an aligned business and impact on State finances; and
11. identify and assess implementation issues, including stakeholder engagement strategy.

Freight environment in Tasmania

Key freight statistics

The Department of State Growth has analysed Tasmania's freight system as part of developing the Tasmanian Freight Strategy. The key findings that provide useful context to the potential alignment of TasRail and Tasports include:

- 99 per cent of Tasmania's imports and exports are moved by sea and, therefore, through Tasmania's ports;
- 13 million tonnes of freight moved through Tasmania's publicly-owned ports in 2012-13 and around 3 million tonnes of this was transported to the ports via rail;
- bulk freight accounts for around two-thirds of volume and containers around one-third;
- Burnie is Tasmania's largest port and moves approximately 55 per cent of containerised freight annually;
- Port Latta is Tasmania's largest bulk freight port. This is owned and operated by Grange Resources and is used to export iron ore from its Savage River mine. Tasports provides towage and pilot services at Port Latta;
- commodity-based specialisation is a feature of Tasmania's ports, largely driven by bulk freight; and
- Burnie to Hobart is Tasmania's key freight corridor, carrying the highest freight volumes. This operates as a parallel road and rail network.

Recent trends and future growth

The freight task in Tasmania is driven by macro economic conditions in Tasmania, Australia and internationally. In recent years, the freight environment has been characterised by a weak global economy, a high Australian dollar, structural problems in the local forestry industry and the rationalisation of the shipping logistics industry that resulted in the loss of international container services from Tasmania. Given this, freight volumes have steadily decreased in Tasmania since the peak experienced in 2008.

Growth projections developed by the former Department of Infrastructure, Energy and Resources indicate that agricultural products will likely be the key driver of any future growth in Tasmania's freight task. Nevertheless, any growth in Tasmania's freight task is likely to be incremental and it is expected that total freight volumes in 2043 will only marginally exceed the freight volumes experienced in 2008.

These projections have underpinned Tasports' 30 year port strategy, which has concluded that future freight growth can be accommodated by its existing port infrastructure under its current port specialisation strategy, where each port provides specialised services based on the natural gateway for major commodity groups.

However, Tasports' strategy is a business-specific analysis and it is expected that the Department of State Growth's freight strategy will provide a thorough analysis and options relating to the optimisation of freight infrastructure from a whole-of-State perspective.

Tasmanian Railway

Overview

TasRail was established under the *Rail Company Act 2009* for the purpose of acquiring, owning and operating a rail business in Tasmania. The business commenced operations on 1 December 2009.

TasRail's core above rail business functions are the provision of rail and associated freight services in Tasmania, the provision of train control services and the management of freight terminals, including bulk handling and loading. TasRail's core below rail business functions are the maintenance of, and upgrades to, the rail network infrastructure in Tasmania.

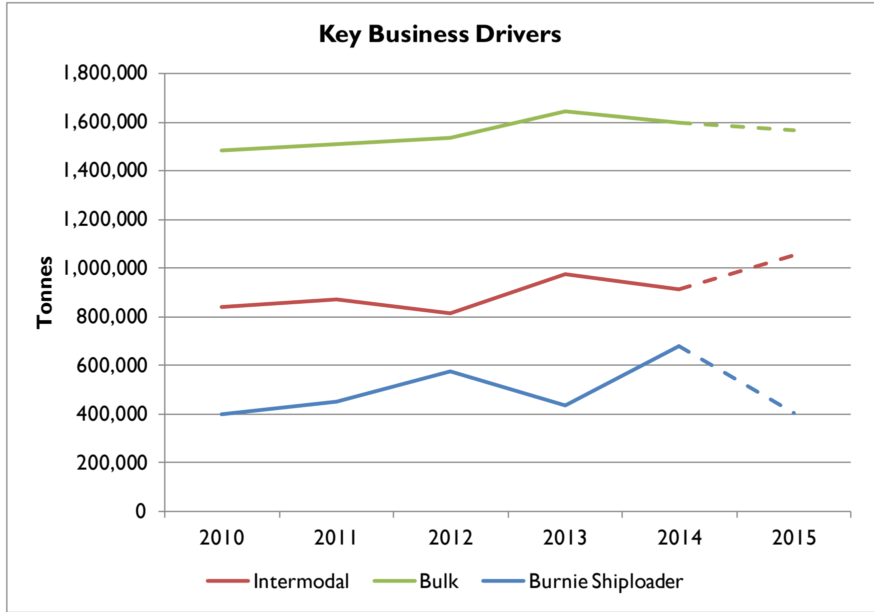
Since its inception, TasRail has undertaken significant capital investment in both below rail infrastructure as well as the procurement of a new locomotive and wagon fleet. The total cost of the new rolling stock is estimated to include $53.3 million on the locomotive replacement and upgrade program and $17.3 million on the intermodal wagon fleet. Replacing the fleet of locomotives and intermodal wagons is expected to reduce TasRail's maintenance and operating costs, and increase efficiencies as the new locomotives will have a trailing capacity of up to 30 per cent greater than the current locomotives. These projects have been funded from State Government equity funding and short term borrowings.

During 2013-14, TasRail relocated its Hobart terminal operations to the Brighton Transport Hub. It is expected that this move will improve transit times between Hobart and the Northern ports and help attract more freight to rail.

Key business drivers

TasRail has been steadily increasing its intermodal and bulk volumes since 2009. TasRail has estimated that its share of the total Tasmanian freight task for 2013-14 was 22 per cent. The majority of TasRail's major customers are under new medium to long term contracts.

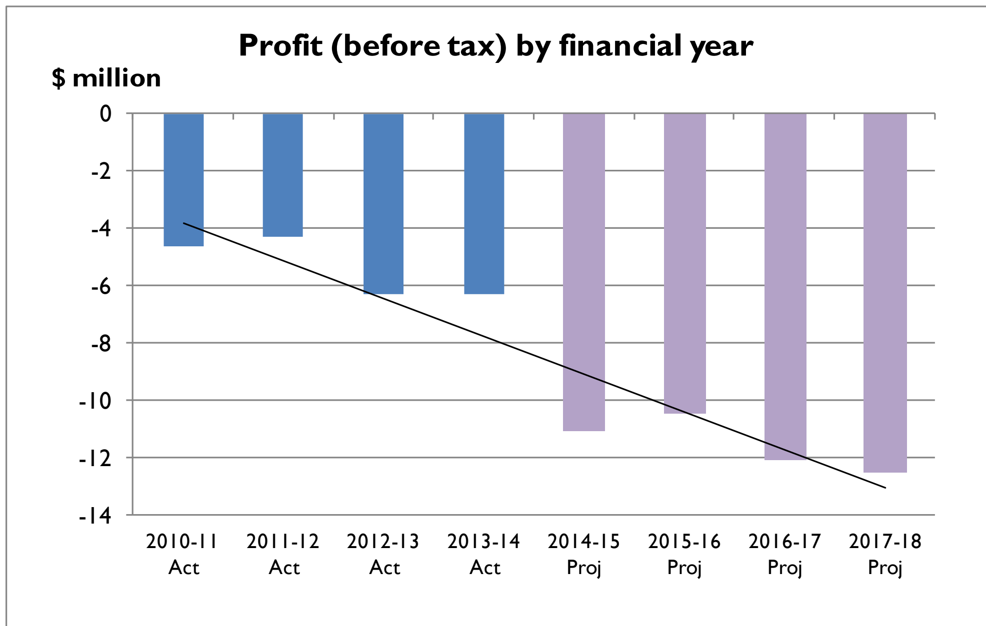
Figure 1: TasRail's key business drivers



Financial performance

TasRail has incurred significant net losses over the past four financial years. In 2013-14, TasRail recorded a net loss of $48 million. Excluding impairment expense, TasRail's underlying net loss was $6.3 million. This poor operating result indicates that TasRail has an insufficient customer base to cover its substantial annual maintenance costs. TasRail's financial performance is forecast to remain weak, as the business will not generate sufficient cash flows to meet its capital expenditure requirements.

Figure 2: TasRail's underlying profit (excluding impairment)



Since TasRail commenced operations in December 2009, it has received significant Australian and State Government funding.

To 30 June 2014, the Australian Government, under its Rail Rescue package and Nation Building 1 package, has contributed $143.3 million to TasRail's capital works program. A further $53.6 million of Rail Rescue funding was received by the former Department of Infrastructure, Energy and Resources prior to TasRail's inception and invested in the rail network. In addition, the Australian Government contributed $8.2 million in 2009-10 for track upgrades.

Securing sufficient funding to enable TasRail to meet its capital expenditure requirements will continue to be a significant challenge for the business. While the Australian Government has budgeted for a further $120 million over five years under its Nation Building 2 package, this funding is yet to be confirmed and requires a matching contribution from the State.

State Government contributions to TasRail to 30 June 2014 will total $215 million. The State funding includes both operating grants and equity contributions. The primary purpose of the equity contribution is to fund TasRail's capital expenditure on new rolling stock.

TasRail's view is that the below rail operations of the business will always require an annual operating grant from the State Government for the ongoing maintenance of the rail network and associated infrastructure. The recent improvements to rolling stock and track infrastructure are expected to allow the business to improve revenue growth and maximise productivity benefits within the organisation.

Tasmanian Ports Corporation

Overview

Tasports was formed in 2006 as part of the merger of the four existing Government-owned port companies at the time. Tasports owns and operates Tasmanian port infrastructure and undertakes related activities including cargo handling, cold storage, pilotage and towage. Tasports also owns and operates the regional airport at Devonport.

Tasports has four main working ports, including :

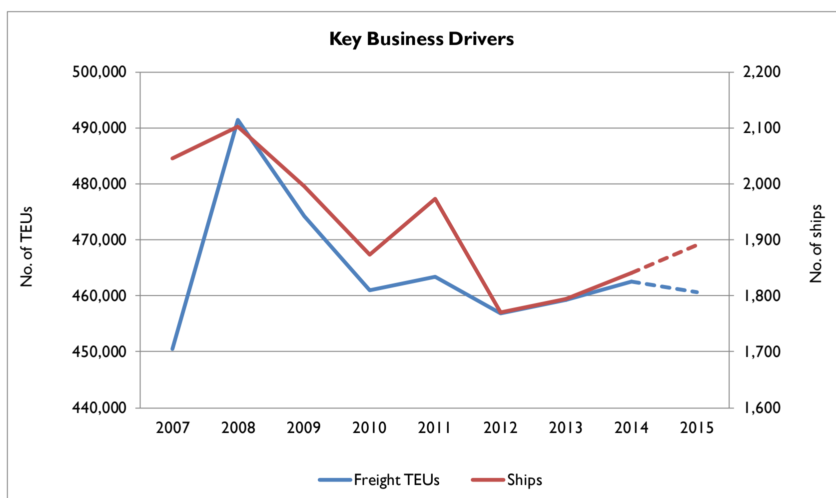
- Hobart port, which specialises in Antarctic operations and cruise vessels;
- Bell Bay port, which is used for containerised freight and dry bulk commodities;
- Devonport port, which provides specialised roll-on, roll-off containerised freight terminals; and
- Burnie port, which has intermodal capacity and is the main container terminal in the North of the State. It is also used for bulk commodities, including woodchips.

Tasports also owns a number of non-commercial port assets, which have a high strategic value for community and tourism use but provide very little, if any, financial return to the business. Tasports has been allocated total Government equity funding of $17.5 million to assist in meeting essential maintenance requirements for some of its non commercial assets, including Sullivans Cove, Inspection Head, Stanley and Strahan.

Key business drivers

Tasports' key business driver is shipping and trade activity for containerised freight and bulk commodities including minerals and woodchips. As mentioned previously, overall freight volumes in Tasmania have declined in recent years, given the persistent weakness of the global economy, increasing international competition, the economic effects of the high Australian dollar, continued structural problems being experienced in the forestry industry and the loss of international container services from Tasmania.

Figure 3: Tasports' key business drivers



Financial performance

Tasports has responded to its difficult operating environment over the past few years by implementing a new pricing strategy and undertaking an operational efficiency program.

Tasports has been phasing in a new pricing structure for a range of uncontracted services over a four year period. This is aimed at introducing uniform state-wide pricing whilst also increasing prices closer to market rates, as Tasports' prices were previously underpriced compared to many other Australian ports. The 2014-15 financial year is the final year of the transition to the new pricing structure.

Nevertheless, Tasports will continue to negotiate prices for larger contracts. Tasports also has a number of legacy contracts that pre-date the aggregation of the four port companies in 2006, and these provide very favourable terms to some customers and limit Tasports' ability to fully align prices. For example, Tasports has a contract with Toll at Burnie Port that is not due to expire until 2029.

While Tasports is generally moving to benchmarked market prices, it remains disadvantaged compared to other Australian ports, which have greater economies of scale than Tasports and can, therefore, generate a better margin from benchmark prices. In addition, due to the geographically dispersed nature of its operations, Tasports faces higher costs from needing to provide towage and pilot services at each port.

Tasports is currently assessing its future pricing strategy, to apply from 2015-16 onwards. Tasports has engaged external advice to compare its current pricing structure to other jurisdictions and this will assist in developing the pricing strategy.

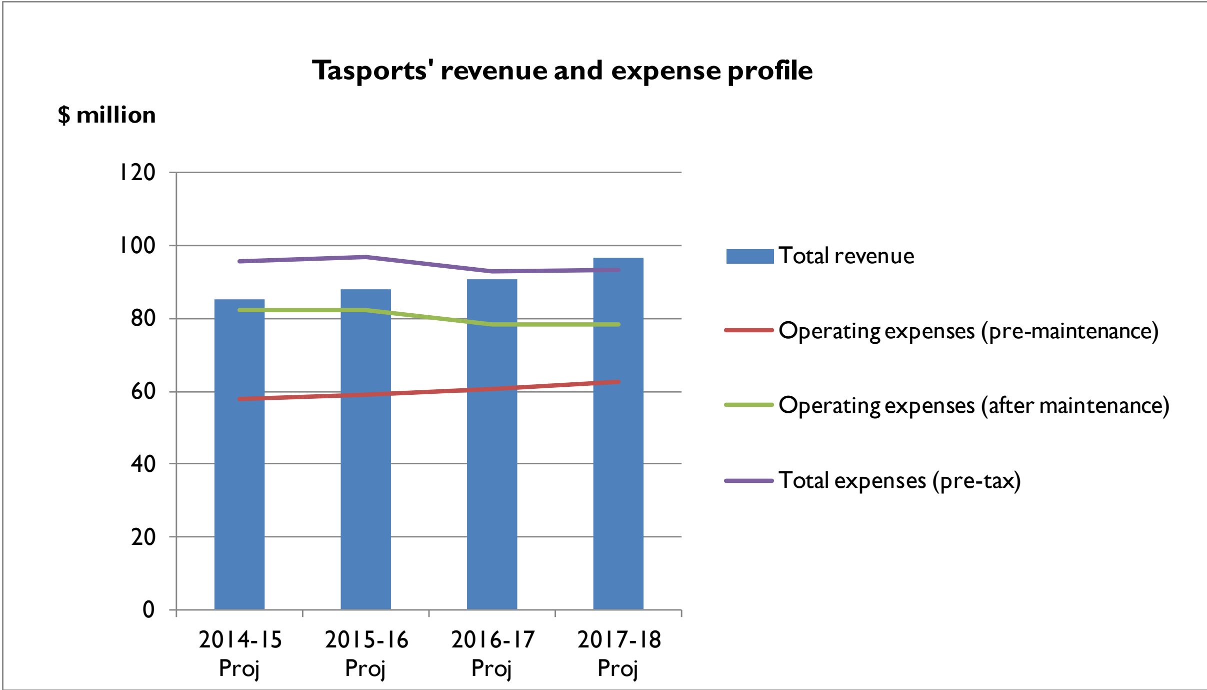
Tasports has implemented an efficiency program over recent years which has delivered a range of cost reductions and employee savings and has aligned Tasports' cost base with its reduced freight volumes and associated activity levels. Tasports considers that its resource levels are now at an efficient level and there is unlikely to be any substantial changes in resourcing levels over the planning period. Instead, Tasports will direct its focus over the planning period towards enhancing productivity within the business by identifying areas that can be streamlined and improved.

In relation to shipping volumes, Tasports forecasts an increase in the number of ships berthing at its ports. This is driven by a forecast increase in the exports of forestry products and manganese alloy. Total volumes of container imports and exports are forecast to remain relatively consistent with the 2013-14 financial year volume.

A key measure of Tasports' operating performance is its Earnings Before Interest, Tax, Depreciation, Amortisation and Maintenance (EBITDAM). In the context of forecast volume increases and its pricing strategy, Tasports forecasts healthy and increasing EBITDAM over the planning period, reflecting that Tasports' revenues are predicted to outpace its pre-maintenance operating expenses.

Despite its improving operating performance, Tasports is forecasting net losses from 2013-14 to 2016-17. This is due to the company's large maintenance program, including its non-commercial asset maintenance program that is largely front ended over the planning period, and its depreciation and interest charges each year. This is outlined in the chart below.

Figure 4: Tasports' revenue and expense profile



PART C: ASSESSMENT

Approach to the assessment

The following approach was used to assess the alignment options.

Step 1 – Identification of key objectives

The key objectives of aligning the operations and investment strategies of both companies were identified by a Working Group consisting of Treasury officers and the Chief Executive Officers and Chief Financial Officers of both businesses. The key objectives, subsequently endorsed by the Steering Committee, were identified as:

- facilitating business investment;
- improved infrastructure planning;
- improved utilisation and productivity of infrastructure; and
- improved business performance, funding capacity and productivity.

Step 2 – Identification of alignment options for assessment

The Steering Committee considered and agreed a set of options that may achieve the objectives of better aligning the operations and investment strategies of Tasports and TasRail. The options identified were theoretical models and were identified solely for the purpose of testing the relative costs and benefits for each degree of business alignment. The options were not tested for the purpose of recommending a final alignment structure, as this should be the matter for the Board of an aligned business, if this was progressed. On this basis, the alignment options identified included:

- a combined board model;
- a shared services model; and
- a full integration model.

Step 3 – Assessment of legal constraints

The identified options were assessed against key legislation and instruments of a legislative nature, which were:

- *Corporations Act 2001* (cwth);
- *Competition and Consumer Act 2010* (cwth); and
- National Competition Policy agreements, to which Tasmania is a signatory.

Step 4 – Identification of potential strategic opportunities

The Working Group consisting of Treasury officers and the CEOs and CFOs of both businesses held a workshop to identify the potential strategic opportunities that may exist in the alignment of both businesses. These were identified in the context of the objectives of the alignment and the purpose of identifying the potential opportunities was to provide a framework for assessing each alignment option. That is, the alignment options were to be assessed in terms of their potential to realise the strategic opportunities.

The potential strategic opportunities that were endorsed by the Steering Committee were:

- coordinated business development;
- improved infrastructure capacity utilisation and productivity;
- better long term strategic planning;
- increased infrastructure funding; and
- enhanced business flexibility.

Step 5 – Identification of potential risks and issues

The workshop held by the above mentioned Working Group also identified the potential risks and issues that may arise in the alignment of both businesses. Again, the purpose of identifying the potential risks and issues was to provide a framework for assessing each alignment option, in terms of whether the risks and issues were likely to materialise under each option. The risks and issues that were endorsed by the Steering Committee were:

- additional operating and trading risks;
- loss of business confidence by private freight operators;
- cultural and internal business risks;
- industrial relations risks; and
- implementation risks.

Step 6 – Establishment of methodology for financial assessment

A methodology for assessing the financial aspects of a potential alignment was drafted by Treasury and discussed with a Working Group comprising Treasury officers and the CFOs of both businesses. Following the Working Group's meeting, the methodology was refined and an information request list was issued to each business.

Step 7 – Assessment of the potential for alignment options to achieve strategic opportunities

The potential for each alignment option to achieve the agreed strategic opportunities was assessed by taking into account information available to Treasury and the information provided by each business. The assessment was largely qualitative in nature and focused on key operational, logistical and strategic matters that are relevant to each business and the overall freight supply industry in Tasmania, including customers. The assessment was endorsed by the Steering Committee.

Step 8 – Assessment of potential for risks and issues to materialise

The potential for the identified risks and issues to materialise under each option was assessed by taking into account information available to Treasury and the information provided by each business. Again, the assessment was largely qualitative in nature and focused on key operational, logistical and strategic matters that are relevant to each business and the overall freight supply industry in Tasmania, including customers. The assessment was endorsed by the Steering Committee.

Step 9 – Assessment of potential operating costs savings and implementation costs

The potential operating cost savings that could be made by an aligned business, and the estimated implementation costs, were assessed by applying the agreed framework to the detailed financial information provided by each business. Specific detail on the framework used is provided in the operating cost savings and implementation cost section of this report.

Step 10 – Assessment of financial forecasts for an aligned business and impact on State finances

Financial forecasts for an aligned business were established by applying the operating cost savings and implementation cost forecasts to the combined final corporate plan forecasts of each businesses. This provided and indicative set of key financial measures that outlined the potential financial performance and strength of an aligned business. The financial forecasts were then used to determine the impact that a business alignment may have on the State's finances by considering the impact on potential returns to Government and the Government's current funding to both businesses.

Step 11 – Assessment of implementation issues, including stakeholder engagement strategy

A range of implementation issues, including legislative and governance requirements, were identified and assessed. The implementation advice was particularly cognisant of the assessments of legal constraints and risks and a recommended implementation process to significantly mitigate key risks was prepared. A stakeholder engagement strategy was developed, taking into account the stakeholders that may be impacted by the alignment of the businesses.

Key objectives

The key objectives identified by the Steering Committee as possibly being able to be delivered through a better alignment of the operations and investment strategies of Tasports and TasRail were identified as:

- facilitating business investment;
- improved infrastructure planning;
- improved utilisation and productivity of infrastructure; and
- improved business performance, funding capacity and productivity.

These key objectives, and the ability of the models to deliver against the objectives, are described in greater detail in the following assessment.

Alignment options

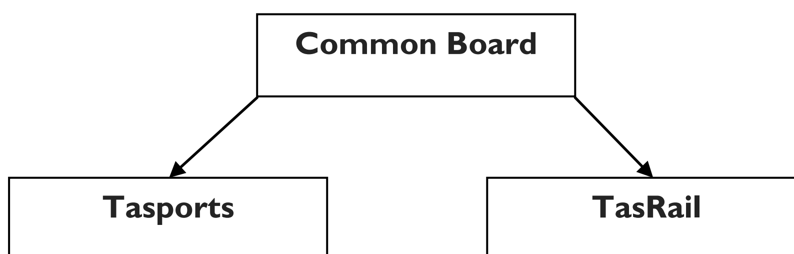
Options identified

In order to assess whether there may be potential benefits from more closely aligning the operations of TasRail and Tasports, theoretical structural models were identified for the purpose of assessing the extent of any potential cost savings or benefits that may be achieved from the implementation of these models.

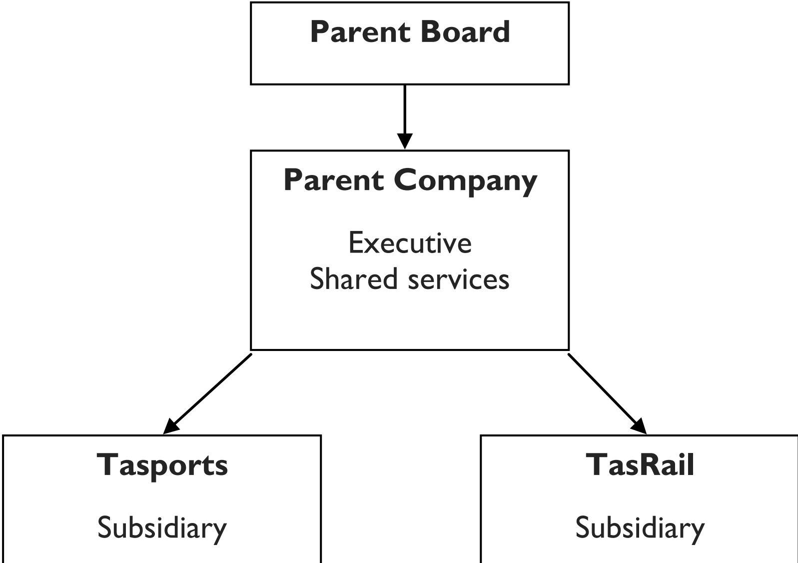
The options examined represent a scale of increasing integration and so have been developed to assess the relative merits of alignment to a lesser or greater extent. The preferred configuration should be left to the discretion of the Board, if a new company is established.

Three primary options were identified for the purposes of this analysis, as detailed below.

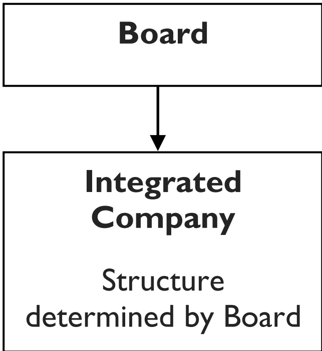
A **combined board model** whereby the Boards of management of the two businesses are integrated to provide strategic governance and oversight of the businesses but each business continues as a separate corporate entity and the entities are not related parties.



A **shared services model** with a parent company that provides executive and corporate services, business development, property and procurement, project management, engineering and IT services to both businesses operating as subsidiaries.



A **full integration model** whereby the two businesses are merged into a single supply-chain public utility corporation.



Legal constraints

Obligations under the Corporations Act 2001

The *Corporations Act 2001* places obligation on directors that seek to ensure that directors act appropriately in governing the affairs of the entity. Directors' duties under the Corporations Act are designed to promote good governance and ensure that directors act in the best interests of the company.

The Corporations Act requires that directors must exercise their powers and discharge their duties with care and diligence[1]. This duty is subject to a business judgment rule that requires a director to make the judgment in good faith and for a proper purpose[2]. In addition, directors must act bona fide in the best interests of the corporation[3].

In the case where a person is a director of more than one company, the director must consider each company's interest as a separate entity. Where the directors of one company are also all directors of a second company, discharging this obligation may be problematic. Directors must not place themselves in a position where they are unable to make decisions in the best interests of the company.

Directors are further bound by fiduciary duties under which a director must not cause detriment to the corporation[4] and must not make improper use of information acquired by virtue of his or her position as director[5]. In many cases, a decision that may benefit one corporation could be at the detriment of another. A director would be in breach of the Corporations Act for engaging in conduct with the purpose and intention of obtaining a benefit for anyone or causing a detriment to the company, despite what actually occurs in fact[6].

A director must avoid conflicts of interests as the position of director encompasses fiduciary obligations owed to the company. Even a director who acts honestly, and who does not stand to benefit personally, can in some circumstances be in breach of this fiduciary duty. There is potential conflict if a director is on the Board of two companies that have formed any kind of relationship.

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[1] Section 180(1) of the *Corporations Act 2001*
[2] Section 180(2) of the *Corporations Act 2001*
[3] Section 181(1) of the *Corporations Act 2001*
[4] Section 182 of the *Corporations Act 2001*
[5] Section 183 of the *Corporations Act 2001*
[6] *R v Byrnes* (1995) 130 ALR 529

In *R v Byrnes* (1995) 183 CLR 501, Brennan, Deane, Toohey, and Gaudron JJ observed the following in relation to conflict of duties that arise from multiple directorships, with their Honours stating (at 516-517):

> *'A company is entitled to the unbiased and independent judgment of each of its directors. A director of a company who is also a director of another company may owe conflicting fiduciary duties. Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit or gain of the second company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent. Nor, of course, can the director exercise those powers for the director's own benefit or gain without clearly disclosing his or her interest and obtaining the company's consent. A fiduciary must not exercise an authority or power for the personal benefit or gain of the fiduciary or a third party to whom a fiduciary duty is owed without the beneficiary's consent.'*

Directors must also ensure that confidential information is preserved so not to breach the director's fiduciary duty.

Corporations Law implications of common board model

The combined board model is the most simple of the three options and is aimed at providing broader strategic oversight of the two businesses than can be provided by separate businesses.

At face value, the combined board model may better align the operations and investment strategies of TasRail and Tasports compared to the status quo, through the ability for the Board to have a level of knowledge and understanding of the operations of each business when making decisions and by making decisions that take account of the broader position of both businesses. This may allow for improved strategic planning and capital investment as the Board would be in a position to steer decision making to better align capital investment decisions.

A potential financial benefit of this option is a reduction in the number of directors from 11 to five or six. This would save the Government between $300 000 and $360 000 per annum in Board fees and is consistent with the Government's policy to reduce expenditure on Boards and committees.

This option, however, presents a number of impediments. Firstly, it may not be possible for a common board to make decisions that are in the best interests of both TasRail and Tasports. Under the common board model, the directors could be placed in a position where they may have to put the interests of one business ahead of the other.

By combining the Boards of TasRail and Tasports to form a common board, the directors must be able to execute their duties independently in regard to each business and consider the interests of one company at a time. This may require the Board to hold separate Board meetings to consider each company and, therefore, may negate any savings that could have been realised under this option.

Further, as the two businesses are not part of a corporate group, the directors are precluded under Corporations Law from exercising their powers for the benefit of the two companies as a whole. This may serve to frustrate the intent of achieving greater strategic planning and capital investment, as even though the common directors would have a view across both businesses, they would be precluded by their obligations as directors from acting against the interest of any one business even if that action would be optimal across both businesses.

The requirements governing how directors exercise their powers limits the ability for the directors to make decisions that would maximise the total utility of both TasRail and Tasports collectively. In addition, directors must not enter into transactions where they would have to put the interests of other parties, in this case the other company, ahead of the interests of the company. Directors have been found to have been in breach of their duties by allowing a company to enter into transactions that produce little or no benefit to that company[7].

The Constitution of State-owned Companies provides a general power for the Shareholding Ministers to issue lawful directions to the directors of a company. While this power exists, it does not exempt the directors from their obligations under the Corporations Act. Further, in some cases, a person could be found to be a shadow director of a company where it can be demonstrated that the person exercises control over the Board from the outside and the Board has become accustomed to act in accordance with that person's wishes or instructions[8]. Under such circumstances, the person is deemed to be a director and the obligations of directors under the Corporations Act would apply as if that person were a director of the company.

However, the Corporations Act allows State legislation to override the Corporations Act where a provision of a law of a State is declared to be a Corporations legislation displacement provision[9]. This means that it may be possible for the Government to provide an indemnity to the directors where the directors are acting on explicit directions from the Shareholding Ministers through State-based legislation.

To provide adequate protection to both directors and Shareholders, the legislation needs to set out the circumstances under which directions may be given. This means that the Government would need to have a clear legislative mandate regarding the direction of the two businesses and the purposes for which it requires the direction power. It is noted that the Shareholding Ministers would not be taken to be shadow directors under the Corporations Act merely because the directors are accustomed to act in accordance with the Shareholding Ministers' instructions[10].

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[7] *Gamble v Hoffman* (1997) 24 ACSR 369; 15 ACLR 1 314l; *ASIC v Adler* (2002) 168 FLR 253; 41 ACSR 72; 20 ACLC 576; [2002] NSWSC 171.

[8] *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2010) 238 FLR 384; 77 ACSR 410; 28 ACLC 10-010; [2010] NSWSC 233 [244].

[9] Section 5G of the *Corporations Act 2001*

[10] Section 5G(5) of the *Corporations Act 2001*

The common board model is also contrary to best practice corporate governance principles. Best practice governance recommends that a majority of a Board of directors should be independent directors to maximise the likelihood that the decisions of the Board will reflect the best interests of the entity and not be biased towards the interests of any other person or group. Therefore, a director must be able to bring an independent judgement when considering issues before the Board.

Assessment of combined board model

On the basis of this assessment, the common board option would not be an appropriate medium to long term approach to facilitate better aligning the operations and investment strategies of TasRail and Tasports. However, it may be appropriate to legislate for short term specific purposes, such as the sale or purchase of a major asset that may not otherwise be commercial, or to facilitate the transfer to a different long term corporate structure, such as full integration.

If improved decision making regarding matters such as investment decisions and end-to-end freight commercial arrangements are the primary benefits that are sought to be achieved, this may be better achieved through enhanced shareholder engagement as well as clear guidance to the businesses in the form of a set of principles that govern decision making, such as through the Members' Statement of Expectations. It is noted that these issues are likely to be addressed as part of the Government's Freight Strategy for Tasmania.

If the Government wishes that the businesses and Boards are able to act independently of legislators or Shareholders to achieve these objectives over the long term, then a corporate structure that creates ports and rail as related entities under Corporations legislation would be required. This could either be through a subsidiary model or the full integration model.

Obligations under the *Competition and Consumer Act 2010*

In considering any potential alignment of TasRail and Tasports, it is necessary to consider whether there are any impediments under the *Competition and Consumer Act 2010* as well as any potential implications under National Competition Policy agreements, to which Tasmania is a signatory. This reflects that TasRail operates its rail and freight services as well as bulk handling and loading services in a competitive market.

Legal Framework - Competition and Consumer Act

Part IV of the Competition and Consumer Act prohibits anti-competitive acquisitions of shares or assets.

Section 50 of the Act prohibits mergers and acquisitions if it can be demonstrated that the merger or acquisition would have the effect or likely effect of substantially lessening competition in any market.

Section 44 of the Act prohibits, amongst other things, cartel agreements. Specifically, competitors or potential competitors are prohibited from making or giving effect to a contract, arrangement or understanding that contains particular types of 'cartel' provisions. Such arrangements are the subject of both civil and criminal prohibitions. A 'cartel' provision includes a provision that has:

(a) the purpose or likely effect of directly or indirectly fixing, controlling or maintaining the price of goods or services supplied or acquired by any or all of the parties to the contract, arrangement or understanding;

(b) the purpose of preventing, restricting or limiting the production, capacity or supply of any or all of the parties to the contract, arrangement or understanding;

(c) the purpose of allocating persons or classes of persons who acquire goods or services from, or who supply goods or services to, any or all of the parties to the contract, arrangement or understanding; and

(d) the purpose of rigging bids in relation to a request for bids for the supply or acquisition of goods or services.

In addition, section 45 of the Act prohibits corporations from making or giving effect to any contract, arrangement or understanding if it has the purpose, or the likely effect, of substantially lessening competition in any market.

Exemptions for agreements authorised under State law

Under section 51 of the Act, an agreement that may otherwise contravene section 45 of the Act, or the cartel prohibitions in section 44, is exempted from the application of those provisions if it is specified in and specifically authorised by an Act passed by a Parliament of a State, or regulations made under such an Act.

However, this exception does not extend to mergers or acquisitions that may contravene section 50 of the Competition and Consumer Act. The exception also does not apply where the Australian Government Minister responsible for competition policy prescribes regulations made for the purposes of paragraph 51(1C)(f) of the Act (which deny the exemption of the conduct).

Approvals and authorisations for conduct that would otherwise breach the Competition and Consumer Act

In relation to an acquisition or agreement that may contravene Part IV of the Act, there are voluntary procedures for obtaining the approval of the relevant regulators:

(a) in respect of an acquisition that may contravene section 50:

  (i) informal clearance from the ACCC. The ACCC routinely investigates proposed acquisitions and in most cases will indicate in writing whether it has any objections to a transaction on an informal basis. However, this does not confer statutory immunity on the acquisition;

(ii) formal clearance from the ACCC. There is a formal clearance process set out in Part VII of the Act. Although formal clearance provides statutory immunity, the onerous information requirements, inflexible procedures and limited confidentiality protections has meant that, to date, this process has not been used; or

(iii) authorisation by the Australian Competition Tribunal; or

(b) in respect of any agreement that may contravene section 45 or the cartel prohibitions, authorisation from the ACCC.

In order to give authorisation for an acquisition or agreement, in either case the ACCC or Australian Competition Tribunal must be satisfied that the relevant acquisition or agreement would result in such a benefit to the public that it should be allowed to proceed despite any lessening of competition. An authorisation provides statutory immunity for the applicant from contravening the Act.

Application of the Competition and Consumer Act

In order to assess whether two or more persons are competitors and whether any lessening of competition in a market as a result of a merger or acquisition would be 'substantial', it is first necessary to define the relevant markets.

It is likely that the competitive impacts of both the shared services model and the full integration model would be assessed in relation to the following markets:

(a) the market for the provision of below rail services in Tasmania (Below Rail Services Market);

(b) the market for the provision of above rail services in Tasmania, including associated loading, unloading and storage services (Above Rail Services Market); and

(c) the market for the provision of port services in Tasmania, including in relation to the provision of channels, berths and port land suitable for stevedoring and other land side activities (Port Services Market).

It is also necessary to assess the counterfactual. That is, it is necessary to establish what the foreseeable future state of the markets would be, both with and without the proposed merger or acquisition, taking into account the following factors:

(a) the degree of countervailing power in the markets;

(b) the level of concentration in the markets;

(c) the height of barriers to entry in the markets;

(d) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;

(e) the extent to which substitutes are available in the markets or are likely to be available in the markets;

(f) the dynamic characteristics of the markets, including growth, innovation and product differentiation;

(g) the likelihood that the merger or acquisition would result in the removal from the market of a vigorous and active competitor; and

(h) the nature and extent of vertical integration in the markets.

The likely future state of competition in the relevant markets is then compared, in the event that the proposed acquisition proceeds and in the event it does not proceed, to ascertain whether there would be a substantial lessening of competition.

Assessment of full integration model

Taking into account the above, it is considered that a possible merger between TasRail and Tasports under the full integration model would be unlikely to have the effect or likely effect of substantially lessening competition in any of the markets outlined above. This is because:

(a) the services provided in the Above Rail Services Market and Below Rail Services Markets by TasRail, and in the Port Services Market by Tasports, are largely complementary as opposed to being competitive in nature. TasRail is concerned with the provision of land transportation infrastructure and above-rail freight services within Tasmania while Tasports is concerned with the provision of port infrastructure and services for transportation of goods and persons to and from Tasmania by sea;

(b) there will be no significant horizontal competitive overlap at the physical or commercial interfaces between TasRail and Tasports as a result of the merger. For example, TasRail currently operates the common-user ship loader at the Port of Burnie while Tasports operates the woodchip loader. There will be no horizontal competitive effect post-merger because these loaders are tailored to the loading of different commodity types and therefore would not compete in any case; and

(c) there will only be limited vertical aggregation between the activities of TasRail and Tasports as a result of the merger, primarily in relation to the ancillary services of freight storage, loading and unloading carried out by TasRail on port land. Both TasRail and Toll can be regarded as competitors for access to port land from Tasports for their respective operations. In these circumstances, Toll could be regarded post merger as having a competitive disadvantage with respect to access to land compared to its pre-merger position, however, this would be mitigated by the long term lease arrangements that Toll has in place with Tasports. This type of limited vertical aggregation would not be likely to have a sufficiently significant impact on the competitive dynamics of the relevant markets that would meet the substantial lessening of competition threshold.

Accordingly, to the extent that TasRail or Tasports has market power prior to a possible merger (for example, due to the current vertical integration of below rail and above rail functions of TasRail), this will not change post-merger and the competitive dynamics in the relevant markets will remain largely the same.

Therefore, it is considered that structural separation of TasRail's below and above rail functions would not be required under implementation of the full integration model.

Assessment of shared services model

In light of the assessment that the full integration model would be unlikely to give rise to the likely effect of a substantial lessening of competition, it is therefore considered that there would not likely be any issues with integration of the back office functions of TasRail and Tasports through the shared services model under section 50 of the Competition and Consumer Act.

Assessment of cartel issues

It is considered that there are no possible cartel issues in respect of the full integration model as TasRail and Tasports would be merged into a single entity. Similarly, the implementation of the shared services model is unlikely to raise any issues under section 45 or the cartel prohibitions in the Competition and Consumer Act as there will only be a single parent entity engaging in the acquisition of corporate and associated services.

Implementation considerations

As described later in this report, the full integration model would involve the transfer of assets, rights, liabilities and employees either from TasRail to Tasports, Tasports to TasRail or from both TasRail and Tasports to a newly established entity. The shared services model would involve a transfer of shares from the relevant Minister shareholders of Tasports and TasRail to a newly established parent entity, as well as various transfers of assets, rights, liabilities and employees between the three entities.

The effect of the implementation of either of the two models could trigger the application of section 50 of the Competition and Consumer Act even if the alleged acquirer is only receiving the transferred assets or shares because it is required to do so by law.

This risk could be mitigated, but not completely eliminated, if the Government adopts one of the following methods to give effect to the transfer of assets under the full integration model or the transfer of shares under the shared services model:

(a) the Tasmanian Parliament could pass legislation that provides for the divestment of relevant assets, rights and liabilities or shares from one entity and for the same to become the assets, rights and liabilities or shares of another entity from a particular date; or

(b) in the case of the full integration model, the Treasurer could use the power to transfer relevant assets, rights or liabilities between government businesses under section 10A(2) of the *Government Business Enterprises Act 1995* or specific enabling legislation to implement the reforms.

If the Government were to implement the full integration model or shared services model in the manner described above, it is likely that the Government, as part of the Crown, would be entitled to Crown immunity from the application of Part IV of the Competition and Consumer Act in accordance with section 2B of the Act. Further, it is likely that TasRail, Tasports and any other entity involved in the implementation of the models may be entitled to derivative Crown immunity from the Competition and Consumer Act.

The following factors support the proposition that the relevant entities involved in the implementation of either model would be entitled to Crown immunity:

(a) an entitlement to derivative immunity in this case would protect the rights and interests of the Tasmanian Government dealing with State-owned assets as it sees fit, conducting what is essentially internal restructuring;

(b) TasRail and Tasports were created by or under law which may mean their activities are more likely to attract derivative immunity; and

(c) the Tasmanian Government is expressly empowered by section 10A of the Government Business Enterprises Act to transfer any assets, rights or liabilities of any government business, which includes State-owned companies such as TasRail and Tasports, to another government business by Gazette notice. This indicates a parliamentary intention that such transfers should be able to be effected without other legal impediments.

Notwithstanding this, if either model were to be implemented, it is considered prudent that specific legislation be drafted that provides a Parliamentary mandate to the new arrangements as well as providing the relevant statutory immunities under the Corporations Act in respect of directors acting in accordance with Ministerial directions. This is discussed further under the implementation section of this report.

Obligations under the National Access Regime

Part IIIA of the *Competition and Consumer Act 2010* establishes a legal regime to facilitate third party access to significant monopoly infrastructure facilities known as the National Access Regime. One of the key objectives of Part IIIA is to promote the economically efficient operation of, use of and investment in infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets.

Part IIIA sets out a number of mechanisms by which access can be sought to infrastructure services of national significance. These include declaration and arbitration, access undertakings and the certification of effective state access regimes. A service is defined in the Competition and Consumer Act and refers to a service provided by means of a facility, including the use of an infrastructure facility.

If a service is declared under Division 2 of Part IIIA, access seekers acquire a legal right to:

(a) negotiate the terms and conditions of access to the service with the service provider; and

(b) if agreement on the terms and conditions of access (including price) cannot be reached, have their request for access determined through arbitration by the ACCC.

Since its introduction in 1995, there have been Ministerial declaration decisions in relation to 34 services.

On 2 October 2007, the then Premier of Tasmania declared the use of rail tracks and associated infrastructure that comprise the Tasmanian railway network (other than the Melba line and the workshops and administration facility at Tamar Junction) for the purposes of operating a rail service on the network (including loading and unloading freight, making up trains, shunting and other activities necessary for the efficient haulage of freight by rail). The Declaration commenced on 23 October 2007 for a period of 10 years.

There is no access regime for Tasmanian Port facilities.

It is considered that neither of the alignment options will have any impact on the operation of the Declaration as there will be no changes to the 'natural monopoly' nature of the below-rail services post-implementation of either model. Therefore, there is no need, or any basis, for seeking to amend or revoke the Declaration.

Obligations under National Competition Policy Agreements

Overview of National Competition Policy

On 11 April 1995, Australia's governments signed three agreements to implement the National Competition Policy:

(a) the Competition Principles Agreement;

(b) the Conduct Code Agreement; and

(c) the Agreement to Implement the National Competition Policy and Related Reforms.

The overarching objective of the NCP is to promote competition in the economy where it is determined to be in the public benefit.

The Competition Principles Agreement sets out the principles agreed for implementing the NCP, including in relation to:

(a) *prices oversight* - states and territories will consider establishing independent sources of prices oversight of government business enterprises;

(b) *competitive neutrality* – government owned businesses will not have any net competitive advantage simply because they are publicly owned;

(c) *structural reform of public monopolies* – before privatising a public monopoly or introducing competition to a sector traditionally supplied by a public monopoly (i) any responsibilities for industry regulation held by the monopoly will be removed; and (ii) there will have been a structural review of the business, including the merits of separating any monopoly and potentially competitive elements of the business;

(d) *legislation review* – legislation will not restrict competition unless the benefits of the restriction to the community as a whole outweigh the costs and the objectives of the legislation can only be achieved by restricting competition; and

(e) *third party access to infrastructure services* – the Australian Government will establish a national regime providing for access to the services provided by significant monopoly infrastructure facilities (this regime is now set out in Part IIIA of the Competition and Consumer Act, as outlined above).

The Conduct Code Agreement committed the states and territories to extend the coverage of the *Trade Practices Act 1974* (now the Competition and Consumer Act) to bodies within their constitutional jurisdiction and provide for its administration by the ACCC. It also defined a process for the States and Territories to exempt, by legislation, certain conduct from Part IV of the Trade Practices Act.

The Agreement to Implement the National Competition Policy and Related Reforms set out the reform commitments agreed by governments, including provision for payments by the Australian Government to the states and territories where reform implementation was achieved.

Application of National Competition Policy

It is considered that both the shared services model and full integration model could be implemented consistently with the requirements of the NCP.

The NCP provides each relevant government with the discretion to determine the precise nature of implementation of the NCP, based on an analysis of the applicable public benefit to a specific proposal. Furthermore, there is nothing express or implied in the NCP that suggests that an integrated and government owned ports/rail business should not be established.

The principles contained in the NCP are set out at a high level and are generally not prescriptive regarding the details of the substantive arrangements for each jurisdiction. In particular, clause 1(e) of the Competition Principles Agreement expressly provides that governments are free to determine their own agenda for the reform of public monopolies and that the Competition Principles Agreement is neutral with respect to the nature and form of ownership of business enterprises.

Accordingly, as the models are being considered in the context of improving efficiency, including removing unnecessary duplication and costs within the Government business portfolio, and given the complementary rather than competitive nature of the services provided by TasRail and Tasports, the NCP does not inhibit the adoption of either of the models.

Notwithstanding that there appears to be nothing in the NCP that would inhibit the adoption of either of the models, the Government may elect to institute a form of price regulation in relation to the port services provided by an integrated entity, if public and business confidence in the arrangements would be reduced by such an arrangement.

The *Economic Regulator Act 2009* (Tas) provides a robust prices oversight framework for the provision of monopoly services by Tasmanian Government businesses. This is the framework by which maximum prices for the services provided by Metro Tasmania and the Motor Accidents Insurance Board are regulated. A service may be declared by the Treasurer to be a declared service for the purposes of the Economic Regulator Act, and hence require the Tasmanian Economic Regulator to recommend maximum prices for the provision of the service, by publishing a notice in the *Gazette*.

If it became necessary, it would therefore be a simple matter to regulate the port access prices charged by an integrated port and rail business. This may be necessary if private sector road freight operators, who compete with rail freight, expressed strong concerns that the integration of Tasports and TasRail may provide the opportunity for port access to be used to influence the competitive dynamic in the land freight service market.

The experience of other businesses with services declared under the Economic Regulator Act is that a pricing investigation costs in the order of $250 000 and is conducted every three to five years.

It is therefore considered that if the full integration model is implemented, port services should remain unregulated but if targeted consultation with key road freight operators indicates a strong case for price regulation, that port services be declared under the Economic Regulator Act by the Treasurer.

Assessment of strategic opportunities

Coordinated business development

At face value, it may appear that the alignment of both businesses would facilitate more streamlined freight transport negotiations with customers, such as manufacturers, importers and exporters. This in turn would reduce the complexity and transaction costs faced by customers when establishing commercial freight arrangements, particularly for new start-up projects such as new bulk mineral projects.

However, in practice, the impact on manufacturers, importers and exporters will depend on the type of freight that is being transported by the rail and ports network.

For containerised freight, the customers of Tasports and TasRail are ordinarily freight logistics companies, such as shipping companies and land based freight forwarders, rather than the manufacturers, importers or exporters of the goods themselves. As an example, Cadbury's will engage Toll to import raw goods and export final products, and Toll Tasmania will then make the rail transport arrangements with TasRail and Toll Shipping will make the necessary port arrangements with Tasports. However, there are some exceptions to this general rule, where some companies have de-bundled their freight logistics procurement and deal directly with TasRail and other providers in the freight supply chain.

On this basis, the alignment of Tasports and TasRail alone is unlikely to have a significant impact on the transaction cost of procuring freight services for manufacturers, importers and exporters in Tasmania that use containerised freight, as these are usually customers of the freight forwarder than Tasports and TasRail directly.

These arrangements differ slightly for bulk commodities operations, such as minerals and woodchips. Bulk commodity exporters generally deal directly with Tasports for wharfage and storage facilities and where the commodities are transported by rail, which is particularly the case for bulk minerals, the exporter will engage directly with TasRail to ship the bulk commodity from the railhead to port. In some cases, TasRail can also provide the road based logistics from mining pits to the railhead.

Once the bulk minerals reach the port, the ship loading arrangements differ between ports. For example, where minerals are transported to Burnie port for exporting, TasRail also provides the ship loading services as it owns the ship loader. Similarly, woodchip exporters engage directly with Tasports for ship loading services at Burnie, where Tasports owns the woodchip loader. Conversely, where minerals are transported to Bell Bay for exporting, the mining company will need to engage a stevedoring company to unload the minerals from the wagons and load the minerals onto the ships.

For sea transport, the bulk commodity exporters will either engage with the shipping companies directly or through an agent and in turn the shipping companies will engage directly with Tasports and pass the ports costs onto the mining companies.

The alignment of Tasports and TasRail may improve the coordination of business arrangements and reduce transaction costs of moving bulk commodities to the ports and storing those commodities on the ports. This will primarily be for new bulk commodity ventures, given that existing bulk commodity exports have existing freight transport and storage arrangements. However, it is unlikely to have a significant impact on the total transaction cost of moving freight to end destinations, given that other transport arrangements still need to be made with third parties, particularly shipping arrangements and in some cases stevedoring arrangements.

Therefore, the Co-ordinator General's role in attracting investment may be assisted by the alignment of TasRail and Tasports by reducing the number of freight transport companies that the Co-ordinator General may need to consult with. Similarly, this may be a benefit to Infrastructure Tasmania when assessing Tasmania's infrastructure requirements.

The full integration model has the potential to better streamline future rail and port negotiations with customers, compared to the shared services model. This is particularly relevant for new mining ventures, where the separation of ports and rail operations under the shared services model may limit the ability to streamline the arrangements for transporting bulk commodities to, and storing them on, the relevant port.

Improved infrastructure capacity utilisation and productivity

Currently, there is some scope to increase the utilisation of port and rail infrastructure in Tasmania. For example, the average occupancy of the Tasports' berths is between 17 to 20 per cent of total available berthing space, whereas anecdotally other Australian ports mostly exceed 40 per cent. This is a reflection of the lower overall economic activity in Tasmania and Tasports' decentralised ports locations.

The ability to better utilise TasRail's infrastructure is more complex. For example, while there is excess capacity in the rail track network, the ability to significantly increase the number of trains using the track at the one time is limited by the small number of loops in the system. Each train would only be able to return to its original destination at specific times, as there is limited ability for trains to pass each other when travelling in opposite directions. In addition, while some existing rolling stock can accommodate greater volumes, particularly for containerised freight, other additional business opportunities would require TasRail to invest in additional rolling stock. This is particularly the case for new mining ventures where the equipment required is specialised and generally already in use for other mining operations.

Putting these constraints aside and without asset rationalisation, increased utilisation of the overall port and rail network can only be achieved by either increasing the freight task in Tasmania and/or by moving freight from road to rail.

The freight task in Tasmania is driven by macro economic conditions in Tasmania, Australia and internationally. In recent years, the freight environment has been characterised by a weak global economy, a high Australian dollar, structural problems in the local forestry and mining industries and the rationalisation of the shipping logistics industry that has resulted in the loss of international container services from Tasmania.

In this regard, increasing the overall freight task is largely out of the control of TasRail and Tasports and will continue to be under an aligned business model.

Therefore, the potential for an aligned business model to better utilise existing infrastructure, compared to the current status quo, primarily rests with the ability of an aligned business model to transfer freight from road to rail. This would primarily relate to intermodal freight, of which a portion of the total freight task is contestable. For example, in its Nation Building 2 submission, the then Department of Infrastructure, Energy and Resources estimated that the contestable market share of Tasmania's intermodal task is around 800 000 tonnes, of a total freight task of around 13 million tonnes.

An aligned business model may increase the overall incentive, from a total freight perspective, to move freight from road to rail. Currently only TasRail has a commercial incentive to move freight from road to rail. Tasports generally does not have a preference as it receives the freight business regardless of whether it gets to the ports from road or rail.

However, there are unlikely to be major competitive advantages that an aligned rail and port business could leverage to transfer the freight task from road to rail. For example, under competition law constraints, port prices for customers that utilise rail and ports must be the same as for port users that use the road network to transport freight to and from the ports. Further, the port charges of any large users are set in long term contracts.

The only competitive advantages that may exist would be the opportunity for an aligned port and rail business to offer an integrated pit to port solution for bulk mineral customers. However, this is unlikely to be materially different to the status quo, given that bulk mineral movements in Tasmania are generally via rail already.

Case Study 1 - Hunter Valley Coal Chain Coordinator

Up until 2003 there was no central planning and coordination process for the movement of coal through the Hunter Valley coal chain. All planning was done at the individual Service Provider level, often resulting in:

- the inefficient planning and scheduling of coal through the coal chain;
- lack of coordinated planned maintenance activities;
- excessive levels of cancellations; and
- excessive rework.

In early 2003 an Industry Review Team recommended that the implementation of a centralised coal chain planning function could potentially deliver enormous benefits to the coal Industry.

Following acceptance of this recommendation the Hunter Valley Coal Chain Planning Group was established in June 2003. This was renamed the Hunter Valley Coal Chain Logistics Team in 2005 and in 2009 it was incorporated as a new legal entity, the Hunter Valley Coal Chain Coordinator Limited (HVCCC). The membership of the HVCCC includes all current Hunter Valley coal chain producers as well as Service Providers.

The HVCCC is uniquely placed to have a complete 'helicopter' view of the entire Hunter Valley coal chain. The centralised planning of coal chain activities by the HVCCC has quickly improved the efficiency and productivity of the integrated Hunter Valley coal network and has released "latent" coal chain capacity to the benefit of the coal industry.

Source: Hunter Valley Coal Chain Coordinator website: www.hvccc.com.au.

While infrastructure utilisation is unlikely to increase under an aligned business model, compared to current arrangements, there is the potential for the productivity of the rail and port network to increase where the operations and logistics of the rail and ports are fully integrated. For example, there is the potential for train and ship schedules to be more aligned, although this would still rely on cooperation with freight forwarders and shipping companies. If successful, this may free up wharf space for additional usage, such as property development.

Infrastructure utilisation can be increased where there is a rationalisation of assets. In this regard, the discussion of potential long term strategic planning benefits in this Report includes examples of where asset rationalisation options may be available under an aligned business model. However, these are theoretical examples and only an aligned Board would be able to determine whether a business case exists for asset rationalisation.

With rail and ports operations and logistics being separated under the shared services model, the potential for this model to facilitate productivity improvements is considered low. The full integration model provides a stronger potential to facilitate productivity improvements, as the operations and logistics aspects of both rail and ports will be fully integrated under this model. Nevertheless, there is limited benefit in increased productivity until infrastructure capacity constraints are reached, and it is unclear whether sufficient asset rationalisation could occur to improve asset utilisation in the medium term.

Better long term strategic planning

Historically, many freight issues in Tasmania have emerged on an ad hoc basis and separate solutions have been implemented on a discreet basis by a range of industry participants.

In recent times there have been effective working relationships between TasRail and Tasports and as a result there has been strong collaboration when undertaking strategic freight and infrastructure planning, particularly in relation to common infrastructure. The alignment of both businesses would institutionalise those relationships over the long term.

Despite the strong working relationship and goodwill between both businesses, the commercial expectations of each business and directors' duties to the company may still ultimately result in outcomes that are suboptimal from a whole-of-state perspective. The alignment of both businesses would align their commercial expectations and would also remove the current conflict between the duties of directors to separate companies.

For example, TasRail owns and operates the minerals concentrates ship loader in Burnie, however, this is located on Tasports land and it is not necessarily the optimal use of that land in its current location. Where this was owned and operated by an aligned rail and ports business, there may be additional strategic options available to the aligned business in terms of the location of the ship loader that may assist in the better utilisation of the port land. While it is possible that Tasports may have some control over the location under the lease terms at present, an alignment of both businesses may facilitate a more coordinated approach.

The alignment may also improve strategic planning by providing a broader freight perspective and overcoming any information asymmetry that currently exists between both businesses. However, there are other options available for establishing a holistic approach to strategic freight and infrastructure planning, for example, the establishment of an overarching Tasmanian Freight Strategy, accompanied by Shareholder directions to both businesses that require each business to plan in accordance with the Freight Strategy.

Over the 30 year horizon, the rationalisation of some infrastructure may need to be considered. If viewed solely from a ports perspective, an outcome might be reached only at a local terminal level, rather than an entire system level. While there are incentives for Tasports to consider and negotiate alterations to existing business practices that might lead to significant future efficiencies, it may be that the combined incentives of an integrated business could provide a stronger business case to negotiate solutions to key obstacles to long term efficiencies being obtained. However, this is unlikely to include the rationalisation of entire ports, nor the freight networks that support them.

The potential rationalisation of some assets impacts not only the efficient operation of ports, but also the opportunity value of land currently occupied by Tasports. If left to Tasports in isolation, there is unlikely to be large enough parcels of land that could be used for private commercial developments, because entire sites cannot be closed and released. The exception is potentially West Devonport and Hobart. These areas may impact on TasRail customers also (particularly West Devonport) – hence an aligned business model would likely facilitate better planning.

Under the shared services model, where rail and port operations and logistics are undertaken by separate subsidiaries, there remains a risks of information asymmetry between port and rail operations that may limit the effectiveness of strategic freight and infrastructure planning. On the other hand, the full integration model provides a stronger potential to better streamline strategic planning for rail and ports.

Increased infrastructure funding

The capacity of both businesses to fund infrastructure upgrades and maintenance is generally impacted by their operating cash flows, debt constraints, the possibility of Australian Government funding and Shareholder equity injections. In addition, common infrastructure is sometimes partly funded by private sector transport companies.

The ability of an aligned business model to enhance operating cash flows and/or take on additional debt, compared to the status quo, is assessed separately as part of the financial assessment. This section instead assesses whether there is the potential for additional Government or private sector infrastructure funding to be provided for rail and port infrastructure under an aligned business model.

Given current fiscal constraints, it is considered that additional Tasmanian Government equity funding for ports and rail infrastructure, to what is already included in the 2014-15 Budget and Forward estimates, will not be available. In any case, the ability of Government to provide equity funding for port and rail infrastructure will not be impacted by any alignment of the businesses.

Case Study 2 – National Partnership Agreement

TasRail has received over $210 million to 30 June 2014 in Australian Government funding through the Rail Rescue Package and Nation Building 1 package (of which around $70 million was spent prior to the formation of TasRail in December 2009).

The National Partnership Agreement on Land Transport Infrastructure Projects was signed by the Prime Minister, the Premiers of New South Wales, Queensland, Victoria, Tasmania and Western Australian and the Chief Minister of the Australian Capital Territory on 10 October 2014. The objective of the Agreement is to contribute to the development of a safe, sustainable national transport system through land transport infrastructure and planning projects. The Agreement sets out the Australian Government's investment priorities and relates to projects administered under the Infrastructure Investment Programme.

Under the Agreement, TasRail's Freight Rail Revitalisation project is specified, with the Australian Government's contribution capped at 50 per cent of the total project cost to a maximum of $119.6 million over a five year period to 2018-19. The State must co-contribute to the project on a dollar for dollar basis.

The Agreement prescribes the roles and responsibilities in respect of projects funded under the Agreement. Funding contributions for projects approved under the Agreement are only provided following the completion of agreed milestones for the relevant project and can only be used for approved purposes.

It is highly unlikely that this funding can be redirected to non-rail related infrastructure projects. Variations to the scope, cost, respective funding contributions and timelines to projects specified in the Agreement must be agreed by the Australian Government. The redistribution of any project cost savings that are made can only be determined in accordance with the Agreement and, where the project is funded by the Australian Government, the Australian Government has the discretion to determine if and how to reallocate the funding to other projects in the State. Where funding has been allocated to a project that is cancelled or withdrawn, the Australian Government may choose to reallocate its funding to another project or projects in the State.

An alternative avenue for increased infrastructure funding under an aligned business model relates to Australian Government infrastructure funding. To date, TasRail has received significant Australian Government funding for specific rail infrastructure projects. This infrastructure funding is governed by a Funding Agreement, which includes strict criteria for dispersing the infrastructure funds. Given the requirements of the Funding Agreement, the funding cannot be redirected to other projects, such as port upgrades.

There is the potential that an aligned business may be able to better develop a case for such Australian Government infrastructure funding than under the current arrangements. An aligned business may be able to better depict the broader freight environment and provide a more compelling business case than the two businesses providing separate submissions. However, there are other ways of preparing coordinated funding submissions to the Australian Government that would have the same effect, such as a coordinated submission from the Department of State Growth.

The alignment of both businesses would provide an opportunity for bilateral negotiations with private sector transport companies for the funding of common infrastructure, for example in loading infrastructure. To date, tripartite funding negotiations have occurred for infrastructure that affects rail, ports and private companies and these have worked effectively to-date. The alignment of both businesses would limit those negotiations to direct bilateral negotiations, however, there is no compelling reason to suggest that this would improve the effectiveness of such infrastructure projects.

In this regard, compared to the status quo, there are unlikely to be any major differences between the shared services model and full integration model in terms of their ability to attract additional Government or private sector infrastructure funding.

Enhanced business flexibility

The alignment of both businesses may provide the opportunity to consider more strategic approaches for the use of existing assets and provide an aligned business with more strategic levers.

The alignment of both businesses may provide an ability to divest surplus assets, should the aligned business model reduce reliance on non-core assets that provide marginal returns. For example, the Devonport Airport is a non-core asset for Tasports. While Tasports has attempted to divest this asset in the past, it currently provides a stable annuity income stream for the business.

However, as noted later in this report, while the alignment of both businesses may produce some operating cash flow savings, these are unlikely to be material enough to remove the need for non-core assets, particularly given the infrastructure funding constraints that will continue to exist for an aligned business.

Strategic land acquisition and retention policy could assist in diversifying revenue streams. There may be a potential to consider more options for revenue streams, for example, by converting certain assets into lease arrangements, thereby converting them from cyclical revenue to annuity revenue.

As mentioned previously, another strategic decision that would potentially be available to an aligned business would be in relation to the investment in loading infrastructure and the provision of loading services. A better business case may be able to be developed by an aligned business to invest in loading infrastructure, based on logistical or strategic benefits.

Similarly, an aligned business may have additional freight logistics services that it could consider providing, if there was potential to add value in the market. This would likely require an expansion of current activities and would move to a freight forwarder type model. However, such a business case may not exist, particularly as the business will be limited to Tasmanian operations and total freight forwarder services usually include sea and road transport.

These strategic decisions will be a matter for the Board of an aligned business and it is difficult to determine the likelihood of these benefits arising at this stage. However, it is considered that such benefits would be less likely under the shared services model. In this instance, the separation of the rail and ports operations into individual subsidiaries may reduce the ability of the business to strategically utilise certain assets.

Assessment of risks and issues

Additional operating and trading risks

The operations and logistics of both companies are specialised and specific to each business and, therefore, the key operational risks of both businesses will likely remain unchanged under an aligned business model. Similarly, an alignment is unlikely to provide any operating risk mitigation measures that are not already available to each business under current arrangements.

From a trading perspective, there is a risk that an alignment would consolidate the exposure to seasonal freight volumes and structural shifts in export markets.

Both businesses currently have limited common exposure to seasonal freight volumes. The common exposure primarily relates to agricultural products, where both businesses experience peaks in the transport of agricultural goods before the Christmas and Easter periods.

In addition, whilst bulk commodities are generally not seasonal in nature, both businesses transport bulk freight and are exposed to variations in bulk freight volumes from changes in market conditions, such as the value of the Australian dollar and international demand. The freight revenue of both businesses can fluctuate year on year depending on bulk freight activity in the State. For example, the financial projections of both businesses have recently been adversely impacted by the closure of Copper Mines of Tasmania and decision by Venture Minerals and Shree Minerals not to proceed with their mining projects.

The impact on both businesses can vary, particularly for new mining ventures, depending on the amount of new infrastructure required by each business to support the projects (for example, rail line improvements, new loading infrastructure) and the ability of each business to obtain security for the required infrastructure investments. However, as with seasonal risks, the financial impact of mining activity in the state on an aligned business will arguably be no different to the current arrangements.

Where there are common freight volume exposures to each business that are seasonal in nature, risk mitigation measures would need to be established. These could include investing in assets that provide an annuity income stream, such as a property portfolio, or by leasing certain assets under take-or-pay arrangements. Nevertheless, the consolidation of seasonal freight volumes and exposure to structural shifts in the bulk freight market, as well as the risk mitigation measures that are available, are arguably no different than the status quo.

Given the above, there is unlikely to be any major differences between the shared services model and full integration model in terms of their operating and trading risks of compared to the status quo.

Loss of business confidence by private sector freight operators

There may be a perception by road freight providers that an aligned rail and port business is "too big" to compete or negotiate with, irrespective of any transparent pricing and access arrangements that are established. Many road freight providers are customers of Tasports and some are customers of TasRail. These customers may have a perception that an aligned business will treat them less favourably than port customers that do not compete with the rail business. This may create intangible barriers to entry in the market, potentially to the detriment of the Tasmanian economy.

In this regard, any access arrangements and transparent pricing regimes that are established will need to be properly communicated to the market. Similarly, to provide absolute certainty to the market, it may be appropriate to include provisions in any legislation created for the business alignment that require such transparent access and pricing regimes to be maintained. This could also be reinforced through the Shareholder's Statement of Expectations for an aligned business.

There is also the potential that the current road transport providers may create significant noise over any planned alignment. Proper consultation with these businesses will, therefore, be critical prior to committing to any alignment. However, this may not be able to solve all issues raised.

While it is difficult to gauge the level of concern over any alignment in the market, it is plausible that having distinctly separate rail and ports operations and logistics subsidiaries, under the shared services model, may alleviate some market concerns about the potential for anti-competitive behaviour by an aligned business.

Cultural and internal business risks

Both businesses are highly specialised in their operations and have significant internalised knowledge, and as is the case in most organisations there are many unwritten nuances to each business. A key risk for any alignment is that such expertise and knowledge may be diluted. This is particularly relevant given that both businesses contain inherent OH&S risks and operate in industry specific regulatory environments.

The culture of both businesses should generally not be an impediment, given that both businesses have a strong customer focus. However, it should be noted that only TasRail operates in a competitive space and therefore, there may be differences in the customer focus of both business that are unable to be identified at this stage.

Both businesses have a similar operational workforce demographic and the relationship between operational and management staff is effective in both businesses. On this basis, it is not anticipated that an alignment would create any long term disruption to the operations of both businesses.

These risks are intangible in nature and difficult to fully assess. Nevertheless, based on discussions with the senior management of both businesses, there does not appear to be any obvious issues that would adversely impact on the business culture or internal operations of an aligned business. On this basis, it is considered that these risks are low for both the shared services and full integration model.

Industrial relations

Both businesses have a sizeable operational workforce and have ongoing relationships with unions. A significant risk is that a union may seek to extend its representation and the scope of business activities covered under particular awards or EBAs, following any alignment of both businesses. For instance, some rail hubs have successfully been argued to be "inland ports" in some other jurisdictions, which has changed the arrangements for employee representation and the industrial relations dynamic of those facilities.

Such an outcome could potentially provide one union with a greater percentage of the overall workforce of an aligned business, potentially providing it with more bargaining power, placing an aligned business at a greater risk of adverse industrial relations outcomes.

There is also potential for conditions of employment that are currently established within one area and negotiated with one union to be sought to be extended across other areas. This is a particular risk in relation to certain allowances, which are prevalent in some related industries.

This risk is considered higher under the full integration model, whereas under the shared services model, the separation of the rail and ports operations and logistics into separate subsidiaries may be seen as essentially retaining two separate operational businesses, which may lessen the ability of any one union to expand its member base to other employees.

Implementation Risks

The issues that will be faced by the businesses in the implementation phase are separately discussed in Part C of this report. Those issues present a number of risks throughout the implementation phase and it is considered that the risks apply equally to both alignment options, given that they both involve the implementation of structural change.

The risks that may arise include:

- unrealistic expectations around implementation timeframes, leading to sub-optimal outcomes;
- the potential loss of existing accreditations under national regulatory and compliance schemes, requiring an aligned business to reapply for such accreditations;
- unanticipated or higher than budgeted implementation costs;
- distractions from core business leading to the loss of key employees and/or a lapse in focus on health and safety outcomes; and
- the potential need to reapply for Australian Government rail infrastructure funding.

These risks can be managed by establishing appropriate governance arrangements for the implementation of any alignment, as outlined in Part C of this report. In this regard, it would be particularly important to establish a transition Board as soon as possible, which would be responsible for managing the business integration process. At that time, the Boards of the existing businesses would transition into a care and maintenance mode where it would be important to avoid binding the future aligned business into any new long term strategies or agreements.

Operating cost savings and implementation costs

An assessment of potential operating cost savings and implementation costs was undertaken by identifying relevant cost areas that may be affected, testing these with each business, seeking detailed cost information from each business and applying assumptions and financial modelling to the relevant cost areas.

The financial assessment applies equally to both the shared services and full integration models, given that the potential savings and costs all relate to the corporate functions of both businesses. The assessment does not estimate any additional regulatory or compliance costs that may arise for an aligned business, on the basis that existing arrangements are likely to meet regulatory compliance obligations.

The assessment is on a present value cash basis, in June 2014 terms. Where the financial assessment differs on an accrual basis, this is factored into the assessment of the financial performance and strength of an aligned business and the impact on the State's finances. For example, differences arise between annual costs and expenses for capital items, such as information technology, where capital costs are incurred in one year but are expensed in the form of depreciation over several years. Avoided capital expenditure in future years, such as the avoided capital expenditure on replacing multiple IT systems, is discounted to current year cash terms.

Board costs

In 2013-14, the Tasports Board comprises six permanent Directors and the TasRail Board comprises five permanent Directors.

The board costs incurred by each business include director fees, committee fees, superannuation and some minor administrative costs. The Board costs incurred by each business in the 2013-14 financial year are shown below.

Table 7: Board costs in 2013-14

$000	Number of Directors	Director Fees	Committee Fees	Super-annuation	Other	Total
Tasports	6	274	41	29	1	345
Tasrail	5	227	38	51	0	316
TOTAL	**11**	**501**	**78**	**80**	**1**	**661**

An assessment of the range of potential board cost savings from an aligned business has been undertaken by determining the average board cost of both businesses, per director, and applying this to either a five or six person board for an aligned business. The difference between the results and the current total board costs of both businesses provides an indicative upper and lower Board cost saving respectively.

It should be noted that, in practice, the actual saving may differ from the theoretical savings assessed in this paper. This is because the actual board cost for an aligned business will be dictated by a sizing statement for the Board that is prepared by the Department of Premier and Cabinet. The remuneration structure for the Board may differ to the average Directors' fees used in this assessment. However, the variation is expected to be minor.

It has also been assumed that the board cost savings will be identical for the shared services and full integration alignment options. While the shared services option is based on having separate operating subsidiaries for rail and ports, it is assumed that the Board of each subsidiary will comprise senior management of the parent company for no remuneration.

Given the above, the Board cost savings range has been identified as follows:

Table 8: Potential board cost savings

$000 p.a.	**Low case** (6 Directors)	**High case** (5 Directors)
Potential board cost savings	300	360

Duplicated executive, middle management and corporate support areas

The corporate structure of each business has been analysed to determine the costs associated with each corporate function, including the number of full time equivalent employees and total employment costs for each corporate function. Employment costs consist of salary, superannuation, incentives and allowances.

The corporate areas that have been analysed include:

- senior executives;
- corporate services, including finance and executive support;
- shared services, including corporate governance and information technology;
- human resources;
- occupational health and safety;
- property;
- procurement; and
- business development.

The cost estimate for each of the corporate areas for each business has been adjusted where required to ensure that they are assessed on a like for like basis. The costs of each business were then added together to establish a baseline cost for each corporate area, from which savings could be estimated.

Potential savings were then calculated by analysing the total number of FTEs in each corporate area and identifying a range of potential FTE savings. The average FTE cost was applied to the range of FTE savings to determine a cost savings range. The FTE count for the merged business was considered to always at least equal the count of either business on a standalone basis, as to assume that the FTE count could reduce below the level that either business currently operates would be to assume that an efficiency saving is possible within the current businesses.

For executive functions, the low case and high cost savings have been assessed as being identical, given that the duplication of the executive functions under an aligned business model is clearly identifiable from the information provided by both businesses.

Based on this, the following savings range has been calculated in relation to potentially duplicated executive, middle management and corporate support areas.

Table 9: Potential cost savings from duplicated corporate areas

$000 p.a.	Low Case	High Case
Executive	1 300	1 300
Common services	1 300	2 500
Total	**2 600**	**3 800**

Increased purchasing power from greater economies of scale

Each business has identified the high level cost buckets for goods and services procured by their business and the procurement areas that are common to both businesses.

Likely quantifiable savings have been identified for corporate costs that would be duplicated under an aligned business, including insurance costs, audit costs and accounting and tax costs. The savings identified amount to $190 000 per annum.

In addition, the types of expenditure that are common to both businesses have been identified, and it is possible that further scale economies may be able to be captured in the purchase of these services. The types of purchases that are common to both businesses include:

- consultants;
- maintenance;
- electricity;
- travel and accommodation;
- training;
- legal;

- communications;
- insurance – other; and
- printing and stationery.

Based on the expenses incurred by both businesses in 2013-14, the total expenditure on these items by an aligned business would be in the order of $30 million.

If savings of one per cent were able to be achieved, this would add $300 000 to the annual savings of an aligned business. If savings of five per cent could be achieved, this could equate to $1.5 million being saved per annum. However, this is largely speculative and has not been included in the financial analysis.

On this basis, the potential quantified cost saving from the increased purchasing power of an aligned business has been estimated to be $190 000.

Table 10: Potential cost savings from greater economies of scale

$000 p.a.	Low Case	High Case
Likely savings	190	190
Possible savings[1]	300	1 500
Total	**190**	**190**

[1] Speculative estimate only and not included in overall net benefit assessment.

Consolidation of office accommodation and/or operational sites

The corporate office locations of each business have been identified as well as the purpose of each office location, the capacity to accommodate additional staff and the lease terms, including annual cost, lease period and termination fees.

Using this information, it has been identified that Tasports and TasRail have office locations in two similar geographic locations, being Launceston and Hobart.

In Launceston, TasRail currently has excess capacity that could accommodate all of Tasports' Launceston based staff. This would potentially save an aligned business around $90 000 per annum, excluding lease termination fees which are assessed under integration costs.

In Hobart, Tasports has capacity to accommodate a small number of additional staff. The number of TasRail's Hobart-based employees slightly exceeds that capacity, however, with potential employee efficiencies under an aligned business, there may be scope to consolidate the office accommodation in Hobart into Tasports' current location. Lease termination fees aside, this would potentially save an aligned business around $50 000 per annum.

The operating site locations of each business have also been examined with a view to assessing whether any feasible relocation options exist. Based on the information provided, it is neither financially nor operationally feasible to transfer any existing operational sites of either business in the short term.

On this basis, the potential cost saving from consolidation of business locations relates solely to office accommodation, and ranges from $90 000 to $140 000 per annum. Lease termination costs are considered later in this section.

Table 11: Potential savings from consolidation of accommodation and operational sites

$000 p.a.	Low Case	High Case
Office accommodation	90	140
Operating sites	0	0
Total	**90**	**140**

Information Technology systems

The IT systems of each business have been identified and analysed at a high level to determine possible annual savings in licence fees and possible capital expenditure required to align the systems. Only the systems required to support corporate and shared services were considered, while specialist operational systems such as train and port access control systems were excluded, as they will likely be required as is under any scenario.

Theoretical cost savings were calculated by estimating the avoided licensing costs under an integrated business. Two scenarios were developed, including:

- the low case annual saving scenario, where the current systems of both businesses are replaced at the end of their current life cycle, which is assumed to be four years. In this case, there are no savings from avoided licensing costs over that four year period; and
- the high case saving scenario, where the corporate systems of both businesses are replaced with an enterprise management system upon the commencement of the alignment of both businesses. In this case, there are annual savings in IT licensing costs of $350 000 per annum.

There is also an avoided depreciation expense on an ongoing basis achieved by rationalising two IT systems into one. This saving accrues quite quickly given the short asset life of the IT systems. Avoided depreciation expenses are not a cash saving but are included in the assessment of the fully aligned business' financial performance and strength.

Table 12: Potential savings in IT licence fees

$000 p.a.	Low Case	High Case
IT licensing costs	0	350
Total	**0**	**350**

Redundancy costs

Redundancy costs have been estimated so as to be consistent with the identified savings from eliminating duplicated executive, middle management and corporate support areas under an aligned business model.

Redundancy costs have not been calculated on a bottom-up assessment of individuals and their actual contractual conditions or years of service. Instead, an average salary level and average years of service for each broad functional area have been calculated based on information provided by the two businesses.

A low case and high case redundancy estimate has then been derived by correlating the FTE reduction under the savings scenarios with a low and high case redundancy cost estimate, as follows:

- Low case – assumes a redundancy entitlement of two weeks of salary per year of service, with an additional three months of salary for senior executive positions; and
- High case – assumes a redundancy entitlement of three weeks of salary per year of service, with an additional six months of salary for senior executive positions.

Superannuation payouts and leave entitlements have not been included in the estimates.

Actual conditions of employment, particularly for senior executives, may differ markedly from these assumptions.

On this basis, potential redundancy costs may be in the range $0.6 million to $1.9 million. This cost would be incurred on a once-off basis.

Table 13: Potential redundancy costs

$000	Low Case	High Case
Redundancy costs	620	1 900
Total	**620**	**1 900**

Information Technology capital costs

The alignment of the two businesses under the full integration model presents an opportunity to rationalise the non-industry specific IT systems of the businesses, however, a capital outlay would be required to achieve this. While past experience has demonstrated that IT systems integration can be a costly exercise, it has been assumed for the purposes of this analysis that the IT integration is undertaken in a cost effective manner.

A high level analysis of the IT systems of the two businesses has been conducted. It is unlikely that the current systems of the two businesses could be merged as they are, as TasRail operates an enterprise system while Tasports maintains several standalone applications.

The degree to which either system would be capable of supporting the integration of the other business's functions would require a detailed analysis of functionality, systems, licences, etc. For the purpose of this analysis, it has been assumed that the entire IT infrastructure of the common functional areas would need to be replaced.

The replacement costs of the business's existing systems are similar and an estimate of $1.5 million has therefore been made. Less capital may be required to be expended if one of the existing systems is identified as being adaptable; however, it is not possible to quantify this without detailed analysis.

As noted previously, there are two options to the timing of the required capital spend that has been assumed. Systems could be replaced at the end of their useful lives, or could be replaced at the commencement of operation of a fully integrated business with a higher residual value of existing systems written off. The choice of approach would be a matter for the Board and would need to be informed by an assessment of the viability of running a fully aligned business while maintain separate systems.

Therefore, to estimate IT integration costs, two approaches have been adopted:

- immediate write-down of existing systems and investment in replacement system; and
- replacement of existing systems with new system at end of useful life.

In the immediate replacement approach, an immediate capital outlay of $1.5 million is required on business integration. However, under this scenario, the immediate rationalisation of IT infrastructure, compared to the status quo of the two businesses, would provide ongoing savings in replacement capital. Over the life cycle of the assets, $1.5 million in replacement costs can be saved and the present value of this is $930 000. This has been included as a one-off benefit under the full replacement scenario.

In the replacement at end of useful life approach, no capital expenditure is assumed until existing assets reach the end of the life, which is assumed to be four years, by which time capital expenditure of $1.5 million is assumed.

The profile of operational savings was matched to the capital expenditure profile.

The impact of IT capital expenditure and operational savings is shown in the following table, noting that this applies to the first four years of operations of the aligned business.

Table 14: Potential IT integration costs

$000	Full replacement	Replace end-of-life
Initial capital expenditure (year 1)	(1 490)	-
Avoided replacement capital (year 5) [1]	930	-

[1] Assumes avoided capital of $1.5 million in year 5, discounted at the average pre-tax real WACC of the two businesses to bring to a June 2014 dollar estimate.

Termination of property leases

The potential office consolidation options previously mentioned indicate that Tasports' Launceston based staff could be relocated to TasRail's current office accommodation in Launceston and, in the best case scenario, TasRail's Hobart based staff could also be relocated into Tasports' current office accommodation in Hobart.

Under the relevant lease terms for Tasports' office accommodation in Launceston, the termination cost would be up to $320 000 if termination occurred immediately upon the alignment of both businesses. However, in reality Tasports has the option to sublet the premises for the remainder of the lease term, which would avoid the termination fee.

Under the relevant lease terms for TasRail's office accommodation in Hobart, the termination cost would be up to $40 000 if termination occurred immediately upon the alignment of both businesses. However, as with the Tasports accommodation, TasRail could seek to sublet this accommodation for the remainder of the lease term, which would avoid the termination fee.

Given the above, the best case scenario is that the leases for the excess accommodation in Launceston and Hobart can be sublet. The worst case is that the accommodation is not sublet, and termination fees are incurred. On this basis, the potential implementation cost range for the termination of property leases is between $0 and $360 000.

Table 15: Potential lease termination costs

$000	Low Case	High Case
Termination costs	0	360
Total	**0**	**360**

Aligning conditions of employment

Recent experience of businesses mergers suggests that there is a potential that the integration of common functions will require an alignment of conditions of employment for employees performing these functions. While it is possible that this could be done on a cost-neutral basis, bringing all employees to the average level of remuneration between the two businesses, experience suggests that there will be considerable pressure to bring all employees to the higher level of current remuneration.

An estimate of the cost if remuneration in each functional area rises to the highest level of remuneration within each functional area across the two existing businesses has been made. The estimate takes account of the possible FTE savings identified in the duplicated employee savings analysis and is consistent with those estimates. The estimate assumes that senior management contracts, including remuneration, will remain unchanged and applies only to employees on awards or EBAs.

On this basis, the cost of alignment of conditions of employment has been estimated to be in the range of $640 000 to $960 000 per annum.

This cost could be mitigated or avoided depending on the successful negotiation of conditions of employment in the new business.

Table 16: Potential annual cost of aligning employment conditions

$000 p.a.	Low Case	High Case
Alignment of conditions	640	960
Total	**640**	**960**

Business establishment costs

Establishing a fully aligned new business would incur a range of transfer and set-up costs. These would include:

- transitional Board fees;
- legal costs;
- aligning business processes and procedures;
- registration of new business;
- transferring authorisations and contracts;
- employee communications; and
- branding, including website and signage.

An effective implementation governance approach will assist to minimise these costs, however, some level of expenditure will be inevitable.

Based on previous experience in implementing business transfers and mergers, costs in the range $1 million to $2 million could be expected. However, this does not account for the risk of significant cost overrun, which can occur where there is poor implementation governance or unforeseen issues.

Table 17: Potential business establishment costs

$000	Low Case	High Case
Establishment costs	1 000	2 000
Total	**1 000**	**2 000**

Financial performance and strength of an aligned business

Background

A set of key financial performance and strength indicators have been estimated for an aligned rail and ports business, by applying the following assumptions to the final Corporate Plan estimates of both businesses:

- the high range cost savings will be achieved by an aligned business;
- the low range one-off integration costs will be incurred, apart from the integration costs that are directly impacted by the cost savings assumptions. For example, the high range redundancy cost estimate has been used to ensure consistency with the high range employee cost savings estimate; and
- the full replacement of corporate information systems will occur upon integration. This is consistent with the assumption that IT licence cost savings will be made by the aligned business.

In this regard, the key financial indicators for the aligned business represent an indicative best case scenario. It is considered that the financial indicators apply equally to the shared services and full alignment models, as the operating cost savings previously identified apply equally to the two options given that they all relate to the corporate functions of each business.

Financial Performance

Table 18: Forecast financial performance measures

$000	2014-15	2015-16	2016-17	2017-18
EBITDAM	31 229	37 930	38 514	43 339
EBITDA	1 152	8 276	13 473	18 815
EBIT	(17 918)	(12 383)	(7 676)	(2 740)
Profit Before Tax (before impairment)	(21 512)	(14 822)	(9 507)	(4 571)
Profit Before Tax	(55 180)	(40 322)	(33 507)	(28 571)
Return on Assets	(9.6%)	(6.8%)	(5.7%)	(4.8%)
Return on Equity	(12.9%)	(8.5%)	(6.9%)	(5.9%)
Percentage change in PBT (compared to status quo)	*(5.4%)*	*10.2%*	*12.0%*	*13.8%*

A key measure of an aligned business' operating performance would be its Earnings Before Interest, Tax, Depreciation, Amortisation and Maintenance (EBITDAM). This indicator demonstrates the business' return from its day-to-day trading activities, before its infrastructure maintenance, capital and financing expenses.

The forecasts for the aligned business demonstrate a healthy and increasing EBITDAM over the planning period, reflecting that its revenues should exceed its pre-maintenance operating expenses over the planning period. However, as shown in the table below, both businesses have a substantial maintenance task, including for Tasports non-commercial port assets. Without any asset rationalisation by an aligned business, this is unlikely to change under an aligned business model.

Table 19: Current maintenance cost forecasts

$000	2014-15	2015-16	2016-17	2017-18
Tasports (commercial)	15 167	17 062	13 238	12 146
Tasports (non-commercial)	8 650	5 447	3 859	3 423
TasRail	6 260	7 145	7 944	8 956
Total maintenance costs	**30 077**	**29 654**	**25 041**	**24 525**

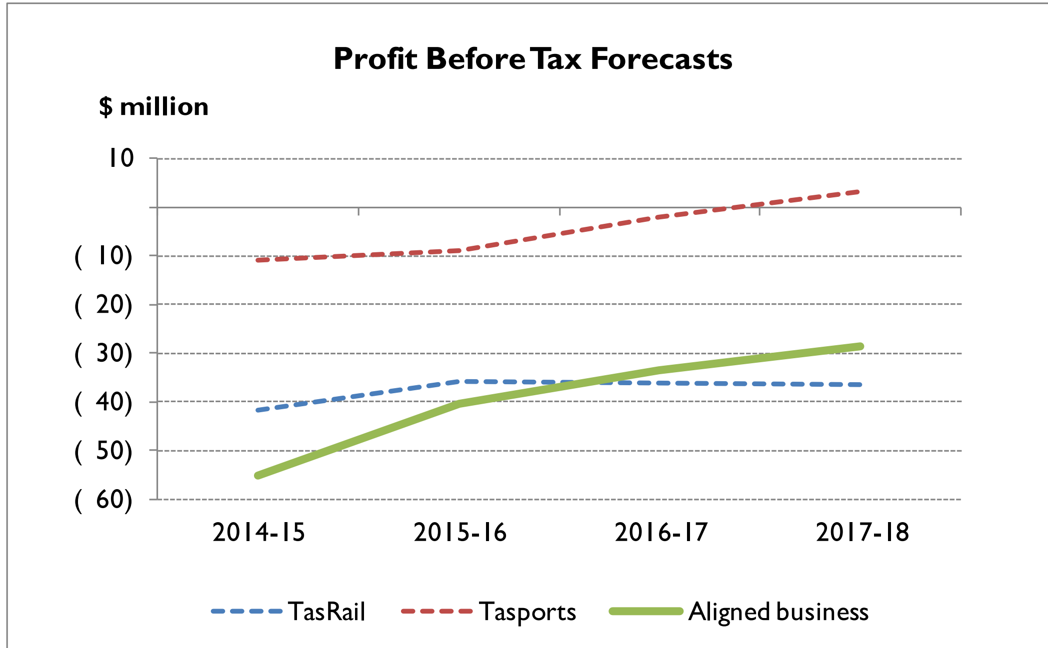
After maintenance costs, an aligned business' revenues would continue to exceed operating expenses, although the margin is a lot smaller. This is depicted in the forecast EBITDA results, which are forecast to increase from around $1 million to $18 million over the planning period. This trend is primarily underpinned by Tasports' current corporate plan forecasts, where increased revenue from increases in its uncontracted prices are expected to exceed the growth in its operating costs, reflecting its efficiency program over recent years and ongoing focus on productivity enhancements.

After depreciation charges, the aligned business is forecast to be loss making over the planning period. This indicates that an aligned business will be unable to produce sufficient revenues to cover operating expenses and capital costs and, therefore, will not be in a position to fully fund the replacement of infrastructure assets at the end of their useful lives. After interest charges, the result is even worse.

Further, after impairment expenses each year, the net losses of an aligned business will be significant. Impairment expenses each year are driven by the write-off of investments in below-rail infrastructure, which reflects that the cost of these investments is not expected to be recovered from customers.

As shown in the chart below, the alignment of both businesses will consolidate their net losses over the planning period. Importantly, the chart also demonstrates that the expected future profits from Tasports, from the end of the corporate planning period, will be forgone by the alignment of both businesses.

Figure 5: Profit before tax forecasts



Financial Strength

Table 20: Forecast financial strength measures

$000	2014-15	2015-16	2016-17	2017-18
Total Assets	402 613	413 846	412 454	414 139
Total Liabilities	103 072	82 211	73 543	72 836
Total Equity	299 541	331 635	338 911	341 303
Total Debt	51 443	34 584	27 334	27 334
Percentage change in equity	*(0.9%)*	*1.4%*	*1.4%*	*1.4%*

The State's total equity in an aligned business is forecast to be between $300 million and $340 million over the planning period. This represents a 1 per cent decrease in total equity in 2014-15, and 1 per cent increase in equity in the years thereafter, compared to the status quo. This is driven by the net profit impact of the alignment, which is negative in the first year given that integration costs exceed the benefit of the alignment in that year.

The debt profile of an aligned business decreases from around $50 million in 2014-15 to around $27 million by the end of the planning period. This profile is underpinned by bridging facilities that both businesses expect to utilise in 2014-15 and 2015-16. Tasports will have a bridging facility in those years to manage the timing mismatch between the maintenance works on its non-commercial assets and Government funding, while TasRail forecasts to have a bridging facility in 2014-15 to manage the mismatch between the timing of below rail infrastructure upgrades and Government funding.

In the later years, the forecast borrowings represent Tasports' forecast commercial borrowing levels. Tasports' current borrowing facility with Tascorp is $27 million and Tasports' commercial debt is forecast to remain at this level over the planning period.

Capital expenditure [1]

Table 21: Current capital expenditure forecasts

$000	2014-15	2015-16	2016-17	2017-18
Tasports				
Plant and equipment	7 879	5 283	6 519	6 270
Floating plant replacement	9 525	3 100	-	-
Total Tasports capital expenditure	**17 404**	**8 383**	**6 519**	**6 270**
TasRail				
Below rail	31 127	29 000	27 500	27 500
Above rail	26 126	5 867	4 000	4 000
Total TasRail capital expenditure	**57 253**	**34 867**	**31 500**	**31 500**
Joint projects				
Burnie Port redevelopment	11 498	-	-	-
Less external funding	(5 000)	(500)	-	-
Total joint projects	6 498	(500)	-	-
Total capital expenditure	**81 155**	**42 750**	**38 019**	**37 770**

[1] Based on final 2014 Corporate Plans.

The above mentioned capital expenditure forecasts are directly taken from the final corporate plans of both businesses. In this regard, it is important to note that the capital expenditure forecasts for TasRail's below rail business are based on the assumption that the business will receive $120 million in Australian Government funding and that the Australian Government will recognise the State's existing rail investment as an in kind co-contribution. At this time, the potential for this funding arrangement remains highly uncertain.

Tasports' business as usual capital expenditure program includes the purchase of new tug boats in 2014-15 and 2015-16 and relatively stable capital expenditure for general plant and equipment over the planning period.

TasRails' capital expenditure forecasts include rail line improvements on the Western, South, Bell Bay, Fingal, Derwent Valley and Melba lines. TasRail has undertaken a comprehensive prioritisation of the required works on these lines; nevertheless, its capital expenditure program may need to be adjusted depending on the level of funding that is secured over the planning period.

In addition, Tasports' Corporate Plan includes capital expenditure forecasts for the optimisation of the Burnie Port, which will realign rail infrastructure and create transport efficiencies at the Port. This will be funded primarily by Tasports, Toll and Australian Government funding.

At face value, the alignment of both businesses does not impact on the total capital expenditure forecasts compared to the status quo. However, the alignment may provide the opportunity to reprioritise the current capital expenditure programs and potentially rationalise some assets.

Credit rating and borrowing capacity

Tascorp undertakes periodic reviews of the stand-alone credit ratings of each business, for the purpose of determining the guarantee fee rate that should apply to a business' borrowings. The Tascorp credit rating is merely a theoretical exercise and in reality does not reflect the implied Government support provided to each Government business.

Nevertheless, for this assessment, the credit rating impact of the alignment has been considered to assess whether there is the possibility of Tascorp increasing the debt limits of an aligned business, compared to the status quo, which would increase the funding available for capital projects.

In July 2011, the Tascorp undertook a credit rating assessment for TasRail. The credit rating was assessed as BBB- and reflected that TasRail does not generate sufficient revenue to operate on a commercially sustainable stand-alone basis.

In June 2012, Tascorp undertook a credit rating assessment for Tasports. At that time, Tascorp reduced Tasports' credit rating from A- to BBB+ and this reflected that, whilst Tasports has proactively responded to reduced freight volumes through the delivery of operating efficiencies and reduced infrastructure spending, it faced a challenging operating environment with reduced financial flexibility to absorb any further deterioration in freight volumes.

The following key credit matrices for an aligned business have been estimated using the forecasts financial results and these have been compared to the industry benchmarks for infrastructure companies. The benchmarks are those that were used by Tascorp in its credit rating assessment for Tasports in June 2012.

Table 22: Key credit rating metrics

$000	2014-15	2015-16	2016-17	2017-18	Benchmarks
Debt to capital [1]	14.7%	9.4%	7.5%	7.4%	A 37.0% BBB 45.1% BB 52.2%
FFO/Total Debt [2]	(4.7%)	16.9%	42.6%	62.1%	A 52.8% BBB 34.3% BB 25.2%
EBIT Interest coverage [3]	(5.0)	(5.1)	(4.2)	(1.5)	A 11.2 BBB 5.7 BB 3.8
EBITDA Interest coverage [4]	0.3	3.4	7.4	10.3	A 14.0 BBB 7.9 BB 5.2

1. Debt to capital = debt / (debt + equity).
2. FFO/Total Debt = (operating profit from continuing operations plus depreciation) / debt.
3. EBIT Interest Cover = earnings before interest and tax / interest paid.
4. EBITDA Interest Cover = (earnings before interest, tax, depreciation and amortisation) / interest paid.

The above analysis demonstrates that an aligned business would not be highly leveraged compared to industry benchmarks. The aligned business would have a gearing ratio that decreased from around 14 per cent in 2014-15 to less than 10 per cent over the remainder of the planning period, which is substantially less than the BBB benchmark of 45 per cent. However, this measure alone does not recognise that the aligned business is unable to extract a commercial level of income from its asset base.

In this regard, the leverage and interest coverage ratios of the aligned business are forecast to be much weaker and suggest the business has limited capacity to take on further debt. While the funds from operations to total debt measure improves in 2016-17 and 2017-18 to the point where it is in the BBB to A range, the business will have poor interest coverage, particularly after capital costs.

On this basis, it is considered that an aligned business would be rated around BBB and Tascorp would not be willing to extend the borrowing limit of an aligned business above the limits already set for both businesses, without explicit Government support. In this regard, it is considered that there will be no additional borrowing capacity available to an aligned business.

Impact on Government finances

Theoretically, the improved profitability and enhanced cash flow of an aligned business can impact on the General Government sector in two ways, including:

- returns to Government; and/or
- reduced equity contributions and/or annual grant funding.

These are assessed below, along with their potential impact on Total State Sector finances.

Returns to Government

The estimate of total returns to Government from Tasports and TasRail that are included in the 2014-15 Budget are outlined in the table below. Apart from some guarantee fees from TasRail in 2014-15, these are all from Tasports.

Table 23: Current Return to Government estimates (per 2014-15 Budget)

$000	2014-15	2015-16	2016-17	2017-18
Returns to Government				
Dividends	0	0	0	2 279
Income Tax Equivalents	791	695	0	2 080
Guarantee Fees	548	440	361	361
Total Returns to Government	**1 339**	**1 135**	**361**	**4 720**

Given that an aligned business is forecast to make significant annual losses, it is expected that the aligned business will not be in a position to remit dividends over the long term. Similarly, given the annual losses of the aligned business, and significant tax losses that have been accumulated by TasRail, it is forecast that no income tax equivalents will be paid by an aligned business over the long term.

For guarantee fees, it is expected that these will remain as per current estimates, given that the alignment is not expected to have any impact on the borrowing profile of the aligned business, compared to the status quo.

In this regard, the return to Government estimates from an aligned business, on a cash basis and over the planning period, are as follows:

Table 24: Forecast returns to Government from an aligned business

$000	2014-15	2015-16	2016-17	2017-18
Returns to Government				
Dividends	-	-	-	-
Income Tax Equivalents	-	-	-	-
Guarantee Fees	548	440	361	361
Total Returns to Government	**548**	**440**	**361**	**361**
Percentage change in Returns	*(59.1%)*	*(61.2%)*	*0.0%*	*(92.4%)*

On this basis, the alignment of both businesses will actually reduce returns to the Government over the Budget and Forward estimates period. This reflects that the future profit of Tasports, on which dividends and income tax equivalents are payable, are more than offset by TasRail's forecast losses and its accumulated tax losses.

Reduced equity contributions and/or grant funding

The following funding has been allocated to Tasports and TasRail over the Budget and Forward Estimates period.

Table 25: Current Government funding allocations

$000	2014-15	2015-16	2016-17	2017-18
Recurrent Grant funding to TasRail	16 834	11 992	22 966	19 700
Equity transfers to TasRail (from TasNetworks)	20 000	20 000	-	-
Equity injections to Tasports	1 000	8 500	7 500	-
Total Government funding	**37 834**	**40 492**	**30 466**	**19 700**

As assessed previously, the potential cashflow savings of aligned both businesses ranges between around $2 million and $4 million per annum. Theoretically, this cash flow saving can be used to reduce the amount of State Government funding to the business each year.

However, if Australian Government funding is not secured for TasRail, the current Board has expressed a view that it will require additional State Government grant funding in the future. In this regard, the estimated cashflow savings of an aligned business may be able to partly offset any additional funding requirements.

If the cashflow savings of an aligned business were used to offset the Government's equity funding to Tasports for its non-commercial asset program, the reduction in this funding would not impact the General Government Operating Statement.

Impact on Total State Sector finances

The abovementioned impacts on the General Government sector will not have an impact on Total State Sector finances. From a Total State Sector perspective, government funding to each business nets to nil, as the payments from the General Government Sector are offset by the receipt of those funds by the business. The reverse is true for the returns paid by each business to the Government.

On this basis, any reduction in returns to Government or reduction in grant funding to the businesses will not impact on Total State Sector finances.

Nevertheless, any financial synergy benefits or efficiency savings that accrue through an integrated business would generate a small positive impact on Total State Sector finances.

PART D: IMPLEMENTATION

Legislative and governance issues

Introduction

There are various methods for implementing an integrated business model. While the analysis in this investigation has considered the benefits and costs of two possible corporate structures, the final business structure is a matter for the new Board to determine and implement.

Both the shared services option and the full integration option require the transfer of all assets, rights, liabilities and employees from the existing two companies into one company.

Transfer of business

Two options are available for transferring a business into another business. These are:

- transferring the assets, rights, liabilities and employees of the business, by transfer notice; or
- transferring the Government's shares in one business to the other business.

Section 10A of the *Government Business Enterprises Act 1995* provides that the Treasurer may by notice of transfer, published in the Gazette, transfer any assets, rights or liabilities of a government business to another government business as specified in the notice. For the purposes of section 10A, a government business includes a State-owned Company.

A transfer notice could therefore be used to transfer the assets, rights and liabilities of Tasports or TasRail. However, the employees of a business cannot be transferred under this provision. Employees would need to be transferred under an offer/accept common law contract approach. This would create additional uncertainty for employees, is a complex process and opens the door to the discussion of conditions of employment to enter into the integration process.

The transfer order approach provides for considerable flexibility in that the notice can nominate specific assets, rights or liabilities to be transferred. In the case where an entire business is being transferred, however, this flexibility is not an advantage, because the transfer order will simply specify that all assets, rights and liabilities are transferred.

Alternatively, the shares of a business can be transferred. In this case, the asset, rights, liabilities *and employees* can all be transferred under existing arrangements.

However, the Government Business Enterprises Act does not include a provision for the transfer of a parent company's shares, only the shares of a subsidiary company. To effect a share transfer under the existing Act, an existing business would need to transfer its entire operations into a subsidiary of itself and then transfer those shares via a transfer order under the Act. Clearly, this is not a preferred approach.

Legislative approach

It would also be possible to introduce specific legislation to effect a merger. This has been the usual practice in the past and has the advantage that it provides a Parliamentary mandate to the new arrangements, as well as providing cleaner and easier provisions by which the merger can be completed.

For instance, specific legislation could confer on a Minister the ability to transfer the parent company's shares, or the business's employees, resolving the issues involved in transferring under the Government Business Enterprises Act.

Further, specific legislation can confer on a Minister the power to issue directions to the existing businesses insofar as they are required for the merger, avoiding the risk of being deemed to be shadow directors while also providing an indemnity to the existing Directors for any actions taken in accordance with a Direction. This avoids the conflict of Directors needing to act in the best interests of their existing company while the new company is being established.

In addition, as outlined in the discussion in Part C relating to the Competition and Consumer Act, introducing specific legislation will mitigate risks associated with ACCC intervention and can extend derivative Crown immunity to the businesses through the transfer process.

The specific legislation approach would be preferred for effecting the integration of Tasports and TasRail as it provides a far more certain means of transferring employees and addresses potential issues relating to the duties of directors and competition concerns that might otherwise arise.

Objectives for any new business in regards to transparent pricing could be achieved through requirements in the enabling legislation, amendments to the *Tasmanian Port Companies Act 2005* and the *Rail Company Act 2009* or through requirements set out in the Shareholding Ministers' Statement of Expectations.

Corporate structure used for transfer

The transfer of two businesses into one business could be done by either:

- creating a new business and transferring the assets, rights, liabilities and employees of each existing business into it; or
- transferring the assets, rights, liabilities and employees of one of the existing businesses into the other business.

Under the first option, a new business would be established, with the assets, rights, liabilities and employees of the two businesses of TasRail and Tasports transferred to it. This is the most commonly used method for giving effect to mergers of Tasmanian government businesses[11]. It also has the benefit that it can be created in advance of the starting date for the new business and it minimises the risk of a dispute associated with the process.

Alternatively, the assets, rights, liabilities and employees of one of the businesses could be transferred into the other business. This would require that business to be subsequently renamed as well as amendments being made to its constitution to reflect the primary purpose of the new business. These would preferably take place on the day the entity commences operations. While this is possible, it may create some difficulties as the internal structure of the business could not be fully set-up prior to the commencement of operation, as the business will still be operating in its current form immediately prior to the commencement of operation of the new business.

While this option has the benefit of not requiring the creation of a new corporate entity and not requiring as many transfers, it may have the disadvantage of creating an impression that the transferring employees are being 'taken over' or that they are subservient of the incumbent business. It may also be viewed that the incumbent employees have received preferential treatment.

However, these issues may be able to be effectively managed through succinct and timely communications to the employees of both businesses. Further, under either of the alternatives for creating a fully integrated business, there will be multiple enterprise agreements applying to the new business for a period of time.

The timing for the creation of a new corporate structure for TasRail and Tasports, whether via a shared services model or a full integration model, is largely the same.

Following the transfer process, the Government would then seek to apply, or require TasRail and/or Tasports to apply, for deregistration of the redundant corporate shells under section 601AA of the Corporations Act.

Establishing the preferred ongoing corporate structure

Once a single business has been incorporated and all assets, rights, liabilities and employees have been transferred to it, the Board can establish whatever structure best suits its corporate direction. The structure can change over time at the discretion of the Board, in discussion with its shareholders.

It would be possible to use subsidiary arrangements to establish the new business according to a predetermined corporate structure, such as the shared services model or a fully integrated model. Transfer orders could then be used to transfer specific assets, rights, liabilities and employees into the parent and subsidiary companies.

However, this approach is administratively far more complex and would require the Government to decide on the preferred corporate structure. This could also result in a business being established in a structure that is different to the wishes of its Board.

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[11] See *Electricity Reform Act 2012*, *Irrigation Company Act 2011* and *Tasmanian Ports Corporation Act 2005*.

For these reasons, the ongoing corporate structure of a combined business would be best determined by the Board of the new business once transfers have occurred.

Transitional arrangements

Transitional governance arrangements will need to be implemented to ensure a smooth transition and to ensure a consistent approach is taken in respect to employees. These arrangements would likely remain in place for six months prior to the new corporate structure commencing operations.

Prior to commencing operations, the following key tasks will be required to be completed:

- Government decision on preferred approach;
- legislation enacted;
- Chair of the new Board appointed;
- CEO and executive management team of the new business appointed; and
- transfer notices published.

There are also a range of other tasks that will be required, such as agreeing and registering a business name and establishing the opening financial accounts of the business.

These matters will all take some time to resolve and a **minimum period of six months** is recommended to complete tasks following the enactment of enabling legislation.

It is recommended that a transition Board be established as soon as practical following the passage of the enabling legislation through Parliament. The transition Board would likely comprise of one Director from each of the two existing companies as well as an independent chair. Having existing directors on the Board facilitates effective coordination and ensures that the interests of both companies are aligned when designing the new business model. As the Board would require authorisation to make decisions, it is preferable that enabling legislation be prepared to give effect to the Board and give it decision making powers for the transition period. At this time, the Boards of the current businesses would effectively go into a 'care and maintenance' mode so as to not bind the new business into any new long term strategies.

While legislation is not strictly necessary to create the Board, and as the Shareholding Ministers could issue directions to the Board, there is the potential for directors to breach their duties prescribed under the Corporations Act. If legislation is prepared, directors could be provided with immunity in respect of their actions taken to give effect to the new corporate structure. This immunity can only be provided via an enactment.

It is likely that some members of the transition Board would ultimately become members of the Board of the new structure.

The Directors of the existing businesses and the expiry of their terms are given below. Most of the existing Directors have terms expiring at the 2015 AGM, which would most likely occur in November 2015. This would facilitate a straightforward transition to a new Board commencing with a new business on 1 December 2015.

Table 26: Expiry of Director terms

Name	Business	Role	Term expires
Robert Annells	Tasrail	Chairman	2015 AGM
Roger Gill	Tasrail	Director	2015 AGM
David George	Tasrail	Director	2015 AGM
Robert Neil	Tasrail	Director	2015 AGM
Sarah Merridew	Tasrail	Director	2015 AGM
Daniel Norton	Tasports	Chair	2015 AGM
Barry Berwick	Tasports	Director	2015 AGM
Evan Rolley	Tasports	Director	2015 AGM
Owen Williams	Tasports	Director	2015 AGM
Jane Bennett	Tasports	Director	2016 AGM

A range of transitional protocols have effectively been deployed in previous business integrations, governing matters such as the appointment of employees and capital expenditure. Such protocols ensure that vacancies that arise in the lead-up to a merger can be first offered to existing employees who might otherwise be in a redundancy situation, benefiting both the existing employee and reducing the redundancy cost. A capital expenditure protocol ensures that assets are not duplicated prior to integration.

Process and Timing

The process for achieving either the shared services model or the full integration model is largely the same.

Legislation would be drafted to provide for the establishment of the new corporation, if required, and for the transfer of the assets, rights, liabilities and employees from the two businesses to the new business.

An indicative timeline to enact legislation, based on the proposed sitting schedule for 2015 for both the House of Assembly and Legislative Council as at 27 October 2014, is set out below.

Table 27: Indicative implementation timetable

Milestone	Indicative timing
Cabinet decision on alignment option for Tasports/TasRail and agreement to draft legislation	March 2015
Legislation tabled in House of Assembly	April 2015
Debate in Legislative Council	30 April 2015
Bill commencement	1 June 2015
Transition Board appointed	1 July 2015
Appointment of CEO	September 2015
Appointment of Executive team	October 2015
Business commences	1 December 2015

This timeframe is considered to be quite aggressive but provides an indication of what might be possible if a determined implementation effort is made. Whilst this timeframe will be challenging, it reflects that a more prolonged timeframe may increase implementation risks, particularly the risk of key personnel leaving the businesses.

It also assumes that this timeframe would suit the Government's legislative program, given that this reform may not be considered a highest priority issue. If the Government's legislative program requires a later introduction for enabling legislation, then a commencement date for a new business is likely to be six months after the proclamation of that Act, unless administrative arrangements are progressed concurrently with the preparation of legislation.

However, the timeline for the establishment of the new business does not require a firm set of milestone dates, once legislation is enacted. Given that there are no changes to the services provided by the businesses or the regulatory arrangement, the integration can occur according to an implementation timetable developed by the transition Board.

Business implementation issues

Both existing businesses and any transition Board established will face a number of challenges throughout the implementation of any alignment option. These are outlined below.

Regulatory and compliance

Both businesses operate under stringent regulatory requirements, particularly in relation to occupational health and safety requirements. The separate businesses hold accreditations to perform their functions in their own rights.

Some accreditations held by the businesses require considerable effort to demonstrate compliance before certification or licensing; for example, rail safety accreditation.

If the corporate structures of the businesses change, for example through full integration, sufficient time will be required to ensure that the new business can obtain the necessary accreditations to legally operate. Obtaining accreditation can involve reviews of business and compliance processes and assessments as to whether operators and even directors are fit and proper persons under relevant schemes and legislation.

Where the compliance obligations exist under Tasmanian legislation, such as Tasports' regulatory approvals from Marine and Safety Tasmania, it would be possible to carry over approvals via legislation. However, this would not be possible for national schemes.

Sufficient due diligence and appropriate lead times will be required prior to the commencement of operations of a new business to ensure compliance and accreditation with relevant schemes.

Implementation costs

The financial assessment has provided an estimate of the cost to align both businesses. However, this is subject to various assumptions and in reality it is impossible to predict the final implementation costs with perfect foresight. Past experience suggests that unanticipated costs are likely to arise, which have in the past related to:

- IT integration;
- crystallisation of risks and business issues;
- redundancy and separation costs; and
- legal costs.

As an example, the total reform costs incurred in relation to the restructure of the State-owned electricity businesses totalled over $80 million for a two year period, well in excess of budget. However, this was a much more complicated restructure process and involved significant restructure of operational processes and systems, which accounted for a very significant proportion of the costs. The cost of aligning of Tasports and TasRail would be on a much smaller scale and would not require changes to the operational parts of the

business. Nevertheless, the establishment of cost control measures and monitoring of implementation costs will be an important role for the Transition Board.

Implementation Governance

Careful attention would need to be given to the implementation governance model that is put in place. The objectives of those involved in the integration process need to be focussed on successfully establishing a new business, rather than the personal or other benefits that could arise from the integration process. For instance, senior management performance incentives may need to be reconsidered and redrafted to ensure that incentives to maximise financial results in the final year of operation of the separated businesses are removed and incentives targeted at achieving the integration of the businesses are included instead.

Further, the integration governance arrangements should ensure that the new Board of the integrated business is not precluded from implementing its preferences for the operation of the business by decisions and agreements made through the integration process.

In general, an integration model that commences with the merging of the Boards and transfers shares from one business to another, or from both businesses into a new shell, and leaves structural and operational decisions to the new Board, would assist in managing many of these risks.

Distraction from core operations and loss of key employees

Even with a relatively simple integration that has little impact on the day-to-day operations of the businesses, there is a strong likelihood of significant distraction from core business. The task involved in completing information requests, communicating with employees and agreeing new structures and operating procedures will place a significant resourcing impost on the business, particularly middle office and management.

The possibility of redundancies through the integration process, particularly if combined with alignment of pay and conditions across the common functional areas of the businesses, could create incentives for key personnel to leave the business. Further, if the restructuring of the business takes a significant period of time to complete, the uncertainty involved may also encourage key personnel to leave. In this instance, it is more likely that employees who are more attractive in the labour market will find it easier to seek alternative employment, which may be to the detriment of the new business.

Therefore, retention payments to identified key employees may be required but should be closely monitored by Shareholders. This may include key employees that are required for a transitional period post alignment, such as those in the corporate areas of the businesses that may not be required in the aligned business in the long term but may need to assist in preparing final accounts for the existing businesses and any wind-up activities.

Again, an implementation approach that transfers both businesses substantially as they are and leaves the structural and operational optimisation to the new Board would significantly assist in managing these risks.

Health and safety

As mentioned above, the integration of both businesses has a strong potential to cause distraction from core business. This has the potential to not only impact on financial and economic outcomes, but also health and safety outcomes.

In this regard, there may need to be an added focus on health and safety throughout any integration, and counselling support may need to be offered to employees that are mentally affected by the integration.

Restructuring both business and regulatory arrangements together

There is a risk of overreach and creating confusion by changing both the regulatory and structural arrangements at the same time. This is particularly the case where third parties engage with the new business through a regulated framework. Changing both frameworks at the same time presents a significant resourcing challenge and each task distracts from the other.

This risk is best managed by staging the changes in regulatory and structural frameworks, completing the regulatory arrangements first, testing them in the known structure and then moving on to structural change once the regulatory arrangements are shown to be adequate. This is, however, a relatively more lengthy process.

Australian Government funding

TasRail is heavily reliant on Australian Government funding for its below rail infrastructure upgrades. As part of its initial process for allocating funding to TasRail, the Australian Government highly scrutinised TasRail's ability to deliver infrastructure projects and this involved face-to-face interviews and a significant administrative burden.

There is a potential that, with any alignment of TasRail and Tasports, the Australian Government will repeat the process of scrutinising the business before confirming any existing infrastructure funding or committing to new funding. This would be a significant administrative burden for the newly aligned business, particularly at a time where other integration tasks were being undertaken.

Stakeholder consultation

The assessment outlined in Part C above has been completed largely on a first principles basis and has considered what is legally, strategically and financially viable. While the assessment of the potential alignment of both businesses has touched on the potential impacts on the freight industry, including customers, it is unclear whether the conclusions reached accurately represent the perceptions of relevant stakeholders.

This is particularly relevant given the nature of the Tasmanian freight industry. As outlined in the Background section in Part B, the parts of the freight system that are impacted by an alignment of Tasports and TasRail represent less than half of the typical freight costs for exporters in Tasmania. Sea freight, both across Bass Strait and internationally, will always be a critical challenge for policy makers in this area.

Bass Strait shipping relies upon private enterprise and long term solutions to sea freight issues will need to involve these parties. Given that the benefits that can be anticipated from a closer alignment of Tasports and TasRail are modest, it would not be prudent to pursue a closer alignment if doing so was to have a negative impact on sea freight arrangements.

In this regard, should the Government wish to progress with the alignment of both businesses, a program of consultation with relevant stakeholders would be important and it would be preferable for this to occur prior to any announcement of the Government's settled policy position.

Stakeholder consultation prior to the Government considering this final report would be of limited benefit, as consultation would necessarily become quite speculative and hypothetical. Rather, once Government considers this report and makes an in-principle decision whether to continue to pursue a closer alignment, a targeted consultation process would be appropriate.

The target of consultation should be key customers. This consultation should examine whether port access arrangements would be a concern to key customers, and if so, whether a regulatory solution would provide an appropriate solution.

Employees of TasRail and Tasports are important stakeholders in relation to the project. Consultation with staff will be the responsibility of the Chairs of the businesses and the development of a communication plan for employees, if required, is the responsibility of the businesses. The Government may exercise a role in coordinating communications to staff to ensure consistency in content and timing of key communications, as well as ensuring that staff communications are coordinated with Government communications.

It would be inappropriate to engage with the ACCC until the Government has decided a preferred approach. Following a decision by Government, Treasury can coordinate liaison with the ACCC consistent with the approach outlined in Part C.

On this basis, the following actions should be considered if the Government chooses to pursue a closer alignment of the two businesses.

Table 28: Suggested stakeholder actions

Action	Responsibility	Timing
Communication of decision	Government	At Government's discretion
Interim findings communicated to employees	Businesses	Concurrent with Government announcement
Interim findings communicated to relevant industry groups	Minister's Office or Businesses	Concurrent with Government announcement
Courtesy notice provided to ACCC officers	Treasury	Concurrent with Government announcement
Targeted customer engagement to discuss implementation issues and concerns	Transition Board	Following appointment of Transition Board
Engagement with ACCC to ensure arrangements are compliant or exempt from Competition and Consumer Act	Transition Board	Following appointment of Transition Board

PART E: APPENDICIES

Appendix A

Terms of Reference

Objective:

The Government has a key objective of improving efficiency and the allocation of scarce Government resources, including reducing unnecessary duplication and costs in the Government Business portfolio.

In this context, the Government is seeking to investigate the feasibility of options that more closely integrate the operations of Tasmanian Railway Pty Ltd (TasRail) and Tasmanian Ports Corporation Pty Ltd (Tasports).

The Government has established a review that is to undertake an investigation into options to better align the operations and investment strategies of TasPorts and TasRail, to achieve cost savings and improve service delivery for businesses, producers and exporters.

Matters to be considered:

The Investigation is to consider options to better align the operations and investment strategies of TasPorts and TasRail, including the implications of those options in terms of the:

- possible savings in operating expenditure;
- possible benefits associated with more efficient capital expenditure and planning;
- commerciality and viability of the businesses;
- possible methods of implementation;
- costs of implementation of possible options; and
- possible governance structures.

In addition, the following matters are to be considered:

- legal constraints and obligations associated with any option, including any competition law implications; and
- whether additional regulatory arrangements would be required to support any option, including consideration of competitive neutrality principles and price regulation.

The Investigation is to take account of:

- Tasports' 30 year port plan;
- the Department of State Growth's development of a Tasmanian freight strategy; and
- the Productivity Commission's review of Tasmanian Shipping and Freight.

Steering Committee:

A Steering Committee is established to oversee the Investigation. The Steering Committee comprises the:

- Secretary of the Department of Treasury and Finance (Committee Chair);
- Secretary of the Department of State Growth;
- Chairman of TasRail; and
- Chairman of Tasports.

Secretariat support to the Committee will be provided by the Department of Treasury and Finance.

All Members will contribute information and working papers to the Committee and the two businesses will support their Members in preparing this material, in addition to material prepared by the Departments of Treasury and Finance and State Growth.

Stakeholder consultation:

The Committee is to develop its advice in consultation with relevant stakeholders.

Timeframes and reporting:

The Investigation is to prepare an Interim Report by December 2014.

The Investigation is to provide advice to the Treasurer and the Minister for Infrastructure in the form of a Final Report by March 2015.

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