

# Queensland Competition Authority

Draft Decision

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## Aurizon Network's 2013 Standard User Funding Agreement Draft Amending Access Undertaking

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October 2014

We wish to acknowledge the contribution of the following staff to this report:

Farhana Chowdhury, Carrie Haines, Tania Homan, and Sean McComish

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## SUBMISSIONS

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Closing date for submissions: 16 January 2015

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore submissions are invited from interested parties concerning its assessment of Aurizon Network's 2013 Standard User Funding Agreement Draft Amending Access Undertaking. The QCA will take account of all submissions received.

Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority  
GPO Box 2257  
Brisbane Qld 4001

Tel (07) 3222 0555  
Fax (07) 3222 0599  
aurizon@qca.org.au

[www.qca.org.au](http://www.qca.org.au)

### Confidentiality

In the interests of transparency and to promote informed discussion, the QCA would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (i.e. the complete version and another excising confidential information) could be provided. Where it is unclear why a submission has been marked 'confidential', the status of the submission will be discussed with the person making the submission.

While the QCA will endeavour to identify and protect material claimed as confidential as well as exempt information and information disclosure of which would be contrary to the public interest (within the meaning of the *Right to Information Act 2009* (RTI)), it cannot guarantee that submissions will not be made publicly available. As stated in s 187 of the Queensland Competition Authority Act 1997, the QCA must take all reasonable steps to ensure the information is not disclosed without the person's consent, provided the QCA believes that disclosure of the information would be likely to damage the person's commercial activities and that the disclosure of the information would not be in the public interest. Notwithstanding this, there is a possibility that the QCA may be required to reveal confidential information as a result of a RTI request.

### Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office, or on the website at [www.qca.org.au](http://www.qca.org.au). If you experience any difficulty gaining access to documents please contact us on (07) 3222 0555.

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## Table of Contents

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SUBMISSIONS	I
Closing date for submissions: 16 January 2015	i
Confidentiality	i
Public access to submissions	i
PREFACE	V
EXECUTIVE SUMMARY	VII
Progress in developing a SUFA arrangement	vii
Draft Decision	ix
Third Party Financing	x
Summary	xiii
THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS	XIV
1 WHAT IS A SUFA AND WHY IS IT NEEDED?	1
1.1 What is a SUFA?	1
1.2 What it seeks to achieve	1
1.3 Summary of the 2013 SUFA DAAU	1
2 LEGISLATIVE FRAMEWORK AND ASSESSMENT APPROACH	5
2.1 Assessment process for making this Draft Decision	5
2.2 Legislative framework	5
2.3 Outline of QCA assessment process	9
2.4 May 2014 Position Paper on Aurizon Network's 2013 SUFA DAAU	10
2.5 Exposure drafts for proposed SUFA agreements	12
2.6 Process going forward	13
2.7 Key matters for this Draft Decision	13
3 SUBMISSIONS ON OUR MAY 2014 POSITION PAPER	14
3.1 Submissions received on the Position Paper	14
3.2 Summary of Aurizon Network's views	14
3.3 Summary of stakeholders' views	15
4 RENTAL METHOD	16
4.1 Summary of the rental mechanism	16
4.2 Summary of our May 2014 position	17
4.3 Summary of Aurizon Network's position	18
4.4 Summary of stakeholders' comments	19
4.5 QCA analysis and Draft Decision	19
5 CONSTRUCTION	23
5.1 Summary of our May 2014 position	23

5.2	Summary of Aurizon Network's position	24
5.3	Summary of stakeholders' comments	27
5.4	QCA Analysis and Draft Decision	28
6	SECURITY AND FINANCEABILITY	47
6.1	Summary of our May 2014 position	47
6.2	Summary of Aurizon Network's position	48
6.3	Summary of stakeholders' comments	50
6.4	QCA analysis and Draft Decision	50
7	TERMINATION	58
7.1	Summary of our May 2014 position	58
7.2	Summary of Aurizon Network's position	59
7.3	Summary of stakeholders' comments	60
7.4	QCA analysis and Draft Decision	61
8	DISCRIMINATION	65
8.1	Summary of our May 2014 position	65
8.2	Summary of Aurizon Network's position	66
8.3	Summary of stakeholders' comments	66
8.4	QCA Analysis and Draft Decision	68
9	PREFERENCE UNIT TRANSFERS	70
9.1	Summary of our May 2014 position	70
9.2	Summary of Aurizon Network's position	70
9.3	Summary of stakeholders' comments	70
9.4	QCA analysis and Draft Decision	71
10	THIRD PARTY FINANCE	72
10.1	Summary of our May 2014 position	72
10.2	Summary of Aurizon Network's position	72
10.3	Summary of stakeholders' comments	73
10.4	QCA analysis and Draft Decision	74
11	TAXATION	76
11.1	Summary of our May 2014 position	76
11.2	Summary of Aurizon Network's position	76
11.3	Summary of stakeholders' comments	78
11.4	QCA analysis and Draft Decision	79
12	2010 ACCESS UNDERTAKING AMENDMENTS	83
12.1	Summary of our position	83
12.2	Summary of Aurizon Network's position	83
12.3	Summary of stakeholders' comments	84
12.4	QCA analysis and Draft Decision	84
13	LIABILITY	88

13.1	Summary of our May 2014 position	88
13.2	Summary of Aurizon Network's position	88
13.3	Summary of stakeholders' comments	90
13.4	QCA analysis and Draft Decision	90
APPENDIX A : PROPOSED SUFA ARRANGEMENTS		93
APPENDIX B : CONSTRUCTION CONTRACT		95
APPENDIX C : LIABILITY		103
GLOSSARY		106
REFERENCES		109

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## PREFACE

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### Context

Aurizon Network Pty Ltd (Aurizon Network) owns and operates the below-rail network in the central Queensland coal region (CQCR) and is responsible for negotiating access with parties seeking to use its rail network.

The use of a coal system for providing transportation by rail is a service under Part 5 of the *Queensland Competition Authority Act 1997* (QCA Act) by operation of section 250 of the QCA Act. It is referred to in this Draft Decision as the 'declared service'.

A 'coal system' means rail transport infrastructure (a 'facility' under section 70 of the QCA Act) that is part of the Blackwater system, Goonyella system, Moura system or Newlands system, plus direct or indirectly connected rail transport infrastructure owned or operated by Aurizon Network, plus extensions built on or after 30 July 2010 owned or operated by Aurizon Network, as defined in section 250 of the QCA Act. The declared rail transport infrastructure is collectively referred to in this Draft Decision as the 'Central Queensland Coal Network' (CQCN).

As a result of the declaration of the declared service, Aurizon Network (as access provider) and access seekers are subject to various rights and obligations under the access regime in Part 5 of the QCA Act.

Section 136 of the QCA Act permits Aurizon Network, as the owner or operator of a declared service, to voluntarily give us a draft access undertaking. Section 142 of the QCA Act also permits Aurizon Network to give us a draft amending access undertaking (DAAU).

We must consider the DAAU and either approve, or refuse to approve it. If we refuse to approve the DAAU, we must give Aurizon Network a written notice stating the reasons for the refusal and the way in which we consider it is appropriate to amend it.

Aurizon Network is the responsible person for the QR Network's 2010 Access Undertaking (2010 AU) we approved on 1 October 2010 (UT3). UT3 is an access undertaking previously given by Aurizon Network in relation to the declared service under section 136 of the QCA Act. UT3 is set to expire on 30 June 2015.

### 2013 Standard User Funding Agreement — Draft Amending Access Undertaking (2013 SUFA DAAU)

On 22 July 2013 Aurizon Network formally withdrew its 2012 SUFA DAAU<sup>1</sup> and submitted its 2013 SUFA DAAU containing the following documents:

- explanatory notes (from its 2012 SUFA DAAU) modified by its submission letter dated 22 July 2013 and related schedule
- regulatory notes (unchanged from its 2012 SUFA DAAU)
- new SUFA template legal agreements
- DAAU (unchanged from its 2012 SUFA DAAU).

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<sup>1</sup> Aurizon Network submitted its 2012 SUFA DAAU under section 142 of the QCA Act. Aurizon Network's 2013 SUFA DAAU did not amend this aspect of its previous DAAU and as such, we are considering the 2013 SUFA DAAU under section 142 of the QCA Act.



### Investigation and consultation process

We commenced an investigation into Aurizon Network's 2013 SUFA DAAU on 25 July 2013. Consistent with section 138(3)(c) of the QCA Act, we published Aurizon Network's 2013 SUFA DAAU on our website and invited stakeholders to make submissions. Six submissions were received. On 14 October 2013, we invited all stakeholders to provide reply submissions on all submissions provided to date. Six reply submissions were received.

On 22 May 2014, we released a Position Paper along with a set of term sheets and a consultant's report commenting on the workability, credibility and bankability of Aurizon Network's proposed 2013 SUFA DAAU. We asked for comments on those documents by 27 June 2014, with six submissions received.

### Relationship between the 2013 SUFA DAAU and 2014 Draft Access Undertaking (DAU) process

Aurizon Network's 2013 SUFA DAAU was submitted as an amendment to the 2010 AU and is being evaluated in this context.

Aurizon Network also submitted its 2013 DAU (which if ultimately approved will become known as UT4) to us for approval in April 2013. This was subsequently withdrawn on 11 August 2014 and replaced by the 2014 DAU. Any submissions with respect to the SUFA agreements submitted as part of the 2013 or 2014 DAU process are not being considered in our review of the 2013 SUFA DAAU.

Ultimately, we understand Aurizon Network's intention is to incorporate an approved suite of SUFA agreements, from the 2013 SUFA DAAU, into its 2014 DAU.

### Draft Decision

We would like to acknowledge the considerable progress which has been made by all parties to develop the 2013 SUFA DAAU to the stage submitted to us in July 2013, and the subsequent cooperative approach of Aurizon Network, and its stakeholders, to continue developing the SUFA documents. However, we must make a decision based on the 2013 SUFA DAAU, as submitted.

Our interim position, as set out in this Draft Decision would be to refuse to approve the 2013 SUFA DAAU, in its current form. This Draft Decision sets out the reasons for our position and the way in which we consider it is appropriate to amend the 2013 SUFA DAAU to achieve what we consider will be a workable, credible and bankable set of SUFA agreements.

### Acknowledgements

The development of the suite of draft SUFA agreements provided in the Draft Decision has been made possible due to the ongoing commitment and cooperation of Aurizon Network and interested stakeholders. We would like to particularly acknowledge the work of Aurizon Network and the QRC for working with our legal team to draft the SUFA agreements to the Draft Decision stage.

### Submissions

We seek submissions to be presented in writing this Draft Decision. Submissions must be received by no later than 16 January 2015. We will consider all submissions received by us within this timeframe.

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## EXECUTIVE SUMMARY

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The Central Queensland Coal Network (CQCN) is the largest coal rail network in Australia.

The CQCN has seen significant expansion over recent years to meet demand for increased railings for coal exports. Aurizon Network estimates that by 2016–17 the CQCN will have a built capacity of around 310 million tonnes (Mt), compared to 187 Mt in 2009–10.<sup>2</sup>

While Aurizon Network has made significant investments in expanding the CQCN, it has also said that, as a commercially listed company, it should not be obliged to expand the network. It has noted it has an obligation to meet its shareholders' legitimate expectations of achieving appropriate returns for infrastructure investments.

The *Queensland Competition Authority Act 1997* (QCA Act), stipulates that under an access regime, a regulator cannot require an access provider, such as Aurizon Network, to pay some or all of the costs of extending its network.<sup>3</sup> Nonetheless, the QCA Act also allows the regulator to require an access provider to extend its network.

### Progress in developing a SUFA arrangement

In our final decision on the 2010 access undertaking (known as UT3), we required Aurizon Network to provide us with a proposed Standard User Funding Agreement (SUFA) and related amendments to UT3 to fully implement the investment framework amendments (Schedule J).

The need for SUFA stems from what Aurizon Network's stakeholders described, during the UT3 review process, as concerns about the company's unwillingness to fund network expansions at the regulated rate of return.

SUFA is designed to be a suite of standard pro-forma agreements to facilitate alternative options to Aurizon Network funding rail infrastructure expansions on the CQCN.

#### First-generation SUFA

The first-generation SUFA, developed late in 2010, consisted of a participation agreement and a construction agreement. The agreements were simple, and straightforward, focusing on Aurizon Network as the constructor and users of the system making monthly payments to Aurizon Network during construction. Unfortunately this model did not work due to tax implications, so was eventually rejected and replaced with the second-generation SUFA.

#### Second-generation SUFA

The second-generation SUFA developed by Aurizon Network during 2011–2013<sup>4</sup> was based upon a trust model, where preference unit holders in a Trust commit the funds required to develop an infrastructure project in return for rights to a future rental cash flow. Preference unit holders do not have ownership rights over the infrastructure constructed under the Trust once completed.

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<sup>2</sup> Aurizon Network, 2013 Draft Access Undertaking, Volume 3, p. 13

<sup>3</sup> Unless the access provider has voluntarily agreed to do so within its access undertaking.

<sup>4</sup> The second generation SUFA broadly comprises the following submissions: the 2012 Standard User Draft Amending Access Undertaking (2012 SUFA DAAU) and the subsequent updated 2013 SUFA Standard User Funding Agreement Draft Access Amending Undertaking (2013 SUFA DAAU).

Under this framework, it was anticipated that primarily larger mining companies would be able to fund a SUFA project off-balance sheet. It was acknowledged that smaller mining companies may lack sufficient funding or reserves to do so.

Considerable progress has been made on the back of the second-generation SUFA, including reaching agreement on there being an independent trustee, and preference units not being stapled in the operational phase.

Both Aurizon Network and the Queensland Resources Council (QRC) made significant investments in developing the framework to this point, and this involved compromises being made by both sides. However, it was clear from submissions we have received on the 2013 SUFA DAAU that Aurizon Network and its stakeholders have collectively not been able to develop a workable SUFA framework. Notably, in August 2013, the QRC indicated that:

*The SUFA Document structure is complex and difficult. If the SUFA Documents are amended as proposed by the QRC in this submission and the QRC Mark-up, it will provide, at best a barely workable framework through which mining companies may invest their own capital...<sup>5</sup>.*

Given the importance of SUFA, particularly in the context of the 2014 DAU and Aurizon Network's proposed approach to expansions, we considered it prudent to undertake a further considered review of the existing SUFA framework, with a view to determining what changes are necessary, or possible, to produce a workable, bankable and credible SUFA.

#### QCA engagement of financial and legal advisors

We engaged Grant Samuel, as financial advisor, to provide us with commercial advice on the 2013 SUFA DAAU. Grant Samuel said the 2013 SUFA DAAU was not workable or bankable. It was not a financing structure which could be attractive to third party financing, and as a result, not credible in its current form.

Despite this, Grant Samuel, working with our legal advisors—Clayton Utz—considered the 2013 SUFA DAAU could be amended to achieve a workable, bankable and credible SUFA. We considered that workable, bankable and credible meant the following:

- **workable:** the documents must achieve the intended outcome and be able to be executed by all parties without negotiation if necessary (for instance, are sufficiently clear and certain and provide an appropriate risk allocation)
- **bankable:** third party funding can be obtained to fund a SUFA. This requires there to be a high level of confidence that the expected returns will be delivered and the asset will be appropriately operated and maintained over its lifecycle. If the SUFA is not financeable through third party debt and equity markets, its utility is limited to those users with the financial capacity to absorb the risks of the SUFA
- **credible:** the SUFA structure does not create such risks and uncertainties for user and financiers or overlay such unnecessarily high transaction, tax or finance costs on an expansion project that the SUFA can never be a credible alternative to Aurizon Network undertaking the expansion itself.<sup>6</sup>

Achievement of a SUFA that is workable, bankable and credible would require change and a compromise to be achieved between Aurizon Network and stakeholders. It would also require us to change aspects of our processes.

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<sup>5</sup> QRC 2013b, p. 5

<sup>6</sup> Grant Samuel (2014), p.2

## QCA Position Paper—May 2014

In May 2014, we released a Position Paper to inform interested parties of our views on the way in which we considered the 2013 SUFA DAAU could be amended to achieve a workable, bankable and credible SUFA.

Our intention was to gauge stakeholder's views on our proposed package of measures and whether the resulting SUFA would be workable, bankable and credible. In the most part, stakeholder submissions indicated broad support for the potential changes we outlined; with stakeholders also indentifying areas where changes could be made to improve the arrangement.

## Draft Decision

We would like to acknowledge the considerable progress which has been made by all parties to develop the 2013 SUFA DAAU to the stage submitted to us in July 2013, and the subsequent cooperative approach of Aurizon Network, and its stakeholders, to continue developing the SUFA documents. However, we must make a decision based on the 2013 SUFA DAAU, as submitted.

Our interim position, as set out in this Draft Decision would be to refuse to approve the 2013 SUFA DAAU, in its current form. This Draft Decision sets out the reasons for our position and the way in which we consider it is appropriate to amend the 2013 SUFA DAAU to achieve what we consider will be a workable, credible and bankable set of SUFA agreements.

In particular, the amendments as set out in our Draft Decision serve to transform Aurizon Network's proposal into a more conventional and attractive financing structure that allows as many financing options for, and potential participants to, a SUFA as possible. Importantly, it is not proposing wholesale changes to the 2013 SUFA DAAU— but builds on the considerable work undertaken by Aurizon Network and its stakeholders to develop the suite of draft SUFA documents to this stage.

In our view, our proposals form the basis for a competitive process for the financing of expansions in the CQCN as it minimises barriers to participation. Our interim position, as detailed in this Draft Decision, sets out a proposed set of amendments that we consider, at this stage, to be a package of measures that work dynamically together and are designed to:

- simplify the SUFA agreements, and refocus the 2013 SUFA DAAU simply to become a financing vehicle for potential future expansions
- ensure roles and responsibilities are clearly defined
- ensure regulatory arrangements are fit-for-purpose in an environment where a SUFA applies.

The changes proposed by our interim position, as set out in this Draft Decision cover four main areas:

- providing security over and certainty in respect of cash flows
- simplifying the construction process (construction, the expansion process and pre-approval)
- ensuring the maintenance of SUFA assets
- allowing for third party financing.

Our interim position, as set out in this Draft Decision reflects a workable tax position, to the best of our ability. However, in respect of the tax arrangements, our interim view is that there are some matters that we cannot make a decision on, as they fall well outside the scope of the QCA Act. In this regard, our

interim position, as set out in this Draft Decision, assumes the issues surrounding tax have been resolved, as if those concerns prove intractable; the SUFA will not be effective.<sup>7</sup>

A summary of the key matters addressed in our interim position, as set out in this Draft Decision, follows below.

### Third Party Financing

Our interim position, as set out in this Draft Decision, is that, to be workable, credible and bankable, the 2013 SUFA DAAU should be developed as a financing arrangement which is attractive to third party financing. The key amendments reflected in our interim position, as set out in this Draft Decision are:

- to provide security and certainty over cash flows
- to ensure that there is an appropriate allocation of risk and liability.

#### Providing security and certainty over cash flows

Our interim position, as set out in this Draft Decision, would be to refuse to approve the 2013 SUFA DAAU—as proposed—as it does not provide sufficient security over and certainty in respect of rental cash flows. This is also true for rent–equivalent cash flows in the event of the termination of the SUFA agreements whilst the SUFA assets continue to generate revenue. Our interim view is, without security and certainty over cash flows, third party financing is not viable and SUFA cannot function effectively.

In order to provide certainty and security over rental cash flows our interim position, as set out in this Draft Decision, reflects that we would accept:

- clarification and simplification of the rent calculation methodology
- mandatory distribution of rental cash flows
- clarification and limits around the circumstances where Aurizon Network can trigger 'set-off'<sup>8</sup> for cash flows
- provision of security over rental cash flows to the Trustee
- provision of security over rent–equivalent compensation cash flows to the Trustee
- provision of security over the Trustee's rights under the SUFA documents to the SUFA funders.

One of the key changes proposed in our interim position, as set out in this Draft Decision, is that the 2013 SUFA DAAU should include a security agreement. Further, we propose amendments to the Extension Infrastructure Sub-lease (EISL), Trust Deed and the Subscription and Unit Holders Deed (SUHD) to ensure the relevant conditions apply for set-off and mandatory distributions.

We also consider that the rental calculation methodologies need to be re-drafted to make them more transparent. Examples of how the rent is calculated in various circumstances should also be developed and provided with SUFA documentation.

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<sup>7</sup> The key tax issues still to be settled are: i) an appropriate form of statutory severance, which requires legislative change, and the Queensland Government is yet to form a position; and ii) the processes and responsibilities for obtaining Administratively Binding Advice (ABA) and Private Binding Ruling (PBR) have to be resolved and the tax indemnities have to be clarified. This can only be done if the parties approach the Australian Tax office.

<sup>8</sup> Where payments are due from both parties to a transaction, the parties agree that, instead of both parties making separate payments, the party due to make the larger payment should pay the difference between the two amounts due.

Of critical importance is that these proposals do not require security over the SUFA infrastructure assets. This is a requirement of Queensland Treasury Holdings (QTH) so that the CQCN remains whole in the event of the termination of the Aurizon Network infrastructure lease and/or SUFA leases.

### Appropriate allocation of risk and liability

Our interim position, as set out in this Draft Decision, reflects a number of amendments to the 2013 SUFA DAAU to more clearly align risks and responsibilities, and to clarify matters regarding liability which are necessary to provide certainty for financing. In particular, we are suggesting a position for liability under which:

- the party that controls the risk generally carries the risk
- consequential loss is defined carefully and specifically
- other than where necessary for a particular SUFA document, is consistent across the SUFA documents.

### Construction, the expansion process and pre-approval

Our interim position, as set out in this Draft Decision, would be to refuse to approve the proposed construction process set out in the 2013 SUFA DAAU and the Project Management Agreement (PMA). Our interim position, as set out in this Draft Decision proposes changes that we consider are necessary to:

- provide a more conventional construction contracting structure
- ensure risk is allocated to the parties best able to manage it
- provide greater certainty about the expansion capacity to be delivered by a SUFA project
- provide greater certainty about the treatment of capital costs, particularly for inclusion in the Regulatory Asset Base (RAB).

In order to achieve this, clarity over the control of construction, the provision of up-front commitments, an effective expansion process and a pre-approval process all need to work effectively together.

### Clarity over the control of construction and up-front commitments

Our interim position, as set out in this Draft Decision, reflects our view that Aurizon Network should have control of the construction of a SUFA project. However, it also reflects that Aurizon Network should be required to:

- provide transparent, up-front commitments to construct the infrastructure as efficiently as possible across the dimensions of scope, standard, cost and time to complete after a proposal has gone through the expansion process
- build a SUFA project to an agreed range of capacity outcomes, as infrastructure planner, asset constructor and operator of the rail network, and be accountable for delivering on these commitments. We consider this critical to the pre-approval process.

Our interim position, as set out in this Draft Decision, also reflects that the expansion process should be developed so that it is able to provide a reliable estimate of the costs of construction for a capital project. The proportion of the construction costs that goes into the RAB defines the rental stream if the project is undertaken via a SUFA. Consequently, we consider that clarity and certainty surrounding the outcome of the expansion process is critical to users and potential third party funders.

Our interim view is that this approach can apply to all capital projects that result in a material capacity change, irrespective of the source of funding.

### Expansion process

Our interim position, as set out in this Draft Decision, reflects our view that major capital projects should be subject to an expansion process capable of delivering feasibility studies to a level of accuracy required to provide credible up-front commitments that satisfy the needs of Aurizon Network as infrastructure provider, third party financiers and user funders.

An expansion process is being developed as part of the 2014 DAU arrangements and Aurizon Network and the QRC have made considerable progress on resolving previous differences. We are of the view that, as far as practicable, this expansion process should be included in UT3.

From the perspective of user funders and third party financiers, the up-front commitments for each capital project that come out of this process can be regarded as a 'package of measures' that define a clear product offering which they can finance.

### Pre-approval process

To remove optimisation risk for users and financiers, we are proposing a capital pre-approval process. We believe that pre-approval will provide greater certainty to all relevant parties that the prudent and efficient capital expenditure will be included in the RAB prior to construction starting.

We also consider that for the benefits of pre-approval to be realised, it needs to be incentive-compatible with a well-functioning expansion process. Consequently, we consider that pre-approval should only apply once the expansion process has been completed and a set of up-front commitments agreed. This strengthens the incentives to engage in the expansion process appropriately. It also means decisions regarding the trade-offs when making a decision to expand are not transferred to the QCA.

This overall process allows the SUFA to be viewed simply as a financing tool. Our view is that it allows a clearly defined product offering to be developed that can be subject to differing financing options from Aurizon Network, or user funders and third party financiers based on their perception of the risks.

This should have the additional benefits of:

- allowing a SUFA trustee to act in a passive manner and focus on administrative tasks
- aligning interests in the construction phase of a SUFA, thereby mitigating any perceived need to significantly constrain ownership of preference units in a SUFA
- using a simplified construction contract in SUFA which reduces the complexity associated with a number of the SUFA documents.

Our interim position, as set out in this Draft Decision, reflects the general acceptance across stakeholders that Aurizon Network is best placed to control the construction of SUFA infrastructure. It also requires that if Aurizon Network is acting as infrastructure planner, constructor and operator of the rail infrastructure, it needs to make a range of up-front commitments.

We also have to change our practices and develop a pre-approval process with stakeholders.

### Maintenance of SUFA assets

Throughout the development of the SUFA arrangements, stakeholders have sought protections to ensure that SUFA assets were treated in the same manner as any other asset in the CQCN. Any participant in a SUFA has the right to expect that the infrastructure they have invested in is appropriately maintained and not treated unfavourably.

Our interim position, as set out in this Draft Decision, reflects that we consider this can be achieved by broadening the existing condition-based assessment process in UT3, rather than defining a separate

process. We also consider that these arrangements would need to be reflected in future access undertakings.

## Summary

Our interim position, as set out in this Draft Decision, is to refuse to approve the 2013 SUFA DAAU under Section 142(2) of the QCA Act.

However, as required by Section 142(3) of the QCA Act, this Draft Decision sets out our reasons for this position and the way in which we consider it is appropriate for Aurizon Network to amend its 2013 SUFA DAAU to achieve what we consider will be a workable, credible and bankable set of SUFA agreements, and a 2013 SUFA DAAU we could approve.

We consider that the development of a workable, credible and bankable SUFA is critical to supporting the objectives of Part 5 of the QCA Act (Section 69E), which is to promote the economically efficient operation of, use of and investment in the CQCN, with the effect of promoting effective competition in upstream and downstream markets.

Our interim position, as set out in this Draft Decision, carefully balances the legitimate business interest of Aurizon Network (Section 138(2)(b) of the QCA Act), by providing for a framework which allows for infrastructure expansion at no cost to Aurizon Network, and by recognising its legitimate risks and liabilities.

Section 138(2)(e) requires that we have regard to the interests of persons seeking access to the service. We consider that a workable SUFA arrangement meets these criteria, by providing for an alternative financing arrangement which should allow access seekers to gain access to the CQCN on terms which reflect efficient cost, as envisaged by Section 168(A)(a) of the QCA Act.

Overall, we consider that the proposals outlined above can result in a SUFA framework that provides a competitive market for financing infrastructure expansions in the CQCN while accounting for the legitimate interests of each of Aurizon Network, its present and future customers, QTH and third party financiers, and is ultimately in the public interest to the extent that it supports efficient investment in the supporting infrastructure for the Queensland mining sector.



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## THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS

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The Queensland Competition Authority (QCA) is an independent statutory authority to promote competition as the basis for enhancing efficiency and growth in the Queensland economy.

The QCA's primary role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

In 2012, that role was expanded to allow the QCA to be directed to investigate, and report on, any matter relating to competition, industry, productivity or best practice regulation; and review and report on existing legislation.

### Task, timing and contacts

On 22 July 2013 Aurizon Network formally withdrew its 2012 SUFA DAAU and submitted its 2013 SUFA DAAU containing the following documents:

- explanatory notes (from its 2012 SUFA DAAU) modified by its submission letter dated 22 July 2013 and related schedule
- regulatory notes (unchanged from its 2012 SUFA DAAU)
- new SUFA template legal agreements
- DAAU (unchanged from its 2012 SUFA DAAU).

We commenced an investigation into Aurizon Network's 2013 SUFA DAAU on 25 July 2013. Consistent with section 138(3)(c) of the QCA Act, we published Aurizon Network's DAAU on our website and invited stakeholders to make submissions. Six submissions were received. On 14 October 2013, we invited all stakeholders to provide reply submissions on all submissions provided to date. Six reply submissions were received.

On 22 May 2014, we released a Position Paper along with a set of term sheets and a consultant's report commenting on the workability, credibility and bankability of Aurizon Network's proposed 2013 SUFA DAAU. We asked for comments on those documents by 27 June 2014, and received six submissions in response.

### Key dates

Our consideration of the 2013 SUFA DAAU is running in parallel with our consideration of Aurizon Network's 2014 DAU. Meeting the timetable in **Table 1** will be dependent on the scope and complexity of issues raised by stakeholders in response to our Draft Decisions.

**Table 1 Timetable**

<i>Task</i>	<i>Indicative Date</i>
2014 DAU submission	11 August 2014
2014 DAU Draft Decision on Maximum Allowable Revenue (MAR) only	30 September 2014
Submissions on 2014 DAU due	3 October 2014
2013 SUFA DAAU Draft Decision	31 October 2014

<i>Task</i>	<i>Indicative Date</i>
<b>Submissions on 2014 DAU Draft Decision on MAR due</b>	<b>12 December 2014</b>
2014 DAU Draft Decision (on policy and pricing principles)	Mid December 2014
<b>Submission on 2013 SUFA DAAU Draft decision due</b>	<b>16 January 2015</b>
Submissions on 2014 DAU Draft Decision (policy and pricing principles) due	February 2015
2014 DAU Final Decision on policy, pricing and MAR	May 2015
2014 DAU Final Approval	By 30 June 2015
UT4 Commences	July 2015

### Submissions

We seek submissions to be presented in writing regarding our views on Aurizon Network's 2013 SUFA DAAU as set out in this Draft Decision. Submissions must be received by no later than **16 January 2015**. We will consider all submissions received by us within this timeframe.

### Contacts

Enquiries regarding this project should be directed to:

Ms Carrie Haines  
 Queensland Competition Authority  
 GPO Box 2257  
 Brisbane QLD 4001  
 Tel (07) 3222 0555  
 Fax (07) 3222 0599  
 Aurizon@qca.org.au  
[www.qca.org.au](http://www.qca.org.au)

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# 1 WHAT IS A SUFA AND WHY IS IT NEEDED?

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## 1.1 What is a SUFA?

A Standard User Funding Agreement (SUFA) in this instance is a suite of pro-forma agreements designed to facilitate funding options for rail infrastructure on the CQCN.

The SUFA framework has been developed to provide an alternative standardised agreement that allows parties—other than Aurizon Network—to finance the costs of railway extensions that accommodate access seekers' capacity requirements and timeframes. A SUFA does not preclude negotiation of alternative funding arrangements with Aurizon Network.<sup>9</sup>

## 1.2 What it seeks to achieve

The SUFA's inception was initiated in response to concerns from Aurizon Network stakeholders that Aurizon Network was under no legislative obligation to fund extension/expansion infrastructure on its own network.

While we have the power to determine an access dispute in respect of declared services that are referred to us<sup>10</sup>, we may not make an access determination that would result in any of the following access outcomes:

- reduction in the amount of the service able to be obtained by an access provider
- an access seeker, or someone else, becoming the owner, or one of the owners, of the facility, without the existing owner's agreement
- an access provider being required to pay some or all of the costs<sup>11</sup> of extending the facility.

Rather than rely on us making a determination in response to an access dispute (respecting user funding of an expansion), the SUFA suite of pro forma agreements was developed to facilitate the funding/access arrangements. This has been a complex process that has involved collaboration between Aurizon Network, the Queensland Resources Council (QRC) and the QCA.

## 1.3 Summary of the 2013 SUFA DAAU

### 1.3.1 Use of a trust

The use of a trust model became the preferred SUFA model as, assuming a certain tax treatment of the SUFA infrastructure, it allows for the most tax efficient method of funding an expansion project.

Under Aurizon Network's 2013 SUFA DAAU, a trust is formed (the Trust) and a trustee appointed (the Trustee). The Trust is financed by access seekers purchasing preference units in it. The preference unit holders are to provide all Trust funding.<sup>12</sup> There is one ordinary unit holder in the Trust, Aurizon Network.

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<sup>9</sup> Aurizon Network 2013b, p. 4

<sup>10</sup> Under Section 119(2) of the QCA Act.

<sup>11</sup> Of note, there is no definition of 'cost' in the QCA Act.

<sup>12</sup> The original 2013 SUFA allowed for Aurizon Network to be a preference unit holder where it chooses to jointly fund the SUFA asset (referred to as hybrid funding).

The Trust finances the construction of SUFA infrastructure assets to be integrated into the relevant railway system. Upon completion, the infrastructure assets are transferred to and owned by QTH, leased to the Trust and sub-leased to Aurizon Network for it to operate and maintain as part of its network.

This framework is designed so that preference unit holders commit the funds required to develop an infrastructure project for an asset that will ultimately be owned by QTH and maintained and operated by Aurizon Network. In return for this, preference unit holders receive, via the Trust, a rental stream from the SUFA infrastructure. It is this cash flow rather than the physical assets themselves which is the principal asset of the Trust.

### 1.3.2 Lifecycle of a SUFA asset

Aurizon Network defined the lifecycle of a SUFA asset as being characterised by the following stages:

- **Stage 1: Pre-closure phase** — Aurizon Network initiates its commercial and technical engagement with access seekers who are potentially preference unit holders, including: discussions on scope, procurement method, target cost and target budget.

Indicative time duration: approximately 12 months to complete.<sup>13</sup>
- **Stage 2: Completion and commencement phase** — execution of all SUFA documents is completed and initial funds are paid into the Trust.

Indicative time duration: approximately 2 months to complete, provided all documents are executed on a timely basis.
- **Stage 3: Project delivery phase** — this phase starts when all the agreements are executed and ends when the last segment<sup>14</sup> constructed becomes available.

Indicative time duration: approximately 2–3 years.
- **Stage 4: Project delivery consolidation phase** — this phase starts when the last segment becomes available and ends when all outstanding construction issues have been addressed.

Indicative time duration: approximately 3–5 years.
- **Stage 5: Revenue phase** — the revenue phase generally starts when rent is first due from Aurizon Network and ends when there is no further obligation to pay rent. This will generally overlap with stage 4.

Indicative time duration: asset dependent, but could be up to 40 years.
- **Stage 6: End of life phase** — this phase begins when the SUFA assets have a zero value in the Regulated Asset Base (RAB) (Zero Value Date). The Extension Infrastructure Sub Lease (EISL) automatically terminates 12 months after the Zero Value Date—which in turn—terminates the SUFA agreements, except for the Trust Deed and the Subscription and Unit Holders Deed.

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<sup>13</sup> The time frames outlined for each stage in the SUFA asset lifecycle are based on discussions with Aurizon Network and should only be viewed as a guideline if the process and construction runs smoothly.

<sup>14</sup> A segment is a contiguous section of the network for which: capacity is required by an access seeker(s), construction is required either within that segment or outside the area of that segment to provide the capacity.

After the Zero Value Date, Aurizon Network, acting as the Ordinary Unit Holder, can direct the Trustee to redeem all of the preference units. Once all preference units have been redeemed, the Trust can be wound up by Aurizon Network (acting as ordinary unit holder).

Indicative time duration: at least one year.

### 1.3.3 SUFA agreements and the parties involved

Aurizon Network's 2013 SUFA DAAU is comprised of nine interconnected template agreements covering funding, legal structures, lease tenures, construction and supporting matters. A summary of Aurizon Network's SUFA suite of agreements is contained in **Figure 1**.

Aurizon Network's proposed SUFA agreements contemplate the involvement of the following six parties:

- **Access Seekers:** fund the construction of infrastructure by purchasing preference units in the Trust and secure access rights by executing access agreements, as contemplated in each access seeker's Umbrella Agreement (UA).
- **State of Queensland:** the ultimate owner of Aurizon Network's railway land; consent is required from the State of Queensland for Aurizon Network to grant a land licence under the Rail Corridor Agreement (RCA). As such, the State of Queensland is signatory to the Integrated Network Deed (IND).
- **Queensland Treasury Holdings (QTH):** is the ultimate owner of all infrastructure assets developed under a SUFA arrangement. QTH as lessee will agree to a SUFA on a transaction-by-transaction basis. Where assets are on the North Coast Line, the ultimate owner of the infrastructure assets is Queensland Rail.
- **Aurizon Network** performs the following roles in the context of SUFA:
  - land owner (as lessee of the State of Queensland)
  - funder/preference unit holder<sup>15</sup>
  - ordinary unit holder of the Trust
  - sub-lessee of SUFA infrastructure (or lessee, with the Trustee as owner, in certain circumstances)
  - project manager
  - access provider
  - network operator
- **Aurizon Holdings:** Aurizon Holdings, Aurizon Network's parent company, is the guarantor to QTH of the performance of Aurizon Network and the Trust.

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<sup>15</sup> Where Aurizon Network chooses to partially fund a SUFA - this is the hybrid funding option.

**Figure 1: Aurizon Network's 2013 SUFA DAAU — Summary of parties involved and applicable agreements**

		Queensland Treasury Holdings	State of Queensland	Aurizon Holdings	Aurizon Network	SUFA Trustee	User Funders
<b>The Trust</b>							
<b>Trust Deed (TD)</b>	Establishes the Trust with Aurizon Network as ordinary unit holder, permits the issue of preference units and appoints the Trustee				Yes	Yes	
<b>Subscription and Unit Holders Deed (SUHD)</b>	- Imposes obligations on access seekers to subscribe for preference units - Establishes the operational rules of the Trust whilst there are unredeemed preference units - Prevails over the Trust Deed if there is a conflict				Yes	Yes	Yes
<b>Project Delivery and Land Access</b>							
<b>Project Management Agreement (PMA)</b>	- Engages Aurizon Network as Project Manager - Identifies the terms and governance requirements under which this role is undertaken				Yes	Yes	
<b>Rail Corridor Agreement (RCA)</b>	- Provides a licence to the Trustee so that it can access Aurizon Network land and modify infrastructure - Identifies the terms and conditions associated with this right				Yes	Yes	
<b>Leasing, Ownership and Rent</b>							
<b>Extension Infrastructure Head-lease (EIHL)</b>	- Establishes the ownership and leasing terms and conditions for the SUFA asset between QTH, the Trust and Aurizon Network	Yes			Yes	Yes	
<b>Extension Infrastructure Sub-lease (EISL)</b>	- Establishes the sub-leasing terms and conditions for the SUFA asset between the Trust and Aurizon Network - Contractually defines the rental terms and conditions for Aurizon Network to pay rent to the Trust				Yes	Yes	
<b>Access Rights and Tax Indemnity</b>							
<b>Umbrella Agreement (UA)</b>	- Establishes that each preference unit holder or nominee will enter into an access agreement - Establishes that each preference unit holder will provide various tax indemnities				Yes	Yes	Yes
<b>Agreement Termination and SUFA Asset Disposal</b>							
<b>Integrated Network Deed (IND)</b>	- Governs the circumstances and process by which the QTH may dispose of SUFA assets following termination of the EIHL - Governs the disposition of any disposal proceeds if a disposal occurs	Yes	Yes		Yes	Yes	
<b>Performance Standards</b>							
<b>Deed Poll Guarantee (DPG)</b>	- Guarantees to QTH, Aurizon Network and the Trustee's performance of their obligations under the EIHL and IND - Indemnifies QTH against any losses it may incur due to a default or delay in the performance of these obligations			Yes			

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## 2 LEGISLATIVE FRAMEWORK AND ASSESSMENT APPROACH

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### 2.1 Assessment process for making this Draft Decision

In accordance with section 142 of the QCA Act, we must consider the 2013 SUFA DAAU and either approve, or refuse to approve, it. In doing so, we must publish the DAAU and consider comments on it.

If we refuse to approve the 2013 SUFA DAAU, we must provide written notice stating reasons for the refusal and the way in which we consider it appropriate to amend the 2013 SUFA DAAU. This Draft Decision reflects our reasons for refusing to approve the 2013 SUFA DAAU and the way in which we consider the 2013 SUFA DAAU can be amended so that we would approve it.

This Draft Decision builds upon our May 2014 Position Paper which described the way we consider SUFA should be amended to provide a workable, bankable and therefore credible alternative to Aurizon Network funding network expansions.

After the release of our Position Paper, we continued discussions with interested stakeholders on our proposed amendments. Those discussions, as well as written submissions, have informed our views for this Draft Decision.

This Draft Decision comprises this document and fully drafted SUFA agreements.

### 2.2 Legislative framework

The factors affecting our consideration and approval of a DAAU are set out in the QCA Act.

## The QCA Act

Section 143(2) of the QCA Act provides that the QCA may approve a DAAU only if it considers it appropriate to do so having regard to the matters mentioned in section 138(2). Section 138(2) of the QCA Act states that we may approve a DAAU only if we consider it appropriate having regard to:

- (a) the object of Part 5 of the QCA Act, which is:
  - to promote the economically efficient operation of, use of and investment in, significant infrastructure by which services are provided, with the effect of promoting effective competition in upstream and downstream markets (s.69E).*
- (b) the legitimate business interests of the owner or operator of the service
- (c) if the owner and operator of the service are different entities - the legitimate business interests of the operator of the service are protected
- (d) the public interest, including the public interest in having competition in markets (whether or not in Australia)
- (e) the interests of persons who may seek access to the service including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected
- (f) the effect of excluding assets for pricing purposes
- (g) the pricing principles in section 168A of the QCA Act, which in relation to the price of access to a service are that the price should:
  - (i) generate expected revenue for the service that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with the regulatory and commercial risks involved
  - (ii) allow for multi-part pricing and price discrimination where it aids efficiency
  - (iii) not allow a related access provider to set terms and conditions that discriminate in favour of the downstream operations of the access provider or a related body corporate of the access provider, except to the extent the cost of providing access to the other operators is higher
  - (iv) provide incentives to reduce costs or otherwise improve productivity
- (h) any other issues the Authority considers relevant.

We are required to assess Aurizon Network's 2013 SUFA DAAU, having regard to the criteria in section 138(2) of the QCA Act. Section 138(2) describes matters which we are required to 'have regard to'. However, the QCA Act does not prescribe the weightings for each matter. Section 138(2)(h) also provides that the QCA can 'have regard' to any other issue(s) we consider relevant.

In the context of statutory interpretation in Australia, the phrase 'have regard to' has been consistently interpreted to require the decision-maker to take into account the matter to which regard has to be had and give weight to it as an element in making the decision.<sup>16</sup>

More specifically, the expression 'have regard to' is capable of different meanings depending on its context. In some contexts, it may require the decision-maker to take the matters into account and 'give weight to them as a fundamental element in making his [or her]

<sup>16</sup> DC Pearce and RS Geddes, *Statutory interpretation in Australia* (7th Ed, 2011) [12.15].



determination'.<sup>17</sup> However, it can also simply require the decision-maker to merely consider the matters, rather than treat them as fundamental elements in the decision-making process, provided that consideration of the matters is 'a jurisdictional prerequisite' to the making of the decision.<sup>18</sup>

In this regard, the High Court of Australia has indicated that in the absence of any statutory or contextual indication of the weight to be given to factors to which a decision-maker must have regard (as is the case in the QCA Act), it is generally for the decision-maker to determine the appropriate weight to be given to them.<sup>19</sup> A decision-maker, for example, is entitled to be brief in his or her consideration of a matter which has little or no practical relevance to the circumstances of a particular decision.<sup>20</sup>

In the context of assessing Aurizon Network's 2013 SUFA DAAU, we have to take into consideration, all of the factors listed in section 138(2) as jurisdictional prerequisites for the decision, but with a weighting of each factor we consider appropriate based on the practical relevance of the factor to our decision.

The criteria in section 138(2) apply to our overall decision whether to approve or refuse to approve the 2013 SUFA DAAU. In order to make that decision, we also need to apply the criteria to the different components of that overall decision, including the acceptability of the SUFA and, hence, the acceptability of each of the relevant parts of the SUFA. Different criteria may have different practical relevance to each of those parts, meaning we are required to exercise our discretion and judgement in a manner consistent with previous judicial authority.

Conversely, while we have considered the section 138(2) criteria for each part of SUFA, as set out in the remainder of this Draft Decision, we must also be satisfied that the SUFA, as a whole, satisfies the section 138(2) criteria.

In the context of assessing Aurizon Network's 2013 SUFA DAAU proposal, we must have regard to the factors listed in section 138(2) and give them an appropriate level of weighting. Against this background:

- we consider that sections 138(2)(a), (b), (d), (e), (f), (g) (which refer to the pricing principles in 168A of the QCA Act) and (h) should be given more weight, as identified below
- we consider that section 138(2)(c) should be given less weight as it is less practically relevant to our assessment of the 2013 SUFA DAAU.

#### Efficient investment in infrastructure and the public interest

Sections 69E and 138(2)(a) require us to have regard to the object of Part 5 of the QCA Act, namely to promote the economically efficient operation of, use of, and investment in the CQCN, as the significant infrastructure by which the declared services are provided. Section 138(2)(d) of the QCA Act requires us to have regard to the public interest in having competition in markets.

Sections 138(2)(g) and 168A(a) require that we have regard to certain pricing principles, including that the price for access to declared services should generate expected revenue that is at least enough to meet the efficient costs of providing access to the service and include a return on investment commensurate with regulatory and commercial risks involved.

We consider that taken together, these objectives are best met by allowing for an investment environment for the CQCN which allows for investment in rail infrastructure at a regulated

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<sup>17</sup> R v Hunt; Ex parte Sean Investments Pty Ltd (1979) 180 CLR 322 at 329 per Mason J

<sup>18</sup> Minister for Immigration and Citizenship v Khadgi (2010) 190 FCR 248

<sup>19</sup> Minister for Aboriginal Affairs v Peko-Wallsend Ltd (1986) 162 CLR 24 at 41 (per Mason J)

<sup>20</sup> Elias v Commissioner of Taxation (2002) 123 FCR 499 at [62] (p 512) (per Hely J)

return. In this way, access seekers should be paying no more, and no less, than the efficient cost of providing access to the declared service.

A workable SUFA arrangement should provide access seekers with a financing choice which is consistent with this approach to efficient investment in infrastructure and competition for financing.

#### The legitimate business interests of Aurizon Network

We are also required to have regard to the legitimate business interests of Aurizon Network (section 138(2)(b)). Ordinarily, for new infrastructure funded by Aurizon Network, we would consider that setting a price for access which allows Aurizon Network to recover its efficient operating and maintenance costs, a regulated return on capital and the depreciation allowance associated with prudently and efficiently incurred infrastructure investment in the CQCN, satisfies section 138(2)(b) and 168A(a).

However, specifically in relation to new infrastructure investment, Aurizon Network has proposed that sections 118 and 119 of the QCA Act are relevant to our consideration of its proposed 2013 SUFA DAAU.

Aurizon Network specifically points to: section 118(d) which allows for an access determination to require an access provider to extend, or permit the extension of, the facility; and section 119(2) which provides limitations on an access determination.<sup>21</sup>

The limitations on an access determination include us making a decision that would have any of the following effects:

- reducing the amount of the service able to be obtained by the service provider
- resulting in an access seeker, or someone else, becoming the owner, or one of the owners, of the facility, without the existing owner's agreement
- requiring an access provider to pay some or all of the costs of extending the facility.

We consider that by providing a financing arrangement, the SUFA arrangements can be developed in a manner which addresses sections 118 and 119 to allow for the development of infrastructure in the CQCN, without cost to Aurizon Network, without reducing the amount of service available

However, we do not consider that sections 118 and 119 are intended to absolve Aurizon Network of the normal costs and risks of doing business. This means we have carefully considered the allocation of liability and risk within the SUFA documents to ensure that parties best able to manage risk have responsibility for managing that risk, and that risks and rewards are matched appropriately.

#### The interests of persons seeking access to the service

Section 138(2)(e) requires that we have regard to the interests of persons seeking access to the service.

We consider that a workable SUFA arrangement meets this criteria, by providing for an alternative financing arrangement which should allow access seekers to gain access to the CQCN on terms which reflect efficient cost, as envisaged by section 168(A)(a) of the QCA Act. We consider the pricing principles best reflect the pre-conditions necessary for the efficient investment in infrastructure for the CQCN.

Further, we consider that it is necessary for access seekers (and financiers where access seekers are not the financiers) to have certainty about the future pricing attached to SUFA funded CQCN

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<sup>21</sup> Aurizon Network 2012d, p.6

assets, in a way which will allow for an appropriate level of security to be provided over the expected future stream of these cash flows.

In this way, we consider the 2013 SUFA DAAU should provide the necessary conditions to allow for access seekers to choose how infrastructure is financed, in the event that Aurizon Network decides that it is only willing to fund investment at 'above regulated returns'.

#### Other matters the QCA considers relevant

In our assessment of Aurizon Network's 2013 SUFA DAAU, we have taken into account some additional considerations within section 138(2)(h). In our May 2014 Position Paper we considered that our assessment of a proposed SUFA framework and associated agreements must necessarily include having regard to whether the framework is workable, bankable and credible—by which we mean the SUFA framework:

- is robust, transparent and sufficiently certain from a legal and commercial perspective
- has an acceptable allocation and pricing of risks for the respective parties
- provides a sufficient level of confidence to potential investors, debt providers and company boards (i.e. is capable of being approved by bank credit committees and company board investment committees on reasonable terms, having regard to prevailing market circumstances).

Our consideration of a SUFA in this Draft Decision will continue to be based on an evaluation of whether a SUFA is considered to be workable, bankable and credible as we consider that a SUFA arrangement which satisfies these criteria necessarily satisfies the section 138(2) criteria. Our reasoning is outlined throughout the relevant subsequent sections of this document.

## 2.3 Outline of QCA assessment process

**Box 1** provides a summary of our assessment process followed to date.

**Box 1: Outline of the QCA's Assessment Process****Relevant documents and assessment process**

In December 2012, Aurizon Network submitted its voluntary 2012 Standard User Funding Draft Amending Access Undertaking (2012 SUFA DAAU) to us for approval. That DAAU contained the following documents:

- explanatory notes
- regulatory notes
- SUFA template legal agreements
- DAAU.

On 22 July 2013 Aurizon Network formally withdrew its 2012 SUFA DAAU and submitted its 2013 SUFA DAAU containing the following documents:

- explanatory notes (from its 2012 SUFA DAAU) modified by its submission letter dated 22 July 2013 and related schedule
- regulatory notes (unchanged from its 2012 SUFA DAAU)
- new SUFA template legal agreements
- DAAU (unchanged from its 2012 SUFA DAAU).

We will assess the documents submitted and amended as per Aurizon Network's submission letter dated 22 July 2013. All documents are posted on the QCA's website at [www.qca.org.au](http://www.qca.org.au).

Aurizon Network submitted its 2012 SUFA DAAU under section 142 of the QCA Act. Aurizon Network's 2013 SUFA DAAU did not amend this aspect of its previous DAAU and as such, we will consider the 2013 SUFA DAAU under section 142 of the QCA Act.

**Investigation and consultation process**

We commenced an investigation into Aurizon Network's 2013 SUFA DAAU on 25 July 2013. Consistent with section 138(3)(c), we published Aurizon Network's 2013 SUFA DAAU on our website and invited stakeholders to make submissions. Six submissions were received. On 14 October 2013, we invited all stakeholders to provide reply submissions on all submissions provided to date. Six reply submissions were received.

**Position Paper**

On 22 May 2014, we released a Position Paper along with a set of term sheets and a consultant's report commenting on the workability, credibility and bankability of Aurizon Network's proposed 2013 SUFA DAAU. We asked for comments on those documents by 27 June 2014 and received six submissions.

**2.4 May 2014 Position Paper on Aurizon Network's 2013 SUFA DAAU**

In May 2014, taking account of stakeholder submissions and feedback from our financial and legal advisors, we released a Position Paper and Term Sheets which set out a proposed package of measures that work dynamically together and were designed to:

- simplify the SUFA agreements, and refocus the 2013 SUFA DAAU simply to become a financing vehicle for potential future expansions
- ensure roles and responsibilities are clearly defined
- ensure regulatory arrangements are fit-for-purpose in an environment in which a SUFA applies.

In the position paper we noted that although Aurizon Network and the QRC undertook a lengthy negotiation period, and reached agreement in principle on a number of key matters, that substantial key issues in respect of workability and bankability had yet to be resolved. We questioned whether another round of re-drafting the SUFA agreements would resolve the key issues.

We concluded that the 2013 SUFA DAAU was not complete and a number of critical issues remained unresolved. It was also the general view of stakeholders that the SUFA could only be used by large mining companies funding off-balance-sheet. Consequently, we formed the view that the SUFA was unlikely to facilitate alternative sources of financing that could effectively compete with the Aurizon Network financing option.

We considered that a broader approach be taken to consider the SUFA framework and that substantial key issues in respect of workability and bankability be resolved before detailed drafting of the agreements was to be revisited.

We proposed an alternative approach. We considered the overall objective of SUFA was to provide a credible choice of competitive financing options for funding an expansion in the CQCN. In our view this meant potential investors could access third party finance via the debt market, and ideally the equity market. To accomplish this, we considered that the SUFA needed to be perceived as workable, bankable and credible.

We also considered that SUFA needed to properly account for the interests of Aurizon Network, its present and future customers and the ultimate owner of the assets — QTH. Furthermore, in order to accommodate SUFA, we considered we might also need to change aspects of the regulatory regime.

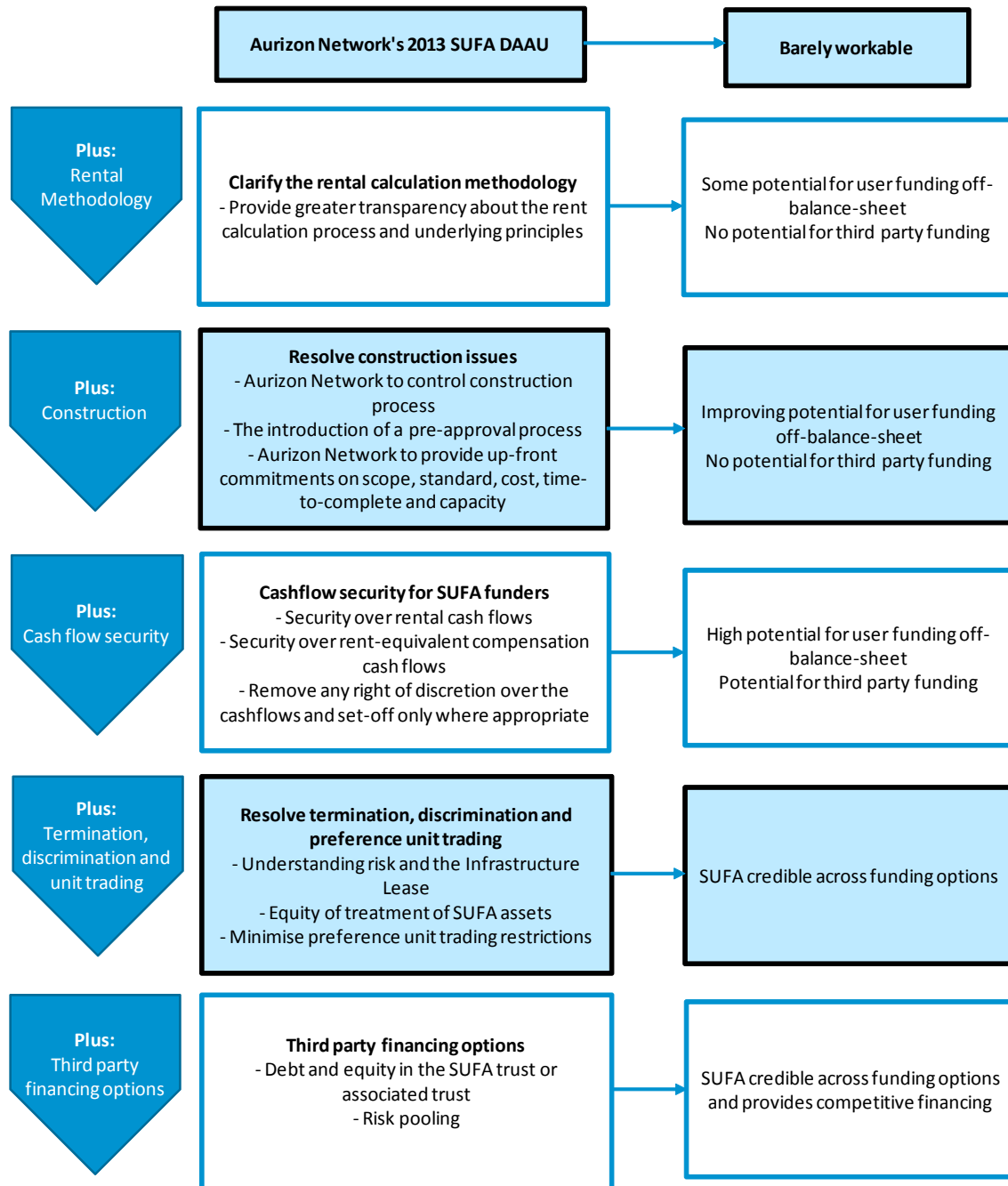
#### Summary of the alternative approach

Notwithstanding some of the concerns expressed by stakeholders as to the workability of the 2013 SUFA DAAU, we considered the work done to that date provided a solid base from which to work. Given this we:

- maintained the Trust structure and the majority of Aurizon Network's SUFA agreements
- considered issues requiring solution, how resolving them could be achieved and the resulting cumulative impact
- considered issues surrounding the rental method, construction, security over rental cash flows, termination, discrimination, preference unit trading, securitisation of the Trust and taxation.

Figure 2 provides a summary of our thinking from the Position Paper. It seeks to illustrate how resolution of the issues ultimately results in a SUFA that provides for competitive user and third party financing for infrastructure expansions in the CQCN.

**Figure 2: QCA view of the steps required to obtain a workable, bankable and credible SUFA**



**Submissions on Position Paper**

We received six submissions on our Position Paper. A summary of submissions is set out in Chapter 3. Overall, stakeholders generally supported the positions we proposed in the Position Paper and Term Sheets, with a number of stakeholders making proposals on how our proposals could be improved.

**2.5 Exposure drafts for proposed SUFA agreements**

Reflecting the views set out in the Position Paper and Term Sheets, and having regard to the comments provided by stakeholders, we have developed Exposure Drafts of each of the proposed SUFA agreements.<sup>22</sup>

<sup>22</sup> Exposure drafts were published in September 2014.

In the lead up to making this Draft Decision, we decided to publish Exposure Drafts on our website. The purpose of the release of the agreements was to inform interested parties of our thinking at that time and to elicit the views of interested parties.

The agreements to which the State (including QTH) is a party to were not released at that time at the request of the State. These agreements included the Integrated Network Deed (IND), the Extension Infrastructure Head Lease (EIHL) and the Financing Side Deed.

We welcomed written submissions on the exposure drafts and noted our willingness to meet with and discuss matters with interested parties.

The agreements released with this Draft Decision will include amendments made to reflect discussions and submissions with respect to the Exposure Drafts.

## 2.6 Process going forward

We have released this Draft Decision with fully drafted SUFA agreements. The draft agreements are based upon the Term Sheets released with our Position Paper and subsequent collaborative working between our, Aurizon Network's and the QRC's legal advisors.

Significant progress has been made to date. We would like to continue working with stakeholders to ensure that progress continues with our focus shifting towards the principles in the proposed drafting of the agreements. Specifically, we would appreciate comments on the agreements where stakeholders support or take issue with the principles in the drafting, rather than the exact drafting itself. We would also appreciate principle-based comments on Draft Decisions made within this document.

## 2.7 Key matters for this Draft Decision

The main matters discussed in this Draft Decision are set out in the following chapters and are:

- (1) Rental method
- (2) Construction
- (3) Security over rental streams
- (4) Termination
- (5) Discrimination
- (6) Preference unit transfers
- (7) Third party financing
- (8) Taxation
- (9) Access undertaking amendments
- (10) Liability.

Prior to this, Chapter 3 summarises the submissions received on our May 2014 Position Paper.

## 3 SUBMISSIONS ON OUR MAY 2014 POSITION PAPER

### 3.1 Submissions received on the Position Paper

We received six submissions on our May 2014 Position Paper. The parties providing submissions included: Anglo American Metallurgical Coal Pty Ltd (Anglo American), Asciano, Aurizon Network, BHP Billiton Mitsubishi Alliance (BMA), Glencore and the Queensland Resources Council (QRC). All submissions have been posted on our website.

BMA and Glencore noted their respective contribution to, and support of, the QRC's submission.

We would like to thank stakeholders for focusing comments on issues identified in the Position Paper as we had requested, rather than on detailed drafting matters.

### 3.2 Summary of Aurizon Network's views

Aurizon Network considered the development of a SUFA framework to be important in ensuring the economically efficient operation of, use of, and investment in Aurizon Network infrastructure.

Given that background, Aurizon Network said it supported the majority of changes presented in our Position Paper and also suggested some alternative proposals for our consideration, provided in **Table 2**. **Table 2** provides a summary, while more detail and background can be obtained from our Position Paper and Aurizon Network's submission in response to this.

**Table 2 Aurizon Network's response to Position Paper**

<i>Issue</i>	<i>Areas of agreement</i>
Construction	Agreed with the change from the project management agreement to a construction agreement
	Agreed with a pre-approval process for capital expenditure
Rental calculation	Agreed with clarification and simplification of the rental calculation method
Infrastructure lease	Agreed to provide further understanding of the risks around the infrastructure leases, including provision of a redacted version of the existing infrastructure leases with the Queensland government in a data room
Debt in the Trust	Agreed to the option of raising debt in the Trust, provided Aurizon Network as ordinary unit holder, is not disadvantaged
Tax	Agreed to support: <ul style="list-style-type: none"> <li>• a statutory solution for severance</li> <li>• Aurizon Network seeking an Administratively Binding Advice (ABA) from the Australian Tax Office (ATO) in respect of the standard SUFA document</li> <li>• Aurizon Network seeking a Private Binding Ruling (PBR) for each SUFA project</li> </ul> Aurizon Network also proposed a Tax ruling process <sup>23</sup>
	<b><i>Aurizon Proposals</i></b>
Capacity shortfalls	Aurizon Network proposed we adopt the method of treatment of capacity shortfalls included within the expansion process. An expansion process developed under UT4

<sup>23</sup> Aurizon Network 2014b, Appendix 2



	was included <sup>24</sup>
Tax indemnity	Aurizon Network proposed that it should not have an obligation to fund tax costs
Termination	Aurizon Network proposed that it not be obliged upon termination to pay a Trust the amount, if any, by which the NPV of its expected rentals exceeds its share of infrastructure disposal proceeds
Variations to the Subscription and Unit Holder's Deed	Aurizon Network proposed that the Subscription and Unit Holder's Deed and the Trust Deed be treated in the same way as other template agreements, which are only varied by agreement
Construction pricing	Aurizon Network proposed the adoption of lump-sum pricing for the construction contract. A discussion on most appropriate pricing approach was included <sup>25</sup>

### 3.3 Summary of stakeholders' views

Stakeholders were broadly supportive of the proposals we put forward in our Position Paper and Term Sheets.

Table 3 is a high-level list of points of agreement noted by stakeholders, and a list of matters which stakeholders recommend we undertake further review upon. Further detail can be found in our Position Paper and stakeholders' responses to this.

**Table 3 Stakeholders' responses to the Position Paper**

<i>Areas of Agreement</i>	<i>Stakeholder proposals</i>
First ranking security over rental cash flows	Tax matters require further attention <sup>26</sup>
Simplification and certainty over rental cash flows	SUFA is not a substitute for the mandatory expansion regime that exists in UT3
Move to a construction contract (rather than the project management agreement)	There may be an incentive for Aurizon Network to game up-front commitments on scope, standard and time to complete a project
Distributions from the Trust to the Preference Unit Holders should be mandatory	There is potential for cross shifting of costs and subsidies within the Aurizon group of companies
No stapling between access rights and units <sup>27</sup>	Ability of the Trust to raise debt financing
Ensuring there cannot be discrimination between the maintenance of SUFA assets and non-SUFA assets	Assurance the model does not lock in one method of financing
Broadening the pool of parties able to participate in a SUFA	Further discussion is required regarding the ways in which finance could be directly provided to the Trust

<sup>24</sup> Aurizon Network 2014b, Appendix 1

<sup>25</sup> Aurizon Network 2014b, Appendix 4

<sup>26</sup> This includes comment from QRC (Tax Appendix) and Anglo American on the Trust's ability to claim tax depreciation.

<sup>27</sup> Asciano did not agree there should be no stapling of access rights and units. Their position is discussed at page 69 of this draft decision.

## 4 RENTAL METHOD

*The right to receive rent<sup>28</sup> from Aurizon Network for its use of the SUFA infrastructure is the primary asset of the Trustee. In order for SUFA assets to attract third party financing, it is critical for there to be clear and transparent information about the future cash flows from SUFA assets (rental arrangements) and how the rent is calculated. This is also important to users considering funding a SUFA project off-balance-sheet.*

*Overall, we are of the view the suite of SUFA documents should:*

- *provide potential SUFA funders with transparency over the calculation of rent*
- *allow potential SUFA funders to clearly understand the risks associated with the rental stream.*

*How the rent is calculated and paid is outlined in the Extension Infrastructure Sub-Lease (EISL).*

### 4.1 Summary of the rental mechanism

Aurizon Network's rent calculation methodology involves a number of steps and provisions about how the funds flow from Aurizon Network to the Trust. The following is a brief summary of Aurizon Network's 2013 SUFA DAAU rental cash flow mechanism.

#### 4.1.1 Underlying principles

The underlying principles behind the rent calculation (in a regulated environment) are based on the concept of system allowable revenue (SAR). This is the same as applied in computing the reference tariffs under UT3. The principles underpinning the rental methodology are outlined in Schedule 2 of the EISL. Schedule 3 of the EISL explains the methodological approach based on the regulatory principles in place at this time.

A fundamental point to note is that if the current regulatory environment was to change from using a revenue cap, Aurizon Network and the Trust would be exposed to volume risk.

#### 4.1.2 Rent and 'direction to pay'

Under the EISL, Aurizon Network pays rent to the Trustee for the sub-lease of the extension infrastructure.

The expected rent paid to the Trustee is derived via the following:

(1) *Expected rent = Distribution Pool x Proportion of that pool attributable to the Trust*

*Where the:*

(2) *Based on our understanding, the Distribution Pool = return on capital + return of capital + net tax allowance (elements of the access charges)*

The rent is raised by Aurizon Network sending invoices to all access holders (to pay access charges). Access holders that have 'linked'<sup>29</sup> access agreements will also receive a direction to pay. The linked access agreement holders are initially those access seekers who are the first investors in a SUFA.

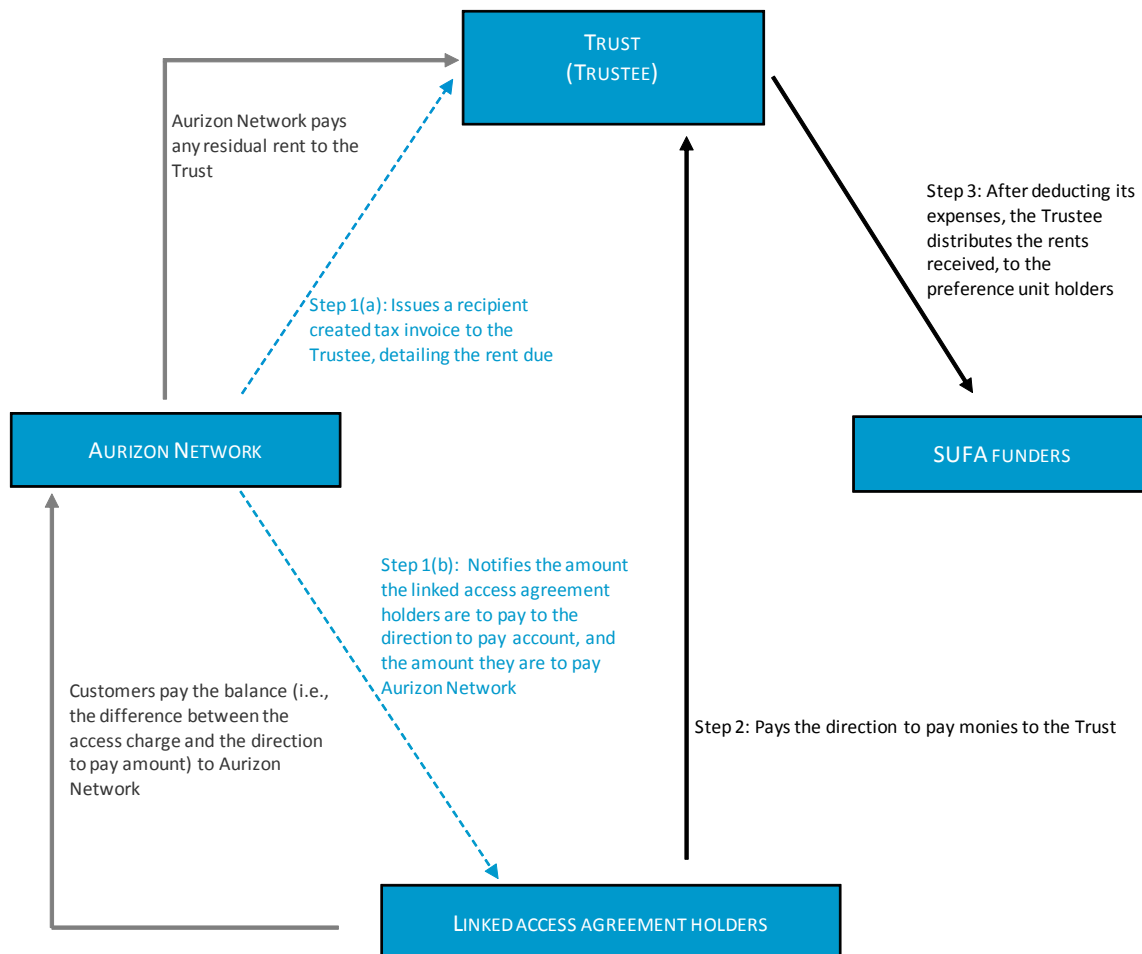
In any month, each direction to pay to a linked access holder should state the portion of the access charges the linked access holder is to pay to the Trustee and the portion that it is to pay

<sup>28</sup> Rent is the revenue stream from the use of SUFA assets.

<sup>29</sup> Linked access agreements are access agreements that contain a direction to pay clause.

to Aurizon Network. If no direction to pay is provided then the linked access holder must pay all of its access charges for that month to the Trustee. The sum of all the individual directions to pay should total the expected rent payable to the Trustee. **Figure 3** is a stylised picture of the flow of rent.

**Figure 3 Flow of rent to the SUFA funders**



## 4.2 Summary of our May 2014 position

Our Position Paper reflected that the right to receive rent from Aurizon Network is the key asset of the Trustee. In order to attract third party financing and off-balance-sheet funding from users, it is critical to have clear and transparent information about the rental arrangements and how the rent is calculated.

Given this, we viewed that the suite of SUFA documents should:

- provide potential SUFA funders with transparency over the calculation of rent
- allow potential SUFA funders to clearly understand the risks associated with the rental stream.

We noted that the proposed rental calculation methodology is based upon the current regulated environment, which in turn is based on the concept of maximum allowable revenue (MAR), SAR and a revenue cap being in place. We noted that if the existing regulatory environment changes, for example, by the revenue cap being removed, or if the SUFA operated in an unregulated environment, the Trust and Aurizon Network would be exposed to differing risk profiles. In such circumstances, the rent calculation methodology would have to be reviewed to consider how best to accommodate this.

#### 4.2.1 Rental calculation based on existing regulatory regime

Our Position Paper noted that despite the underlying philosophy appearing reasonable, Aurizon Network's proposed rent calculation methodology lacked clarity and assumed a high degree of specialist knowledge of the regulatory environment.

We also noted that we were in the process of addressing this with Aurizon Network by:

- developing spreadsheet examples
- reviewing the areas in the EISL underpinning the rent calculation method.

This covers the practical month-on-month process associated with the rental calculation, as well as the methodological process linking the rental calculation methodology to the calculation of MAR/SAR and the revenue cap/adjustment processes in the undertaking.

#### 4.2.2 Rental calculation if the regulatory regime changes

We said that SUFA funders should be provided with a level of certainty that, in the event there is a change in the regulatory environment, their rental stream is still protected.

#### 4.2.3 Rental calculation in an unregulated environment

Aurizon Network's 2013 SUFA DAAU included provisions for rental arrangements in the event of an unregulated environment (i.e. the situation where the rail infrastructure is no longer a declared service). These comprised:

- SUFA funders bearing the risk in the event the access charge and subsequent revenue stream is lower than that in the regulated environment
- if the access revenue is higher than that allowed in a regulated environment, the SUFA funders being excluded from the benefit higher rental cash flows.

Stakeholders were broadly of the view that Aurizon Network's proposal was inequitable.

We considered that in order for Aurizon Network's infrastructure to no longer be regulated, there would have to be effective competition in the markets that are dependent on the market for the regulated service. If unregulated, the SUFA funder and Aurizon Network would be in a position to negotiate:

- the contracts
- terms and conditions
- sharing of risks.

Against this background, we noted that the QCA Act allows the access holders' existing contractual rights and obligations applicable in a regulated environment to continue if the declared service becomes unregulated.<sup>30</sup> We proposed alignment of these provisions in the QCA Act and the SUFA documents so that SUFA funders are provided with a level of certainty in the event of an unregulated environment.

### 4.3 Summary of Aurizon Network's position

Aurizon Network agreed that the SUFA documents should have a clear and simple method of calculating the rent, and this method should closely align with the regulatory arrangements.<sup>31</sup>

Aurizon Network also agreed to the following, with some proposed changes:

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<sup>30</sup> Section 95 of the QCA Act

<sup>31</sup> Aurizon Network 2014b, p.7

- rental calculation method to be clarified and simplified — Aurizon Network welcomed further consultation, but cautioned that due to the nature of the regulatory regime, the method of rental calculation would, by its nature, be complex
- development of worked examples — Aurizon Network noted that worked examples included in SUFA documentation should be for illustrative purposes only and would not govern its legal interpretation
- provision of certainty over the rental stream in an unregulated environment — Aurizon Network noted that it was open to discussions on providing certainty over rental streams in a post regulatory environment. Aurizon Network, however, said it would be difficult for it as a private sector entity to agree to a regime that would effectively treat services it offered as being subject to regulation at a time when it was not.<sup>32</sup>

#### 4.4 Summary of stakeholders' comments

The QRC noted that although rent calculations would always have a degree of complexity, given the inherent complexity in the calculation of access charges, there ought to be the means to explain the calculation more clearly. Given this, the QRC supported our suggestion of example spreadsheets.

The QRC also noted its support for the concept that if the declared service in the CQCN ceased to be regulated there would need to be certainty of continuity of rent. It said rent would need to be at a market level and structured so as to avoid a transfer of value to non-SUFA assets.<sup>33</sup>

#### 4.5 QCA analysis and Draft Decision

##### 4.5.1 Rental calculation based on existing regulatory regime

Our interim position in this Draft Decision reflects our view that the objective and underlying philosophy of the rental calculation methodology under the existing regulatory practises are reasonable.

However, we agree with stakeholders that the rental calculation is complex and consider there is benefit in providing numerical examples of how rent is calculated. Given this we are continuing our process of working with Aurizon Network on the development of:

- spreadsheet examples
- reviewing the schedules underpinning the rental calculation.

This includes developing examples of the rental calculation process for month-on-month under- and overpayment. We also intend to provide examples outlining the role that revenue cap adjustments and volume forecast re-sets play with respect to calculating rent and maintaining the value of the flow of the rental stream on a net present value (NPV) basis.

We will release the spreadsheet examples separately, along with our review of the rent schedules, for stakeholder review and comment.

These examples will form part of the SUFA documentation.

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<sup>32</sup> Aurizon Network 2014b, p.7-8

<sup>33</sup> QRC 2014a, p.3

### Draft Decision

- 4.1 We propose to accept that the objective and underlying philosophy of the rental calculation methodology under current regulation practises are reasonable.**
- 4.2 However, the rental calculation is complex, and we consider simple examples should be provided with the SUFA agreements in order to assist SUFA funders to assess the future revenue streams from user funded assets.**

#### 4.5.2 Rental calculation if the regulatory regime changes

We received advice from Grant Samuel, that the SUFA raises the question of whether, and when, as a practical matter, the regulatory regime can be eliminated (or materially altered). This is because of the need to provide third party financiers with a high level of confidence of the income stream that can be earned by the SUFA Trust.<sup>34</sup>

Two regulation-related changes which may influence the stability and certainty of the rental cash flow are:

- moving from a revenue cap to a price cap
- methodological and parameter assumption changes under a revenue or price cap.

##### Change of regulatory regime

Under the existing revenue cap, Aurizon Network should obtain its MAR/ SAR for the regulatory period on an NPV basis. This translates to the SUFA rental cash flows being predictable on a NPV basis over the regulatory period in question.

The primary issue under a revenue cap relates to the precise timing that the cash flow is received. Within the existing regulatory regime, revenue cap adjustments take place with a two-year lag. Consequently, year-on-year cash flows for the regulatory period will depend on the actual circumstances and volume throughput for a particular year. For instance, if in the first year of the regulatory period volumes are less than forecast, then, other things being equal, Aurizon Network's actual revenue may be lower than that allowed. This can translate into lower SUFA rental cash flows than expected in that year. This is because SUFA funders and Aurizon Network both bear the same timing risk prior to the cash flows being corrected through the revenue cap process at the end of year two of the regulatory period.

Should the regulatory regime shift to a price cap, the stability and certainty of the SUFA rental cash flow could change. With a price cap, revenue is subject to volume risk. In this case, if in the first year of the regulatory period volumes were lower than expected, Aurizon Network's revenue would be less than expected and there would be no adjustment to mitigate this in the future. As such, SUFA funders would bear their share of this risk with rental cash flow declining relative to those anticipated.

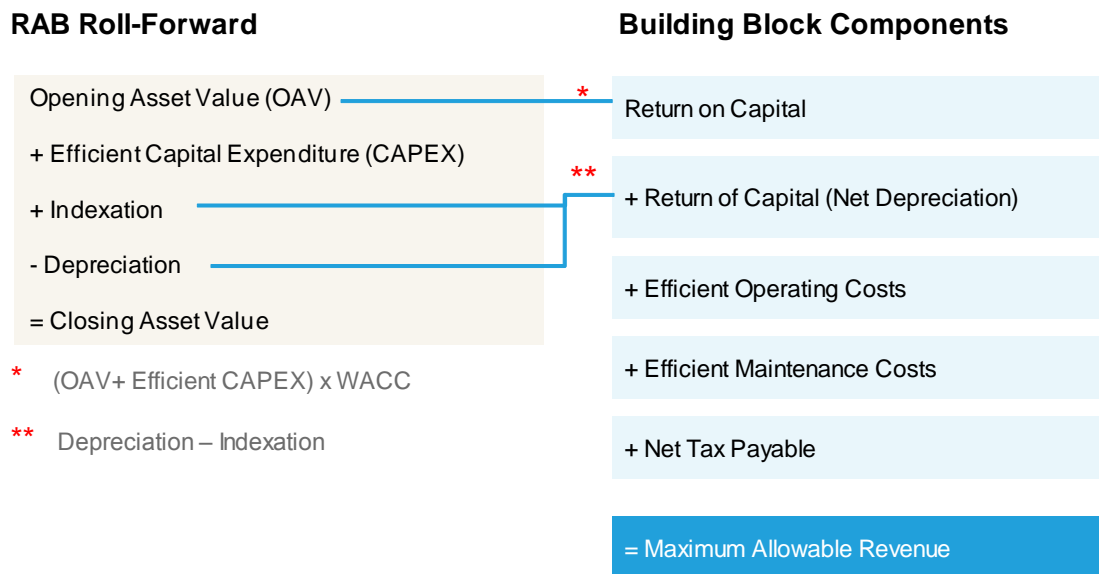
##### Methodological and parameter assumption changes (under a revenue or price cap)

Aurizon Network's revenue cap is calculated by using a 'building block' approach.

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<sup>34</sup> Grant Samuel 2014, p. 5

**Figure 4: Building block approach**



The building block approach builds up the costs of a regulated entity, for each year in a regulatory period. Figure 4 provides a stylised diagram of this process.<sup>35</sup>

The calculation of rent is based on the SUFA's proportion of the return on, and return of (net depreciation) capital, as well as the net tax payable.

Across regulatory periods regulators may change assumptions and methodological processes underpinning the calculation of the MAR. This is part of the normal regulatory process and it can impact on the rent attributable to SUFA assets through time. The precise impact will depend on the exact changes including when they take place.

We regard the potential changes to the regulatory regime as matters to be considered by parties entering into a SUFA arrangement. It is expected that parties would undertake an evaluation of the level of regulatory risk involved, the extent to which it could be mitigated and the degree to which they have the opportunity to influence how the regulatory regime evolves.

In particular, we note that any SUFA funders, whether third party funders or mining companies, would be expected to be involved in the review and consultation process associated with any changes to the existing regulatory regime.

### 4.5.3 Rental calculation in an unregulated environment

Grant Samuel considered the post-regulatory tariff regime proposed by Aurizon Network was inappropriate insofar as it provided revenue that is effectively the lower of actual revenue or the notional revenue that would have applied.<sup>36</sup> The QRC shared this view.

We also agree that Aurizon Network's proposed post-regulatory rent objective does not provide certainty over rental cash flows should the declared service/infrastructure cease to be regulated. This detracts from the bankability of the SUFA.

As noted in our Position Paper, the QCA Act provides for two circumstances where the service, provided by way of SUFA infrastructure, may no longer be declared. In both circumstances, this would only occur where:

<sup>35</sup> WACC is the weighted average cost of capital.

<sup>36</sup> Grant Samuel 2014, p.5

- we are satisfied that the service provided by way of the infrastructure no longer meets the declaration criteria in Section 76 of the QCA Act
- our recommendation to revoke or not to re-declare was accepted by the QCA Minister.

For example, the declaration of the CQCN is set to expire on 8 September 2020. There is a process under the QCA Act allowing for a declaration recommendation to be made before the expiry date.<sup>37</sup> Under that process we make a recommendation to the QCA Minister to declare, declare part, or not to declare. In making our decision of whether to declare, we must take into account the declaration criteria.

As noted in our Position Paper, a key determinant in making a determination to revoke declaration would be the presence of effective competition in markets that are dependent on the market for the regulated service. It is likely, where declaration has been revoked for the network as a whole, that there is a competitive environment. In a competitive environment, we would expect SUFA funders and Aurizon Network to negotiate amongst themselves the contracts, terms and conditions and the sharing of risks.

We also noted that in the event that a declaration is revoked, parties have the right to remain on their existing access agreement (section 95 of the QCA Act).

Given this background, we consider the SUFA should allow:

- for parties to remain under the regulated contract (under section 95 of the QCA Act) given neither party is materially disadvantaged, and
- linked access agreements for SUFA assets to include a schedule setting out access charges in the event that an asset is no longer declared.<sup>38</sup>

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<sup>37</sup> Sections 87A-87E, Part 5, division 2, subdivision 4A of the QCA Act.

<sup>38</sup> There are numerous examples of infrastructure services in Queensland where access is provided in an unregulated environment. These included Abbot Point Coal Terminal, the Gladstone Port Corporation and Sunwater pipelines. In these instances, prices for access are negotiated and typically reflect a 'building block' approach for determining charges.



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## 5 CONSTRUCTION

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*The Project Management Agreement (the PMA) and aspects of the Rail Corridor Agreement (the RCA) defined the proposed construction process for SUFA assets within the 2013 SUFA DAAU.*

*The proposed PMA and RCA in the 2013 SUFA DAAU are not in an industry recognised form and there are a number of issues which make these arrangements complex and unlikely to work.*

*Our Draft Decision reflects that we consider that an alternative approach is necessary to achieve a workable construction arrangement. Our Draft Decision reflects a more conventional construction agreement that has been developed in consultation with Aurizon Network and the QRC. We consider this provides the necessary environment to encourage third party financing. It also allows the 2013 SUFA DAAU to be refocused as a financing tool—which we consider to be the primary objective of the SUFA arrangements.*

*Advice by Grant Samuel (financial advisors) highlights that the more certainty there is surrounding construction and capacity delivered, the more attractive SUFA will become to third party financiers. This also applies to users funding off-balance-sheet.*

*Accordingly, our interim position in this Draft Decision proposes:*

- *replacing the PMA with a standard construction contract to clarify the role of the 2013 SUFA DAAU as a financing vehicle*
- *consequential amendments to the RCA to remove the agency concept (that was embedded in the PMA) and clarify that the Trustee's access to the rail corridor is for very limited purposes*
- *introduction of a capacity guarantee*
- *development of a pre-approval process for capital expenditure to reduce asset optimisation risk for SUFA funders, which will reduce project risk and thereby increase project bankability.*

### 5.1 Summary of our May 2014 position

One of the main objectives set out in the Position Paper was to reduce the complexity of the construction process and reposition SUFA as the financing tool it was originally intended to be.

Specifically, we considered that every expansion project should be developed in the same manner culminating in a defined set of up-front commitments which would allow Aurizon Network, existing users and prospective investors to assess the project from a competitive financing perspective.

We noted that while a considerable amount of collaborative effort had been expended on the PMA, the result was a complex construction agreement that had yet to be agreed. Moreover, we considered the PMA would have been difficult for SUFA funders to practically use because of its complexity. It also required the Trustee to take on risk that it is not equipped to manage in the construction of new infrastructure.

We considered there was merit in developing a simpler approach and proposed changes seeking to:

- ensure that risks are allocated to the parties best able to manage them
- provide greater certainty over what is delivered via a capital project
- provide greater certainty over the treatment of capital costs
- ensure the role of the Trustee is passive and, as far as possible, limited to administrative activities.

We proposed the following approach, which covered aspects within the SUFA agreements and the undertaking.

### Control over construction and up-front commitments

Our view was that Aurizon Network should have control of construction of SUFA projects and provide up-front commitments regarding scope, standard, cost and time-to-complete. We also considered that Aurizon Network should be required to build a SUFA project to an agreed range of capacity outcomes.

Allowing Aurizon Network control significantly reduces the complexity of the construction process and the suite of agreements. It also refocuses SUFA as a financing tool.

### Expansion process

For our approach to be effective, we suggested that UT3 be amended to include an expansion process. This process needs to be capable of delivering feasibility studies to a level of accuracy required to provide credible up-front commitments that satisfy the needs of Aurizon Network as infrastructure provider, third party financiers and users funding off-balance sheet.

### Pre-approval process

We also proposed a pre-approval process, whereby we would approve prudent capital expenditure for inclusion in the RAB prior to the SUFA project commencing. We considered a pre-approval process would provide greater certainty to all relevant parties that the prudent and efficient capital expenditure associated with the expansion will be included in the RAB.

## 5.2 Summary of Aurizon Network's position

### 5.2.1 Control over construction and up-front commitments

Aurizon Network agreed it should be subject to financial consequences, should its commitments as construction contractor not be delivered—the exception being capacity.

However, Aurizon Network did not agree that it should be subject to financial consequences if its commitments, as a network planner, were not delivered—based on the expansion process not providing Aurizon Network with full control over the planning phase of the expansion.<sup>39</sup> Rather, it allows the involvement from access seekers, including:

- *the process of reaching agreement by negotiation between Aurizon Network and access seekers as to:
 
  - *what should be studied, and*
  - *the content of schedules to the SUFA documentation (including scope, standard, time to complete, risks passed through the construction contract and pricing of the construction contract); and**
- *the process of binding dispute resolution that determines these matters if the parties are unable to reach agreement by negotiation.*

Aurizon Network considered that while the involvement of access seekers will benefit the expansion process and provide for a better outcome—this comes at a cost to participants in that they also need to bear responsibility for outcomes.<sup>40</sup>

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<sup>39</sup> Aurizon Network considers this expansion process is in the form that was provided to the QCA on 16 May 2014.

<sup>40</sup> Aurizon Network 2014b, p.13

### 5.2.2 Capacity shortfall

Aurizon Network noted the expansion process, negotiated with QRC for the 2014 DAU, dealt with circumstances where an expansion failed to deliver capacity. It said that the treatment of capacity shortfall—developed with the support of the QRC—recognised that Aurizon Network does not have full control over the decisions on scope and standard, key determinants as to whether capacity is delivered. Aurizon Network said that if our proposed approach to capacity shortfalls was adopted, the expansion process would require amendment to give full control of scope to Aurizon Network.<sup>41</sup>

Aurizon Network noted the following:

- As capacity shortfalls predominantly impact access seekers, the QRC has sought greater involvement for access seekers in the expansion process—rather than impose financial consequences on Aurizon Network in the event of such a shortfall.
- Imposition of financial consequences would motivate Aurizon Network to ensure scope was robust and highly likely to deliver capacity with a corresponding increase in cost.
- The scope would be locked down in the construction contract and Aurizon Network would not have a unilateral right to modify the scope to mitigate capacity shortfall risk.
- User funders would be indifferent to capacity outcomes as the pre-approved cost would be included in the RAB upon commissioning.<sup>42</sup>

### 5.2.3 Expansion process

Aurizon Network supported the position of having an expansion process in the access undertaking. It noted that, as part of the 2014 DAU, it had been working with the QRC to develop a workable expansion process. However, the resulting process was drafted prior to the release of the Position Paper, and certain variations will be required to reflect the outcomes. These would include the change to a construction contract and inclusion of a pre-approval process.

Aurizon Network included a diagram explaining its expansion process and drafting of the expansion process for the 2014 DAU.<sup>43</sup>

### 5.2.4 Construction contract

Aurizon Network supported the proposal to simplify the construction arrangements by replacing the PMA with an industry standard construction contract.<sup>44</sup> It noted use of a construction contract would materially strengthen the SUFA model's workability, bankability and credibility.

Aurizon Network provided the following further comments, which included proposed amendments to the construction contract outlined in the Term Sheets:

#### Risk/reward structure of the construction contract

- The template construction contract should be consistent with industry practice of undertaking comparable projects. When used for a SUFA project, the risk/reward profile of the contract should reflect industry standard risks and rewards for similar projects.
- Lump-sum pricing was the most suitable form of pricing for the construction contract.

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<sup>41</sup> Aurizon Network 2014b, p.13

<sup>42</sup> Aurizon Network 2014b, p.13

<sup>43</sup> Aurizon Network 2014b, pp. 12 and 37-71

<sup>44</sup> Aurizon Network noted its support for use of a construction contract was dependent on it being the construction contractor under the contract.

- The expansion process would require dispute resolution of project specific schedules.
- Aurizon Network did not entirely understand the GMP<sup>45</sup> pricing approach proposed, and wanted to gain further insight on this matter.

**Liquidated damages**

- Liquidated damages for late delivery must be based on the pre-estimated loss suffered by the Trust (the construction contract's counterparty), not other parties such as access seekers or SUFA funders.

**Role of an independent certifier**

- An independent certifier should undertake the role of superintendent with the usual duty of care applying to superintendents.

**Flexibility of head contractor**

- Aurizon Network wanted scope to be defined at a high level rather than being specified in detail in order to reflect the design and construct model of engagement and the passive role of the Trustee.<sup>46</sup>

**5.2.5 Pre-approval process**

Aurizon Network supported the inclusion of a pre-approval process. It offered the following comments, as set out in **Table 4** to assist with further development:

**Table 4 Aurizon Network comments on pre-approval process<sup>47</sup>**

<i>Matter</i>	<i>Aurizon Network suggestion</i>
Value included in the RAB	In discussions with the QCA, Aurizon Network said that it believed it was clarified that the amount paid under the lump-sum contract (plus prudent variations) would be included in the RAB, rather than the costs of the construction contractor.
Dispute resolution	Aurizon Network noted its support for the proposal of the Independent Engineer to assess prudence.  Aurizon Network proposed that the Independent Engineer should also be the expert appointed for the dispute resolution regarding the SUFA schedules.
System Tests	<u>Pricing</u> Aurizon Network noted it supported the concept that prudence must consider the impacts on existing users. However, the pricing principles being discussed in UT4 are expected to remove the need for a price test.  <u>Capacity</u> Similarly, Aurizon Network noted that whilst it agreed that existing access holders should not have their existing capacity entitlements impacted, it was not clear how an expansion may impact the existing capacity entitlements because: <ul style="list-style-type: none"> <li>• the expansion would not impact the access agreements of existing access holders</li> <li>• where an expansion did not provide sufficient capacity, it was the incremental users that were compressed.</li> </ul>
Adjustment events	Aurizon Network noted that costs in respect of Adjustment Events that were in excess of the contingency amount would be considered prudent as they result from events beyond the construction contractor's control and were not priced

<sup>45</sup> Guaranteed Maximum Price

<sup>46</sup> Aurizon Network 2014b, p.10

<sup>47</sup> Aurizon Network 2014b, pp.14-15

<b>Matter</b>	<b>Aurizon Network suggestion</b>
	<p>into the lump-sum contract.</p> <p>Aurizon Network also suggested that the Independent Engineer would approve events specified as Adjustment Events and the pricing of resulting variations. During the construction process, any claim by Aurizon Network (as the contractor) on an Adjustment Event would be submitted to an Independent Certifier. Aurizon Network would be entitled to payment of that claim if the Independent Certifier considered the adjustment claim has been made correctly. This process would be without prejudice to Aurizon Network's right to seek approval post construction.</p>

## 5.3 Summary of stakeholders' comments

### 5.3.1 Control over construction and up-front commitments

Anglo American considered the provision of up-front commitments by Aurizon Network for scope, standard, cost and time to complete, could incentivise it to over-scope or over-estimate project costs in order to ensure that it is not required to bear excess costs toward the conclusion of the expansion. Anglo American said the only way to avoid this is to ensure that funding users, most appropriately through information provided to the Trust, have enough insight into the construction and project management processes to determine whether efficiency objectives, scopes and time constraints are being followed.

Anglo American, therefore, strongly supported the QRC's submission that funding users (or potential funding users) should have complete transparency of information (available to Aurizon Network). Unless that was the case, any dispute or expert determination provisions in the SUFA would be entirely ineffective.<sup>48</sup>

### 5.3.2 Capacity shortfall

In our Position Paper, we noted that to provide clarity over the construction and up-front commitments Aurizon Network should:

*...as infrastructure planner, asset constructor and operator of the rail network, build a SUFA project to an agreed range of capacity outcomes and be accountable for delivering on these commitments.<sup>49</sup>*

Anglo American said this concept is fundamentally flawed because the baseline capacity for each system on CQCN is unknown to the stakeholders. Further it noted that if stakeholders and Aurizon Network agree to a range of capacity outcomes, stakeholders have no foresight regarding what capacity is available and truly required in a system. For example—an agreement that Aurizon Network will produce 15 mtpa of capacity for a cost to funding stakeholders of \$600 million is flawed where it is not known what capacity the system is able to deliver without the expansion. It concluded this would not only make scoping of SUFA projects difficult, but also result in inefficient or uneconomic investment, undermining the competitiveness of the Queensland coal network.<sup>50</sup>

### 5.3.3 Expansion process

The QRC noted that under the process for the 2014 DAU, it had been discussing and exchanging drafts of the 2014 DAU expansion process, covering demand assessments, studies, and prioritisation of expansion projects and allocation of access seekers to projects. The QRC noted that the parties had not discussed planning, capacity assessments and pre-approval of expansions, and as such the agreed form of the expansion process would need to be modified.

<sup>48</sup> Anglo American 2014, p.3

<sup>49</sup> QCA Position Paper, p.vii

<sup>50</sup> Anglo American 2014, p.3

The QRC proposed the following changes:

- Determination by the QCA (or an expert) of the scope of an expansion project, or a study, should not result in 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 transaction
- An effective dispute resolution process to determine disputes about the scope or price for a SUFA construction contract.
- Pre-approval processes and a process to deal with variations to SUFA projects.<sup>51</sup>

Asciano noted that development of the pre-approval and approval processes should consider:

- the impact of the expansion proposal on all system users
- the ring-fencing and confidentiality regime proposed to apply to any expansion proposal (with a view that any SUFA expansions or extensions must be subject to the same ring-fencing and confidentiality provisions as those applying to the regulated Aurizon Network).<sup>52</sup>

#### 5.3.4 Construction contract

The QRC strongly supported the change to the construction arrangements as it considered the PMA to be far from the market standard project management agreement. Further, the QRC noted that construction by way of an Engineer, Procure, Construct and Manage (EPCM) contract style, as was used in the PMA, was a less preferred procurement method from a funder's point of view.

The QRC submitted that a move away from a management agreement towards a fixed price and fixed completion date construction contract would improve the bankability of the SUFA as third party construction projects were typically constructed under a fixed price and fixed completion date.<sup>53</sup>

The QRC also noted four matters on the construction contract:

- The SUFA suite should include a standard form of construction contract.
- The construction contract should require the contractor to rectify defects in its works (at its cost).
- The expansion process should include a dispute mechanism, applicable if parties could not agree on the price, scope or schedule for a construction contract and that the result be binding on all parties.
- For user funders to have any meaningful contribution to the negotiation of scope, price and schedule for a construction contract—the study agreements and expansion process would need to provide the access seekers with complete transparency of the information which was available to Aurizon Network. Otherwise a dispute mechanism would be difficult for the access seekers to pursue.<sup>54</sup>

## 5.4 QCA Analysis and Draft Decision

The SUFA construction process spans both the suite of SUFA agreements and aspects of the access undertaking. If SUFA is to be effective these have to work together. We consider that

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<sup>51</sup> QRC 2014b, p.4

<sup>52</sup> Asciano 2014b, p.3

<sup>53</sup> QRC 2014b, p.4

<sup>54</sup> QRC 2014b, p.4

the SUFA construction process represents a dynamic holistic system and has to be viewed as such. In particular, the SUFA agreements have to be viewed in the context of the proposals for developing the undertaking and vice-versa.

In coming to our position we have assessed the relevant issues in the following order:

- Overarching principles
- SUFA agreements—overarching form of the construction contract
- SUFA agreements—issues of detail in the construction contract
- Undertaking—approach to developing the expansion process
- Undertaking—approach to capacity guarantees and shortfalls
- Undertaking—role of pre-approval

#### 5.4.1 Overarching principles

Our interim position as set out in this Draft Decision with respect to the SUFA construction process is broadly based on the following the principles:

- SUFA is a financing tool.
- Control over the construction of SUFA projects should reside with Aurizon Network.

We consider that this approach:

- ensures that risk is best allocated to the parties best able to manage it
- provides greater certainty of what is delivered via a capital project
- provides greater certainty of the treatment of capital costs
- ensures the role of the Trustee is passive and limited to administrative activities.

These principles remain unchanged from those outlined in our Position Paper. They are underpinned by the construction agreement in the SUFA framework; as well the expansion process, the approach to capacity guarantees and shortfalls, and pre-approval; all of which will reside in the undertaking. In our view these all play a role in ensuring SUFA is effective and the up-front commitments made by Aurizon Network are perceived as credible.

Within this context, Anglo American noted that the provision of up-front commitments for scope, standard and time to complete could incentivise Aurizon Network to over-scope and over-estimate project costs in order to ensure that it is not required to bear excess costs towards the conclusion of the expansion. Anglo American also said that the only way to avoid over-scoping and over-costing was to ensure that funding users, through information provided to the Trust, have enough insight into the construction and project management processes to determine whether efficiency objectives, scope and time constraints are being followed.<sup>55</sup>

Whilst we understand Anglo American's concerns, we do not consider the provision of up-front commitments will necessarily result in any greater incentive to over-scope and over-cost than may already exist. We consider that it is more a question of how those up-front commitments have been developed and the extent to which they are perceived as equitable and credible by the parties involved.

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<sup>55</sup> Anglo American 2014, p.3



We do, however, share the view that relevant information provision is critical. We consider that this engenders trust and constructive collaboration, as well as having the potential to reduce the likelihood of over-scoping and over-costing<sup>56</sup>. We also consider that:

- pre-approval of a project can reduce incentives to over-scope and over-estimate project costs. This is because the chance of obtaining pre-approval for a capital project that is demonstrably over-scoped and over-costed is minimal.
- the approach adopted for the feasibility stage of the expansion process will have to be sufficiently robust to meet the needs of all potential stakeholders, including third party financiers. This provides an opportunity to consider how this is best achieved in a manner that minimises the potential for over-scoping, over-costing and appropriately allocates risk. This is considered further in the section on capacity guarantees and shortfalls.

Overall, we consider that the overarching principles we have adopted provide an appropriate balance between the criteria in section 138 of the QCA Act. In particular, we consider that the legitimate business interests of Aurizon Network (section 138(2)(b) of the QCA Act) are appropriately accounted for through providing Aurizon Network with control over the construction process, given that Aurizon Network operates and maintains the CQCN.

We are also of the view that the provision of the relevant up-front commitments is in the interests of access seekers and SUFA funders, as well as the public interest (sections 138(d), (e) and (h)). This provides greater transparency and predictability.

We also consider that our approach aligns with sections 69E and 138(2)(a) of the QCA Act that require we have regard to promoting the economically efficient operation, use of and investment in the CQCN, as the significant infrastructure through which the declared services is provided.

### Draft Decision

**5.1 We consider the construction process for the 2013 SUFA DAAU should be based on the following principles:**

- (a) SUFA is a financing tool.
- (b) Control over the construction process of SUFA projects should reside with Aurizon Network.

**5.2 As a consequence of this we consider Aurizon Network should provide:**

- (a) up-front commitments with respect to scope, standard, cost and time to complete
- (b) an up-front commitment regarding the capacity outcome.

#### 5.4.2 SUFA agreements—overarching form of the construction contract

The PMA and aspects of the RCA define the construction process within the 2013 SUFA DAAU. The PMA and the RCA are not an industry recognised form of document. They include a complex agency structure that allows Aurizon Network to claw back control of the construction process, which technically resides with the SUFA trustee given the trust framework adopted in the 2013 SUFA DAAU.

We remain of the view, outlined in our May 2014 Position Paper that the PMA in the 2013 SUFA DAAU is difficult for potential SUFA funders to use practically. We also remain of the view that it will be challenging to find an independent corporate trustee to undertake the role of SUFA

<sup>56</sup> We consider provision of this information meets with section 138(2)(e) of the QCA Act, wherein it is in the interest of access seekers to be informed of whether their access request will be met and at what cost.



trustee at a reasonable cost. This is because the PMA requires that the Trustee undertake tasks beyond its administrative abilities (i.e. effectively becoming a construction manager).

Within this context, and subject to the underlying principles described in the previous section, we proposed in our Position Paper that the PMA should be replaced with a construction contract that reflects Aurizon Network having control of the construction process. In their responses to the Position Paper, both Aurizon Network and the QRC agreed with the use of a construction contract, rather than the PMA in the 2013 SUFA DAAU, noting it represents a more conventional market standard agreement that would materially strengthen the SUFA model's workability, bankability and credibility.

We also agree with Aurizon Network's proposal that the construction contract template should be consistent with industry practice of undertaking similar projects.

Against this background, we have been working collaboratively with Aurizon Network and the QRC to develop a pro forma construction contract. This has been based on the Australian Standard template AS 4902–2000—General Conditions of Contract for Design and Construction.

The benefits in using an Australian Standard contract are:

- Given the standard nature of the contract, parties entering into a SUFA agreement could have previous experience with and knowledge of this standard of contract.
- Familiarity with the contract type may make the process of finalising and executing the contract more efficient.
- Once the standard form of contract is in place, modifying the standard contract to suit the requirements of a specific SUFA project would be relatively faster and would likely minimise transaction costs (i.e. information search, negotiation, creating and executing the contract).

A further benefit of this approach has been that it has allowed the RCA to be simplified through the removal of the agency structure that existed across the PMA and RCA in the 2013 SUFA DAAU.

Overall, we consider that replacing the PMA in the 2013 SUFA DAAU with a more standardised construction contract will enhance the workability, bankability and credibility of the SUFA framework. We are also of the view that it appropriately balances the legitimate business interests of Aurizon Network (section 138(2)(b) of the QCA Act) and the interests of access seekers and SUFA funders (section 138(2)(e) and (h) of the QCA Act), as evidenced by the collaborative approach adopted between ourselves, Aurizon Network and the QRC on this issue.

We believe that this approach aligns with sections 69E and 138(2)(a) of the QCA Act that require we have regard to promoting the economically efficient operation, use of and investment in the CQCN. This is because enhancing the workability, credibility and bankability of the SUFA framework is likely to increase the pool of potential SUFA funders. We also consider this to be in the public interest (section 138(d) of the QCA Act).

### Draft Decision

**5.3 We are minded to refuse to approve the PMA and RCA in the 2013 SUFA DAAU. We consider it appropriate that Aurizon Network amends the 2013 SUFA DAAU as follows:**

- (a) the PMA is to be replaced by a contractual structure based on the Australian Standards template AS 4902–2000—General Conditions of Contract for Design and Construction, as set out in the Design and Construct Contract— Standard User Funding Agreement (amended form of AS 4902-2000) (incorporating the Formal Instrument of Agreement and General Conditions), attached to this Draft Decision.**
- (b) the RCA is to be revised in a manner that ensures it aligns with the change in approach to the construction contract, as set out in the RCA, attached to this Draft Decision to the RCA.**

Where the drafting of the construction contract differs from the Term Sheet provided with the May 2014 Position Paper, it is included in Appendix B. The complete draft of the proposed construction contract and the revised RCA is provided as part of the Draft Decision.

#### 5.4.3 SUFA Agreements—issues of detail in the construction contract

The following matters regarding details of the content of the construction contract were raised by stakeholders:

- contract pricing
- variations and adjustment events
- role of the independent certifier
- liquidated damages
- rectification of works
- flexibility of the head contractor.

#### Contract pricing

The QRC's submission noted that the move away from a PMA to a construction contract—with a fixed price and fixed completion date—would improve the bankability of the SUFA, as third party construction projects are typically constructed under a fixed price, fixed completion date structure.

We share the view that a lump-sum price for delivering the scope and standard of the infrastructure within a specified time to complete is the most suitable way to price the construction contract. We consider that this should be assessed on a project-by-project basis and developed via the use of an effective expansion and feasibility study process. This is discussed further in Section 5.4.4.

We consider that the main advantage of a lump-sum contract is that it provides a degree of predictability with respect to the overall capital cost of the project. We also recognise that a disadvantage is the potential for a price premium relative to other more flexible forms of construction contract pricing. We are, however, of the view that the adoption of a pro forma construction contract based upon lump-sum pricing does not preclude other pricing structures being negotiated if it is in the interests of the relevant parties to do so.

Overall, we consider that the legitimate business interests of Aurizon Network, the interests of access seekers and SUFA funders (sections 138(2)(b),(e) and (h) of the QCA Act) are appropriately balanced if the pro forma construction contract adopts a lump-sum price

approach. This provides all parties with a transparent base price within the context of a set of up-front commitments with respect to scope, standard, time-to-complete and capacity outcome. Alternative pricing options can be considered for particular projects if the relevant parties wish to do so.

In our view this approach aligns with sections 69E and 138(2)(a) of the QCA Act that require we have regard to promoting the economically efficient operation, use of and investment in the CQCN. This is because it does not restrict parties to a lump-sum approach if they can achieve a more efficient approach to pricing the project. As such, we consider that this aligns with the public interest (section 138(2)(d) of the QCA Act).

### Draft Decision

**5.4 We are minded to decide that the pro forma construction contract adopt a lump-sum price for the delivery of a set of up-front commitments in relation to scope, standard and time-to-complete.**

### Variations and adjustment events

Given the nature of rail infrastructure and the construction risks involved, it is likely that some level of contingency funding will be needed. As part of developing the pro forma SUFA construction contract for the Draft Decision, we have included a regime for discretionary variations and a set of adjustment events. We consider that the items included appropriately balance the interests of access seekers and SUFA funders, with the legitimate interests of Aurizon Network (sections 138(2)(b),(e) and (h) of the QCA Act). This is because we are of the view that it provides a standard objective set of variation and adjustment events.

For the avoidance of doubt, we are of the view that the inclusion of variation and adjustment events within the pro forma construction contract should not be interpreted as ensuring any incurred costs with respect to these events will be automatically included in the RAB. This applies regardless of whether they have independent certifier certification.

We are of the view that automatic inclusion of construction costs into the RAB does not provide appropriate incentives to manage costs and minimise cost overruns. Moreover, we are also of the view it undermines the attractiveness of the cost predictability benefits that are provided by the lump-sum contract structure. We consider that this position aligns with sections 69E and 138(2)(a) of the QCA Act that require we have regard to promoting the economically efficient operation, use of and investment in the CQCN. We are also of the view that it appropriately accounts for the public interest (section 138(2)(d) of the QCA Act).

Our overall approach to the magnitude of contingency funding and the process for inclusion within the RAB is discussed further in Section 5.4.6 on pre-approval.

## Draft Decision

**5.5 We are minded to approve the 2013 SUFA DAAU with the following variation and adjustment events included in the pro forma construction contract:**

### Discretionary variations

- (a) Under the construction contract, the contractor is not to carry out any construction works that are not part of the WUC (work under contract) or the scope. At any time during construction, the Trustee or Aurizon Network may propose to vary the following:
- (i) increase, decrease or omit any part of the scope
  - (ii) change the character or quality of the project
  - (iii) change the levels, lines, positions or dimensions
  - (iv) carry out additional work
  - (v) demolish or remove work no longer required by the principal.
- (b) Where the parties agree to a discretionary variation, the matter is referred to the independent certifier for certification. The independent certifier's certification can allow for:
- (i) variation of the Trustee's project requirements
  - (ii) variation of the date for practical completion
  - (iii) adjustment of the contract sum.

### Adjustment events

- (c) The construction contract contains a list of events that qualify as adjustment events, specifically:
- (i) any act of prevention, negligent act, negligent omission or breach of the construction contract by the independent certifier or the principal
  - (ii) any delay in providing the contractor with access to the port or other coal supply chain land or infrastructure
  - (iii) industrial action, other than industrial action which is specific to the construction site or which is limited to the contractor's employees
  - (iv) inclement weather which affects part or all of the site or delays or disrupts the construction works
  - (v) delay or disruption to the WUC arising from the need to comply with an injunction or other court order in relation to the site or the WUC (other than where caused by the default or negligence of the contractor)
  - (vi) any delay by the principal in providing access to the site for the contractor to commence or carry out the WUC (if so required by the construction contract)
  - (vii) latent conditions
  - (viii) unexpected contamination
  - (ix) force majeure events
  - (x) changes in legislative requirements
  - (xi) a suspension by the principal pursuant to its right under the Unit Holders Deed to suspend the contractor's performance of the construction contract
  - (xii) a suspension by the contractor for a failure by the principal to make a payment or provide security

- (xiii) where an adjustment event requires the contractor to carry out works outside the extension land and the work needs to be suspended while attempts are made to make the relevant land part of the extension land
  - (xiv) a direction by the independent certifier as to how to deal with a discrepancy in the contract documents that is not in accordance with the order of precedence in the construction contract
  - (xv) a determination of a dispute that overturns a direction by the independent certifier on documents supplied by the contractor
  - (xvi) a direction that the contractor rectify loss or damage to the works arising from an excepted risk
  - (xvii) finding on site valuable minerals, fossils, articles or objects of antiquity or of anthropological or archaeological interest, treasure trove, coins and articles of value
  - (xviii) a direction by the independent certifier that the principal elects to accept defective work
  - (xix) removal of redundant infrastructure if the construction contract is terminated other than as a result of the contractor's default.
- (d) If the constructor intends to claim an adjustment event, it must give notice to the Trustee and the independent certifier along with the details of the effect of the adjustment event on the works.

### Role of an independent certifier

Aurizon Network proposed the independent certifier should also undertake the role of superintendent with the usual duty of care applying to superintendents. We believe that many, but not all, of the functions of the superintendent should be undertaken by the independent certifier with a view to the Trustee being passive as far as possible. Where this was thought appropriate, the role of the superintendent has been passed on to the Trustee. We would welcome stakeholder comments on whether the instances where the functions of the superintendent have been passed on to the independent certifier or the Trustee (principal) are appropriate in the context of the pro forma SUFA construction contract.

### Draft Decision

**5.6 We believe the independent certifier should undertake many, but not all, of the functions of the superintendent in the pro forma construction contract.**

### Liquidated damages

Our interim position in this Draft Decision is to maintain the overarching principles proposed in our Position Paper regarding the SUFA construction process. This included an up-front commitment with respect to the time-to-complete a capital project.

In the Term Sheets, published with the Position Paper, we proposed that should Aurizon Network fail to deliver the expansion project on time, it should pay liquidated damages (or similar). We considered that the rate of liquidated damages would be determined by the parties prior to entry into to the construction agreement. The estimate would be based on the parties' genuine estimate of the damages that would be incurred by preference unit holders (and the access seekers or funders, if different).

By contrast, Aurizon Network proposed that liquidated damages for late delivery must be based on the estimated loss suffered by the Trust—as the Trust is the counterparty to the construction agreement.

We do not support Aurizon Network's proposal. We consider that in the event there is a delay past the practical completion date for a project, the parties most impacted by the delay would be the infrastructure users and funders. We do not consider it appropriate that a trust structure adopted primarily for tax efficiency reasons should 'shield' Aurizon Network from non-delivery of its commitments with respect to the parties most impacted by the delay.

We consider Aurizon Network's proposal shifts the risk of non-delivery to these parties, despite Aurizon Network having control over the construction of the infrastructure. Moreover, we are also of the view that liquidated damages in relation to the loss suffered by the Trust would not be material because the Trust undertakes a limited set of administrative functions.

As such, we consider that Aurizon Network's proposal undermines the incentive properties associated providing up-front commitments. We do not consider this to be in the spirit of the overarching principles underpinning the SUFA construction process discussed previously.

Although it is in Aurizon Network's interests to minimise any exposure to liquidated damages, we do not consider that its proposal constitutes a legitimate business interest in the context of interpreting the QCA Act and section 138(2)(b) in particular. This is for the reasons outlined in the preceding paragraphs. We consider that our initial proposal outlined in the Term Sheets published with the May 2014 Position Paper provides a more appropriate balance between the interests of access seekers, SUFA funders and Aurizon Network's legitimate business interest (sections 138(2)(b),(e) and (h) of the QCA Act).

### Draft Decision

**5.7 We consider the 2013 SUFA DAAU pro forma construction contract should be drafted to account for the following:**

- (a) The rate of liquidated damages is to be determined by the parties prior to entry into to the construction agreement. The estimate is to be based on the parties' genuine pre-estimate of the damages that would be incurred by preference unit holders (or the access seekers or funders, if different).**
- (b) If construction of the extension has not reached practical completion by the date for practical completion, the independent certifier will certify the principal (Trustee) be paid liquidated damages.**
- (c) Liquidated damages will be payable for each 'separable portion' of the extension project.**
- (d) The maximum amount of liquidated damages payable is limited to a negotiated percentage of the lump-sum contract**
- (e) Liquidated damages is the Trustee's only remedy for Aurizon Network not meeting practical completion.**

### Rectification of works

The QRC's submission noted that if Aurizon Network, as contractor, fails to deliver the agreed fit-for-purpose scope, and the defect is discovered during the defects liability period, Aurizon should rectify that defect at its own cost.

We consider that it is common for most contracts to include a defect liability clause specifying the contractor is responsible for rectifying defects occurring within a period (13 months) after the certification of practical completion. We are of the view that this appropriately balances the legitimate business interests of Aurizon Network and the interests of access seekers and SUFA funders (sections 138(2)(b), (e) and (h)), as it represents common practice.

### Draft Decision

**5.8 We consider the pro forma construction contract should be drafted such that if the independent certifier becomes aware that work done by the contractor does not comply with the contract, the following will transpire:**

- (a) The independent certifier will give the constructor details of the non-compliance.**
- (b) The contractor (Aurizon Network) must place the non-compliance on a defects register.**
- (c) The contractor (Aurizon Network) must rectify the non-compliance at its cost.<sup>57</sup>**

### Flexibility of head contractor

In its response to our Position Paper Aurizon Network proposed that scope be defined at a high level, rather than being specified in detail, in order to reflect the design and construct model and the passive role of the Trustee.

We consider that the level of scope definition would be determined through the expansion process. We are also of the view that the scope definition would have to be sufficiently robust to cover the interests of all stakeholders, including third party financiers and the QCA acting in its capacity to grant, or otherwise, pre-approval.

Against this background we consider it unlikely that a project that has been through the expansion process, negotiated, scrutinized by financiers and submitted to us for pre-approval would be scoped at a high level only. Notwithstanding, where Aurizon Network prefers to design and construct with a high level of scope definition, we consider that Aurizon Network should be prepared to take on the associated scope change risk within the construction agreement.

Furthermore, it will also be necessary to have the agreement of SUFA funders and if pre-approval was sought, the QCA would need to grant this. Within this context it would be necessary, amongst other things, to ensure that any variation process adopted could not be used to pass risk onto SUFA funders that Aurizon Network should bear if it wishes to adopt a high-level scope definition. If this could not be guaranteed, it is possible that this would limit the likelihood of the project obtaining pre-approval.

Overall, we do consider it appropriate for a pro forma construction contract to specify what level of scope definition should be adopted. We are of the view that the level of scope specificity should be considered on a project-by-project basis and will depend on the preferences of the stakeholders involved and whether pre-approval by the QCA is sought. We consider that this a level of flexibility that appropriately balances the legitimate business interests of Aurizon Network, access seekers and SUFA funders (sections 138(2)(b), (e) and (h)).

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<sup>57</sup> Clause 35 of the Construction Contract

### Draft Decision

**5.9 We consider the pro forma construction contract should not define the level of scope specificity. This should be developed on a project-by-project basis.**

#### 5.4.4 Undertaking—approach to developing the expansion process

The 2013 SUFA DAAU was submitted under and is being assessed with respect to the 2010 access undertaking (2010 AU). Within this context, for SUFA to be effective, the 2010 AU would need to be amended to include an explicit expansion process. The expansion process to be developed will need to be capable of delivering feasibility studies to a level of accuracy required to provide credible up-front commitments that satisfy the needs of Aurizon Network as the infrastructure provider, third party financiers and user funding off balance sheet.

No stakeholder has objected to an expansion process being included into UT3. Indeed, we are of the view that the inclusion of an effective expansion process is in the interests of all stakeholders (section 138(2) of the QCA Act). We also consider that it aligns with section 138(2)(a) and section 69E of the QCA Act that requires we have regard to promoting the economically efficient operation, use of and investment in the CQCN.

As discussed the section on task, timing and contacts, however, the assessment of Aurizon Network's 2014 DAU is being undertaken parallel to this SUFA Draft Decision process. An expansion process is already being developed as part of the 2014 DAU arrangements. We note comments from Aurizon Network and QRC that an expansion process had largely been agreed between these two parties prior to the release of our May 2014 SUFA Position Paper. We also note the QRC's comment that the parties had not discussed planning, capacity assessments and pre-approval of expansions—elements we consider are needed for the SUFA to be workable, bankable and credible.

Against this background, we are conscious of the need to ensure that effort is not expended on the development of an expansion process to include in the 2010 Access Undertaking (AU) if it is possible that the 2010 AU will be replaced by a new undertaking in the near future. We consider that the actual SUFA documents being developed can be included in the 2014 DAU and that it is pragmatic to focus effort on ensuring that the expansion process being developed as part of the 2014 DAU process is fit-for-purpose and supports an effective SUFA. Consequently, we intend to progress issues surrounding the expansion process as part of our assessment of the 2014 DAU.

In the event that it becomes apparent that a new undertaking is unlikely to become available in the near future, we will then consider how best to include an expansion process within the 2010 AU.

### Interim Position

**5.10 Issues regarding the development of an expansion process that ensures SUFA is workable, bankable and credible will be developed as part of our assessment process of the 2014 DAU. This is currently underway.**

**We will only consider how best to include an expansion process within the 2010 AU if it becomes apparent that it is unlikely that a new undertaking will become available in the near future.**

#### 5.4.5 Undertaking—approach to capacity guarantees and shortfalls

As noted previously in the section on underlying principles, we are of the view that if Aurizon Network is to have control of the construction process of SUFA infrastructure, this has to be subject to credible up-front commitments. One of these commitments is a defined capacity



outcome and failure to deliver that should have some form of consequence. This position was outlined in our May 2014 Position Paper.

The issue primarily relates to developing the expansion process to ensure, amongst other things, an effective SUFA. Consequently, the development of explicit Draft Decisions will form part of our assessment of the 2014 DAU. Against this background, this section outlines how our thinking has developed on this issue based, in part, on the responses received in relation to the Position Paper.

In response to our Position Paper, Aurizon Network said that it should only be subject to financial consequences should its commitments as a construction contractor not be delivered. This did not apply in respect of capacity delivery. Aurizon Network also argued that the expansion process developed with support from the QRC recognises that Aurizon Network does not have full control over the decisions on scope and standard (key determinants of whether capacity is delivered) because of the involvement of access seekers in the expansion process.

Aurizon Network also submitted that the imposition of financial consequences with respect to capacity delivery would motivate Aurizon Network to mitigate risk by ensuring scope was robust and highly likely to deliver capacity with a corresponding increase in overall project costs.

In addition to Aurizon Network's comments Anglo American said it considered our proposal that stakeholders and Aurizon Network should be able to agree to a 'range of capacity outcomes' to be fundamentally flawed because the baseline capacity is unknown to stakeholders.

We are unconvinced by these arguments. We are of the view that once an expansion project is triggered, having some form of commitment regarding the capacity that will be delivered is unlikely to leave stakeholders in a worse position than having no form of commitment. Whilst we would agree that there is a clear and definite need to understand baseline capacity, this, in our view, does not suggest that a commitment to a level of capacity for an expansion represents a 'fundamental flaw' in our approach to making SUFA workable, bankable and credible. We consider this relates more to whether the expansion was needed in the first instance. In our view this is a different, albeit critical, question that should be addressed in the context of the assessment of the 2014 DAU.

We also consider that the core issue with respect to capacity guarantees relates to developing a pragmatic, fair way of dealing with the uncertainty around a capital project's scope, cost and expected capacity it will deliver, and how this relates to the desired level of capacity that stakeholders may want delivered.

Essentially, can a mechanism be developed to provide a capacity guarantee from Aurizon Network, while appropriately accounting for the value that those with an indicative capacity allocation/who are funding the expansion attaches to certainty regarding the delivery of a desired capacity outcome? We are of the view that this is potentially possible but that it would require a change in the way the feasibility study and the 're-engineering' process are undertaken. Our thinking is outlined below.

We are of the view that it is beneficial to consider an expansion as a set of various scopes that may deliver a desired level of capacity but with varying levels of success. Ultimately, these scopes represent a set of choices. To facilitate such choices, the trade-off between the specific project scope, the expected capacity this will deliver, and the cost associated with that scope should be more explicit and transparent at the feasibility stage of the expansion process.

If this is the case those with an indicative capacity allocation/who are funding the expansion can make an informed decision regarding the option they wish to take with regard to the trade-off between the scope and the certainty of delivering the desired level of capacity. They may wish to attain. Moreover, in such circumstances it would seem reasonable for Aurizon Network to provide a capacity guarantee regarding the expected capacity that the chosen option can

deliver. An example of the process to develop a capacity guarantee is illustrated in the subsequent example.

**Figure 5 Proposal for developing a capacity guarantee****Capacity versus cost options example:**

The desired capacity for a project is 100 mtpa. A project scope is designed that will deliver 100 mtpa with certainty at a cost of \$500 million (scope A). If, however, there is a reluctance to incur a cost of \$500 million, there are two alternative options comprising:

- (a) Scope B: can be built at a cost of \$300 million. This has a 90% chance of providing 100 mtpa or an expected capacity of 90 mtpa.
- (b) Scope C: can be built at a cost of \$200 million. This has a 75% chance of providing 100 mtpa or an expected capacity of 75 mtpa.

Effectively, there is a 'menu' of potential options comprising a set of scopes/costs that can provide an expected capacity relative to the desired capacity. This does not mean that desired capacity will not be delivered, it means that for certain scopes it is less likely. Those with an indicative capacity allocation/potential funders can be offered a set of choices by Aurizon Network— in the above example, these would be:

**Table 5 Scope/Capacity trade-off matrix**

<i>Scope</i>	<i>Desired Capacity</i>	<i>Expected Capacity</i>	<i>Cost</i>
Scope A	100 mtpa	100 mtpa	\$500 million
Scope B	100 mtpa	90 mtpa	\$300 million
Scope C	100 mtpa	75 mtpa	\$200 million

We consider these scope options can be defined in the feasibility study. We would expect each of the options to be accompanied by relevant cost build-up information, scopes and justification for the expected capacity outcomes. An independent assessment of the options could be obtained if deemed necessary.

Parties would be free to select and/or negotiate on the options. Once the preferred option is determined, Aurizon Network essentially provides a binding commitment to deliver the expected capacity that the chosen option is expected to deliver, not the desired level of capacity. It should be noted that, if the options are negotiated, it may in principle result in a differing expected capacity for the given option.

In this way, those with indicative capacity allocations/potential funders can make an explicit and transparent assessment of the extent to which they value certainty in relation to the delivery of the desired capacity relative to the potential scope /cost combinations on offer. The ultimate choice defines the level of uncertainty they are prepared to accept regarding delivery of the desired capacity and places a value upon it.

Under these circumstances, we consider it equitable that Aurizon Network would commit to delivering the expected capacity of the scope chosen. The following three options with respect to the actual resulting capacity would apply:

<i>Outcome</i>	<i>Approach</i>
Actual capacity = expected capacity	The project has delivered as required– no further action required
Actual capacity < expected capacity	Aurizon Network will be required to rectify/compensate for the shortfall at its cost
Actual capacity > expected capacity	Those with indicative capacity allocation/SUFA funders have first call priority on capacity over-delivered, including any capacity delivered over the desired level.

A practical consideration for our current thinking relates to the role of feasibility studies in the expansion process.

Our understanding is that the expansion process adopted by Aurizon Network and project funders means that after the feasibility study there can be some re-engineering of the scope of the project in order to reduce its capital cost. Essentially the process involves assessing the extent that differing scope and cost profiles have on the project delivering the level of capacity desired. We consider that the process should become more transparent, be included as part of the feasibility process and be extended to provide an explicit estimate of the expected capacity obtained from a given scope/cost profile. We consider that this would allow the proposed approach to be implemented and would ensure a robust approach to the feasibility study process.

We consider this approach would reduce Aurizon Network's perceived need to over-scope and -cost an expansion project when providing up-front capacity commitments. This is because Aurizon Network is committing to provide the expected capacity given a particular scope, rather than being asked to commit to the desired capacity regardless of scope change. This also ensures that indicative capacity allocation holders/funders have to explicitly consider their preference for certainty and the extent to which this is valued. A further outcome of this approach would be a defined capacity outcome from which to measure the extent of any capacity shortfall that Aurizon Network would have to rectify/provide compensation for at its cost.

Additionally, information provision to relevant stakeholders would reflect a set of options. We are of the view that this provides robust information sets for all capacity allocation holders/funders to consider. This can potentially enhance constructive engagement and trust in the expansion process.

Overall, we consider that this approach appropriately balances the legitimate business interests of Aurizon Network with the interests of access seekers and funders (section 138(2)(b) and (e) of the QCA Act). Access seekers and funders can choose how much they value certainty whilst Aurizon Network is committed to providing the capacity outcome associated with this valuation. We also consider that it aligns with section 138(2)(a) and section 69E of the QCA Act that requires we have regard to promoting the economically efficient operation, use of and investment in the CQCN. As such, we consider it in the public interest (section 138(2)(d) of the QCA Act).

We welcome stakeholder comments on whether they consider this approach to be worth pursuing and practically achievable. It would also be extremely beneficial if submissions could provide alternative approaches—if our proposal is not considered viable.

#### 5.4.6 Undertaking: role of pre-approval

In our Position Paper, we proposed to approve—or not approve—capital expenditure for inclusion in the RAB prior to the project commencing. Our view is third party funders would be more likely to invest given an up-front approval of costs by the QCA to be included in the RAB. This removes asset optimisation risk for the tranche of funding pre-approved and provides some certainty about the costs to be included in the RAB.

Similarly to the previous section regarding capacity commitments and shortfalls, this issue primarily relates to developing the expansion process to ensure, amongst other things, that there is an effective SUFA. Consequently, the development of explicit Draft Decisions will form part of our assessment of the 2014 DAU. Against this background, this section outlines how our thinking has developed on this issue based, in part, on the responses received in relation to the Position Paper.

The remainder of this section outlines our current thinking regarding:

- pre-approval submissions
- inclusion of capital costs into the RAB
- treatment of contingency funding for adjustment and variation events
- role of the system test.

### Pre-approval submissions

Under clause 3.1 of Schedule A of the 2010 AU, Aurizon Network may seek pre-approval of the scope or the standard of a capital expenditure project, or of a procurement strategy.

To date, Aurizon Network has not used this option.<sup>58</sup>

Aurizon Network also has the option to seek customer acceptance of projects under clause 3.2, Schedule A of the 2010 AU. Aurizon Network may only seek customer acceptance of the scope of a project. If customers vote to accept the scope of the project, we will only accept the scope of the capital expenditure project as being prudent, not the capital cost of the project.

Neither of these options has been developed in the context of having a workable, bankable and credible SUFA framework that encourages third party funding. Against this background, in our May 2014 Position Paper, we proposed that a pre-approval process for capital expenditures should apply once the expansion process was complete and all parties to the feasibility study had agreed on a set of up-front commitments. Our Position Paper also considered that it was necessary for the feasibility study to meet the requirements of all potential stakeholders, including third party financiers.

In this context, we are of the view that an up-front capacity commitment, for a given standard, scope, cost and time-to-complete is essential for the QCA to be able to commit to including capacity costs into the RAB prior to the infrastructure being constructed. As discussed in section 5.4.5 on capacity guarantees and shortfalls, we also consider that the feasibility study process needs to be refined if this is to be achieved.

We consider that a capacity guarantee underpins the pre-approval process and appropriately balances the legitimate business interests of Aurizon Network, access seekers and funders (sections 138(2)(b) and (e) of the QCA Act). We are also of the view that it is necessary in ensuring we fulfil our duties with respect to section 138(2)(a) and section 69E of the QCA Act that requires we have regard to promoting the economically efficient operation, use of and investment in the CQCN. We also consider that it ensures we fulfil our duties with respect to the public interest (section 138(2)(d) of the QCA Act). We would welcome stakeholder comments on this position.

### Inclusion of capital costs into the RAB

Against this background, a key question is precisely what capital costs are pre-approved for inclusion in the RAB. Within this context, Aurizon Network commented that it believed that the amount paid in the lump-sum construction contract is the amount that was to be pre-approved for inclusion into the RAB, rather than the costs of Aurizon Network as constructor. We also note Aurizon Network submitted that the independent engineer will assess and approve the costs of the construction contract as prudent to permit construction to commence<sup>59</sup>.

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<sup>58</sup> We note the Dalrymple Bay Coal Terminal has applied a form of pre-approval for its major expansion of the coal terminal.

<sup>59</sup> Aurizon Network 2014b, p.15, figure 2

We do not share Aurizon Network's view that costs approved by the independent engineer will automatically be included in the RAB. Our position regarding the pre-approval process remains broadly unchanged from our May 2014 Position Paper insofar as pre-approval comprises the following:

- **Step 1:** Aurizon Network is to submit a pre-approval submission providing the required information. A report from an independent engineer/expert advisor by Aurizon Network but responsible solely to the QCA, would also be provided.
- **Step 2:** We would choose to either approve or reject the project based on the recommendation of the independent engineer/expert advisor. This assumes that the recommendation is considered credible.

Subject to there being an appropriate capacity commitment, this assessment relates to the reasonableness of the terms and conditions within the construction contract and whether these have been translated into an appropriate lump-sum costing. If the pre-approval assessment concludes the construction contract and up-front commitments reasonable it is likely that the lump-sum will be preapproved for inclusion into the RAB. If, however, the QCA deems the lump-sum excessive it will not be pre approved into the RAB. The critical point is that for each project we will review the construction contract and the up-front commitments associated with this as a package and assess whether, based on this package, the lump-sum can be pre-approved.

For avoidance of doubt, given our duties under the QCA Act, only the QCA can decide whether capital expenditure can be included in the RAB. This is not a function of independent engineers, certifiers and advisors to undertake. They provide recommendations which may or may not be considered credible.

We would welcome further stakeholder comments and suggestion on our approach

### Treatment of contingency funding for adjustment and variation events

With respect to contingency funding, Aurizon Network said it agreed that general variations (which are not required, but may be desired by Aurizon Network as the construction contractor, or the Trustee as principal) should be assessed on a case-by-case basis and not pre-approved. Aurizon Network also considered that adjustment events in excess of the contingency amount would nonetheless be prudent as they result from events beyond the control of the constructor. Aurizon Network proposed an independent certifier determine prudence of an adjustment event during construction, rather than seek approval at the end of construction.<sup>60</sup>

We have a number of concerns with Aurizon Network's proposal. We cannot see how it provides any credible incentive for cost control. We are of view that it limits the value of pre-approval for both potential third party financiers and user funders because the 'size' of the cheque they are committing to becomes unduly open-ended. Furthermore, in our view, Aurizon Network's proposal undermines the pre-approval concept, potentially reducing the regulatory role to 'rubber stamping' adjustment events endorsed by an independent certifier.

Overall, although the proposal is clearly in Aurizon Network's interests, we do not consider that in the context of applying the QCA Act it is in their legitimate business interests (section 138(2)(b) of the QCA Act). Furthermore, we are also of the view it does not align with the other relevant aspects of the QCA Act (sections 138(2)(a), (d), and (e) of the QCA Act). This is because the lack of credible incentives for cost control does not encourage efficient investment and is not in the public interest, or that of access seekers and third party funders.

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<sup>60</sup> Aurizon Network 2014b, pp.14-15

In our view Aurizon Network's proposals do not provide a credible reason for amending our view in the May 2014 May Position Paper— which proposed that a contingency fund, over and above the lump-sum, should be adopted for variation and adjustment events. This fund should be considered as part of the expansion process and agreed upon by parties prior to seeking pre-approval and included as part of the pre-approval submission.

We continue to be of the view that the approach outlined above reflects that each capital project will have a unique set of risks and terms and conditions within the construction contract. It also provides all prospective funders with a level of assurance as to the maximum expenditure the project is perceived to face. We also consider that the adoption of the approach discussed in the capacity guarantee and shortfall section 5.4.5 can assist in assessing contingency funding. This is because it is based on Aurizon Network committing to expected capacity outcomes.

Moreover, in order to ensure that there is a credible incentive to 'size' the contingency correctly and use it efficiently, we continue to be of the view that variations outside the agreed contingency funding or not within the specified variation and adjustment events would not be part of the pre-approval process. They will be subject to a separate assessment upon completion of the project, to determine whether the incremental costs associated with these events should be included in the RAB. This also applies for any variations Aurizon Network decides to undertake on its own initiative.

Legitimate variation proposals that are agreed with funders, and submitted for approval, would generally be accepted. The exception would be if the variation resulted in a failure of the system test (discussed in the subsequent section) or the contingency fund being used up. If a variation is signed off, the lesser of the actual capital cost associated with the variation and the approved capital cost for the variation will be included in the RAB.

We consider that this approach meets the relevant criteria in sections 138(b) and 69E of the QCA Act. We would welcome further stakeholder comments and suggestions on this approach.

### System Test

As noted previously, we consider that the pre-approval process is part of the expansion process and we intend to assess this under the 2014 DAU submitted by Aurizon Network. Part of the pre-approval approach is the system test. As such, we do not intend to provide a Draft Decision on this issue within this document. The below discussion outlines our current thinking based, in part, on the responses to our May 2014 May Position Paper.

Our view in the position paper was that the system test should comprise the following:

- a tariff test to assess whether the SUFA infrastructure should be socialised with existing infrastructure or not
- a baseline capacity test to assess whether the SUFA infrastructure impacted on existing contractual obligations.

We noted that failure of the system test could impede pre-approval, depending on the mitigating actions proposed. We are of the view that this approach appropriately balances the interest of all stakeholders (sections 138(2)(b), (d) and (e) of the QCA Act).

Aurizon Network's response to the Position Paper supported the concept that prudence must consider the impact on existing users. Aurizon Network noted that, the system test proposed in UT4 (the 2014 DAU) has progressed to the 'in-principle' level at the time of its submission on the SUFA Position Paper.

Aurizon Network also considered whilst it supported the concept that existing access holders should not have their capacity impacted, it is not clear how an expansion could do so as:

- the expansion does not impact existing access agreements
- where the expansion does not create sufficient capacity, it is the expanding users that are suppressed, not existing customers.

With regard to the baseline capacity test component of the system test, it may be that in the majority of—or indeed all—circumstances the capacity entitlements of existing access holders would not be impacted upon if there is an expansion. We, however, are of the view that for the purposes of transparency and to ensure stakeholder confidence in the pre-approval process, Aurizon Network should commit, confirm and provide evidence that this would be the case for each expansion. We note that Aurizon Network's position suggests this would largely appear to be a formality.

In relation to the tariff test component of the system test, we continue to be of the view that this test should include both the lump-sum contractual cost and the contingency fund discussed in the previous section. This effectively provides an assessment based on the maximum agreed capital cost between Aurizon Network and prospective funders. We are of the view that this provides the most robust assessment possible of whether a SUFA infrastructure project will be socialised or not. This provides prospective funders with a better understanding of any risks they may consider relevant with respect to the socialisation or otherwise of the SUFA infrastructure. This is further reason why we are of the view that Aurizon Network's proposed approach to variation and adjustment events is inappropriate.

We would welcome further stakeholder comments and suggestions on our approach.



## 6 SECURITY AND FINANCEABILITY

*A key to the success of the SUFA agreements is ensuring the framework allows for third party financing. Third party financiers will require security over the Trust's cash flows and contractual rights. Third party financiers also require a cash flow that is stable and predictable.*

*Aurizon Network's SUFA agreements do not contemplate security over cash flows and prohibit the granting over contractual rights. Rather, the agreements focus on:*

- *users providing financing—whether by way of their own equity or debt facilities*
- *Aurizon Network partially funding a SUFA project.*

*The following actions have been raised as impediments to third party financing as each may reduce the certainty and stability of the cash flows back to the user funders:*

- *Direction to pay—it is not clear that this contractual mechanism is strong enough to survive an Aurizon Network insolvency*
- *lock-up of distributions—under the (SUHD, Aurizon Network may (acting as the ordinary unit holder) direct the Trustee not to make distributions to the preference unit holders*
- *set-off—under the EISL, Aurizon Network may set-off any amounts which are due to it by the Trustee against amounts payable to the Trustee.*

*Our Draft Decision proposes there be security over the rental cash flows in order for SUFA to be considered credible and bankable. To enable security be taken, a Specific Security Agreement has been included as part of the SUFA suite of agreements. We have also proposed amendments to the direction to pay to clarify what happens to the rental cash flow if the lease agreements are terminated. In addition, we have explained our position on the use of set-offs.*

### 6.1 Summary of our May 2014 position

In our Position Paper, we said an effective credible SUFA would permit both third party funding, as well as off-balance-sheet funding provided by users.

We also concluded that if security could not be granted over the rental cash flows, third party funding was unlikely to be achieved—and off-balance-sheet funding would be limited. We also concluded that there must be a mechanism in place to allow for the payment of cash flows to be enforced—if certain circumstances occur.

Based on our assessment we considered that there was insufficient stability and predictability of cash flow. Within this context, the following specific areas were raised as impediments to third party financing: direction to pay, lock-up of distributions and set-off under the EISL.

#### 6.1.1 Direction to pay<sup>61</sup>

We were advised by our financial advisor, Grant Samuel, that a contractual mechanism, such as the direction to pay mechanism, by itself, would not be sufficient to ensure security over cash flows. We also understood, from discussions with stakeholders that security could not be taken over the infrastructure assets as ownership ultimately lies with the State of Queensland (through QTH).

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<sup>61</sup> Under the EISL, Aurizon Network is required to pay rent to the Trustee. We understand that, as a form of protection against Aurizon Network not paying the rent, Aurizon Network is to direct nominated access holders to pay a matching amount of access agreement revenue directly to the Trustee. This mechanism operates through a contractual obligation called a direction to pay.

However, for there to be a credible and bankable SUFA arrangement, we consider it to be essential that there be a form of security over the right to receive future rental cash flows—given the cash flows from the SUFA assets is the primary asset of the Trust.

In this regard, we proposed that security be granted over that part of the access charges of the linked access agreements that formed the rental stream. It was considered that this security arrangement would:

- not reach any further than the rental payment due to the Trustee
- provide the additional certainty that the trust will be entitled to receive payments in the event that the direction to pay is no longer an effective mechanism.

We noted that similar issues apply to certain termination events where security could be taken over any compensation cash flows. This is discussed in Chapter 7 (Termination).

### 6.1.2 Lock-up of distributions

Under the SUHD, Aurizon Network may (acting as the ordinary unit holder) direct the Trustee not to make distributions to the preference unit holders. We were advised by Grant Samuel that this discretion should be removed as it is fundamentally important for external lenders to receive a rental payment that meets its interest and capital repayments. Allowing a mechanism where cash flow may not to be paid lowers the attractiveness of lending into such a framework as the certainty of receiving the cash flow is reduced. We proposed the SUFA framework require the Trustee to make distributions to preference unit holders (if the Trustee has sufficient funds to make that distribution).<sup>62</sup>

### 6.1.3 Set-off under the EISL

Aurizon Network proposed to set-off any amounts which were due to it by the Trustee against amounts payable by Aurizon Network to the Trustee.<sup>63</sup> We considered that set-off may be acceptable to third party financiers if the amounts being set-off are not material and set-off rights flowed in both directions. We proposed that minor rent over/under payments be adjusted through the rent adjustment provisions and the right to set-off be available to all parties in such cases.

By contrast, we considered that in the case of low probability high impact events—such as a tax law change—Aurizon Network could seek a change to the tariff by the amount of the impact. Only if the change in tariff is not approved, could Aurizon Network seek to set-off the amount of the impact.

## 6.2 Summary of Aurizon Network's position

Aurizon Network said it supported the majority of our proposed changes from the Position Paper in relation to security and financeability.

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<sup>62</sup> We noted that where Aurizon Network chooses to partly fund a project (hybrid funding) - parties would be free to negotiate away from the standard agreement to allow for a non-mandatory distribution arrangement.

<sup>63</sup> Under the EISL, Aurizon Network may set-off any amounts which are due to it by the Trustee against amounts, payable to the Trustee. If Aurizon Network wants to deduct any amount from the rent payable, it can reduce the amount it would otherwise direct a customer to pay into the direction to pay account. Under Aurizon Network's 2013 SUFA DAAU, set-off provisions would only work in one direction— Aurizon Network using setting-off.

### 6.2.1 Direction to pay

Aurizon Network agreed to a form of security over access charges under linked access agreements for an amount equal to the rent payable in the event that the direction to pay mechanism is no longer effective.<sup>64</sup>

### 6.2.2 Lock up of distributions

Aurizon Network agreed to removing the Trustee's obligation to withhold distributions if so required by the ordinary unit holder.<sup>65</sup>

### 6.2.3 Set-off

Aurizon Network agreed to the following set-off proposals:

- rent over/under payment is to be dealt with through the rent adjustment mechanism
- each party is to have a right of set-off
- both Aurizon Network and the Trust are to be kept whole in respect of tax exposure (following a change in law) by seeking a change to the regulatory tariff from the QCA (by including the tax cost in the RAB).

Aurizon Network did not agree that it should fund tax costs, whether that is:

- the temporary financing of tax costs from their occurrence until the QCA decided on their RAB inclusion, and/or
- the ongoing regulatory investment in respect of tax costs if the QCA approved their inclusion in the RAB.

Aurizon Network considered that, where a favourable tax ruling was obtained prior to a SUFA transaction becoming unconditional, any tax costs incurred at a later time would be considered prudent. In its view the parties that should bear the ultimate tax burden are the access holders through their access charges.<sup>66</sup>

Aurizon Network agreed to include an obligation on itself to seek the inclusion of any tax cost amounts in the RAB as capital amounts which would be depreciated for regulatory purposes over a number of years. It noted that it was necessary to specify which parties would be the temporary funders of these costs—until included in RAB—and the ultimate funders of the tax costs. Aurizon Network said it did not wish to be the temporary or ultimate funder of the tax costs, which would arise solely from entry into a user funding transaction.<sup>67</sup>

Instead, Aurizon Network proposed that, in the event of such a tax cost, it retain the ability to call on the tax indemnity while seeking inclusion in the RAB. Where the tax cost was included in the RAB, the rent would increase to reflect the returns on the tax indemnity amounts included in the RAB.<sup>68</sup>

### 6.2.4 Tax indemnifying party

Aurizon Network noted that the 2013 SUFA DAAU provided that the party providing the tax indemnity was each user funder (under each user funder's respective UA)—which, unless assigned, was the access holder under the SUFA access agreement. Aurizon Network noted that given there was the potential for earning additional rent where the tax cost was included in the

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<sup>64</sup> Aurizon Network 2014b, p.17

<sup>65</sup> Aurizon Network 2014b, p.17

<sup>66</sup> Aurizon Network 2014b, p.18

<sup>67</sup> Aurizon Network 2014b, p.18

<sup>68</sup> Aurizon Network 2014b, p.18

RAB, there could be merit in the tax indemnity obligation being transferred to the SUFA funders—or the preference unit holders.<sup>69</sup>

## 6.3 Summary of stakeholders' comments

### 6.3.1 Direction to pay

The QRC supported the Trustee being granted first-ranking security over rental cash flows. The QRC noted that security over the rental cash flow is more consistent with customary funding arrangements and will substantially assist with the bankability of SUFA.<sup>70</sup>

### 6.3.2 Lock up of distributions

The QRC strongly supported our position that all distributions from the Trust be mandatory.<sup>71</sup>

### 6.3.3 Set-off

The QRC supported our position on set-off for immaterial amounts, provided the materiality threshold was low and recognised both single and cumulative set-off amounts.<sup>72</sup>

### 6.3.4 Liability

The QRC noted that a key component of the SUFA framework and the EISL in particular, is the right of the Trustee to receive rent from Aurizon Network. The QRC said that in recognizing the obligation of Aurizon Network to pay rent, it is of the view that the limitations of liability in the EISL are unacceptable. For example, it noted Aurizon Network had proposed its liability be limited to \$1—other than for fraud, gross negligence and wilful default. It concluded that this would leave the Trustee and user funders exposed to liability where, for example, there had been a material breach of the EISL and Aurizon Network has failed to pay rent that is otherwise due.

The QRC also commented that Aurizon Network should not be relieved from its liability for failure to raise invoices, or any negligent conduct in obtaining access revenue payments from customers.<sup>73</sup>

## 6.4 QCA analysis and Draft Decision

As discussed in Chapter 10 (Third party financing), we have sought to develop the SUFA documents to allow for flexibility in funding arrangements. We have also sought to allow for flexibility of potential funding parties to encourage competition in the market for infrastructure finance.<sup>74</sup> In this regard, we consider it is essential to include security over the rental cash flows in order for SUFA to be credible and bankable.

### 6.4.1 Security Agreements

We note stakeholders agreed with our proposal to include security over rental cash flows.

Accordingly, the suite of SUFA documents attached to this Draft Decision now includes a Specific Security Agreement which allows security to be taken over the cash flows.

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<sup>69</sup> Aurizon Network 2014b, p.19

<sup>70</sup> QRC 2014a, p.4

<sup>71</sup> QRC 2014a, p.4

<sup>72</sup> QRC 2014a, p.4

<sup>73</sup> QRC 2013b, p.17

<sup>74</sup> We consider this meets with section 138(2)(d) of the QCA Act.

The Specific Security Agreement is an agreement between the Trustee as the secured party and Aurizon Network as the grantor of security over the direction to pay amounts and direction to pay undertakings.

The direction to pay amounts are the amounts of access charges Aurizon Network has directed access seekers under access agreements to pay to the Trustee (and, in the absence of a direction to pay, all the access charges to the Trustee).

The direction to pay undertakings are undertakings given by access seekers (whose access agreements do not include direction to pay provisions) to Aurizon Network to pay amounts of access charges to the Trustee as directed by Aurizon Network (and in the absence of a direction to pay, all the access charges to the Trustee).

The Specific Security Agreement ensures that should Aurizon Network enter into insolvency, the Trustee can enforce the security to preserve its rights to the direction to pay amounts, and the undertakings under the direction to pay undertakings.

We consider our position meets with section 69E of the QCA Act since putting security in place over the rental cash flows, allows for third party finance. Allowing for third party finance increases the competitiveness of the market for rail infrastructure finance. We also consider our position meets with the interest of access seekers as it broadens their choice for finance, not simply being restricted to fund off balance sheet (section 138(2)(e) of the QCA Act).

#### Draft Decision

**6.1 We consider the 2013 SUFA DAAU documents should be amended to include the Specific Security Agreement to allow for security to be taken over the cash flows.**

**6.2 The Specific Security Agreement we would consider accepting is included in the suite of SUFA agreements attached to this Draft Decision.**

#### 6.4.2 Direction to pay amount

In our Position Paper, we were of the view that a contractual direction to pay mechanism would not be sufficient to provide the Trust or financiers with security over the rental cash flows. This is particularly relevant in the event of a lease termination.

We have drafted the SUFA agreements such that the amount Aurizon Network directs access seekers to pay the Trustee is determined by Aurizon Network under the EISL:

- by reference to the rent due to be paid for that month (either under access agreements with direction to pay provisions or direction to pay undertakings).
- Where the sub-lease has been terminated, Aurizon Network directs access seekers to pay a 'compensation' payment in lieu of rent.

Where the sub-lease has been terminated and Aurizon Network is the cause of termination, Aurizon Network is to pay the Trustee any detriment amount. The detriment amount is intended to compensate (in this case) the Trustee for the adverse consequence of being paid 'compensation' rather than rent.

### Draft Decision

**6.3 We are minded to determine that the 2013 SUFA DAAU EISL be amended to achieve the following in respect of Direction to Pay:**

- (a) The amount Aurizon Network directs access seekers to pay the Trustee (either under access agreements with direction to pay provisions or direction to pay undertakings) is determined by Aurizon Network under the EISL by reference to the rent due to be paid for that month.**
- (b) Where the sub-lease has been terminated, Aurizon Network directs access seekers to pay a 'compensation' payment in lieu of rent.**
- (c) Where the sub-lease has been terminated and Aurizon Network is the cause of termination, Aurizon Network is to pay the Trustee any detriment amount. The detriment amount is intended to compensate (in this case) the Trustee for the adverse consequence of being paid 'compensation' rather than rent.**

**6.4 The Direction to Pay arrangements we would accept is included in the suite of SUFA agreements attached to this Draft Decision.**

#### 6.4.3 Lock-up of distributions

All stakeholders agreed distributions from the Trust should be mandatory. Aurizon Network has advised us (in meetings) that a result of this amendment is that Aurizon Network may choose to not enter into hybrid funding under as a result of possible adverse accounting consequences. We understand that whether or not this is the case would depend on the circumstances of the particular project and the level of funding Aurizon Network would be likely to inject.

We have removed the Trustee's obligation to withhold distributions if so required by the ordinary unit holder. We consider this improves the bankability of the SUFA framework. Both third party financier and user funding off-balance-sheet as external lenders will be provided with greater certainty that the expected returns (rental cash flows) will be delivered. We consider this is in the public interest as per section 138(2)(d) of the QCA Act.

### Draft Decision

**6.5 We are minded to require that the Trustee's obligation to withhold distributions if so required by the ordinary unit holder be removed from the 2013 SUFA DAAU documents.**

#### 6.4.4 Set-off

In its 2013 SUFA DAAU, Aurizon Network proposed that it may set-off any amounts due to it by the Trustee, against amounts payable to the Trustee. Under its proposal, if Aurizon Network wanted to deduct any amount from the rent payable, it could reduce the amount it would otherwise direct a customer to pay into the direction to pay account.<sup>75</sup> The set-off was proposed to work in one direction only, in favour of Aurizon Network.

As noted above, in our Position Paper, we considered that set-off of rent may be acceptable (for third party financiers), if:

- the amounts to be set-off are not material
- the right to set-off flows in both directions.

We note that Aurizon Network and the QRC agreed to each party having a right to set-off.

<sup>75</sup> Set-off was proposed under the rent provisions under the Extension Infrastructure Sub Lease.

Notwithstanding the above, we also note the following comments were made:

- The QRC said it agreed to set-off for immaterial amounts provided the materiality threshold was low, and recognised both single and cumulative set-off amounts.
- Aurizon Network said the rent over-/underpayment is to be dealt with through the rent adjustment mechanism.

Within this context we have considered set-off in the following cases:

- over-/underpayment of rent via the rent adjustment mechanism
- non-rental immaterial amounts
- non-rental material amounts

### Set-off and the rent adjustment mechanism

Under the EISL, monthly over- and underpayments of rent are captured under the rent adjustment mechanism. The following boxes contain simple examples of how the rent adjustment mechanism captures rent over- and underpayments in certain circumstances.

#### Overpayment of rent

The following is an example of how the rent adjustment mechanism adjusts for an overpayment of rent in month 2:

	<i>Month 1</i>	<i>Month 2</i>	<i>Month 3</i>	<i>Total</i>
<b>Invoice to access holders (\$)</b>				
Direction to pay amount	200,000	225,000	175,000	
<b>Expected Rent (\$)</b>	200,000	225,000	212,000	637,500
<b>Received by the Trust (\$)</b>	200,000	262,500	175,000	637,500
<b>Overpayment (\$)</b>		37,500		
<b>Adjustment (\$)</b>			-37,500	

- **Step 1:** Aurizon Network sends a monthly invoice to linked access agreement holders notifying the amount to be paid to the Trust (direction to pay amount).
- **Step 2:** Aurizon Network sends a recipient created tax invoice (RCTI) to the SUFA Trust indicating the rent it will receive.

#### The overpayment and adjustment:

In month 2, the SUFA Trust receives \$262,500, an overpayment of \$37,500.

In month 3, the linked access agreement holders are directed to pay \$175,000, which is \$37,500 less than the calculated rent for that month, to adjust for the overpayment in month 2.

At the end of month 3, the amount of rent due to the Trust has been received by the Trust.

## Underpayment of rent

The following is an example of how the rent adjustment mechanism adjusts for an underpayment of rent in month 1.

	<i>Month 1</i>	<i>Month 2</i>	<i>Month 3</i>	<i>Month 4</i>	<i>Total</i>
<b>Invoice to access holders (\$)</b>					
Direction to pay amount	200,000	225,000	175,000	224,000	
<b>Expected Rent (\$)</b>	200,000	225,000	212,000	204,000	841,000
<b>Received by the Trust (\$)</b>	180,000	225,000	212,000	224,000	841,000
<b>Underpayment (\$)</b>	20,000				
<b>Adjustment (\$)</b>					
<b>Rent Shortfall Adjustment Amount (RSAA)</b>				19,000	
<b>Rent Shortfall Amount (RSA)</b>				1,000	

- **Step 1:** Aurizon Network sends a monthly invoice to linked access agreement holders notifying the amount to be paid to the Trust (direction to pay amount).
- **Step 2:** Aurizon Network sends a recipient-created tax invoice (RCTI) to the SUFA Trust indicating the expected rent it will receive.

### The underpayment and socialised adjustment:

- In month 1, the SUFA Trust receives \$180,000, an underpayment of \$20,000.
- If the amount of the underpayment has not been recovered within three months, the shortfall is socialised across all users in the following month (month 4) as follows:

$$RSAA = R_i - (R_o - S)$$

Where:

$R_i$  = Trust's share of the distribution pool (all system revenues) net of the shortfall. In this example the distribution pool is \$4,000,000 and the SUFA Trust's share of the distribution pool is 5%.

$R_o$  = Rent for the month

$S$  = Shortfall amount

$$R_i = (\$4,000,000^{76} - \$20,000) \times 5\%^{77} = \$199,000$$

$$RSAA = \$199,000 - (200,000 - 20,000) = \$19,000$$

- \$19,000 is returned to the Trust in month 4.
- \$1,000 is the Trust's portion of the socialisation of the shortfall (RSA.)

Effectively if the underpayment remains unpaid and the SUFA expansion is socialised, the \$20,000 shortfall which has been carried by the Trust for three months is shared across the system. The Trust's share of the \$20,000 shortfall is \$1,000. So, \$19,000 is transferred to the Trust.

<sup>76</sup> Distribution pool (system revenues)

<sup>77</sup> Applicable interest (proportion compared to system)



Notwithstanding differences in the monthly lag processes, the rent adjustment mechanism attempts to ensure that the flow of rent received by the Trust has a similar flow to the total access charges paid for a given month. This means that a SUFA Trust broadly bears its proportion of the cash flow risk associated with the actual payment of access charges.

This system does not distinguish between material and immaterial changes in actual access charges received for a given month relative to that invoiced. Consequently, at the extreme it is technically possible that for a given month a SUFA trust could receive no rent if no access charges were received. We consider that there is little historic evidence or behavioural incentives for access charges to remain unpaid and have formed our Draft Decision based on this premise.

Against this background, our current thinking is that the rent adjustment mechanism is reasonable. As yet, we are not aware of any legitimate reason why a SUFA Trust should have a more favourable risk profile than Aurizon Network with respect to the actual payment of access charges. Notwithstanding any detailed issues concerning the monthly lag processes in the rent adjustment mechanism, we consider that in broad terms it appropriately balances the interests of access seekers and funders, with the legitimate business interests of Aurizon Network (sections 138(2)(b), (e) and (h) of the QCA Act).

We would welcome stakeholder comments on this position.

#### Draft Decision

**6.6 Solely in relation to rental streams, we consider the rent adjustment mechanism an acceptable set-off arrangement. This is based on the assumption that there is little historic evidence or behavioural incentives for access charges to remain unpaid.**

#### Set-off for non-rental material amounts

We are of the view that the rental adjustment process and the direction to pay should solely relate to rental amounts. It should not include other adjustments. As mentioned previously the right to a rental stream is the main asset associated with a SUFA and this approach ensures that the rental stream remains clear and transparent.

We consider that a standard invoicing and payment approach can be adopted for all immaterial amounts associated with the flow of other monies between Aurizon Network and a SUFA trust. As yet, we are not aware of any legitimate reason regarding the need to set-off these amounts against rental streams. Notwithstanding any detailed issues regarding what constitutes a 'material' amount, we consider that this approach appropriately balances the legitimate business interests of Aurizon Network with those of access seekers and funders (sections 138(2)(b), (e) and (h) of the QCA Act).

#### Draft Decision

**6.7 Set-off for immaterial non-rental amounts to be excluded from the suite of SUFA agreements as a standard invoicing and payment approach can be adopted.**

#### Set-off for non-rental material amounts

We consider that this generally relates to low probability events that can result in a significant cost change that is outside Aurizon Network's control and cannot initially be dealt with through existing regulatory arrangements. An example would be a change in the tax law that has an immediate and significant cost impact upon SUFA funders and potentially Aurizon Network.

Aurizon Network's 2012 SUFA proposals would allow any such costs relevant to SUFA funders to be set-off against rental streams. We, however, do not consider that set-off in the context of these types of non-rental cash flow adjustments appropriate. This is because it could potentially

result in SUFA rental streams being reduced to the point where there are insufficient distributions to cover the principle and interest due to a financier. We are of the view that this is not in the interests of access seekers and funders (sections 138(2)(e) and (h) of the QCA Act). We are also of the view that this form of set-off has the potential to reduce the pool of competitive financing options available, which is counter to section 138(2)(a) and 69E of the QCA Act in relation to encouraging efficient investment.

We do, however, note that account needs to be taken of Aurizon Network's legitimate business interests (section 138(2)(b) of the QCA Act). Within this context we suggested in our position paper that Aurizon Network could seek a change to the regulatory tariff to mitigate the unplanned cost impact of such events.

In response Aurizon Network said that it did not want to finance costs associated with material events. In respect of a potential tax liability, we understand Aurizon Network does not want to be the ultimate funder of the associated costs, or temporary financier until the costs can be recovered through reference tariffs. We consider this to be a reasonable position, provided it is interpreted as relating to the relevant share of any such costs attributable to SUFA infrastructure.

Given this, we have proposed the preference unit holders be responsible for funding any immediate material cash liability attributable to the SUFA infrastructure, such as a tax liability as a result of a change in tax law. Preference unit holders will be responsible for funding this share of any liability as the Trust does not have assets or sufficient cash flow to finance this type of unplanned expense. This effectively represents a cash payment to Aurizon Network to cover the share of any immediate cash liability associated with the SUFA infrastructure if such an event occurs.

As a result of this, we are also of the view that Aurizon Network should be required to seek to change the regulatory tariff to account for at least the amount of that liability attributable to the SUFA infrastructure. That liability would then be refunded back through time to preference unit holders as increased rent. Based on the regulatory assumptions and process adopted at the time of the reference tariff amendment, the stream of increased rents would equate to the up-front cost of the liability on a net present value basis.

We consider this approach aligns with how Aurizon Network would deal with cost impacts due to a change in law (or other significant events) for its existing business. We are of the view that it appropriately balances Aurizon Network's legitimate business interests and that of access seekers and SUFA funders (sections 138(2)(b), (e) and (h) of the QCA Act). This is because it maintains the integrity of a SUFA rental stream whilst providing a mechanism for funding the immediate cash impacts of low probability high cost events.

### Draft Decision

- 6.8 We consider the EISL should be amended so that there is no set-off for non-rent material liabilities, but preference unit holders are responsible for funding the SUFA infrastructure's share of any material liability, such as a tax liability. Preference unit holders will be responsible for funding the liability as the Trust does not have assets or sufficient cash flow to finance this type of unplanned expense.**
- 6.9 However, we also consider the EISL should be amended to place an obligation on Aurizon Network to seek a change to the regulatory tariff to account for the amount of that liability attributable to the SUFA infrastructure. That liability would then be refunded back to preference unit holders as increased rent. Based on the regulatory assumptions and process adopted at the time of the reference tariff amendment, the stream of increased rents would equate to the up-front cost of the liability on a net present value basis.**

#### 6.4.5 Tax indemnity

We agree with Aurizon Network's proposal that there may be merit in the tax indemnity obligation being transferred to the preference unit holders<sup>78</sup> given there may be potential for additional rent being earned through inclusion of the tax cost amount in the RAB.

Our consideration of this matter is discussed in Section 11.4.5.

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<sup>78</sup> Rather than the access holder under an Access Agreement as proposed by Aurizon Network under the 2013 SUFA DAAU.

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## 7 TERMINATION

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*To have an effective financing arrangement, SUFA funders will necessarily need to understand the risks associated with recovering their loans in the event of a termination event.*

*There are numerous ways that the suite of leases can terminate. If these issues are not satisfactorily resolved, or there is uncertainty around the termination risks, the SUFA framework is unlikely to attract third party financing and will not be effective.*

*Accordingly, our Draft Decision proposes that a redacted version of the Infrastructure Lease be available to relevant parties during negotiation of a SUFA agreement, security will extend to compensation cash flows in the event the lease agreements terminate and liability for termination of a lease agreement sit with the party causing the termination.*

### 7.1 Summary of our May 2014 position

The following leases are relevant to SUFA:

- Aurizon Network's infrastructure leases with QTH and with Queensland Rail (Infrastructure Leases) for existing infrastructure operated by Aurizon Network<sup>79</sup>
- The Extension Infrastructure Head-Lease (EIHL) of a SUFA
- The Extension Infrastructure Sub-Lease (EISL) of a SUFA.

In our Position Paper we considered whether some aspects of the leasing and termination regime in the SUFA framework could impede efficient and cost effective investment.

Specifically, we noted that SUFA funders would need to review the complete risk portfolio before committing to invest in a SUFA project. As part of this they would have to consider:

- whether they could measure the costs of termination risk accurately
- the possibility of Aurizon Network triggering a termination being minimised/mitigated
- whether security exists over compensation cash flows, as well as rental cash flows.

In our Position Paper, we noted the following issues respecting termination of these leases:

- the termination provisions of the Infrastructure Leases being confidential
- the implications that a termination event has on cash flows where the SUFA assets remain under the control of Aurizon Network.

We considered that these issues would represent concerns for financiers and, if not satisfactorily resolved, the SUFA would be unlikely to attract third party financing. We did not specifically discuss circumstances where a termination event would occur and SUFA assets would be transferred to QTH.

#### 7.1.1 Termination provisions in the Infrastructure Lease

We concluded that the confidentiality restrictions claimed by Aurizon Network and QTH in respect of Infrastructure Leases could deter potential SUFA funders from investing or lead to the inclusion of unnecessary risk premia in assessing the viability of a SUFA project.

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<sup>79</sup> Given the potential location of SUFA assets, we have focussed on the Infrastructure Lease with QTH.

To mitigate this potential risk, we proposed that either the relevant information in the Infrastructure Leases be made available to potential SUFA funders, or the default provisions in the Infrastructure Leases and EIHL be harmonised.

### 7.1.2 Security over compensation cash flows

We considered termination in our Position Paper from the perspective of the compensation to be paid when a party causes termination of a lease agreement. The following table summarises the compensation arrangements for differing types of termination events:

**Table 6: Compensation arrangements for differing types of termination events**

<i>Event</i>	<i>Outcome</i>
QTH Infrastructure Lease terminates <sup>80</sup>	Compensation (to the extent there is any) due to the Trustee by QTH under the IND (Disposal Amount)
EIHL and sub-lease <sup>81</sup> under the EISL terminate due to Aurizon Network cause (but QTH Infrastructure Lease remains on foot)	Compensation paid to the Trustee in lieu of rent plus any applicable detriment amount (owed to the Trustee)
EIHL and sub-lease under the EISL terminate due to Trustee cause (but QTH Infrastructure Lease remains on foot)	Compensation paid to the Trustee in lieu of rent less any applicable detriment amount (owed to Aurizon Network)

We considered that, where the EIHL and the sub-lease under the EISL had been terminated, but the QTH Infrastructure Lease had not, the Trustee should benefit from security in respect of the compensation payments—much like the proposed arrangement for rental cash flows. In addition, we concluded that the compensation amount should be defined to be the rent-equivalent that would have been paid in the absence of the default event.

### 7.1.3 A termination event and SUFA assets remaining under Aurizon Network control

We also considered that the circumstances under which the EIHL and the sub-lease under the EISL could terminate due to an Aurizon Network default should be narrowly defined so as to deal with very particular circumstances. This should reduce the risk of default and rental streams being replaced by compensation payments.

We proposed adopting QRC's submitted definition of Insolvency Events which narrows the scope of what constitutes an insolvency event to prevent otherwise insignificant events from triggering termination of the lease agreements.

## 7.2 Summary of Aurizon Network's position

### 7.2.1 Termination provisions in the Infrastructure Lease

Aurizon Network agreed that it should make a redacted version of the relevant Infrastructure Leases available.<sup>82</sup> However, it proposed that rather than attach a redacted version of the Infrastructure Lease to the SUFA documentation, it be provided to access seekers during the negotiation of each SUFA transaction, provided that:

<sup>80</sup> Of note, if the Infrastructure Lease expires and the Trust is still in existence, the Trust will receive a compensation amount based on its proportion of the sum of the amount QTH is paid by a purchaser of the network less the costs of disposal.

<sup>81</sup> A sub-lease exists in the Extension Infrastructure Sub-Lease Agreement. The sub-lease can continue to exist, even if the agreement has been terminated.

<sup>82</sup> Aurizon Network notes there are two separate leases, one with QTH for rail infrastructure on the CQCN (other than the North Coast Line) and one with Queensland Rail for CQCN rail infrastructure on the North Coast Line.

- the infrastructure lessor (QTH or Queensland Rail) consents to the disclosure
- the access seeker enters into a suitable confidentiality agreement.

It also noted that the redacted version would include all default and termination provisions, and that the redactions would only relate to confidential commercial positions.<sup>83</sup>

### 7.2.2 Security over compensation cash flows

Aurizon Network agreed to the proposal that the Trustee should benefit from security in respect of the compensation payments if the EIHL and sub-lease under the EISL are terminated, but the Infrastructure Leases remain on foot. It noted:

*The security arrangement for compensation cashflows should apply to rent-equivalent payment net of any detriment amounts.*<sup>84</sup>

### 7.2.3 A termination event and SUFA assets remaining under Aurizon Network control

Aurizon Network agreed with the proposed amendment to the definition of insolvency event. However, it also noted that the definition as contained in the EIHL would require the consent of the infrastructure lessor. It said it had requested QTH to provide favourable consideration of the proposed change.<sup>85</sup>

### 7.2.4 Liability for termination

Aurizon Network did not agree with the position<sup>86</sup> that the Trustee may claim uncapped damages where the Infrastructure Lease has terminated due to an Aurizon Network default.

Aurizon Network said that it understood our position to be that, if the Infrastructure Lease is terminated due to its default, it should be liable on a contingent basis to make a one-off payment to the Trustee. That payment would be equal to the NPV of the rental payments (foregone by the Trustee due to the sub-lease termination) less the Trustee's share of the disposal proceeds under the IND.

Aurizon Network accepted it was the party best able to manage the risk of its default under the relevant Infrastructure Leases. It also noted that there would already be a high degree of alignment of business interests between Aurizon Network and the SUFA investors because Aurizon Network would naturally be motivated by its own business interests to avoid any such default.

However, if it were to assume the risk of paying what it called the 'disposal proceeds top-up obligation' then SUFA investors would face a lower investment risk profile on its investment than Aurizon Network would face on a comparable investment—although both investments would earn the same regulated WACC. It considered that SUFA investors would gain the benefit of a long term underwriting risk that is not available to Aurizon Network itself on its investments.

Furthermore, Aurizon Network also noted that no form of compensation was contemplated for the provision of this underwriting.<sup>87</sup>

## 7.3 Summary of stakeholders' comments

Stakeholders did not comment on the proposed termination arrangements.

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<sup>83</sup> Aurizon Network 2014, p. 21

<sup>84</sup> Aurizon Network 2014, p.21

<sup>85</sup> Aurizon Network 2014, p.21

<sup>86</sup> QCA Term Sheets 2014a, p.33 (Clause 7.4(q))

<sup>87</sup> Aurizon Network 2014b, p. 22

## 7.4 QCA analysis and Draft Decision

### 7.4.1 Termination provisions in the Infrastructure Lease

We note Aurizon Network's agreement to provide a version of the redacted Infrastructure Lease during negotiation of the SUFA agreements subject to:

- the lessor's consent
- relevant access seekers entering into a confidentiality agreement.

We agree with most of Aurizon Network's proposal. We agree that it would be prudent to make a redacted version of the Infrastructure Lease available to 'relevant parties' during negotiation of the SUFA agreements. We also agree it would be in Aurizon Network's and the applicable lessor's interest to request 'relevant parties' to enter into a confidentiality agreement.

We consider however that the 'relevant parties' seeking access to the termination provisions in the Infrastructure Lease would likely be financiers, who are not, strictly speaking, access seekers for the purposes of Aurizon Network's undertaking.<sup>88</sup> We propose therefore to allow for 'relevant parties' to access provisions of the Infrastructure Lease, where relevant parties include both access seekers and financiers. We note that this approach requires the consent of QTH or Queensland Rail (as appropriate).

We consider this meets with the interests of persons who may seek access to the service, including whether adequate provision has been made for compensation if the rights of users of the service are adversely affected (section 138(2)(e) of the QCA Act).

#### Draft Decision

**7.1 We are minded to require that the 2013 SUFA DAAU be amended to reflect Aurizon Network will provide a version of the redacted Infrastructure Lease during negotiation of the SUFA agreements subject to:**

- the lessor's consent**
- relevant access seekers and financiers entering into a confidentiality agreement.**

### 7.4.2 Security over compensation cash flows

We note Aurizon Network's agreement that the security arrangement should apply to the rent-equivalent payment, net of any detriment amounts.

The SUFA is structured such that if the EIHL terminates—other than by reason of termination of the relevant Infrastructure Lease—the sub-lease under the EISL will terminate at the same time.<sup>89</sup> The provisions in the EISL—other than the sub-lease—will continue with the Trustee entitled to a rent-equivalent cash flow as compensation in lieu of rent. We consider this would likely be necessary to secure third party funding.<sup>90</sup> If the relevant Infrastructure Lease is terminated then both the EIHL and the EISL terminate.

As detailed in Chapter 6 (Security and Financiability), Aurizon Network is to grant security in respect of the compensation cash flows and, where the compensation is payable as a

<sup>88</sup> Access seeker is defined in Aurizon Network's 2010 Access Undertaking as: a person who is seeking new or additional access rights.

<sup>89</sup> This will reduce complexity and remove issues arising on termination of the EISL where the EIHL does not terminate. We consider this meets with section 138(2)(e) of the QCA Act.

<sup>90</sup> We consider that third party financiers will require a form of compensation in lieu of the rental cash flow. Encouraging third party financing, and therefore competition for infrastructure finance meets with section 138(2)(d) and 69E of the QCA Act.

consequence of the early termination of the leases due to Aurizon Network's cause, any detriment amounts due from Aurizon Network to the Trustee.

**Figure 6: Termination of the EIHL and the sub-lease under the EISL**

<i>Event</i>	<i>Outcome</i>	<i>Liability/Compensation</i>
EIHL and the sub-lease under the EISL are terminated due to Aurizon Network fault	The remainder of the EISL continues to apply	Aurizon Network will pay the Trustee: <ul style="list-style-type: none"> <li>• compensation in lieu of rent</li> <li>• a detriment amount (if any is due)</li> </ul>
EIHL and the sub-lease under the EISL are terminated due to Trustee fault	The remainder of the EISL continues to apply	Aurizon Network will pay the Trustee compensation in lieu of rent.  The Trustee will pay Aurizon Network a detriment amount (if any is due)
EIHL and the sub-lease under the EISL are terminated at no fault of Aurizon Network or the Trustee <sup>91</sup>	The remainder of the EISL continues to apply	Aurizon Network pays compensation in lieu of rent, but neither party pays a detriment to the other

### Draft Decision

**7.2 We are minded to require that the 2013 SUFA DAAU documents should reflect that Aurizon Network is to grant security in respect of:**

- (a) the compensation cash flows**
- (b) where the compensation is payable as a consequence of the early termination of the leases due to Aurizon Network's cause, any detriment amounts due from Aurizon Network to the Trustee**

#### 7.4.3 Minimising/mitigating Aurizon Network triggering a termination

We note Aurizon Network's support for amendment of the definition of Insolvency Event. We also note its comment that the definition of Insolvency Event would require the consent of the lessor under the EIHL and as such they have requested that QTH provide favourable consideration to the proposed change.

While we understand the need for consistency between the leases, we have decided not to amend the definition of Insolvency Event, taking account of the position of QTH.

#### 7.4.4 Termination of the Infrastructure Lease

In the event the QTH Infrastructure Lease is terminated, all Aurizon Network funded infrastructure assets in the QTH Infrastructure Lease revert to the control of QTH, on behalf of the State of Queensland.

QTH has a right to return any of the SUFA funded assets—both Aurizon Network funded and SUFA funded—with Aurizon Network and the SUFA funders being allocated proportionate shares of the disposal amount (after deduction of QTH's costs).



In our Position Paper, we did not discuss termination events and compensation where control and ownership of the CQCN reverts to QTH. However, we noted in our updated Term Sheets that the Trustee may claim uncapped damages where the EIHL is terminated due to a default of Aurizon Network. We considered this provision would not only protect the interests of users and financiers but would enable the provision of third party finance.<sup>92</sup>

Grant Samuel considered that although the right to share in any compensation paid by QTH for the sale of the CQCN—following termination of the Infrastructure Lease—provides some comfort, it considered Aurizon Network should still be obliged to repay the NPV of the then future cash flows of the extension infrastructure as the SUFA Trustee has no ability to prevent a termination of the QTH Infrastructure Lease.<sup>93</sup>

Alternatively, Grant Samuel proposed the SUFA Trustee should be entitled to claim damages on behalf of the Trust.<sup>94</sup>

Aurizon Network said it is the party best able to manage the risk of its default of the QTH Infrastructure Lease and it would naturally be motivated by its own business interests to avoid such a default. Aurizon Network also said if it were to assume 'Disposal Proceeds Top-up Obligation':

*...SUFA investors would face a lower investment risk profile on their investment than Aurizon Network would face on a comparable investment, even though the two investments would earn the same regulated WACC.<sup>95</sup>*

We consider Aurizon Network has a natural motivation to act in a manner so as not to breach the Infrastructure Leases. However, ultimately, a user funder, a financier or the Trust cannot manage the risk associated with an Aurizon Network default—notwithstanding that an Aurizon Network breach event is remote.

Ultimately, we consider Aurizon Network has full control of its actions in respect of potential defaults under the Infrastructure Lease and should accept a measure of risk associated with that control. Accordingly, we retain the view that Aurizon Network should be liable for damages where an Infrastructure Lease is terminated.

We understand that potential SUFA financiers could be concerned with the position that QTH has the right to return any of the SUFA funded assets upon termination of the Infrastructure Lease. We hold the view that our pre-approval process will provide sufficient checks and balances to ensure that only prudently incurred assets are rolled into the RAB. We believe this should provide QTH with the confidence that no SUFA funded assets need be returned if the Infrastructure Lease is terminated. Therefore we consider this risk can be mitigated, but should be noted.

**Table 7** summarises our views on termination events and liability outcomes with respect to the Infrastructure Lease.

**Table 7 Termination of the Infrastructure Lease**

<i>Event</i>	<i>Outcome</i>	<i>Liability/Compensation</i>
QTH terminates the Infrastructure Lease	Both the EIHL and the EISL terminate	QTH will pay the Trustee a share of the disposal amount (QTH having first deducted its costs)

<sup>92</sup> Term Sheets 2014a, p.26-27

<sup>93</sup> Grant Samuel 2014, p, 6

<sup>94</sup> Grant Samuel 2014, p.6

<sup>95</sup> Aurizon Network 2014b, p.22

<i>Event</i>	<i>Outcome</i>	<i>Liability/Compensation</i>
The Infrastructure Lease expires	Both the EIHL and the EISL terminate	QTH will pay the Trustee a share of the disposal amount based on the fair market value of the network
Aurizon Network breaches the Infrastructure Lease	The Infrastructure Lease could terminate. If it does, both the EIHL and the EISL terminate	Aurizon Network is liable for its actions. Liability is not capped.
Trustee causes Aurizon Network to breach the Infrastructure Lease	<ul style="list-style-type: none"> <li>• The Infrastructure Lease could terminate</li> <li>• Aurizon Network could be liable for damages</li> </ul>	The Trustee is liable for its actions, but that liability is limited by the assets of the Trust. The assets of the Trust to the extent it contributed to the damages/termination

Throughout the SUFA agreements, we have sought to allocate risks with parties best able to manage risks. This extends to the allocation of termination risks to parties best able to manage termination. We consider our position on termination and liability achieves a balance between meeting the interests of Aurizon Network, the preference unit holders and SUFA financiers. We consider this meets with sections 138(2)(c), (e) and (h) of the QCA Act. We have also taken the interests of QTH as ultimate owner of the network into consideration and consider our position also meets section 138(2)(b) of the QCA Act (as the owner and the operator of the service are different entities).

### Draft Decision

**7.3 We are minded to require that, in respect of liability for termination, the 2013 SUFA DAAU agreements should be drafted to reflect the following:**

- (a) For Aurizon Network, for actions in respect of the QTH Infrastructure Lease, liability is not capped.
- (b) For the Trustee, for actions in respect of the QTH Infrastructure Lease, liability is limited by the following:
  - (i) It knowingly breaches the QTH Infrastructure Lease.
  - (ii) Compensation amount is limited to the amount it receives from QTH as a result of the sale of the CQCN.
  - (iii) It has no liability if it is doing something it is required to do under another document.
  - (iv) It is liable only to the extent it contributed to the damages/termination.
  - (v) Liability is capped at the Trust.
- (c) For the Trustee/Aurizon Network, for breach of the EISL or the EIHL (Infrastructure Lease remains), the party that caused the breach must pay the detriment amount to the other party, except if:
  - (i) no party is at fault; then neither party receives a detriment amount
  - (ii) the breach is caused by Aurizon Network not taking action; then the Trustee is not liable, and Aurizon Network is liable for the detriment amount.

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## 8 DISCRIMINATION

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*To have a workable, bankable and credible SUFA arrangement, all parties need to be satisfied that the SUFA arrangements do not give rise to a circumstance whereby Aurizon Network is able to discriminate.*

### 8.1 Summary of our May 2014 position

Stakeholders raised concerns that Aurizon Network had the ability to undertake discriminatory behaviour in the following ways:

- Aurizon Network could treat SUFA assets in a different manner from Aurizon Network funded assets
- parties eligible to participate in the funding of SUFA projects could be restricted
- Aurizon Network could use the SUFA framework to advantage its above-rail operator.

#### 8.1.1 Asset condition

We considered that the assessment criteria of the condition based assessment could be broadened to include a comparison of the condition of the SUFA assets and the Aurizon Network funded assets. We considered that if the SUFA assets were treated differently, the assessment would capture this. If the condition based assessment uncovered that there had been unequal treatment, Aurizon Network was to provide a plan to the QCA and the Trustee on how and when it would rectify the condition of the assets.

We also proposed the following amendments:

- an access seeker or a Trustee be allowed to seek an audit of conduct considered by them to be discriminatory
- a SUFA user (or its customer) or a Trustee be permitted to bring a dispute to the QCA
- condition based assessments to be performed as per the undertaking, are to include an obligation to specifically address SUFA assets and provide a certificate confirming those assets are not worse off than the rest of the system
- a breach of non-discrimination to be disputed under the undertaking with the QCA as arbiter. If the QCA determines there has been discrimination, further breaches will be a wilful default by Aurizon Network, resulting in unlimited liability for Aurizon Network
- the party bringing the discrimination dispute to bear the costs if no discrimination is found.

#### 8.1.2 Parties eligible to fund

We considered that any creditworthy party wanting to invest in a SUFA should be eligible, particularly in the context of a pre-approval regime. This includes above-rail operators.

#### 8.1.3 Above-rail advantage and cost shifting

We noted that we did not understand how a SUFA arrangement could provide a channel for cost shifting and subsidies between Aurizon Network and its' above-rail business, but were open to further discussion on the matter.

## 8.2 Summary of Aurizon Network's position

### 8.2.1 Asset condition

Aurizon Network supported, in-principle, our approach to discriminatory conduct. However, it proposed the following amendments:

- dividing assets (in the condition based assessments) into SUFA and non-SUFA assets
- Trustee to be the only SUFA party able to raise potential discriminatory concerns
- QCA to engage a consultant at the Trustee's expense to assess potential discrimination
- the SUFA asset should be compared with an Aurizon Network asset on a 'like-for-like' basis in respect of usage or technical standard, and must be subject to a significance threshold.<sup>96,97</sup>

Aurizon Network noted its support for the concept of liability for further discrimination breaches, but proposed a modified liability position. It also noted that it accepted the concept that following a determination of discriminatory conduct—based on one condition based assessment—that it should assume liability on a second determination of discriminatory conduct. Further, if a second instance of discriminatory conduct was not found—in a consecutive condition based assessment—there should be a reset on its discriminatory conduct.

Aurizon Network proposed the following liability provisions:

- the liability should be to the Trustee (and no other party)
- liability to extend to the Trustee's direct loss only
- that liability should relate to the period in between the date of the second discriminatory conduct determination and the date where the remedy plan for rectification is completed.<sup>98</sup>

### 8.2.2 Parties eligible to fund

Aurizon Network noted its support for broadening the scope of parties eligible to be SUFA investors. It noted that in the context of a passive Trustee and the construction contract concept, any party should be entitled to be a user funder.<sup>99</sup>

## 8.3 Summary of stakeholders' comments

### 8.3.1 Asset condition

The QRC, Asciano and Anglo American supported expanding the scope of the condition based assessment to ensure the SUFA assets were not treated differently from Aurizon Network funded assets. Stakeholders proposed the following enhancements be considered regarding potential asset discrimination:

- in addition to the condition based assessment, the Trustee and user funders to have separate audit rights<sup>100</sup>
- the comparison of SUFA and non-SUFA assets to include an individual breakdown of deterioration between each separate SUFA asset to prevent discrimination amongst the various SUFA-assets<sup>101</sup>

<sup>96</sup> For instance, differences in asset condition are disregarded unless SUFA assets have an asset condition equal to 97% of Aurizon Network funded assets.

<sup>97</sup> Aurizon Network 2014b, p.25

<sup>98</sup> Aurizon Network 2014b, p.26

<sup>99</sup> Aurizon Network 2014b, p.24

<sup>100</sup> QRC 2014a, p.4

- if an assessment uncovered unequal treatment of assets, Aurizon Network's plan on how and when it would rectify the condition of the asset(s) should be:
  - at Aurizon Network's cost
  - time-limited so that Aurizon Network provides the report and describes how it plans to rectify the condition of the SUFA-assets within a given time.<sup>102</sup>

### 8.3.2 Eligible funders

Asciano supported the position of broadening the scope of potential SUFA funders to include above-rail operators. Asciano said involvement of other parties (including the above-rail operators and ports) in a SUFA could enhance innovation in supply chain solutions.<sup>103</sup>

Asciano requested that final documentation clarify whether an above-rail operator could hold a unit in a trust.<sup>104</sup>

The QRC was also supportive of train operators (and any party willing and able to sign up to a SUFA agreement) providing funding for a SUFA project.<sup>105</sup>

### 8.3.3 Above-rail advantage and cost shifting

Asciano considered SUFA could place Aurizon in a favourable commercial position, by providing a potential channel for:

- Aurizon's above-rail business to engage in discussions with end users through Aurizon Network
- Aurizon Network to choose extensions which favour Aurizon's above-rail business and end users contracted to it.<sup>106</sup>

Anglo American supported submissions made by Asciano on the potential cross-shifting of costs and subsidies within the Aurizon group of companies. Further, Anglo American noted that Aurizon Network's proposed SUFA gave the Aurizon Group the ability to move costs into entities that would recover that expenditure from funding users, rather than commercially absorbing the cost. Anglo American noted cost shifting could occur:

- between Aurizon Network and its related entities for provision of back-end office services
- between Aurizon Network and its related above-rail operator, Aurizon Operations, for the provision of maintenance and operating services (including electrification) when the completed SUFA would require these aspects
- between Aurizon Network and its related port entity, Aurizon Terminal, for any instance where a SUFA involved connection to port facilities and costs could be shifted to the Aurizon entity holding the port rights.<sup>107</sup>

Anglo American noted that the outcome of this potential cost shifting would be a potential competitive disadvantage to other above-rail operators, namely Pacific National (Asciano). Further, any competitive disadvantage to operators in competitive markets would undermine the purpose of regulating Aurizon Network and should not be permitted. As such, it recommended that any discriminatory advantage was countered with clear, objective criteria

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<sup>101</sup> Anglo American 2014, p.5

<sup>102</sup> Anglo American 2014, p.5

<sup>103</sup> Asciano 2014, p.2

<sup>104</sup> Asciano 2014, p.2

<sup>105</sup> QRC 2014a, pp.4-5

<sup>106</sup> Asciano 2014, p.2

<sup>107</sup> Anglo American 2014, p.4

approved by the QCA, so that such cost shifting potential could not have an adverse impact on upstream or downstream competitive markets, or the overall bankability of the SUFA.<sup>108</sup>

## 8.4 QCA Analysis and Draft Decision

### 8.4.1 Asset condition

Stakeholders broadly agreed to the principle of comparing the condition of SUFA assets against Aurizon Network funded assets to identify if Aurizon Network maintains the SUFA assets to a different standard. A number of amendments have also been suggested to the condition based assessment.

We consider that Aurizon Network's obligations regarding the maintenance and operation of SUFA infrastructure should not be less than those Aurizon Network owes to QTH under its Infrastructure Lease. We consider that ensuring consistency of treatment is necessary to protect the interests of users of the network, section 138(2)(e) of the QCA Act. We also consider that in undertaking its obligations respecting maintenance and operation of the SUFA Infrastructure, it also meets the legitimate interests of QTH, as ultimate owner of the infrastructure (section 138(2)(b) of the QCA Act).

As the return to SUFA funders is linked to the whole system and not only the SUFA assets, we do not consider that discrimination between asset classes is a relevant consideration. We do, however, consider the general condition of the network to be a relevant consideration—both to ensure maximum rent is recoverable and to ensure that maximum compensation is payable if the network is sold by QTH.

For this reason, we propose that the condition based assessment should:

- be on a reasonably aggregated basis (where groups of assets are compared) and that regard must be had for Aurizon Network's asset maintenance cycles
- be published on Aurizon Network's website.

We note Aurizon Network's proposal that a 'threshold' measure be used—for example SUFA assets have an asset condition equal to 97 per cent of Aurizon Network funded assets. We consider use of this type of threshold measure would be difficult to both qualify and quantify, especially taking into account age of the infrastructure.

In this context, we consider the use of mechanistic thresholds does not provide any significant benefit. As part of the asset condition based assessment, the independent assessor will make a comparison of actual asset deterioration rates relative to the benchmark value for both SUFA and the other network assets. This provides an appropriate indication of any maintenance concerns that require rectification.

We also consider a competent expert assessor is capable of assessing materiality and providing credible recommendations based on their experience. This coupled with the fact that Aurizon Network is provided with a significant time lag within which to remedy any issues, provides a dynamic evolving approach that focuses on actual conditions.

Similar to our position reached on the expansion process, we consider it likely that a SUFA project will not be undertaken under UT3. Should it be necessary and a SUFA project is completed within UT3, we consider we could develop the condition based assessment to account for differences in condition between SUFA and non-SUFA funded assets. We consider it prudent to focus on the condition based assessment under the 2014 DAU process.

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<sup>108</sup> Anglo American 2014, p.4

### Interim Position

**8.1 The potential for discrimination in respect of asset maintenance to be considered as part of the broader condition based assessment approach. This will be considered further under the 2014 DAU process.**

#### 8.4.2 Parties eligible to fund

No stakeholder objected to our position that any creditworthy party wanting to invest in a SUFA should be eligible to do so.

We consider that allowing non-access seekers (including third-party investors and other service providers) to fund an expansion not only improves funding choice but also fosters potential competition in finance, meeting section 138(2)(d) of the QCA Act. We consider this improves financing efficiency and leads to greater bankability of the SUFA arrangements. We also consider it meets section 69E of the QCA Act. In addition, we consider this proposal meets with the interests of access seekers as it allows access seekers the ability to obtain third party finance if required (section 138(2)(e) of the QCA Act).

### Draft Decision

**8.2 The 2013 SUFA DAAU should not place restrictions on who can participate in funding a SUFA arrangement.**

#### 8.4.3 Above-rail advantage and cost shifting

In the context of SUFA, we are interested in areas of potential discrimination that could arise which are specific to a SUFA transaction, rather than issues that can arise regardless of whether an expansion is undertaken via a SUFA.

We note Asciano and Anglo American provided some examples of potential discriminatory behaviour in their submissions. Our understanding is that these primarily relate to cost shifting and Aurizon Network choosing expansions that unreasonably favour Aurizon Holdings' above-rail business. Notwithstanding the importance of these concerns, we do not consider them to be specific to a SUFA transaction.

We consider the issues surrounding cost shifting are best addressed under the access undertaking's ring-fencing regime. We also consider an effective expansion process should contain objective decision criteria which would restrict Aurizon Network from subjectively 'picking' an expansion project.

### Interim Position

**8.3 Potential issues of cost-shifting and other discriminatory behaviour to be considered as part of the 2014 DAU process.**

## 9 PREFERENCE UNIT TRANSFERS

*For the SUFA to be an effective financing arrangement, we consider it should minimise restrictions on who can participate in, and fund, a SUFA. It should also minimise restrictions on transferability, unless there is a clear need to do so.*

### 9.1 Summary of our May 2014 position

SUFA funders subscribe to preference units according to their contribution to the capital costs of a SUFA project. These units provide their holders with various rights, including a share of the distributions made by the Trustee in proportion to their preference unit holding.

Aurizon Network proposed to 'staple' preference units to access rights.<sup>109</sup> Aurizon Network noted the intention of stapling preference units to access rights was to 'align' the commercial interests of parties in the construction phase of a SUFA project. In our Position Paper, we considered concerns regarding any potential misalignment of interests could be mitigated through the pre-approval process.

Aurizon Network also proposed it have a 'first right of refusal' to acquire any preference units being sold by a unit holder. We agreed that Aurizon Network should have the opportunity to acquire preference units but not on a right of first (or last) refusal basis. Such a right is likely to impact on bids as others may be deterred from bidding—potentially impacting the value of preference units.

### 9.2 Summary of Aurizon Network's position

Aurizon Network supported our position of no stapling in both the construction and operation phases of the SUFA, given our position that the Trustee act passively and the use of a construction contract, rather than the PMA.

Aurizon Network also supported our position that it be allowed to bid for preference units being sold by a unit holder. However, it proposed that a seller of preference units must give Aurizon Network a reasonable opportunity to buy the units. Aurizon Network said that if it submitted an offer, the seller must not sell the units to a party that has offered terms that are less favourable than those of Aurizon Network.<sup>110</sup>

### 9.3 Summary of stakeholders' comments

The QRC noted its support on the removal of stapling between access rights and preference units. The QRC said stapling access rights to preference units would limit the pool of people who could be willing or able to provide user funding. The QRC said that for SUFA to be workable, it must be accessible to a broad range of parties.<sup>111</sup>

Asciano considered that preference units should align with a unit holder's access entitlement created as a result of the SUFA infrastructure. If there was a misalignment, Asciano suggested that preference units be transferred to ensure there was an alignment.<sup>112</sup>

<sup>109</sup> In the 2013 SUFA DAAU Aurizon Network adopted the concept of 'stapling'. Stapling means that a SUFA funder must hold both preference units and access rights, or that the parties holding preference units and access rights have shared ownership. Stapling effectively creates a constraint on who can own preferences units.

<sup>110</sup> Aurizon Network 2014b, p.27

<sup>111</sup> QRC 2014a, p.5

<sup>112</sup> Asciano 2014, p.3



## 9.4 QCA analysis and Draft Decision

We note Asciano submitted that preference units should align with a unit holder's access entitlement. However, Asciano did not elaborate on why it considered stapling to be a superior outcome. We also note that the remainder of stakeholders commenting on stapling agreed to its removal. At this point we remain of the view that by removing the stapling of preference units and access rights SUFA will be a more effective, and bankable arrangement allowing for a greater number of participants to participate in the provision of financing. We consider this meets section 69E of the QCA Act, as it promotes efficient investment and effective competition in the market for infrastructure finance in the CQCN. We also believe it is in the interest of access seekers as it allows for competitive pricing of finance of infrastructure (section 138(2)(e) of the QCA Act).

With regard to Aurizon Network's participation in the bidding for any preference units being sold by a unit holder, we consider Aurizon Network should be given the same opportunity as all other potential purchasers. Third party financiers will require that the secondary market for the preference units be as liquid as possible. We consider this meets section 69E of the QCA Act as it promotes effective competition in the market for infrastructure finance in the CQCN. A first right of refusal for Aurizon Network adds illiquidity to the market, which is not in the public interest (section 138(2)(d) QCA Act), and could also breach the object of Part 5 of the QCA Act – to promote efficient investment in the network (section 69E of the QCA Act).

We do not consider that Aurizon Network should be given any specific priority to purchase and consider that Aurizon Network has not provided a compelling reason why it should be given priority.

### Draft Decision

**9.1 We consider the 2013 SUFA DAAU SUHD should be amended so:**

- (a) there is to be no requirement for stapling**
- (b) Aurizon Network will be permitted to bid in the process for the transfer of preference units, without a first right of refusal.**

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## 10 THIRD PARTY FINANCE

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*The design of Aurizon Network's 2013 SUFA DAAU does not easily support third party financing. However, if the amendments we have proposed in the Draft Decision are implemented, our view is that third party financing becomes a viable option.*

*In particular, securing rental cash flows allows the Trust to consider obtaining and holding third party finance itself (as an alternative to the SUFA investors raising debt themselves to allow them to participate in the SUFA arrangements). This allows the underlying credit risk of SUFA funders to be pooled. Grant Samuel considers that this can lead to a lower financing cost for a SUFA project and a widening of the financing choices available to potential SUFA participants.*

### 10.1 Summary of our May 2014 position

In our Position Paper we concluded that Aurizon Network's proposed 2013 SUFA DAAU framework would not easily support third party financing.

We proposed that third party financing may be achievable if rental cash flows and rent-equivalent compensation streams could be secured. The Trust could then raise debt itself, thereby:

- providing maximum funding efficiency with a widening of financing choices available to potential SUFA participants
- reducing transaction costs.<sup>113</sup>

Grant Samuel also noted that placing a financing trust above the Trust may overcome concerns regarding the Trust raising debt directly.

Overall, we considered that to make a SUFA arrangement attractive to a wide range of potential financiers the SUFA documents should:

- allow the Trust to obtain finance itself
- not restrict the Trust from issuing units to third party finance entities
- not prevent a financing trust being placed above the Trust to allow credit risk pooling
- allow the Trustee to charge its rights in the SUFA documents to ensure that lenders to the Trust are secured creditors of the Trust.

We considered that the SUFA arrangements should not place unnecessary restrictions on a SUFA funder's ability to obtain debt and equity as cost efficiently as possible. We also considered that any tax risk arising from a particular debt structure could be considered on a case-by-case basis by potential SUFA funders.

### 10.2 Summary of Aurizon Network's position

Aurizon Network noted its 2013 SUFA DAAU provided that user funders could not raise debt finance at the Trust level—but that there were no restrictions on raising debt finance outside the Trust. In addition, in order to safeguard Aurizon Network's rights as the ordinary unit holder, the Trust was prohibited from granting a security interest over the Trust or its assets.

Against this background, Aurizon Network submitted its positions as outlined in **Table 8**.

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<sup>113</sup> As opposed to SUFA investors raising debt independently of the Trust.

**Table 8 Aurizon Network's positions on third party finance<sup>114</sup>**

<i>QCA position</i>	<i>Aurizon Network position</i>
<p>1. Inclusion of an acknowledgement that the <i>Trust Deed</i> may be amended as required to permit third party finance, subject to Aurizon Network as ordinary unit holder not being 'materially affected'.</p> <p>2. Inclusion of an acknowledgement that the <i>SUHD</i> may be amended as required to permit third-party finance, subject to Aurizon Network as ordinary unit holder not being 'materially affected'.</p>	<p>Aurizon Network did not support this position as it noted that an amendment to an approved template that has been made without its consent was unacceptable, especially considering the template was only binding on Aurizon Network and not on other parties.</p> <p>It did not consider the protection afforded by 'no material adverse effect' was an effective protection as the onus was placed upon Aurizon Network to assess every change for materiality and to challenge each change.</p>
<p>3. Aurizon Network will consent to the Trustee charging its rights under the suite of SUFA Agreements, provided that Aurizon Network's rights as ordinary unit holder are not prejudiced by the security.</p>	<p>Aurizon Network agreed with the QCA's position and proposed the following amendments to 'strengthen protection to Aurizon Network to any adverse consequences of the Trustee's financing':</p> <ul style="list-style-type: none"> <li>• security must not impair or threaten Aurizon Network's ability to wind up the trust structure following the Zero Value Date</li> <li>• Aurizon Network (as ordinary unit holder) must be protected from any liability under the Trust's financing or financing security throughout their respective lives</li> <li>• Aurizon Network must have a high level of certainty that the preceding requirements would be achieved.</li> </ul>
<p>4. The Trust should be allowed to obtain finance itself.</p>	<p>Aurizon Network would support these positions if its response to QCA positions (#1-3) was accepted.</p>
<p>5. The Trust should be free to issue units to third party finance entities or to create a financing trust above the Trust</p>	
<p>6. The Trust should be allowed to charge its rights in the SUFA documents to ensure that lenders to the trust were secured creditors to the Trust.</p>	

### 10.3 Summary of stakeholders' comments

The QRC said further thought should be given to ways in which finance could be provided directly to the Trust. In its opinion, the Trust procuring finance would be an efficient means of funding, and will avoid the concerns which may be raised by lenders funding individual preference unit holders about lack of control.<sup>115</sup>

Anglo American broadly agreed with the Trust raising debt financing on behalf of the unit holders, as it encourages participation in SUFA expansions. However, it noted that there could be certain instances in which raising debt within the Trust could lead to further tax and financing implications for preference unit holders. Given this, Anglo American recommended that preference unit holders not be locked into one financing method by the standard form

<sup>114</sup> Aurizon Network 2014b, pp.28-30

<sup>115</sup> QRC (2014), p.5

drafting of the SUFA, but instead, should be given the choice of financing on a project-by-project basis.<sup>116</sup>

Anglo American considered a large number of SUFA funders could be foreign preference unit holders. Under the 'thin capitalisation rules'<sup>117</sup>, there is a limit to the amount of debt the unit holders can use to fund SUFA assets. With the Trust's ability to raise debt, the debt limit for these funders could exceed the amount under these rules. Anglo American considers this would impact the Trust. This is because even where finance is sourced from Australian banks or financiers, there will be an additional layer of tax compliance for consideration by the Trustee and incorporation in the overarching tax policy of the Trust.

## 10.4 QCA analysis and Draft Decision

In our Position Paper, we considered the structure of the SUFA should not place undue restrictions on a SUFA funder's ability to obtain equity and debt as efficiently as possible.

It was and remains our intention to develop a SUFA framework that does not preclude a specific type of finance—such as the Trust raising debt—if the potential investors are willing to pursue that option and the associated risks. We consider that the standard documents should allow for as many types of financing as possible, but not direct what type of financing must be used. We believe this allows for needed flexibility of finance and improves the bankability of the framework.

We consider this meets section 138(2)(d) of the QCA Act by promoting the competitiveness of the market for infrastructure finance in the CQCN. We also consider this meets the object of part 5 of the QCA Act (section 69E) — insofar as it promotes efficient investment by allowing for the most efficient type of finance to be accessed by access seekers.

We continue to propose that the SUFA framework allow for parties to determine the type of financing desired on a case-by-case basis as befits the circumstances. For the avoidance of doubt, we are not developing the SUFA documents with a view that the Trust must raise debt itself.

We have considered Aurizon Network's position that the Trust Deed and the SUHD should not be amended 'as required' to permit third-party finance. We agree that this is a matter that should be negotiated amongst the parties to a SUFA transaction, rather than be varied without Aurizon Network's consent. However, we also believe that Aurizon Network should not be able to unreasonably disagree with the type of finance and financing structure proposed by potential SUFA investors. Therefore we consider it appropriate that such a matter be subject to dispute resolution.

We consider this meets with section 138(2)(b) of the QCA Act as it recognises Aurizon Network's legitimate business interests to enter into a contract that will not be varied without its consent. We also consider this position is in the public interest as it does not limit the type of financing to be used by SUFA funders, allowing for the most efficient type of financing to be used on a case-by-case basis (section 138(2)(d)).

Aurizon Network proposed that it be further 'protected' from any adverse consequences resulting from choice of financing, including:

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<sup>116</sup> Anglo American 2014, p.6

<sup>117</sup> The thin capitalisation rules apply to certain entities, including foreign controlled Australian entities and foreign entities investing directly into Australia. Under the rules, the amount of debt used to fund those Australian operations or investments is limited. The rules operate to disallow the debt deductions an entity can claim against Australian assessable income when the debt used by the entity to fund its Australian assets exceeds certain limits. For more information, visit: <https://www.ato.gov.au/Business/Thin-capitalisation/>.

- protection from any liability under the Trust's financing or financing security throughout their respective lives (as an ordinary unit holder)
- security must not impair or threaten Aurizon Network's ability to wind up the trust structure following the Zero Value Date
- certainty that the previous objectives will be achieved.

The Financing Side Deed is intended to limit the rights of the parties benefitting from security granted by the Trustee, while addressing the concerns of Aurizon Network and regulating the position of the secured parties as against QTH and the State of Queensland. We consider this meets sections 138(2)(b) and (e), as the deed sets out the responsibilities and rights of the parties— allowing for legitimate interests of Aurizon Network, QTH and access seekers to be addressed and accommodated.

### Draft Decision

- 10.1 We consider the 2013 SUFA DAAU arrangements should allow for third party financing.**
- 10.2 We are minded to propose a Financing Side Deed be included as one of the SUFA documents. The Financing Side Deed is intended to limit the rights of the parties benefitting from security granted by the Trustee, address the concerns of Aurizon Network, and regulate the position of the secured parties as against QTH and the State of Queensland.**

## 11 TAXATION

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*Taxation has been a key issue throughout the many iterations of the SUFA framework.*

*Given that SUFA funders are to provide Aurizon Network with a tax indemnity<sup>118</sup> and will be exposed to the full tax risk of any SUFA framework, they want the most tax efficient structure. Within this context, Aurizon Network proposed a unit trust model to take advantage of a lower level of tax risk than other frameworks.*

*In our Draft Decision we propose that the tax effectiveness of the SUFA will be determined through an Administratively Binding Advice, or a Private Binding Ruling when an actual SUFA transaction arises. We have noted that an appropriate form of statutory severance is still required. We have also proposed our view respecting roles and responsibilities for parties when seeking an ABA or PBR.*

### 11.1 Summary of our May 2014 position

In our Position Paper, we noted that a number of concerns still remain over the tax treatment of a SUFA transaction and unless these issues were addressed, the SUFA framework would not be effective. We also noted that the SUFA documents and Aurizon Network's undertaking should provide the maximum level of certainty possible regarding the tax position of a SUFA transaction. This included the following:

- SUFA should be tax effective for all parties
- An appropriate form of statutory severance for the SUFA assets is essential. Aurizon Network's proposed SUFA framework is based on the assumption that the appropriate form of statutory severance will be obtained. Without the appropriate statutory severance, the transfer and lease-back of infrastructure would attract substantial stamp duty.
- Aurizon Network to provide an up-front commitment to obtain an administratively binding advice (ABA) for the suite of finalised pro forma SUFA documents.
- Aurizon Network to provide transparency regarding the process and the roles and responsibilities of parties for obtaining PBRs for each individual SUFA.
- Clarify what risks are intended to be covered in the QTH tax indemnity.

### 11.2 Summary of Aurizon Network's position

#### 11.2.1 Statutory severance

Aurizon Network noted that it did not support the position that it is the party responsible for seeking a statutory severance regime and it would require a change in law to effect the change. It also noted it understood we would make the request of the Queensland Government and it would be ready to make a submission in support of our request.

Additionally, Aurizon Network stated that if a statutory severance regime was established and that regime called for application of statutory severance on a project-by-project basis, it was prepared to take on that obligation.<sup>119</sup>

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<sup>118</sup> This is part of the back-to-back tax indemnity SUFA funders provide across QTH and Aurizon Network.

<sup>119</sup> Aurizon Network 2014b, p.33

### 11.2.2 Administratively binding advice

Aurizon Network said it was prepared to accept an obligation to seek—but not obtain—an Administrative Binding Advice (ABA) for tax matters on the SUFA template documentation relating to the affairs of Aurizon Network and a notional trust for approved SUFA documentation.

Aurizon Network noted that an ABA in relation to Aurizon Network and a notional trust may not address all taxation aspects of the SUFA structure. For instance, it noted the following:

- Aurizon Network would not be able to seek an ABA on behalf of the Relevant Infrastructure Lessor(s)<sup>120</sup> if those lessors are under either the National Tax Equivalent regime or Federal tax regime (if applicable).
- The Australian Tax Office (ATO) would in its view be unlikely to provide an ABA in respect of the SUFA template documents, but that it would pursue an ABA provided the cost of doing so is included in its operating costs.<sup>121</sup>

Aurizon Network also said that it would consult with our expert tax advisor regarding:

- content of its submissions to the ATO
- its discussions and correspondence with the ATO
- whether the response is favourable
- what to do with an unfavourable response.

It noted that the expert tax advisor should be free to provide information to us, but we should not publish confidential information.

Aurizon Network also noted that obligations should be documented in the expansion process in its 2014 DAU proposal.<sup>122</sup>

### 11.2.3 Application for PBR

Aurizon Network noted that it supported the position of assisting in the application for a PBR once users agree to fund a SUFA. Aurizon Network also provided its view of how the process would work.<sup>123</sup>

### 11.2.4 Tax indemnity arrangements

Aurizon Network said the tax-indemnity arrangements should not preclude it from raising a second claim on an event/circumstance for which a first claim existed if the second claim sought to recover costs not addressed in the first claim.<sup>124</sup>

### 11.2.5 Tax related amendments to the SUHD

Aurizon Network recounted that under the SUHD, if the Trust was wound up early, distributions should be split between the ordinary unit holder and the preference unit holders.

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<sup>120</sup> Aurizon Network uses the following definition for a 'relevant infrastructure lessor': In respect of a SUFA project, the lessor of a Relevant Infrastructure Lease. A 'relevant infrastructure lease' is defined to be: In respect of a SUFA project, each Infrastructure Lease of infrastructure that would be augmented, modified or removed during the delivery of that project. There are two Infrastructure Leases: between Queensland Rail and Aurizon Network on the North Coast Line and between QTH and Aurizon Network on CQCN rail infrastructure (other than on the North Coast Line).

<sup>121</sup> Aurizon Network 2014b, p.33

<sup>122</sup> Aurizon Network 2014b, p.72

<sup>123</sup> Aurizon Network 2014b, p.34&72-73

<sup>124</sup> Aurizon Network 2014b, p.34

Aurizon Network proposed that this process for distributions should act such that Aurizon Network and its related entities could avoid 'any disadvantage', rather than avoid 'any material disadvantage'. Aurizon Network stated that it did not wish to assume the risk of any disadvantage arising from the Trust being wound up early as it was a risk over which it had no control and could not appropriately manage.<sup>125</sup>

### 11.3 Summary of stakeholders' comments

The QRC said although our proposed measures relating to tax will go some way to creating a SUFA that is credible, workable and bankable, there were several key matters requiring further consideration. These are discussed in the following table.

**Table 9 QRC: Key tax matters requiring further consideration**

<i>Matter</i>	<i>Discussion</i>
<p><b>Ability to claim tax depreciation deductions</b></p> <p>How the Trust will establish that it is entitled to claim depreciation deductions in respect of the Extension Infrastructure</p>	<ul style="list-style-type: none"> <li>Further clarity needed on how the Trust will establish it is the 'holder' of the extension infrastructure thereby being eligible to claim depreciation deductions<sup>126</sup></li> </ul>
<p><b>Tax indemnities</b></p> <p>The scope of tax indemnity provided to Aurizon Network and QTH</p>	<p>Aurizon Network's tax indemnity:</p> <ul style="list-style-type: none"> <li>The tax indemnity should not provide for a loss of tax relief (for example for tax losses utilised). Aurizon Network will be compensated for actual tax costs in the period they arise. The QRC noted its concern that providing an indemnity for tax relief forgone as well as actual tax paid would potentially allow Aurizon Network to claim twice for the same loss<sup>127</sup></li> </ul> <p>Statutory severance:</p> <ul style="list-style-type: none"> <li>In respect of the back-to-back tax indemnity the preference unit holders give to QTH, the QRC supported appropriate legislative amendments be made for effective severance so that the transfer and lease back did not attract stamp duty</li> </ul> <p>Appropriateness of QTH's tax indemnity:</p> <ul style="list-style-type: none"> <li>indemnification of QTH in respect of duty paid to the Queensland State Treasurer was not appropriate as it did not represent a 'real' loss to QTH, being a State-owned body</li> <li>indemnification of QTH in respect of National Tax Equivalents Regime (NTER) paid to the Queensland State Treasurer was not appropriate as it again did not represent a real 'loss' to QTH<sup>128</sup></li> </ul>
<p><b>Generation of tax losses</b></p> <p>The circumstances in which a SUFA can generate tax losses and the ability of the Trust to carry forward these tax losses to offset future income</p>	<p>Debt Financing:</p> <ul style="list-style-type: none"> <li>As a general comment, the QRC agreed with QCA's position that the tax risk arising as a result of a particular debt structure could be considered on a case-by-case basis by potential SUFA funders, and noted that these types of issues were regularly encountered and addressed by parties to infrastructure projects and transactions<sup>129</sup></li> </ul>

<sup>125</sup> Aurizon Network 2014b, p.34

<sup>126</sup> QRC 2014b, p.2

<sup>127</sup> QRC 2014b, p.3

<sup>128</sup> QRC 2014b, p.3-4

<sup>129</sup> QRC 2014b, p.4



<b>Matter</b>	<b>Discussion</b>
<p><b>ABAs and PBRs</b></p> <p>The processes and roles and responsibilities of the parties in obtaining ABAs and PBRs from the ATO.</p>	<p>Roles and responsibilities for ABAs:</p> <ul style="list-style-type: none"> <li>• where the ABA related to tax treatment of the Trust, tax consequences for preference unit holders or tax issues relevant to QTH, the QRC (acting as a representative of and in conjunction with Access Seekers) should be responsible for the preparation of the ABA application, negotiation with the ATO, as well as deciding whether that ABA was favourable, with Aurizon Network providing reasonable assistance and having reasonable review rights throughout this process</li> <li>• to the extent the ABA related to the tax treatment or consequences of SUFA for Aurizon Network (for example, the deductibility of the Rent), Aurizon Network should be responsible for the preparation of the ABA application, negotiation with the ATO, as well as deciding whether that ABA was favourable, with the QRC having reasonable review rights throughout this process.</li> </ul> <p>Roles and Responsibilities for PBRs:</p> <ul style="list-style-type: none"> <li>• The QRC considered the roles and responsibilities for seeking PBRs should be similar to seeking ABAs, although flexibility should be retained so that parties to a particular SUFA transaction could agree whether a PBR on a particular tax issue was required and if so, which party would be responsible for seeking that PBR.<sup>130</sup></li> </ul>

Anglo American commented on its concern about the clarity of the tax provisions contained within the SUFA proposal—specifically, the Trust's ability to claim depreciation in respect of the extension infrastructure. It said that should the Trust not be able to claim depreciation, this primary tax benefit for unit holders investing in and owning SUFA assets for a period of time will be lost.

Anglo American noted that it understood that Aurizon Network's drafting of the RCA gave the Trust:

- a licence to access the Extension Land, a right which it believes would be considered akin to a 'quasi-ownership right' for the purposes of the *Income Tax Assessment Act 1997* (Cth) (ITAA)
- an express right to remove the Extension Infrastructure at any time.

It said it believed both of these factors lead to the conclusion that the Trust is the 'holder' of the Extension Infrastructure for the purposes of the ITAA (allowing it to operate in tax deferral mode).

Anglo American said with respect to our proposed amendments of the RCA:

*Anglo American notes that the QCA's redraft of the RCA potentially impacts on the operation of the inbuilt tax deferral mechanism and, while it supports the majority of the QCA's drafting amendments, Anglo American wishes to ensure that the tax effect of SUFA continues to apply as envisaged.<sup>131</sup>*

## 11.4 QCA analysis and Draft Decision

### 11.4.1 Tax depreciation

We note the QRC considers further clarity is required about the particular basis on which the Trust will establish it will be the 'holder' of the extension infrastructure and therefore be eligible

<sup>130</sup> QRC 2014b, pp.7-8

<sup>131</sup> Anglo American 2014, pp.5-6

to claim depreciation deductions. We also note Anglo American's concern that our redraft of the RCA may limit the Trust as being the holder of the Extension Infrastructure for the purposes of the ITAA.

The RCA has been drafted to include a licence from the landholder to the Trustee (and its associates) to access and use the extension land in accordance with the terms of the RCA. The licence allows the Trustee:

- to access, modification and use of the landholder infrastructure
- to keep the extension infrastructure on the extension land
- to use the land as required by or permitted in the transaction documents.<sup>132</sup>

We have also included a clause giving the Trustee the right to remove any part of the extension infrastructure without the prior consent of the Landholder at any time.<sup>133</sup>

To the extent possible, we have retained Aurizon Network's drafting within the RCA. We have taken care to ensure we retain the clauses in the RCA considered by stakeholders to give the Trustee a 'quasi-ownership right' of the infrastructure for the purposes of the ITAA—and thus be able to claim tax depreciation.

We note, however, that the effectiveness or otherwise of the SUFA documents to enable the Trust to claim tax depreciation must be tested with the ATO—through an ABA, and a PBR when an actual SUFA transaction arises—and, an appropriate form of statutory severance for the SUFA assets, helps to advance the position which needs to be put to the ATO. Having said that, to the extent possible, we have incorporated suggestions from the tax advisors of both Aurizon Network and the QRC into the documents to ensure the best possible position is included from a tax depreciation perspective.

We consider this meets sections 138(2)(b), (c) and (e) of the QCA Act since parties involved in a SUFA will only come to understand whether their legitimate interests are being met by the arrangement by seeking ABAs and PBRs from the ATO.

### Draft Decision

**11.1 The effectiveness or otherwise of the SUFA documents to enable the Trust to claim tax depreciation must be tested with the ATO—through an ABA, and a PBR when an actual SUFA transaction arises.**

#### 11.4.2 Tax Losses

The QRC noted that parties had previously proceeded on the basis that a SUFA Trust would not generate tax losses. It said that this was because it was understood that the Trust would not raise debt—either directly or indirectly—and that depreciation deductions would be absorbed by rent received by the Trust such that no tax losses would arise at any stage.

As noted in Chapter 10 (Third party finance), we have developed flexibility into the SUFA framework to allow parties to determine the type of financing desired on a case-by-case basis. Debt financing raised through the Trust is not the only viable option of third party financing.

However, we have not attempted to address the QRC's concerns with respect to recouping tax losses which might be generated where the Trust raises debt. The tax advisors for both Aurizon Network and the QRC have noted that comprehensively addressing those concerns may require structural changes to the Trust Deed that could re-open the entire arrangement and, for that reason, we are not prepared to consider those changes at this time. Should parties to the SUFA

<sup>132</sup> Exposure Draft - Rail Corridor Agreement 2014, clause 3.1

<sup>133</sup> Exposure Draft - Rail Corridor Agreement 2014, clause 8

agreements choose to pursue debt financing through the Trust, the parties can agree the necessary amendments at that time.

It should be noted that our objective, with respect to flexibility for the type of financing to be adopted, has been to ensure that there is no contractual prohibition included in the SUFA agreements but we have not attempted to remove all commercial (including tax) obstacles to a particular form of financing to the detriment of other forms of financing where to do so would result in fundamental structural changes to the arrangement.

### 11.4.3 Statutory severance

We will continue to work with the Queensland Government with respect to statutory severance, noting that any decision in this area is ultimately a decision for the Government.

We also acknowledge that Aurizon Network is prepared to submit project-specific applications as necessary should a statutory severance regime require applications on a project-by-project basis. At present, carriage of project specific applications has not been allocated in the SUFA documents.

We consider this meets sections 138(2)(b), (c) and (e) of the QCA Act since it would be in the legitimate interests of all potential parties to a SUFA to have a form of statutory severance available. We believe a SUFA project will not be undertaken without statutory severance.

#### Draft Decision

**11.2 An appropriate form of statutory severance for the SUFA assets is still required.**

### 11.4.4 Seeking ABAs and PBRs

The following table outlines our understanding of stakeholder submissions on roles and responsibilities for seeking ABAs and PBRs.

**Table 10: Roles and Responsibilities for seeking PBRs and ABAs<sup>134</sup>**

	<i>Aurizon Network</i>	<i>QRC</i>
Aurizon Network tax treatment or consequences of SUFA	Aurizon Network to seek a tax ruling for Aurizon Network and the Trust tax positions for the ABA. Aurizon Network to seek tax ruling for Aurizon Network position for a PBR.	Aurizon Network should be responsible for: <ul style="list-style-type: none"> <li>the preparation of the ABA and PBR</li> <li>negotiation with the ATO</li> <li>decision as to whether ABA (or PBR) is favourable</li> </ul>
Tax consequences for Preference Unit Holders or the Trust	Aurizon Network to seek a tax ruling for Aurizon Network and the Trust tax positions for the ABA. Aurizon Network will consult regarding coordination if Trust is seeking PBR for their position.	The QRC, acting as a representative for access seekers is responsible: <ul style="list-style-type: none"> <li>for the preparation of the ABA and PBR</li> <li>negotiation with the ATO</li> <li>decision as to whether ABA (or PBR) is favourable</li> </ul>
Tax issues related to QTH	If QTH is seeking a tax ruling in respect of its tax position under SUFA, Aurizon Network will consult regarding coordination. Aurizon Network will consult regarding coordination if QTH is seeking PBR for its position.	The QRC, acting as a representative for access seekers is responsible for the preparation of the ABA and PBR.

<sup>134</sup> Aurizon Network 2014b, p.72-3, QRC 2014b, pp.7-8

### Administrative Binding Advice

We welcome Aurizon Network and the QRC agreeing to seek an ABA on the final set of SUFA documents, noting that an ABA may not be able to be obtained. This indicates a willingness to continue with the collaborative approach adopted to date.

We consider that seeking an ABA on the standardized set of SUFA agreements would benefit from having Aurizon Network, the QRC and the QCA work on a joint submission.

We also consider that where Aurizon Network has sought an ABA from the ATO, we will include the prudent and efficient cost of doing so in its operating costs.

### Private binding rulings

We note Aurizon Network's willingness to assist in the application for a PBR once users agree a SUFA. We also note the QRC's similar proposal for seeking PBRs.

We agree that each party to the SUFA agreements should be responsible for pursuing a tax ruling for their respective tax position. We also consider there is considerable merit in parties consulting with each other and coordinating submissions to the ATO.

The Extension Project Agreement has been drafted to reflect that the Trustee will seek a PBR in respect of itself and that Aurizon Network will seek a PBR in respect of itself. Obtaining a PBR is a condition precedent to the extension project agreement; however, either party has a right to waive the condition.

### Draft Decision

**11.3 We are minded to accept the following roles and responsibilities for the parties seeking an ABA and PBR:**

- (a) Aurizon Network, the QCA and interested parties (such as the QRC) to work on a joint submission to the ATO for an ABA.**
- (b) Efficiently incurred costs by Aurizon Network in seeking an ABA will be included in its operating costs.**
- (c) Each party to the SUFA agreements be responsible for pursuing a PBR for their respective tax position.**

### 11.4.5 Tax indemnity

#### Tax indemnity for Aurizon Network

On the assumption that a SUFA arrangement will not be entered without a PBR to support it, we query the need for the tax indemnity being sought by Aurizon Network. We welcome comments on the need for this indemnity to remain in the documents.

To the extent that it does remain within the documents, we consider that the indemnity should be from the preference unit holders as the Trust may not be able to meet the indemnity if the amount is significant. As the tax indemnity may present a significant risk to SUFA funders, absent a PBR, we consider the PBR an essential condition precedent to any SUFA arrangement.

#### Tax indemnity as it relates to QTH.

We note the QRC's concern that there is still significant uncertainty in respect of what the tax risks the 'back-to-back' indemnity (to QTH) is intended to cover, specifically whether the indemnity covers:

- duty paid to the Queensland State Treasurer
- amounts payable under the National Tax Equivalents Regime (NTER).

QTH has now removed its income tax liability which specifically addresses the concerns around NTER. Assuming an appropriate form of statutory severance is in place, reducing stamp duty risk, we consider this indemnity is now acceptable. We will consider any views to the contrary.

## 12 2010 ACCESS UNDERTAKING AMENDMENTS

### 12.1 Summary of our position

Aurizon Network proposed a number of amendments to its 2010 Access Undertaking (UT3) to address matters related to its proposed SUFA framework. Aurizon Network's proposed amendments and our views expressed in the Position Paper are presented in the table below.

**Table 11 Proposed Access Undertaking Amendments**

<i>Aurizon Network's proposed amendments</i>	<i>QCA Position</i>
Recognition of SUFA assets in the RAB	We welcomed stakeholders' comments on this matter, particularly in light of our proposed pre-approval process.
Implications for user funded capacity shortfalls	In our view, once Aurizon Network and user funders have received the pre-approval of scope, cost and capacity for a project, Aurizon Network will be responsible for rectifying any capacity shortfall. This includes either paying to rectify the shortfall, or paying a rebate to the users who have not received their capacity for so long as the shortfall exists. However, it is our preliminary view that the 2014 DAU review (rather than SUFA) would be a better avenue to address this issue. The chapter on construction provided a proposal on how capacity shortfalls could be defined and measured.
Limitations on the application of SUFA and an access seeker's ability to fund	The value of an asset should not be a restriction on whether that asset is funded by Aurizon Network or through SUFA arrangements.
Development of alternative SUFA models	The UT3 provisions, allowing the QCA to develop its own SUFA, should continue applying, until such time as SUFA is seen to be workable and usable from a practical perspective.
Recovery of the SUFA development costs	Should Aurizon Network seek to recover these costs, we consider that it would be a matter to be discussed at that point.
Dispute resolution	We were open to engaging with stakeholders if they believe that entering into the dispute resolution process adds unwarranted delays to the development of a project.

### 12.2 Summary of Aurizon Network's position

Aurizon Network said it recognised that UT3 requires a workable SUFA, but as there are no projects in the current pipeline that would require the use of a SUFA; it questioned the need to pursue changes to the UT3 documentation. It also recognised that the work done to date by all parties needs to be retained and incorporated into UT4.

Aurizon Network suggested it could withdraw the SUFA DAAU, and replace it with a revised SUFA DAAU to be addressed under UT4 arrangements. Aurizon Network proposed this approach could be supplemented by the right for the QCA to prepare its own SUFA documentation if the new SUFA DAAU is not approved by an agreed date.<sup>135</sup>

<sup>135</sup> Aurizon Network 2014b, p.36

## 12.3 Summary of stakeholders' comments

### 12.3.1 Obligation to fund

The QRC noted that one of the purposes of SUFA is to provide competition to Aurizon Network funded 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. The QRC said the QCA's changes to SUFA would provide a greater likelihood of parity between third party and the Aurizon Network funding. Despite that, certain aspects of the SUFA could already include greater costs than Aurizon Network funding (for example, contingency costs being included in the construction costs by Aurizon Network).<sup>136</sup>

The QRC noted that the SUFA is only one part of the expansion process and there remains a real need for Aurizon Network to be obligated to fund some expansions at the regulated WACC. It also said that in some circumstances, Aurizon Network should be obligated to fund shortfalls in capacity at the regulated WACC.<sup>137</sup>

Similarly, Anglo American noted that the SUFA was not a substitute for mandatory expansion requirements outlined in UT3 and that, while this is a matter for discussion in relation to Part 8 of UT4, it re-iterated that it is essential that the mandatory expansion regime remain strong and functional due to the complexity and uncertainty surrounding SUFA.<sup>138</sup>

Anglo American noted that this was particularly so for provisions relating to minor expansions, replacement capital expenditure and the various other expansions Aurizon Network is required to complete under UT3. Further, Anglo American stated that it is fundamental that the owner/operator of any regulated asset should expand its asset base provided it is done under the regulatory regime at the appropriate risk parameters.<sup>139</sup>

### 12.3.2 Dispute resolution

Asciano noted that the final SUFA documentation should clarify whether above-rail operators could be parties to SUFA-related disputes that could affect the above-rail operators' operations (for instance, an issue relating to track quality and maintenance would be likely to have significant impact on an above-rail operator).<sup>140</sup>

## 12.4 QCA analysis and Draft Decision

We note Aurizon Network's query regarding the need to pursue changes to the UT3 documentation as there are no projects in the current pipeline that may wish to use a SUFA. While we recognise continuing to work on SUFA in the context of UT3 may appear to be unnecessary as there is a SUFA submitted as part of UT4, we consider there is merit in continuing our assessment under UT3.

We appreciate and agree with Aurizon Network's comment that the work done to date by all parties will need to be retained and incorporated into UT4.

We are also of the view that, to the extent they are pertinent to UT4, any potential amendments made to UT3 should be retained and incorporated in UT4. We also consider that a decision made by us on this matter will need to result in a SUFA that is workable, bankable and credible. If the access undertaking does not allow for a potential user, or funder, to 'make SUFA happen', we would not consider that we had fulfilled SUFA's objective.

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<sup>136</sup> QRC 2014a, p.2

<sup>137</sup> QRC 2014a, p.2

<sup>138</sup> Anglo American 2014, p.2

<sup>139</sup> Anglo American 2014, p.3

<sup>140</sup> Asciano 2014, p.3.

We cannot at this point pre-judge when the transition will occur from UT3 to UT4. Thus our view is that it is necessary for us to consider SUFA as part of UT3.

#### 12.4.1 Obligation to fund

We note the QRC's comment that Aurizon Network should be obligated to fund some expansions at the regulated WACC.

However, we consider that an imposition of an obligation to fund (upon Aurizon Network) is not a matter to be considered in the context of the 2013 SUFA DAAU.

#### 12.4.2 Recognition of assets in the RAB

Aurizon Network had proposed in its 2013 SUFA DAAU that due to the timing implications for review of prudence and acceptance of capital projects by the QCA for inclusion in the RAB, SUFA infrastructure enhancements will necessarily be represented in the system allowable revenue (SAR) through the existing or an increased capital indicator.<sup>141</sup> However, the QRC said that the capital indicator and tariff smoothing (undertaken in the access undertaking) means it would be possible for the revenue attributable to an expansion to be collected before the expansion exists— and perhaps even before the decision to user-fund has been made.

The capital indicator is Aurizon Network's annual capital expenditure allowance approved by the QCA. The capital indicator may be used to determine the reference tariffs. The use of the capital indicator (as a proxy for actual capital spend) in the setting of reference tariffs at the beginning of the regulatory period, does not imply that the QCA will accept this level of capital expenditure as prudent for inclusion of the RAB.

We consider the issue of whether the SUFA assets should be included in the capital indicator should actually be viewed as a question of when the pre-approved assets should be rolled into the RAB. Specifically, if the SUFA assets are included in the capital indicator and reference tariffs account for the capital indicator, it is possible that rent revenue associated with the SUFA will be collected with no Trust in existence to pay the rent to.

We consider at this time, the capital cost of a SUFA project should not be included in the capital indicator. To do so may lead to a timing mismatch between rent revenue, actual commissioning and use of the asset.

We are of the view that as SUFA assets are likely to be extensive capital projects in most instances they should be the subject of a DAAU submitted by Aurizon Network for approval of:

- inclusion of SUFA capital into the RAB
- the related reference tariff.

For pre-approved capital projects that have come within budget (the overall cost is not greater than the defined project cost and associated contingency), this should be a relatively straightforward process. If the overall cost is greater than the project cost and the associated contingency, the unapproved incremental element will be subject to a prudence assessment.

In either circumstance, we are of the view that managing the timing of the DAAU will be a matter for SUFA parties to determine on a case-by-case basis. This is because they are best placed to understand the timing requirements.

We would welcome stakeholder comments on this proposal.

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<sup>141</sup> Aurizon Network 2013o, p.19



### 12.4.3 Implications for user funded capacity shortfalls

This matter is addressed in the section dealing with capacity shortfalls. The following is a brief summary of our proposal.

We propose that Aurizon Network provide a range of 'scope-cost-expected capacity' choices to the indicative capacity allocation holders/potential funders. The capacity allocation holders/potential funders can make an informed decision regarding which scope-cost-expected capacity choice would best suit their requirements.

The process of generating options also means that Aurizon Network would be committing to provide the expected capacity of a particular scope. This approach would provide a defined capacity outcome from which to measure the extent of any capacity shortfall.

### 12.4.4 Limitations on the application of SUFA and an access seeker's ability to fund

Aurizon Network proposed that the SUFA model was intended to work for high-value projects (in excess of \$300 million). We noted in our Position Paper that the value of an asset should not be a determinant of whether an asset is funded via the SUFA. Rather, it should be a decision left for potential SUFA funders to make.

### 12.4.5 Development of alternative SUFA models

While Aurizon Network retained Schedule J from UT3, it noted that parts 6 and 7 of its 2013 DAU (now 2014 DAU) reflect the investment framework. Aurizon Network also removed the right for the QCA to develop its own SUFA and Investment Framework Amendments<sup>142</sup>. We noted in our Position Paper we were comfortable for these to be removed from UT3, if further progress was made towards what we considered to be a workable SUFA model.

We consider at this stage that these provisions and rights should continue to apply until such a time when there is a developed, workable and usable SUFA framework and there is evidence that it is effective in practice.

### 12.4.6 Recovery of SUFA development costs

Aurizon Network proposed it should recover the development costs associated with a SUFA to ensure prices (access charges) generate sufficient revenue to meet (at least) the efficient costs of providing access.

We maintain the position outlined in our Position Paper, that the recovery of the development costs should be considered if and when Aurizon Network seeks to recover these costs.

### 12.4.7 Dispute resolution

If an access seeker and Aurizon Network are in dispute regarding the proposed terms of a user funding agreement or issues arising under an existing user funding agreement, either party may pursue the dispute under UT3. According to Aurizon Network, the stakeholders suggested that the dispute resolution process should be amended to include specific targeted and expedited dispute resolution procedures. Aurizon Network said that the UT3 dispute resolution provisions provide sufficient protection for all parties.

We noted in our Position Paper that we are open to discussing ways to improve the dispute resolution process if stakeholders consider that entering into a dispute resolution process would delay project development. We continue to be willing to discuss the dispute resolution process and consider potential improvements.

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<sup>142</sup> Aurizon Network 2014 DAU, Volume 2, The 2013 Undertaking Proposal, p.365



#### 12.4.8 Expansion process

The expansion process was discussed in Chapter 5 (Construction). Our discussion is summarised here.

From a practical point of view, we understand that the expansion process may not be used in UT3, but rather in UT4. Given this, we consider an effective expansion process could be 'retrofitted' into UT3 if this becomes necessary. This, to a large extent, is dependent on when UT4 is finalised. Overall, we consider it prudent to focus on the expansion process under the UT4 assessment process. We will monitor this position based on the progress made regarding the assessment of the 2014 DAU.

#### 12.4.9 Standard access agreements

In order to ensure there are sufficient access charges collected by Aurizon Network to pay out the rent each month to the Trustee, we proposed in our Term Sheets<sup>143</sup> that Aurizon Network ensure all access agreements entered into after the date of the SUFA contain a direction to pay. This includes a right for Aurizon Network to require that access charges be paid to a nominated third party or a nominated account.

To enable Aurizon Network to direct that access charges be paid to a nominated third party, or account, the standard access agreement will require amendment. We consider this amendment is necessary to ensure that after the linked access agreements terminate, obligations under future access agreements can be secured, in order to permit third party funding arrangements to extend beyond the life of the initial linked access agreements.

This will be considered further as part of our assessment of the 2014 DAU.

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<sup>143</sup> Term Sheets 2014a, p.5

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## 13 LIABILITY

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*As noted in the legislative framework section, one of the criteria<sup>144</sup> we have had regard to is whether the 2013 SUFA DAAU is workable, bankable and credible. We consider this means the documents achieve the intended outcome and are able to be executed by all parties without negotiation if necessary. As part of this, the documents should be sufficiently clear and certain and provide an appropriate allocation of risk and liability.*

### 13.1 Summary of our May 2014 position

Our May 2014 Position Paper did not explicitly tackle the risk and liability framework built into the 2013 SUFA DAAU. Rather, we identified amendments we considered would reshape the 2013 SUFA DAAU to be more workable, bankable and credible, including refocusing it primarily as a financing tool. The key changes proposed with respect to considering risk and liability positions were:

#### Construction

- Aurizon Network is best placed to design and construct the expansion. It is also the party best placed to bear the associated risks.
- Use of a standard construction contract, rather than the PMA, allows the Trustee to be largely passive during the construction process. Aspects of the RCA relating to construction and providing the Trustee and its representatives with access to land have generally been removed.

#### Termination and leasing regime

- Termination provisions in the Infrastructure Lease should be transparent to allow SUFA funders to assess risk more accurately.
- If either the EIHL or EISL are terminated, the defaulting party keeps the non-defaulting party whole for any detrimental cost consequences.
- Security should be held over compensation cash flows.

The above proposals represented significant amendments to some aspects of the SUFA framework and we considered there to be little value in considering the risk and liability framework as a whole until the above proposals had been consulted upon. Consequently our discussion of Aurizon Network's and stakeholder comments on risk and liability largely draws upon the 2013 SUFA DAAU and submissions associated with this. As such, they should be viewed in that context.

### 13.2 Summary of Aurizon Network's position

#### 13.2.1 Allocation of risk and liability

Aurizon Network said it considered the 2013 SUFA DAAU achieved an acceptable balance between the interests of Aurizon Network and preference unit holders for a 'base case' SUFA transaction. In its explanatory notes, Aurizon Network said that as infrastructure funded via SUFA would be earning the same rate of return as the rest of Aurizon Network's regulated business, it should face the same risk. Aurizon Network also noted that this concept of risk neutrality was intended to ensure that SUFA transactions do not prejudice or give advantage to either Aurizon Network or SUFA funded transactions.

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<sup>144</sup> Section 138(2)(h) of the QCA Act

Given this 'base case' framework, Aurizon Network noted that the submitted SUFA legal documents left the liability of some risks with Aurizon Network, notably:

- impacts of changes to accounting standards over time
- consequences of Aurizon Network's fraud, gross negligence or wilful default.<sup>145</sup>

This liability was subsequently broadened to the following in response to discussions with the Customer Working Group:

*Aurizon Network is liable for fraud, gross negligence and wilful default and that liability is uncapped. In addition, Aurizon Network is liable for breach and negligence under the PMA, but that liability is capped at the amount of Aurizon Network's project management fee.*<sup>146</sup>

In addition to this liability portfolio for a 'base case' SUFA transaction, Aurizon Network also considered it was entitled to an element of the return associated with SUFA assets. Aurizon Network said that the WACC return earned on SUFA assets incorporates both an asset-based element, as well as an element of return for the risks Aurizon Network bears as operator of those assets. In this context, Aurizon Network noted that the Operating Performance Risk Allowance (OPRA) proposed provided for compensation to Aurizon Network in respect of the risk of operating SUFA assets.<sup>147</sup>

From this 'base case' risk and liability position, Aurizon Network noted that the 2013 SUFA DAAU allows for commercial negotiation of compensation for additional risk—whereby Aurizon Network may assume some or all of the risk ordinarily allocated to preference unit holders in the 'base case' SUFA transaction in return for commercially negotiated returns.<sup>148</sup>

Aurizon Network noted further that if adjustments to the SUFA 'base case' template documentation were to be required for a specific transaction, it would be best done by Aurizon Network and the preference unit holders agreeing to vary the standard documentation to protect their commercial interests by (amongst other things), jointly assessing project specific risks, requirements and positions.<sup>149</sup>

### 13.2.2 OPRA

Aurizon Network said that as the operator of the existing and the expanded facility, the return on assets for the existing facility will not be commensurate with the commercial, legal and regulatory risks of providing the service on the extended facility where Aurizon Network is not the funding party of the expansion.<sup>150</sup>

Aurizon Network noted that the WACC return earned on a SUFA asset incorporates both an asset-based element, and an element of return for the risks Aurizon Network bears as operator of those assets. Aurizon Network proposed to include an operating and performance risk allowance (OPRA). This risk allowance is to compensate Aurizon Network for the risks it bears as operator of the SUFA assets. The OPRA is payable by the Trust to Aurizon Network.<sup>151</sup> This would reduce Aurizon Network's lease payments otherwise payable to the Trust; in order to ensure Aurizon Network's legitimate business interests as operator of the extension are protected.<sup>152</sup>

<sup>145</sup> Aurizon Network 2013b, p. 6

<sup>146</sup> Aurizon Network 2013b, p. 18

<sup>147</sup> Aurizon Network 2013b, p. 16

<sup>148</sup> Aurizon Network 2013b, p.6

<sup>149</sup> Aurizon Network 2013b, pp. 9-10

<sup>150</sup> Aurizon Network 2013o, p.12

<sup>151</sup> Aurizon Network 2013b, p.16

<sup>152</sup> Aurizon Network 2013b, p.12

## 13.3 Summary of stakeholders' comments

### 13.3.1 Allocation of risk

Stakeholders generally held the view that Aurizon Network's proposed 2013 SUFA DAAU favours Aurizon Network with respect to risk allocation and compensation.

The QRC said that an overriding concern with the SUFA documents is the lack of commercial balance and that the documents largely only have regard to the interests of Aurizon Network and provide it with significant control and discretions.<sup>153</sup>

Anglo American noted that under various agreements, Aurizon Network is entitled to various fees, expenses and costs in order to compensate it for risk it has accepted. Conversely, in other areas of its agreements, it has taken a zero risk approach. Anglo American said this leaves all risk with the coal producers under a SUFA, even in instances where they are unable to mitigate the extent of the risk.<sup>154</sup>

### 13.3.2 Limitation of liability

The QRC noted the following with respect to limitations of liability:

- it is unacceptable for Aurizon Network's liability to be limited to \$1 under the EISL as the Trustee will be exposed to liability where, for example, there has been a material breach and Aurizon Network has failed to pay rent<sup>155</sup>
- it is inappropriate for Aurizon Network to limit its liability under the Umbrella Agreement (limited to \$1) given that its obligations, such as entering into an access agreement, are basic and of fundamental importance to the Trustee.<sup>156</sup>

Anglo American noted in its August 2013 submission that there are numerous risks which have been placed on the coal producers and circumstances where the coal producers are not in a position to control or mitigate those risks. It also noted that the situation is exacerbated by the unreasonable position being adopted by Aurizon Network in respect of the limitation of liability provisions throughout the SUFA framework — for example, under the EISL it was proposed that Aurizon Network's liability be limited to \$1 (other than for fraud, gross negligence and wilful default).

Further, Anglo American noted that because of the protection from liability, Aurizon Network may cause users to suffer damage because of its own negligence and provides users with no means of rectifying the situation or receiving a remedy.<sup>157</sup>

### 13.3.3 OPRA

Based on our review, we are not aware of stakeholders providing a substantive response on OPRA.

## 13.4 QCA analysis and Draft Decision

We have reviewed Aurizon Network's proposed liability regime across the suite of SUFA documents provided with the 2013 SUFA DAAU and consider that it does not provide for a balanced allocation of risk or compensation. We have formed our view by considering the liability regime of SUFA as a whole, rather than looking at the liability of each SUFA agreement

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<sup>153</sup> QRC 2013b, p.6

<sup>154</sup> Anglo American 2013a, p.5

<sup>155</sup> QRC 2013b, p. 17

<sup>156</sup> QRC 2013b, p. 28

<sup>157</sup> Anglo American 2013a, pp.5-6

in isolation. We have also considered it in the context of the SUFA documents provided as part of this Draft Decision.

In forming our position on liability, we have worked from the general principle that 'the party that controls the risk should generally carry the risk'.

We have also used the following principles respecting the allocation of liability:

- It is not appropriate to limit liability where the risk is wholly within a party's capability to manage its exposure.
- Except for consequential loss arising from third party claims, in respect of damage to people and property, neither party should bear consequential loss of an economic nature.
- To avoid unnecessary disputes, there should be consistent treatment of loss/liability across all documents.

We consider that within the context of the SUFA framework these principles align with sections 138(2) and 69E of the QCA Act, insofar as they ensure risk is appropriately allocated to the party that is best placed to manage it and the liability regime associated with risk allocation is proportionate. A summary table of the details of our proposed liability regime is in Appendix C. The following is a brief discussion of our overall view.

#### 13.4.1 Allocation of risk

We have sought to amend the SUFA documents to provide what we consider to be an appropriate allocation of risk. We believe this improves the workability, bankability and credibility of the SUFA suite of documents.

As noted above, we have followed the principle of allocating risk/liability to the party best able to manage that risk. Taking that into account, we propose the following:

- Aurizon Network can control its ordinary course of activities, construction and terms and conditions to its construction site. Given this, we believe Aurizon Network should carry risks associated with construction,
- The Trustee can manage its actions when on the construction site, or when removing the asset. It follows that we believe the Trustee can control its breaches under the RCA. Given this, the Trustee has been allocated the risk of breach of the RCA.

#### 13.4.2 Limitation of liability

We consider that it is not appropriate to limit liability to \$1 where risk is wholly within the party's capability to manage its exposure.

With the replacement of the PMA with the construction contract, we consider that Aurizon Network will have control over construction and the ordinary course of activities. We also consider that after construction, the risk Aurizon Network bears is no different to that of the rest of its network. Given this, we consider there should be no limitation on its liability.

Replacement of the PMA has also changed the participation level of the Trust/Trustee. The Trustee is now a relatively passive participant, especially in respect of construction. We consider it is unlikely that the Trustee may cause damage— whether during construction, or operation. However, to the extent that it does, it should be liable for direct damage.

Throughout the suite of SUFA documents, the Trustee is subject to limited liability except in instances where it:

- has committed a wilful default
- has committed gross negligence

- has committed fraud.

### 13.4.3 Consequential loss

Aside from consequential losses that arise from third party claims of damage to people and property, neither party should bear consequential losses of an economic nature. For example: loss of coal, loss of profit or loss of a deal. We acknowledge that neither party should be underwriting the profits of the other party. As the SUFA arrangement is intended to be a funding solution, we consider the loss of the Trust (and the Preference Unit Holders) should be limited to recovery of the value of its investment and should not extend to recovery of the value of an investment in an associated coal mine.

However, we also consider the ability to recover direct loss should be real and not limited by a widely drafted definition of consequential loss (that may be appropriate for other documents relevant to the declared service but does not seem appropriate to a funding arrangement).

For this reason, we are inclined to depart from the standard definition of consequential loss used by Aurizon Network in the standard access agreements, to permit the recovery of losses that a lender would expect to recover. We welcome comments on this view.

### 13.4.4 OPRA

We do not agree that part of the return on SUFA infrastructure be attributable to Aurizon Network because it operates the SUFA infrastructure. Nor do we consider it appropriate to include a margin for the operation of SUFA infrastructure. Although both these options are in Aurizon Network's interests, we do not consider that in the context of assessing SUFA under the QCA Act they represent a legitimate business interest (section 128(2)(b) of the QCA Act).

SUFA is a financing arrangement. Its objective is to allow for financing choice if Aurizon Network makes the conscious decision not fund an expansion; that has gone through the expansion process, at the regulated rate of return. In our view, choosing to finance an expansion via SUFA is causally related to Aurizon Network's funding proposal. If this results in SUFA being adopted, this should not be interpreted as subsequently triggering some form of operational 'service agreement' with Aurizon Network.

Furthermore, we are of the view that SUFA infrastructure should be operated holistically with Aurizon Network infrastructure in order to maximise operational efficiency. We also note that SUFA infrastructure attracts an operating and maintenance cost allowance to account for the operational impact it has. This allowance should reflect any objectively justified changes in risk resulting from the SUFA infrastructure. We consider that in the context of SUFA this appropriately balances the legitimate business interests of Aurizon Network as the operator of the infrastructure, with the interests of access seekers and funders (sections 138(2)(b), (e) and (h) of the QCA Act).

Overall, we are minded to exclude the concept of OPRA from rental calculation methodology, rather than simply set it at zero.

We would welcome stakeholder comments on this view.

#### Draft Decision

**13.1 Exclude OPRA from the suite of SUFA agreements and the rental calculation methodology in particular. This will be implemented as part of the review of the rental schedules discussed in the chapter on rent.**

## APPENDIX A: PROPOSED SUFA ARRANGEMENTS

### SUFA Agreements and the parties involved

The SUFA framework proposed in this draft decision is comprised of 12 interconnected template agreements, involving nine parties. This Appendix is to be read in conjunction with Figure 7.

- **Access Seekers:** secure access rights by executing access agreements (as contemplated in the Access Agreement Specific Terms Deed)
- **Preference Unit Holders:** fund the construction of infrastructure by purchasing preference units in the Trust (as contemplated in the SUHD).
- **Queensland Treasury Holdings (QTH):** is the ultimate owner of all infrastructure assets developed under a SUFA arrangement. QTH, as lessee, will agree to a SUFA on a transaction-by-transaction basis. For infrastructure assets on the North Coast Line, the ultimate owner is Queensland Rail.
- **Aurizon Holdings:** is Aurizon Network's parent company and the guarantor to QTH of the performance of Aurizon Network and the Trust (Deed Poll Guarantee).
- **Aurizon Network:** performs the following roles in the context of SUFA:
  - landholder
  - ordinary unit holder of the Trust
  - constructor of infrastructure
  - sub-lessee of SUFA infrastructure
  - access provider
  - network operator
- **Trustee:** is an independent Trustee with duties set out under the Trust Deed and the SUHD. Will be the 'secured party' for the security agreement in respect of the rental and compensation cash flows.
- **State of Queensland:** is the ultimate landowner of the land on which the rail infrastructure (including the SUFA funded infrastructure) is situated. The State's approval is required for Aurizon Network to grant the licence to the Trustee under the RCA. This consent is provided in the IND to which the State is a party.
- **Facility Agent:** is the agent for any third party financiers to the Trustee and, amongst other responsibilities, is responsible for the administrative aspects of the security granted by the Trust over its assets.
- **Independent certifier:** has the role to certify that variations from the construction contract are prudent during construction.<sup>158</sup>

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<sup>158</sup> It should be noted that any variation costs will still be subject to assessment by the QCA (under the process detailed in the EPA) for their inclusion in the RAB.

**Figure 7: Proposed SUFA Arrangements — Summary of parties involved and applicable agreements**

		Queensland Treasury Holdings	Aurizon Holdings	Aurizon Network	Trustee	Preference unit holder	Access Seeker	State of Queensland	Facility Agent	Financier
<b>The Trust</b>										
<b>Trust Deed (TD)</b>	- Establishes the Trust with Aurizon Network as ordinary unit holder, permits the issue of preference units and appoints the Trustee			Yes	Yes					
<b>Subscription and Unit Holders Deed (SUHD)</b>	- Prevails over subscription process for preference units - Establishes the operational rules of the Trust whilst there are unredeemed preference units - Prevails over the Trust Deed if there is a conflict - Establishes that each preference unit holder will provide various tax indemnities.			Yes	Yes	Yes				
<b>Project Delivery and Land Access</b>										
<b>Construction Agreement (and Formal Instrument of Agreement)</b>	- Aurizon Network is contracted to design and construct the extension by a designated date for practical completion in order to deliver an expansion infrastructure project.			Yes	Yes					
<b>Rail Corridor Agreement (RCA)</b>	- Provides a licence to the Trustee so that it can have the extension infrastructure built on Aurizon Network land and identifies the terms and conditions associated with this right			Yes	Yes					
<b>Leasing, Ownership and Rent</b>										
<b>Extension Infrastructure Head-lease (EIHL)</b>	- Establishes the ownership and leasing terms and conditions for the SUFA asset between QTH, the Trust and Aurizon Network	Yes		Yes	Yes					
<b>Extension Infrastructure Sub-lease (EISL)</b>	- Establishes the sub-leasing terms and conditions for the SUFA asset between the Trust and Aurizon Network - Contractually defines the rental terms and conditions for Aurizon Network to pay rent to the Trust			Yes	Yes					
<b>Access Rights and Tax Indemnity</b>										
<b>Extension Project Agreement</b>	- 'Wrapper Document' setting out common terms and conditions - Provides an overview of the key obligations between Aurizon Network, the Trustee and the Preference Unit Holders - Establishes which parties will be entering into a linked access agreement			Yes	Yes	Yes	Yes			
<b>Access Agreement Specific Terms Deed</b>	- The access seeker and Aurizon Network agree to enter into an access agreement to secure access rights to Aurizon Network's infrastructure (including extension infrastructure)			Yes	Yes		Yes			
<b>Agreement Termination and SUFA Asset Disposal</b>										
<b>Integrated Network Deed (IND)</b>	- Governs the circumstances and process by which the QTH may dispose of SUFA assets following termination of the Infrastructure Lease - Governs the disposition of any disposal proceeds if a disposal occurs	Yes		Yes	Yes			Yes		
<b>Performance Standards</b>										
<b>Deed Poll Guarantee (DPG)</b>	- Guarantees to QTH on Aurizon Network and the Trustee's performance of their obligations under the EIHL and IND - Indemnifies QTH against any losses it may incur due to a default or delay in the performance of these obligations		Yes							
<b>Security</b>										
<b>Specific Security over Access Charges</b>	- Provides security over amounts paid under the direction to pay.			Yes	Yes					
<b>Financing Side Deed</b>	- Provides consent for and regulates any security to be provided by the Trustee to third party financiers.	Yes		Yes	Yes			Yes	Yes	Yes



## APPENDIX B: CONSTRUCTION CONTRACT

Construction of the extension will involve both a Construction Agreement— General Conditions and Design and Construct Contract— Formal Instrument. The construction agreement sets out the terms and conditions on which the Expansion is to be designed and built. The Design and Construct Contract— Formal Instrument is the actual contract and attaches documents such as: the Scope of Work, Contractor's Proposal, Allocation Principles, Independent Certifier Deed, Lump-sum breakdown and Expert Determination Agreement.

Table 12: Construction Contract Structure

<i>Description</i>	<i>Term Sheet structure</i>	<i>Draft Construction Contract</i>	<i>Clause</i>
Type of contract	Design and construct contract based upon the Standards Australia AS4902-2000 updated to reflect agreed risk profile (as reflected in the term sheet)	Design and construct contract based on Standards Australia AS4902-2000.	
Price	Price for the contract to be lump-sum (being the amount approved by QCA) or schedule of rates (if that approach is approved by the QCA) with a fee (also approved by the QCA).	<p>Price for the contract is a lump-sum. The contract sum (or lump-sum) includes provisional sums but excludes pre-funding payments (such as funding feasibility studies).</p> <p>The provisional sum is the amount included in the contract sum for monetary sum, contingency sum and prime cost item.</p> <p>The pre-funding mechanism is paid by the Principal to the contractor under the construction contract, but is not treated as part of the contract sum.</p>	Definitions
Aurizon Network's role	Responsible for entire design and construct	<p>Aurizon Network is the Contractor. The Contractor must carry out the work under contract (WUC) and complete the design and construction of 'the Works' in accordance with the Contract (See Construction Agreement Formal Instrument).</p> <p>It must also undertake all tasks necessary to design and specify the works required by the contract— including the preparation of the design documents (Contractor design obligations).</p> <p>The Contractor warrants that the Works, when completed, will be fit for purpose.</p> <p>However, the Contractor does not warrant the Works will meet any incremental capacity requirements stated in the project requirements.</p>	Definitions
Scope and target cost	To be defined as the scope and cost pre-approved by the QCA before commencement	The Contractor shall carry out and complete WUC in accordance with the 'Contract' and 'directions' authorised	Definitions

<b>Description</b>	<b>Term Sheet structure</b>	<b>Draft Construction Contract</b>	<b>Clause</b>
	of construction, with a design brief setting out the capacity requirements (plus any capacity modelling assumptions that are relevant) for the finished extension.	<p>by the Contract.</p> <p>The Contract means the contract comprising the documents listed in the Formal Instrument of Agreement. The documents listed include scope of works, among other documents.</p> <p>The Contractor shall carry out and complete the design obligations as per the Principal's project requirements, i.e. the design, timing and cost objectives for the works and preliminary design.<sup>159</sup></p> <p>The contract will be a lump-sum for the Contractor to deliver the scope specified in the project requirements included in the contract. The lump-sum is subject to potential adjustment as set out in Variations below.</p>	
Variations	<p>Variations:</p> <ul style="list-style-type: none"> <li>Notwithstanding the requirements for the QCA to consent to certain variations, the contract must include a mechanism to formally approve variations (under the contract).</li> <li>A regime for pricing variations to be set out. QCA pre-approval will require that the price be agreed before approval is sought.</li> </ul> <p>Pre-approval of variations:</p> <ul style="list-style-type: none"> <li>Trustee or Aurizon Network can approach the QCA for pre-approval of a variation.</li> <li>The construction contract will need to address the risk of delay whilst QCA approval is being sought.</li> <li>Variations for agreed contingency events funded out of the contingency funding will be deemed to be part of the original pre-approval by the QCA.</li> </ul>	<p>Variations :</p> <p>Works or items (for which provisional sums are included in the contract sum) are to be priced by the Independent Certifier, and the difference is to be added to or deducted from the contract sum. Where any part of such work or item is carried out by a subcontractor, the Independent Certifier shall allow the amount payable by the Contractor to the subcontractor for the work or item.</p> <p>There are 'discretionary variations', whereby, prior to any time before the date of the practical completion, a party may notify the other party and the Independent Certifier that it proposes to vary:</p> <ul style="list-style-type: none"> <li>the WUC, the 'Discretionary variations' can include changing the character or quality, carry out additional works, among others. If the Principal and the Contractor agree to proceed with the variations, the matter shall be referred to the Independent Certifier for certification.</li> <li>The Independent Certifier shall price an adjustment to the contract sum due to the discretionary variation or an adjustment event.</li> </ul> <p>There is no mechanism in the construction contract for QCA approval of variations. If the Trustee and Aurizon Network (as contractor) agree a variation is to be carried out, then it can be carried out and the costs are added to the contract sum as assessed by the independent certifier.<sup>160</sup></p> <p>Adjustment events:</p> <ul style="list-style-type: none"> <li>The Contract defines what could be an 'adjustment event'.</li> <li>The Contractor is entitled to an adjustment to the contract sum for adjustment events. Adjustment events include:</li> </ul>	25 29

<sup>159</sup> Preliminary design is not defined

<sup>160</sup> It should be noted that any variation costs will still be subject to assessment by the QCA (under the process detailed in the EPA) for their inclusion in the RAB.

<i>Description</i>	<i>Term Sheet structure</i>	<i>Draft Construction Contract</i>	<i>Clause</i>
		<ul style="list-style-type: none"> <li>- latent conditions— which are any site conditions that are different to the baseline site conditions</li> <li>- changes in legislation</li> <li>- discovering on-site minerals, fossils, objects of antiquity or of anthropological or archaeological interest</li> <li>- unexpected contamination</li> <li>- some types of industrial action</li> <li>- inclement weather</li> <li>- force majeure events.</li> </ul> <p>Another adjustment event is where the Principal agrees to accept defective work (rather than have the Contractor rectify). The Independent Certifier must adjust the contract sum accordingly.</p>	
Superintendent	The superintendent is to be an independent certifier (possibly with a duty of care to the QCA). The cost of the independent certifier forms part of the project cost. The QCA will have a right to approve, or not approve the independent certifier.	<p>An Independent Certifier will be appointed by the Contractor, the Principal and the QCA to carry out certifier services under an Independent Certifier Deed. The costs of the Independent Certifier are to be borne by the Principal —these costs are not included in the contract sum.</p> <p>If the Independent Certifier is terminated, resigns or is unable to continue its role, the Principal and the Contractor will appoint another on substantially the same terms. If an Independent Certifier has not been appointed within 20 business days, the parties will accept an appointment by the QCA.</p>	20
Liquidated damages	The profit element of the cost of construction (which could also be considered as the project management fee) will be at risk if the extension is not delivered on or prior to the target date. Parties to consider also further damages in the form of interest payments if the extension is delivered after the target date.	<p>Liquidated Damages:</p> <ul style="list-style-type: none"> <li>• If the Contractor does not reach practical completion by the date specified (for practical completion), the Independent Certifier certifies the amount of liquidated damaged due to the Contractor (Trustee) for every day after the date for practical completion.</li> <li>• Liquidated damages for delay will accrue and be payable separately for each 'separable portion'.</li> <li>• The Contractor's maximum aggregate liability is limited to an amount to be agreed.</li> </ul> <p>Delay Damages:</p> <ul style="list-style-type: none"> <li>• The Contractor can claim damages due to delay for an Extension of Time that is for a compensable cause.</li> </ul>	34
Completion of works	<ul style="list-style-type: none"> <li>• Practical Completion is to be defined - however, it must include satisfaction that the nameplate capacity has been achieved.</li> <li>• Defects: to include shortfall of capacity</li> </ul>	Practical completion is defined as that stage in carrying out and completion of WUC when the Works are complete, tests carried out and passed, information/documents (required under the contract) have been supplied, and the contractor certifies the works are ready to enter operational service. The practical completion regime applies to each separable portion.	Definition

<i>Description</i>	<i>Term Sheet structure</i>	<i>Draft Construction Contract</i>	<i>Clause</i>
	<ul style="list-style-type: none"> <li>Aurizon Network to warrant in relation to the completed extension infrastructure.</li> </ul>	<p>Defect is defined as:</p> <ul style="list-style-type: none"> <li>defect, shrinkage, movement, error, omission, deficiency or other imperfection in the Works, in respect or, or arising from, any cause including design, materials or workmanship</li> <li>the aspect of the Works which is not in accordance with the Contract, or</li> <li>physical damage to the Works resulting from any of the matters referred to in the bullet points above.</li> </ul> <p>The Contractor shall give the Independent Certifier at least 14 days written notice of the date upon which the Contractor anticipates that practical completion will be reached. When the contractor is of the opinion that practical completion has been reached, it shall, in writing, request the Independent Certifier to issue a certificate of practical completion.</p> <p>The Contractor, will provide no warranty to the principal as to whether the railway, as augmented by the Works, will fulfil the incremental capacity requirements of the Principal (or any capacity requirements stated in the Principal's project requirements). This means a failure to achieve capacity will not be a defect and will not be subject to the defect rectification obligations in the contract.</p>	
Payment	<ul style="list-style-type: none"> <li>Construction Fee: profit element for Aurizon Network to form part of the lump-sum or schedule of rates as approved by the QCA</li> <li>Payment regime: monthly on receipt of invoices.</li> </ul>	<p>The contract does not provide for a construction fee. The Contractor's margin will be included in the lump-sum.</p> <p>The provisional sum (which is included in the contract sum) is to include a percentage for profit and attendance.</p> <p>The Contractor will be paid progressively throughout the Contract, on a monthly basis.</p> <p>The Independent Certifier will assess the amount it believes if payable to the Contractor each month and issue a progress certificate that the Principal must pay. The Contractor may dispute this valuation.</p> <p>A final payment claim to be made by the Contractor after the defects rectification period.</p>	37
Authority to construct	Aurizon Network to have in place all necessary authorisations for the works.	The Contractor must obtain all approvals necessary for carrying out the WUC and constructing the Works, other than those that are expressly specified in the contract as being the Principal's responsibility.	11.3
Safety	<ul style="list-style-type: none"> <li>Aurizon Network to be the principle contractor for the purposes of the Work Health &amp; Safety Act</li> <li>Aurizon Network to be responsible for work health and safety and environmental protection</li> </ul>	<p>The Principal shall appoint the Contractor or a nominee identified by the Contractor, to be the principal contractor for the purposes of the WHS Act. The Contractor will be deemed to have accepted the appointment.</p> <p>The Contractor is the Rail Infrastructure Manager for the railway. The Principal will, and ensure its employees, agents and other contractors will comply with all directions on safety matters given by the Contractor to ensure compliance with its obligations as the Rail Infrastructure Manager.</p>	11.4 12

<i>Description</i>	<i>Term Sheet structure</i>	<i>Draft Construction Contract</i>	<i>Clause</i>
		<p>The Contractor shall take measures necessary to:</p> <ul style="list-style-type: none"> <li>• protect people and property</li> <li>• avoid unnecessary interference with the passage of people and vehicles</li> <li>• prevent nuisance and unreasonable noise and disturbance.</li> </ul> <p>If the Contractor damages the property, the Contractor shall rectify the damage and pay any compensation which the law requires the Contractor to pay.</p>	
Access to land	Trustee is to procure access through the RCA and Aurizon Network is to indemnify the Trustee for any breach of the conditions imposed on the Trustee under the RCA during construction.	<p>The contractor must maintain sufficient access to the site to allow the contractor to carry out the WUC.</p> <p>The Principal and the Principal's employees, consultants and agents (including the Principal's engineer) may at any time, after reasonable written notice to the Contractor, have access to any part of the site for the purpose of inspecting the progress of the work under Contract in accordance with the landholder requirements under the RCA. The Principal is to ensure that none of these people impede the Contractor).</p> <p>The Contractor will at all reasonable times give the independent certifier access to the work under contract.</p>	24.1 24.2
Insurance	Aurizon Network to be responsible for the insurance of the works and for public liability and to obtain professional indemnity insurance commensurate with industry practice.	<p>The Contractor will, before commencing the Works under the Contract, effect and maintain the following insurances:</p> <ul style="list-style-type: none"> <li>• insurance for the Works against loss or damage resulting from any cause (save for excepted risks) until the contractor is no longer responsible</li> <li>• professional indemnity insurance</li> <li>• public liability insurance</li> <li>• insurance of employees</li> </ul> <p>The insurance is not to limit liabilities or obligations of the Contractor under other provisions of the Contract.</p>	16A 16B 17 18 19.1
Termination for convenience	Termination for convenience permitted provided QCA involvement on prudence of costs incurred to date determines the payment to be made on termination.	<p>The Principal may terminate the Contract if it is obliged to terminate the construction contract pursuant to the Unit Holder's Deed.</p> <p>If the contract has been terminated:</p> <ul style="list-style-type: none"> <li>• by the Contractor because the Principal has suspended the performance of the works for 90 business days in accordance with the Unit Holder's Deed;</li> <li>• by the Principal because work is suspended for 180 days as a result of an adjustment event requiring work outside of extension land</li> </ul>	40.1 40.2 40A 40B

<i>Description</i>	<i>Term Sheet structure</i>	<i>Draft Construction Contract</i>	<i>Clause</i>
		<ul style="list-style-type: none"> <li>• by the Principal because is obliged to terminate the contract under the Unit Holder's Deed, then, the Principal must pay the Contractor:</li> <li>• for works executed prior to the termination date for which the contractor has not been paid – the amount which would have been payable for that work if the contract had not been terminated</li> <li>• actual costs incurred by the contractor prior to the date of termination</li> <li>• the costs of the contractor in demobilising from the WUC and the site</li> <li>• the break fee specified in the contract.</li> </ul> <p><u>Force Majeure:</u></p> <p>If a delay caused by a force majeure event continues for more than 180 days, the Principal may terminate the contract by giving a written notice to the Contractor.</p> <p><u>Pre-termination work:</u></p> <p>Where the contract is terminated:</p> <ul style="list-style-type: none"> <li>• by the Contractor because the Principal has suspended the performance of the works for 90 business days in accordance with the Unit Holder' Deed;</li> <li>• by the Principal because work is suspended for 180 days as a result of an adjustment event requiring work outside of extension land;</li> <li>• by the Contractor for a default by the Principal;</li> <li>• by the Principal because the Principal is required to terminate the contract under the terms of the Unit Holder's Deed; or</li> <li>• by the Principal because of a force majeure event lasting 180 days, the Principal is obliged to pay the Contractor for the removal of the redundant extension infrastructure and restore the site to the condition it was prior to the commencement of the WUC (pre-termination work).</li> </ul>	
Replacement contractor	Replacement contractor provisions to be permitted.	<p>If the contract is terminated for any reason, including due to default of the Contractor, then the Principal has no entitlement to have that work carried out by another contractor.</p> <p>Similarly, if the Contractor does not rectify a defect, there is no right for the Trustee to have that work done by another Contractor.</p>	39
Default	Default for a fundamental breach of contract by Aurizon Network or the Trustee to be	<u>Contractor:</u>	39

<i>Description</i>	<i>Term Sheet structure</i>	<i>Draft Construction Contract</i>	<i>Clause</i>
	<p>included with the following matters to be defined:</p> <ul style="list-style-type: none"> <li>• what is to be considered a fundamental breach</li> <li>• what are to be the default rights (e.g. suspension by the contractor and taking over the works by the principal)</li> <li>• what process is to apply before those default rights can be used.</li> </ul>	<p>If the Contractor commits a ‘substantial breach’ of the contract, the Principal may give the Contractor a written notice to show cause. Examples of substantial breaches by the Contractor include failing to:</p> <ul style="list-style-type: none"> <li>• provide evidence of insurance</li> <li>• comply with a direction of the Independent Certifier</li> <li>• comply with the Contractor's defect rectification clause.</li> </ul> <p>Other substantial breaches could include:</p> <ul style="list-style-type: none"> <li>• wrongful suspension of work</li> <li>• refusing to proceed with the WUC in accordance with the requirements of the contractor or abandoning the WUC</li> <li>• knowingly provide documentary evidence containing an untrue statement.</li> </ul> <p>If the Contractor fails to show cause, the Principal may suspend or terminate the Contract. The Contractor is to pay compensation to the Principal.</p> <p><u>Principal:</u></p> <p>If the Principal commits a substantial breach of the Contract, the Contractor may give the Principal a written notice to show cause. Substantial breaches by the Principal are failing to:</p> <ul style="list-style-type: none"> <li>• provide security or</li> <li>• make a payment due and payable pursuant to the Contract.</li> </ul> <p>The Contractor may suspend the whole or part of any WUC. The Contractor can remove the suspension if the principal remedies the breach. If the Principal does not remedy, the Contractor will be entitled to claim an extension of time and an adjustment to the contract sum in respect of any delay or increased costs incurred by it as a result of the WUC being suspended.</p> <p><u>Insolvency:</u></p> <p>If the Contractor is insolvent, the Principal may terminate the Contract.</p> <p>If the Principal is insolvent, the Contractor may suspend or terminate the Contract.</p>	
Dispute Resolution	Dispute resolution procedure may refer to the standard position in the Extension Project Agreement; however, the appropriateness of this will need to be considered further.	Dispute resolution between the Contractor and the Principal must be resolved in accordance with the process outlined in the Contract.	42

<b>Description</b>	<b>Term Sheet structure</b>	<b>Draft Construction Contract</b>	<b>Clause</b>
Security	Trustee may grant security over all its rights under the Construction Contract without consent in accordance with the requirements of the Expansion Project Agreement.	The Contractor consents to the Principal's granting security over its rights under the Contract in accordance with the Principal's obligations under the Extension Project Agreement.	9.2



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## APPENDIX C: LIABILITY

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The following table provides the details of our draft position on liability as it relates to the parties in a SUFA arrangement. In drafting the SUFA agreements we have undertaken to allocate risk to parties best able to manage that risk and balance the associated risks and liabilities amongst the parties.

We ask that parties choosing to comment on this section of the decision do so at a policy position level, rather than comment on the drafting contained in the agreements. We want to ensure we understand parties' positions on the proposed framework before any refinement of drafting in the agreements will take place. Following our review of liability across the SUFA document suite, our view is that:

- the party that controls the risk should generally carry the risk. It is not appropriate to limit liability to \$1.00 where the risk is wholly within the party's capability to manage its exposure (whether that is by performing the obligations or backing off the risk to other parties such as contractors)
- during construction:
  - Aurizon Network is compensated for the risk it will carry under the Construction Contract through its price for the contract
  - the Trustee is relatively passive so is unlikely to cause damage. However, to the extent it does, it should be liable for direct damage
- after construction:
  - the opportunity for the Trustee to cause Aurizon Network damage is very remote. Damage that could arise are the termination of the Infrastructure Lease or tax costs
  - the risk to Aurizon Network is no different to the risk it carries on the rest of its network. It is compensated for that risk through the operation and maintenance element of the access charge
- Aurizon Network should carry all risk associated with the land (including risk arising because of the Trustee's actions even though the Trustee complied with the RCA terms), but as the Trustee can control breaches of the RCA, it should carry risk arising out of its breaches of the RCA. The risk carried by Aurizon Network should extend to the state of the land at the commencement of the RCA
- except for consequential loss arising from third party claims (through the Trustee by the actions of a preference unit holder or financier or Aurizon Network by another SUFA) in respect of damage to people and property, neither party should bear consequential loss of an economic nature (such as loss of coal, loss of profits, loss of deal)
- consequential loss should be defined with particularity and not with reference to undefined terms such as 'special, indirect or consequential loss'. In our view, the interaction between the definition of Consequential Loss (under Aurizon Network's 2013 SUFA DAAU) and Claim meant that it would be nearly impossible to determine any loss that was recoverable
- to avoid unnecessary dispute, the SUFA documents should feature a consistent treatment of loss and liability, with any points of difference to be contained in the relevant documents.

**Table 13 Summary of liability regime**

<i>Party</i>	<i>Activity</i>	<i>Position</i>
<b>Construction and ordinary course activities</b>		
Aurizon Network	<ul style="list-style-type: none"> <li>• Construction</li> <li>• Terms and conditions for entry to construction site</li> </ul>	Aurizon Network should carry risk associated with construction or ordinary course activities. Aurizon is likely to be compensated for the risk it will carry through the construction contract.
Trustee	Breaches of the RCA	<p>The Trustee is relatively passive, so it is unlikely it will cause damage. However, to the extent it does, it should be liable for direct damage.</p> <p>The Trustee can control negligence or wilful acts or omissions in breach of the RCA and as such should carry the risk of default</p>
<b>After construction</b>		
Aurizon Network	Ordinary course activities	The risk Aurizon Network carries after construction is no different to risk it carries on the rest of its network. It is compensated for that risk through Operation and Maintenance charge
Trustee	Causing damage	The opportunity for the Trustee to cause damage is remote. Damage that could arise includes: termination of the Infrastructure lease (discussed below) or tax (discussed below).
<b>Breach or termination of lease agreements</b>		
Aurizon Network	Actions in respect of the QTH Infrastructure Lease	Liability is not capped.
Trustee	Actions in respect of the QTH Infrastructure Lease	<p>Liability is limited by the following:</p> <ul style="list-style-type: none"> <li>• It knowingly breaches the QTH Infrastructure Lease</li> <li>• compensation amount is limited to the amount it receives from QTH as a result of the sale of the CQCN</li> <li>• it has no liability if it is doing something it is required to do under another document</li> <li>• it is liable only to the extent it contributed to the damages / termination</li> <li>• liability is capped at the Trust</li> </ul>
Trustee/Aurizon	Breach of the EISL or the EIHL (Infrastructure Lease	The party that caused the breach must pay detriment to the other party, except:

<i>Party</i>	<i>Activity</i>	<i>Position</i>
Network	remains)	<ul style="list-style-type: none"> <li>• if no party is at fault, neither party receives a detriment amount</li> <li>• if the breach is caused by AN not taking action, the Trustee is not liable, and Aurizon Network is liable for the detriment amount</li> </ul>
<b>SUFA Cause or impact on another SUFA</b>		
Trustee/Aurizon Network	Actions of other SUFAs— for example, the Trustee is penalised if another SUFA brings down the transaction	Neither party is liable to the other
Trustee	Liable for consequential loss where suffered by Aurizon Network where those actions have impacted another SUFA	<ul style="list-style-type: none"> <li>• Consequential loss is limited to damage to people and property and does not extend to loss, profits or the deal.</li> <li>• Liability for consequential losses only arises where the terms of the other SUFA are on the same terms (in respect of liability for people and property) as the standard SUFA.</li> </ul>
<b>Limitation of liability</b>		
Aurizon Network	Capacity	Aurizon Network will not have any liability to the Trustee or the unit holder in respect of the capacity created by the extension - except for any liability it may have under the access undertaking or under an access agreement.
<b>Consequential loss</b>		
Trustee/Aurizon Network	Consequential loss	No party will bear consequential loss of an economic nature (such as loss of coal, loss of profit, and loss of deal) aside from consequential loss arising from third party claims in respect of damage to people or property.
<b>Environment and land issues</b>		
Aurizon Network	Any activity concerning the extension land	Aurizon Network carries all risk for matters related to land except where the Trustee fails to comply with the RCA (clause 3.5(a)), has wilfully defaulted, is grossly negligent or is acting in bad faith.

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## GLOSSARY

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### A

2010 access undertaking	Aurizon Network's current Access Undertaking, approved by the QCA on 1 October 2010, together with any subsequent changes made by the QCA.
ABA	Administratively Binding Advice
Aurizon Group	The Group of Companies held by Aurizon Holdings Limited, which includes Aurizon Network
Aurizon Holdings	Aurizon Holdings Ltd
Aurizon Network	Aurizon Network Pty Ltd (formerly known as QR Network Pty Ltd)
ATO	Australian Tax Office
AU	Access Undertaking

### B

BMA	BHP Billiton Mitsubishi Alliance
BMC	BHP Billiton Mitsui Coal

### C

CQCN	Central Queensland Coal Network
CC	Construction Contract
CWG	Customer Working Group

### D

DAU	Draft Access Undertaking
DAAU	Draft Amending Access Undertaking
DPG	Deed Poll Guarantee

### E

EIHL	Extension Infrastructure Head Lease
EISL	Extension Infrastructure Sub-lease
EPCM	Engineer, Procure, Construct and Manage

### F

### G

### H

**I**

ITAA                                      Income Tax Assessment Act

IND                                        Integrated Network Deed

**J****K****L****M**

MAR                                      Maximum Allowable Revenue

**N**

NPV                                        Net Present Value

NTER                                      National Tax Equivalent Regime

**O**

OPRA                                      Operating Performance Risk Allowance

**P**

PBR                                        Private Binding Ruling

PMA                                        Project Management Agreement

**Q**

QCA                                        Queensland Competition Authority

QCA Act                                    *Queensland Competition Authority Act 1997*

QRC                                        Queensland Resources Council

QTC                                        Queensland Treasury Corporation

QTH                                        Queensland Treasury Holdings

**R**

RAB                                        Regulatory Asset Base

RCA                                        Rail Corridor Agreement

RSA                                        Rent Shortfall Amount

RSAA                                       Rent Shortfall Adjustment Amount

**S**

SAR                                        System Allowable Revenue

SUFA                                       Standard User Funding Agreement

SUHD Subscription and Unit Holders Deed

**T**

TD Trust Deed

**U**

UA Umbrella Agreement

UT3 The third access undertaking covering the CQCN

UT4 The fourth access undertaking covering the CQCN

**V****W**

WACC Weighted Average Cost of Capital

WUC Work under contract

**X****Y****Z**

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Asciano	<p>Submission to the Queensland Competition Authority in relation to the Aurizon Network Proposed Standard User Funding Agreement, August (2013a)</p> <p>Reply submission: Aurizon Network Standard User Funding Agreement Draft Amending Access Undertaking, December (2013b)</p> <p>Submission on the QCA Position Paper on the Aurizon Network 2013 SUFA DAAU, June (2014)</p>
Aurizon Network	<p>Submission Letter: Standard User Funding Agreement (SUFA), December (2012a)</p> <p>Standard User Funding Agreement (SUFA): SUFA Template Legal Documents (Volume 2A and Volume 2B), December (2012b)</p> <p>Explanatory Notes, 2012 SUFA DAAU, Volume 1, December (2012c)</p> <p>Regulatory Notes, 2012 SUFA DAAU, Volume 3, December (2012d)</p> <p>Standard User Funding Agreement (SUFA): Aurizon Network's 2010 Access Undertaking (UT3): Draft Amending Access Undertaking (UT3), Volume 4, December (2012e)</p> <p>Submission Letter: Standard User Funding Agreement (SUFA), July (2013a)</p> <p>Explanatory Notes, 2012 SUFA DAAU as modified by Submission Letter of July (2013b)</p> <p><i>SUFA Template Legal Documents:</i></p> <ul style="list-style-type: none"> <li>Extension Infrastructure Sub-Lease, clean copy, July (2013c)</li> <li>Extension Infrastructure Sub-Lease, marked-up copy, July (2013d)</li> <li>Extension Infrastructure Head-Lease, July (2013e)</li> <li>Integrated Network Deed, July (2013f)</li> <li>Project Management Agreement, clean copy, July (2013g)</li> <li>Project Management Agreement, marked-up copy, July (2013h)</li> <li>Rail Corridor Agreement, July (2013i)</li> <li>Subscription and Unit Holders Deed, clean copy, July (2013j)</li> <li>Subscription and Unit Holders Deed, marked-up copy, July (2013k)</li> <li>Trust Deed, clean copy, July (2013l)</li> <li>Trust Deed, marked-up copy, July (2013m)</li> <li>Umbrella Agreement, July (2013n)</li> </ul> <p>Regulatory Notes, 2012 SUFA DAAU (unchanged from December 2012) (2013o)</p> <p>Draft Amending Access Undertaking, 2012 SUFA DAAU (unchanged from 2012) (2013p)</p> <p>Reply Submission: Letter to the QCA, December (2013q)</p>

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	Integrated Network Deed, marked-up copy, August (2013g)
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