



**Asciano Submission to the
Queensland Competition Authority
in relation to the Aurizon Network
Proposed Standard User Funding
Agreement**

August 2013

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1 INTRODUCTION AND BACKGROUND

Asciano welcomes the opportunity to make a submission to the Queensland Competition Authority (QCA) on the Aurizon Network proposed Standard User Funding Agreement (SUFA) which is intended to facilitate the funding of extensions to Aurizon Network rail infrastructure by Aurizon Network customers.

Asciano's subsidiary Pacific National operates trains on the Aurizon Network infrastructure. Asciano is likely to be a future operator on user funded rail infrastructure in Queensland.

In December 2010 Aurizon Network submitted a proposed SUFA to the QCA in accordance with clause 7.6 a) of its Access Undertaking. Asciano made a submission to the QCA on this SUFA in March 2011. This SUFA was subsequently withdrawn while Aurizon Network and stakeholders worked through a separate consultation process which developed the current SUFA proposal. Asciano was not invited to be engaged in this separate consultation process.

This consultation process involved a further submission and withdrawal of a SUFA document package. This current Asciano submission is a submission on the SUFA document package submitted to the QCA in July 2013.

Asciano's understanding of the current SUFA proposal is that a trust develops the assets, which then leases the assets to Aurizon Network. The assets are ultimately owned by the state. Participating access seekers hold preference units in the trust, and as preference unit holders they provide all of the trusts funding and receive all of its distributions (where the trust receives the same rate of return as the regulated Aurizon Network). Each project would involve a separate trust and lease.

The SUFA documents and the QCA Issues Paper have been reviewed by Asciano on the basis that miners, Aurizon Network and the State will be parties to documents. It is unlikely that operators, such as Asciano, will be a party to the documents as

operators are unlikely to directly fund extensions under the SUFA process¹. Thus the comments in this submission are made from the perspective of Asciano as a current and future operator on both the Aurizon Network and future network expansions facilitated by the SUFA process.

Asciano notes that the proposed Aurizon Network SUFA documents have also been lodged by Aurizon Network with the QCA as part of the 2013 Draft Access Undertaking (DAU). Asciano believes that there are now in effect two parallel consultation processes being undertaken on the SUFA documents. Asciano believes that the interrelationship between the two consultation processes should be clarified by the QCA.² (For example the QCA should clarify if submissions made by a party under one consultation process will be taken into account in the other consultation process).

This submission contains no confidential information and may be considered a public document.

2 ASCIANO' GENERAL CONCERNS WITH THE SUFA CONSULTATION AND TIMING

Asciano understands that there are still outstanding matters in relation to the development of the SUFA. Asciano believes that it would have been preferable to wait until the document package was closer to completion before moving towards consultation. As the process currently stands there may be the need for a further round of consultation when these documents are finalised (depending on how the current consultation process interacts with the UT4 consultation process).

Asciano recognises that SUFA is largely related to funding of network infrastructure by end users; however Asciano believes that some involvement by operators in the consultation process would be of benefit. Asciano did not undertake any direct consultation in relation to the proposed SUFA arrangements.

¹ Asciano notes that the documentation is drafted in terms of "access seekers" which would allow operators to be a preference unit holder in a SUFA trust if an operator sought this outcome.

² Asciano notes that this issue is not isolated to the QCA consultation on the SUFA documents.

3 ASCIANO' GENERAL CONCERNS WITH THE PROPOSED SUFA STRUCTURE AND APPROACH

3.1 SUFA and Aurizon's Vertical Integration

Asciano has ongoing concerns about the current ownership and operating structure of Aurizon which centre on its vertically integrated nature as both the owner and operator of the monopoly below-rail assets and the largest above-rail user of these assets. Asciano notes that the submitted SUFA documentation makes numerous references to issues related to Aurizon Limited's debt, financial position and financial metrics. While Asciano appreciates that SUFA related issues will impact on the financial position of Aurizon Limited the focus on Aurizon Limited raises concerns that broader Aurizon issues, including Aurizon above rail issues may be taken into account in Aurizon's decision making in regards to SUFA issues.

In particular, Asciano has concerns that:

- the proposed SUFA provides a potential channel for cost shifting and cross subsidies between Aurizon Network, Aurizon's above rail business and the SUFA extension to the detriment of other rail users including above rail businesses such as Pacific National. For example the allocation of maintenance and operating costs between SUFA assets and other existing assets may favour one set of end users or one set of operators. Asciano believes that this issue of cost allocations should be addressed via the Aurizon Network Cost Allocation Manual. This requires that Aurizon Network develop an updated, detailed and rigorous Cost Allocation Manual;
- the SUFA arrangement does not clearly address how ongoing operating expenditure (e.g. ongoing maintenance costs for the SUFA investment) will be treated for the life of the asset. In particular the issue of who pays these costs and how they are paid should be clarified. Related to this is the issue of the trade-off between capital expenditure and maintenance expenditure. In making a decision on this trade-off Aurizon Network and other parties should ensure the most efficient and effective investment and maintenance profile is chosen. Decision making in relation to this capital expenditure and maintenance expenditure trade-off does not appear to be considered in the current SUFA documentation. This issue should be explicitly addressed prior to the QCA making a Final Decision on this issue. (This matter is addressed

further under section 3.2 of this submission in the section Treatment of the Impact of Extension on Existing Capacity);

- the proposed SUFA provides a potential channel for the facilitation of discussions between Aurizon's above rail business and end users through Aurizon Network to the detriment of other above rail businesses such as Pacific National; and
- the proposed SUFA provides a potential channel for Aurizon Network to effectively select capital extension and expansion projects which favour Aurizon's above rail business and end users contracted to Aurizon above rail. Asciano's understanding of the SUFA structure and approach is that ultimately Aurizon Network has a large degree of discretion as to which projects, if any, will progress through the SUFA process. For example Aurizon Network can;
 - raise issues such as system integrity (Section 2.2.1 of the Aurizon Network SUFA Explanatory Notes December 2012 page 5) to delay projects from proceeding
 - enter into user funding agreements for smaller projects (under section 7.6 a) ii) A) of the proposed amendments to the Access Undertaking) which could favour potentially Aurizon's above rail operator; and
 - enter into non-standard user funding agreements (under section 7.6 a) ii) B) of the proposed amendments to the Access Undertaking) which could potentially favour Aurizon's above rail operator (particularly if such non-standard agreements were not subject to regulatory scrutiny).

Asciano's concern is that this level of Aurizon Network discretion as to which projects proceed in a timely manner may be able to be used to favour Aurizon's above rail business. Asciano believes that any proponent of a project that is likely to be subject to the SUFA process would be likely to identify Aurizon as their above rail provider in order to minimise any concerns about differential treatment of different above rail operators to the detriment of competition. Asciano believes that the discretion of Aurizon Network should be limited by the inclusion of a set of criteria, which if met, ensure that a project proceeds.

Further to these concerns Asciano is seeking that QCA monitor any discussions, agreements and payments related to the SUFA process in order to ensure that no

decisions are made which are detrimental to competition. In particular the QCA should ensure:

- any payments to and from Aurizon Networks are transparent to the QCA and are consistent with the Access Undertaking, particularly section 3.2 of the Access Undertaking;
- any cost allocations relating to costs shared between SUFA assets and Aurizon Network assets are undertaken on a transparent and equitable basis and are consistent with an upgraded, detailed and rigorous Aurizon Network Cost Allocation Manual;
- any discussions between end users and Aurizon are limited to below track issues only; and
- the prioritisation of SUFA projects by Aurizon Network is on an equitable basis and that if certain criteria are met then Aurizon discretion to delay the project is limited.

Asciano believes that, to the extent that these processes are not already covered by the Access Undertaking, then these processes should be subject to increased regulatory audit powers of the Access Undertaking to ensure that all Aurizon Network decisions are made at a commercial arms length from Aurizon above rail operations and that the Aurizon above rail operator is not benefitted by cost allocations or Aurizon Network decision making.

3.2 Clarity on Various SUFA Related Issues

Asciano has not been involved in the discussions that have resulted in the development of the current SUFA proposal. As such Asciano is seeking that certain concepts and assumptions be clarified.

Identity of Preference Unit Holder

Asciano recognises that the wording in the proposed undertaking amendments and the Aurizon Network Explanatory Submission of December 2012 indicates that any access seeker can be a preference unit holder. Asciano is seeking that it be explicitly confirmed whether an above rail operator (including either Asciano or Aurizon above rail operations) can hold a preference unit in a trust.

Treatment of Impact of Extensions on Existing Capacity

Asciano recognises that the implementation of a SUFA investment on the Aurizon Network has the potential to impact other users who are not a party to the SUFA arrangement. Although Aurizon Network can consider issues such as the impact that a SUFA extension has on existing capacity under system integrity provisions, Asciano believes that a more transparent and equitable process is required which involves all impacted users. A clear and equitable voting process is required, which includes votes from all users affected. This ensures that all users impacted by the SUFA investment have clear voting rights via a formal process, through which they can provide input into the decision making process relating to the SUFA investment. The votes and input from the impacted users needs to be taken into account by Aurizon Network prior to any SUFA investment being approved.

A similar voting process needs to be adopted in relation to decision making relating to the ongoing maintenance costs for SUFA investments. The voting process should consider “capital versus maintenance” tradeoffs (as outlined earlier in this submission) to ensure the most efficient and effective investment and maintenance profile is chosen to deliver the right outcome for all users impacted.

Ringfencing and Confidentiality

Asciano understands that as a SUFA project will be operated by Aurizon Network and subject to the Aurizon Network Access Undertaking. Given this Asciano assumes that SUFA extensions will be subject to the same ring fencing provisions and confidentiality provisions as the Aurizon Network, however Asciano is seeking confirmation that this will be the case.

In addition, Asciano believes that where a party (for example a coal mining company) funds a SUFA extension and is also actively involved in operations (for example as an above rail operator) then there should be strong protocols in place which ensure arms length operations between the party’s role as a capital funder and the party’s role as an operator. To the extent that a preference unit holder receives any preferential treatment in relation to rail operations then this should be transparent.

Dispute Resolution

Asciano believes that any dispute resolution process relating to a SUFA dispute should have the flexibility to allow operators to be involved if required. For example if

a dispute related to track quality then an operator's capital and employees may be directly impacted and as such the operator should have the ability to be involved in the dispute.

Overall Asciano has strong concerns that the proposed SUFA provides a potential channel for Aurizon to benefit from cost allocations and the prioritisation of SUFA projects where Aurizon is the above rail operator.

4 ASCIANO'S DETAILED CONCERNS WITH ELEMENTS OF THE PROPOSED SUFA

Asciano also has a series of more targeted concerns relating to the detail of the proposed SUFA. These are outlined below.

Transfer of Preference Units

Section 4.3.3 of the Aurizon Network SUFA Explanatory Notes December 2012 (page 12) raised the issue of preference unit transfers and how approval for such transfers is at Aurizon Network's absolute discretion. Asciano had concerns with the approval for transfers being at Aurizon Network's absolute discretion. However, Asciano notes that under the revised SUFA document package of July 2013 the position on preference unit transfers has been amended such that in the project delivery phase the ownership of preference units is "stapled" to the contingent rights, but following project delivery a preference unit can be transferred but Aurizon network must have an opportunity to bid for these preference units. The preference units cannot be transferred at an amount less than the Aurizon network bid.

Asciano has no major concern with this revised proposal as Asciano believes that preference units should align with the preference unit holder's incremental access entitlements created as a result of the SUFA funded infrastructure. If, for some reason in the SUFA process access rights do not align with funding obligations then Asciano believes that the transfer of preference units should occur to ensure this alignment occurs.

Requirements Relating to 130% of Project's Target Cost

Section 4.5.1 of the Aurizon Network SUFA Explanatory Notes December 2012 (page 14) states that the notional, aggregate, paid-up amount of all of the preference units is required to amount to 130% of the project's target cost. There is no clear explanation of why this 130% of the project's target cost is required, apart from an

implication that it is required to manage the preference unit holder's default risk (December 2012 Aurizon Network SUFA Explanatory Notes page 19). Asciano believes that a rationale which supports the derivation of the 130% should be provided.

In addition Asciano believes that further clarity should be provided around whether reimbursements of the additional 30% would occur via the reallocation (i.e. true-up) process outlined in the December 2012 Aurizon Network SUFA Explanatory Notes (page 19). To the extent that the 30% (or another residual amount) is not re-allocated Asciano has concerns that Aurizon Network has the ability to make returns above the regulated cost of capital.

Inclusion of SUFA Assets in the Regulatory Asset Base

Asciano understands that SUFA assets will be included in the regulatory asset base although preference unit holders, rather than Aurizon Network, will receive the capital returns (Aurizon Network December 2012 SUFA Explanatory Notes page 16).

Asciano is seeking clarity in regard to both the timing of including the SUFA assets into the regulatory asset base and whether assets will be subject to a prudency test prior to their inclusion into the regulatory asset base.

Asciano also has broader concerns regarding the inclusion of SUFA infrastructure into the regulatory asset base. Asciano's concerns are that the SUFA assets are included in the RAB and at some time in future are socialised amongst existing users via changes to the SUFA approach, the tariff setting approach, the access undertaking or the broader regulatory regime. Thus existing access holders may pay for these expansions. Asciano recognises that this is a regulatory risk but believes that it should be considered as a possible exposure for current users moving forward, particularly as Aurizon Network is effectively the only party which controls the process of undertaking amendment - thus if the SUFA process does not provide the expected regulatory outcomes Asciano can envisage a process where Aurizon Network seeks to shift risk to other parties via changes to the then Access Undertaking via the regulatory system.

Consistency in Treatment of Capacity Shortfalls

Asciano is concerned that the proposed Aurizon Network amendments to section 7.5.1 (a) of the Access Undertaking now state that any capacity shortfall issues for

user funded expansions will be dealt with in accordance with the terms of the user funding agreement.

Asciano is concerned that this could lead to inconsistency across SUFA arrangements and between SUFA funded expansions and expansions funded by other approaches. Asciano believes that any loss of access entitlements due to capacity shortfalls should be transparent and consistent across the entire Aurizon Network. Each access holder's access rights should be reduced consistently regardless of whether the capacity shortfall was related to SUFA funded infrastructure, Aurizon Network funded infrastructure etc.

Asciano notes that in its correspondence to the QCA of 22 July 2013 Aurizon Network has identified the expansion process as an issue which requires further work. Asciano would encourage Aurizon Network to address the issue identified above in its review of the expansion process.

Suspension of Negotiation Period

Asciano is concerned that the proposed Aurizon Network amendments to section 7.5.5 (a) (iv) of the Access Undertaking allows Aurizon Network to suspend the Negotiation Period pending the parties agreement on the matters necessary to complete the SUFA documentation. The Negotiation Period is defined in the Access Undertaking as the period during which the terms and conditions of an access agreement will be negotiated.

Asciano is concerned that suspending the Negotiation Period may be used to tactically or strategically to ensure Aurizon's above rail operator is involved in any haul associated with the extension.

Dispute Resolution Process Alignment

Asciano notes that under the proposed Aurizon Network amendments to section 7.5.5 (j) of the Access Undertaking the dispute resolution process in the SUFA arrangements takes precedent to the dispute process in the undertaking. Asciano believes that to the extent possible the dispute resolution processes in the SUFA and the undertaking should be aligned to avoid the possibility of multiple disputes relating to the same issue.

Requirement to Use a SUFA

Asciano notes that the proposed Aurizon Network amendments to section 7.6 of the Access Undertaking seem to imply that if the expansion is a Significant Investment (i.e. greater than \$300 million) then a user funding agreement must be executed.

Asciano notes that this position seems inconsistent with Aurizon Network December 2012 SUFA Explanatory Notes (page 4) where they state that “SUFA is not the only funding option and does not preclude the negotiation of alternative funding arrangements”. Asciano believes that in instances where the expansion is greater than \$300 million a SUFA may be the most likely approach to funding there may be instances where other approaches to funding may be more appropriate and as such these approaches should not be disallowed by the Access Undertaking.

Project Management Risk Allocation

Asciano notes that under the proposed Project Management Agreement the Project Manager appears to have control over the construction and operation of SUFA projects, meaning most risks can be controlled by the Project Manager. However Asciano notes that the Project Manager’s liability is limited to their management fee. Asciano believes that those parties best able to control a risk should bear the risk. This does not seem to be the case in this instance.

5 CONCLUSION

The comments in this submission are made from the perspective of Asciano as an operator on the Aurizon Network and future network expansions facilitated by the SUFA process.

Asciano has strong concerns that the proposed SUFA provides a potential channel for Aurizon to benefit from cost allocations and the prioritisation of SUFA projects where Aurizon is the above rail operator. This would have a detrimental impact on competition. Given this Asciano is seeking that:

- any payments involving Aurizon Networks are transparent to the QCA and are consistent with the Access Undertaking;
- any cost allocations relating to costs shared between SUFA assets and Aurizon Network assets are undertaken on a transparent and equitable basis consistent with the Aurizon Network cost allocation manual;

- any discussions between end users and Aurizon are limited to below track issues only;
- the prioritisation and selection of SUFA projects by Aurizon Network is on an equitable basis; and
- all users impacted by a SUFA have a means of providing input into decision making via a transparent voting process.

Asciano believes that these processes should be subject to the regulatory audit powers of the Access Undertaking to ensure that the Aurizon above rail operator is not benefitted by cost allocations or Aurizon Network decision making. Such an approach will facilitate competition.

In addition Asciano is seeking that various issues of detail be addressed and that various issues be clarified. In particular Asciano is seeking that ring fencing and confidentiality be clarified, including in cases where a party funding a SUFA extension is also an above rail operator.