Dr Malcolm Roberts and Ms Tania Homan
Chairman and Director – Rail
Queensland Competition Authority
Level 27
145 Ann Street
BRISBANE QLD 4000

7 July 2014

Dear Dr Roberts and Ms Homan

SUFA – QRC comments on QCA Position Paper

1 The Queensland Resources Council

The Queensland Resources Council (**QRC**) provides this submission on behalf of its members in response to the Standard User Funding Agreement (**SUFA**) Position Paper (**Position Paper**) published by the Queensland Competition Authority (**QCA**) in May of 2014.

The QRC is the peak industry association representing the commercial developers of Queensland's mineral and energy resources. The QRC works collaboratively with stakeholders to achieve positive outcomes for QRC members.

The QRC confirms that this submission may be made public.

Capitalised terms used in this submission have the meaning given to them in the SUFA documents.

2 Overview

In its submission on Aurizon Network's draft amending access undertaking for SUFA, the QRC suggested that the proposed SUFA documents were:

- *"a barely workable framework through which mining companies may invest their own capital;*
- *[had] some prospect of transferring the investment to a third party (most likely at a discount to the investment cost, and only post-construction);*
- *[had] no possibility of third party equity investment during the construction phase; and*
- *[had] no possibility of third party debt funding at any stage, other than through corporate debt held by the individual user-funders."*

It is fair to say that the QRC's description of the proposed SUFA documents as a *"barely workable framework"* was (and is) too optimistic. Since the time at which the QRC's original submission was made the risk appetite of third party funders for coal related investments has not improved – in fact, it has materially worsened primarily as a result of worsening coal prices. The effect of the worsening appetite for coal related investments is that the tolerance for unusual terms and complexity is very low (if indeed there is any tolerance). For a coal related investment to be economic or bankable the terms of the transaction need to be as customary and as close to market standard as possible.

The QRC is almost wholly supportive of the views expressed by the QCA in its Position Paper. It is the QRC's view that the changes to SUFA proposed by the QCA in its Position Paper materially improve the workability and bankability of SUFA. While the changes proposed by the QCA do not remove all of the complexity and novelty of SUFA, it reflects a much more customary funding arrangement. In particular, the QRC is supportive of:

- first ranking security being granted over rental cashflows;
- simplification and certainty of rental calculations;
- a substantially simpler structure during construction; with Aurizon Network being responsible for delivering a fit for purpose scope, for an agreed price and by an agreed time;
- distributions from the Trust being mandatory;
- no stapling between access and units and more free trading of units;
- ensuring that there cannot be discrimination between the maintenance of SUFA assets over non-SUFA assets.

The QRC notes that there remain a number of material tax related issues which need to be resolved to make SUFA workable. These tax related issues are detailed in the attached document.

In accordance with the QCA's request, the QRC has focused its comments on the issues raised in the QCA's Position Paper, and not detailed drafting or the term sheets included with the Position Paper. The QRC notes that there will be a need to address a number of second order issues in the detailed drafting of the revised SUFA documents.

3 Why SUFA

SUFA remains an important component of the expansion process. One of the purposes of SUFA is to provide competition to Aurizon Network funding expansions. If this purpose is to be achieved SUFA must provide access seekers with the opportunity to source funding at a cost which is less than or equal to the cost of Aurizon Network funding. There is no doubt that using Aurizon Network's version of SUFA third party funding would have been substantially more expensive than Aurizon Network funding (to the extent that such third party funding was available at all). The QCA's changes to SUFA provide a greater likelihood of parity between third party and Aurizon Network funding. There are however some aspects of SUFA which may build in greater cost than Aurizon Network funding (for example, the contingency that would be built in to the construction costs by Aurizon Network).

It is the QRC's view that properly structured and properly drafted there is a high likelihood of infrastructure investors and other third party funders investing in SUFA. It will however take some precedent to show such investors that it can work.

Finally, the QRC notes that SUFA is only one part of the expansion process. There remains a real need for Aurizon Network to have an obligation to fund some expansions at the regulated WACC. In some circumstances Aurizon Network should be obliged to fund (at the regulated WACC) shortfalls in capacity from expansions. Aurizon Network should also have an obligation to fund some expansions at the regulated WACC.

4 Expansion process

Through processes related to UT4 the QRC and Aurizon Network have been discussing and exchanging drafts of the UT4 expansion process. This has covered demand assessments, studies, prioritisation of expansion projects and allocation of access seekers to projects. The parties have not discussed planning, capacity assessments and pre-approvals of expansions. The QRC and Aurizon Network have agreed a form of the expansion process. The agreed form of the expansion process will need to be modified to reflect the concepts provided for in the QCA's Position Paper. Examples of changes which will be required include:

- Determination by the QCA or an expert of the scope of an expansion project (or a study) should not result in the access seekers bearing the risk related to that scope;
- Aurizon Network should be obliged to fund any expansion needed to rectify a shortfall in capacity resulting from a SUFA expansion;
- An effective dispute resolution process to determine disputes about the scope or price for a SUFA construction contract;
- Pre-approval processes and process to deal with variations to SUFA projects.

5 Rental calculation method

The calculation of 'rent' under the EISL is unnecessarily complex. While the rent will always have a degree of complexity, given the inherent complexity in the calculation of access charges, there ought to be means of explaining the calculation more clearly. The QRC therefore supports the QCA's suggestion of example spreadsheets.

The QRC also supports the concept that if the railway infrastructure ceased to be regulated that there needs to be certainty of continuity of rent. That rent would need to be at a market level and structured so as to avoid a transfer of value to non-SUFA assets.

6 Construction of SUFA infrastructure

The QCA notes that the PMA is complex. The QCA also noted that the PMA transfers risk to the trust without the trust having any control over the risks and that the PMA relies on the trust having a trustee who is very active in the management of the construction (which the QCA further notes is unlikely to be within the skill set of professional trustees).

The QCA suggests that given that Aurizon Network will operate and maintain the expansion that it should construct the expansion. The QCA further suggests that in lieu of a management agreement Aurizon Network should be engaged under a construction contract and that that contract be on customary terms. The QCA notes that it is customary for a construction contract to require the contractor to deliver a fit for purpose scope for an agreed price and by an agreed completion date.

The QRC strongly supports the proposed change to the construction arrangements. The PMA is far from a market standard project management agreement. Construction through an EPCM style (as is the case with the PMA) is from a funders point of view a less preferred procurement method. Third party funded projects are typically constructed under fixed price, fixed completion date construction contracts. A move away from a management agreement and toward and fixed price, fixed completion date construction contract will assist in making SUFA more bankable.

The QRC wishes to note four matters in relation to the construction contract:

- Firstly, the QRC is of the view that the SUFA suite should include a standard form construction contract. Parties to a SUFA project should be free to agree different terms, but a standard form agreement is necessary to ensure that delay in agreeing SUFA documentations is minimised;
- Second, it is standard for a construction contract to require the contractor to rectify defects in its works. If Aurizon Network as constructor fails to deliver the agreed fit for purpose scope (that is, there is a defect) which defect is

discovered during the defects liability period, Aurizon Network should rectify that defect at its own cost.

- Thirdly, as there is no competition in the performance of the construction work (that is, user funders are bound to use Aurizon Network), the QRC suggest that the expansion process include a dispute mechanism which applies if the parties cannot agree on the price, scope or schedule for a construction contract. The QRC suggest that that process be binding on Aurizon Network and user funders (that is, Aurizon Network must be required to enter into the construction contract for the scope, price and schedule determined through dispute resolution. If the dispute resolution was not binding and Aurizon Network could refuse to enter into the construction contract (or Aurizon Network were not responsible for delivering to the expert determined scope, price or schedule), there would be an incentive for Aurizon Network to dispute all matters (to ensure that it did not have to bear the risk intended to be borne under the construction contract other than on conditions that Aurizon Network were satisfied with).
- Fourth, for user funders to have any meaningful contribution to the negotiation of scope, price and schedule for a construction contract the expansion process and study agreements need to provide access seekers with complete transparency of the information which is available to Aurizon Network. Without that transparency, it will be very difficult for user funders to initiate or prosecute a dispute relating to a construction contract.

7 Security and financeability

In its original submission on SUFA the QRC noted that user funders needed real rights in the event that Aurizon Network were not paying the rent. Among other things and in light of the fact that Aurizon Network had indicated that it could not allow security over rental cash flow, the QRC suggested that user funders should be able to suspend the lease where Aurizon Network defaulted on its rent payments. The QCA does not consider such a suspension right to be practical. The QCA does however consider it necessary that user funders have first-ranking security over the cash flow. Security over the rental cashflow is more consistent with customary funding arrangements and will substantially assist with the bankability of SUFA. The QRC supports the requirement for first ranking security to be given to user funders over the rental cashflows.

The SUFA documents proposed by Aurizon Network provide for trust distributions to be discretionary. The QCA consider that trust distributions should be mandatory, as any user funder would require certainty of its return. The QRC strongly supports this view.

In relation to set off, the QRC had suggested that the EISL should not allow Aurizon Network to set off against rental payments. The QCA broadly agreed with this, but suggested that immaterial amounts could be set off. The QRC would support this if the materiality threshold was low and recognised single and cumulative set off amounts.

8 Discrimination

The QCA’s comments in relation to discrimination address two issues. Firstly, concerns of stakeholders that Aurizon Network may in some circumstances treat SUFA assets differently to Aurizon Network funded assets. On this issue, the QCA considers that one means of protecting against the concerns of differential maintenance treatment is to expand the scope of the condition based assessment. The QRC is supportive of expanding the scope of the condition based assessment report. However, the QRC also consider it necessary for the trustee and user funders to have separate meaningful audit rights.

The second discrimination issue raised by the QCA are the categories of parties that may provide user funding. It is the QRC’s view that any party that is willing and able to sign up to a SUFA agreement should be entitled to do so. In other words, there should be no limitations on the parties that may offer user funding. The QRC would be supportive of train operators providing user funding.

9 Preference unit transfers

The QRC is supportive of the QCA's proposal that there be no stapling between access rights and units. Stapling access rights and units limits the pool of people who may be willing or able to provide user funding. To make SUFA workable, it needs to be accessible to a broad range of parties.

10 Third party finance

In the QRC's opinion, further consideration should be given to ways in which finance could be provided directly to the trust. The trust procuring finance will be an efficient means of funding, and will avoid concerns which may be raised by lenders funding individual unit holders about lack of control.

11 Tax

The QRC's tax comments are set out in the attached document.

Yours sincerely

[redacted]

David Rynne
Director - Infrastructure