

18 March 2011

## QRC's commentary on Participation Agreement

## Purpose

This document sets out the QRC's comments on the Participation Agreement. The comments set out below are not exhaustive. Where a provision is not commented on it is not to be taken as accepted by the QRC.

In addition to the comments set out below the QRC proposes to provide a mark-up of the Participation Agreement.

References to clause numbers in the table below are references to clauses in the Participation Agreement.

## Definitions

**Construction Agreement** means the draft construction agreement submitted by QR Network to the QCA for approval.

**Funder** means a 'Funder' under the Participation Agreement.

**Participation Agreement** means the participation agreement submitted by QR Network to the QCA for approval.

**QR Network** means QR Network Pty Ltd.

Item	Clause	Issue	Comment
<b>Term of agreement</b>			
1	2	<p>Term – unless terminated earlier, the agreement continues until the 'Distribution End Date'.</p> <p>The 'Distribution End Date' means the last day of the month during which QR Network ceases to earn regulated revenue attributable to any part of the relevant extension.</p>	<p>This may not provide sufficient certainty for a third party financier providing funding on the basis of expected cash flow under this agreement.</p> <p>To the extent that this means the contract is not for a fixed or minimum term and the end date may change before the expected repayment of any debt facilities, a prospective financier will likely not be comfortable relying solely on the expected cash flow under this agreement (so may look for alternative sources of repayment/protections or – worst case – will be unwilling to provide funding).</p> <p>The agreement should be amended so that it continues until it is terminated. See additional comments below in relation to the termination provisions – a third party financier will require the parties to agree not to terminate the agreement without its consent other than in the case of a default, in which case an opportunity to rectify any defaults before the agreement can be terminated will be required. The agreement should contemplate a side deed being entered into with a third party financier which provides for this.</p>

Item	Clause	Issue	Comment
<b>Calculation of payments</b>			
2	3.1, 4	<p>Monthly distributions – QR Network undertakes to provide monthly invoices setting out the monthly distributions, to be calculated based on the 'Calculation Methodology'.</p> <p>The distributions payable are based on the calculation objective and methodology which is set out in schedules 2 and 3.</p> <p>The Funder is required to acknowledge that payments will be determined in part by QR Network's revenue from the mainline system to which the relevant extension relates and those revenues are dependent on various known and unknown risks.</p>	<p>The Calculation Methodology is in early stages of formulation.</p> <p>As the Calculation Methodology is developed greater certainty as to prospective cash flows may be apparent. However, at this stage there is no way of guaranteeing that the risks inherent in the way payments are calculated will be acceptable to a financier or what may be required by a financier in order to mitigate those risks.</p> <p>QRC will provide further comments on this aspect once more details are added to the Calculation Methodology.</p>
<b>Rights of set-off</b>			
3	3.7	<p>Set off – QR Network may deduct from any amounts which are due and payable by it to the Funder amounts which are payable by the Funder to QR Network.</p>	<p>Financiers are likely to object to this on the basis that:</p> <ul style="list-style-type: none"> <li>• they will be relying on the payments from QR Network for servicing debt so any set-off may jeopardise the ability of the Funder to make payments due under any financing arrangements; and</li> <li>• allowing QR Network to set-off such amounts would arguably be the equivalent of allowing QR Network to have a first ranking right/security interest to receive the income stream generated by the completed lines (which would likely be inconsistent with the requirements of any finance arrangements).</li> </ul> <p>For these reasons the provision should be deleted.</p>

Item	Clause	Issue	Comment
<b>Amendments to Calculation Methodology</b>			
4	4.4, 4.5	Calculation Methodology – the methodology for calculating monthly payments may be varied in accordance with these provisions.	<p>Clauses 4.4 and 4.5 should be deleted and replaced with a clause consistent with the following principles:</p> <ul style="list-style-type: none"> <li>• If the access undertaking pricing principles change and a party reasonably believes that a corresponding change is required to the Calculation Methodology, the parties will meet for the purpose of agreeing any consequential changes to the Calculation Methodology.</li> <li>• If the parties fail to agree on any amendments, an expert will be appointed who will determine, in accordance with the Objectives set out in the Agreement whether any change to the calculation methodology is necessary, and if so, what change.</li> <li>• QR Network must not propose or put forward any change to the Access Undertaking which change is intended to have or has the effect of a material adverse affect on User Funders or the share of revenue payable to User Funders under the Participation Agreement.</li> </ul>
<b>Deductions</b>			
5	5	Outstanding amounts under Construction Agreement – QR Network can deduct amounts due from the Customer under the Construction Agreement from amounts payable under the Funding Participation Agreement.	<p>Financiers are likely to object to this provision, on the basis that:</p> <ul style="list-style-type: none"> <li>• payments under the funding participation agreement should relate to completed works in respect of which construction costs have been paid (and so the financier (and the Funder) should receive the benefit of payments related to those completed works);</li> <li>• payments due under the construction contract should be subject to controls required under the finance documents (such as confirmation from the financier's engineer confirmations etc) and having the right to deduct these amounts would by-pass the financier's requirements; and</li> <li>• as with the set-off provisions, allowing QR Network to deduct those amounts would be equivalent to allowing QR Network to have a first ranking</li> </ul>

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			<p>right/security interest in the income stream generated by the completed lines (which would likely be inconsistent with the requirements of any finance arrangements).</p> <p>For these reasons this requirement should be deleted.</p>
<b>Security</b>			
6	N/A	<p>The payment obligations under the agreement are unsecured obligations of QR Network.</p> <p>QR Network has proposed that Funders be entitled to a charge over the participation agreement.</p>	<p>The proposal for Funders to take security over the Funder's rights under the agreement would not be sufficient from a financier's perspective.</p> <p>On its own, this does not provide the Funder or third party financier with any security in relation to QR Network if it were to become insolvent or default on its participation agreement obligations.</p> <p>In circumstances where:</p> <ul style="list-style-type: none"> <li>• Funders are funding the costs of an extension over which they have no interest or title; and</li> <li>• QR Network is part of a wider corporate group with interests outside of the certainty of a regulated coal rail network (in particular, QR National's haulage business),</li> </ul> <p>insolvency of QR Network is of great concern.</p> <p>In order for the user funding model to be bankable, and for users funding from the balance sheet to obtain comfort that their investment is protected, the following additional security would be required as a minimum:</p> <ul style="list-style-type: none"> <li>• first, that revenue from the user funded Extension (less operation and maintenance charges) be paid into a trust account, and QR Network will hold such funds on trust for Funders (or their financiers). Such an account should be capable of being easily administered by QR Network without affecting any of its existing access agreements;</li> <li>• secondly, that there be a registered security over the user funded Extension infrastructure securing the revenue payable under the participation agreement;</li> </ul>

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			<ul style="list-style-type: none"> <li>• thirdly, that QR Network grant security to the Funders (or their financiers, as applicable) over its rights to payment under the access agreements entered into in respect of the Expansion (i.e. the access agreements which give rise to the revenue from the user funded Extension);</li> <li>• fourthly, QR Network be required to enter into a financier side deed with a Funder's third party financier which addresses the usual requirements of lenders in respect of such agreements. See further comments below in connection with the termination provisions for further elaboration of the basic requirements for a financier side deed.</li> </ul> <p>The modifications outlined above are in addition to the security over the participation agreement proposed by QR Network.</p>
<b>Audit</b>			
7	6.2(f)	Audit – the auditor is only entitled to disclose certain matters to the Funder.	<p>Financiers will want to see any auditor's report. The limited scope of reporting to the Funder by an auditor in this clause is also likely to be objected to by financiers. To the extent the Funder is required to pay for an audit, the Funder should be able to receive details of all findings of the auditor and to pass those on to its financiers.</p> <p>This clause should therefore be deleted.</p>
<b>Force Majeure</b>			
8	7	Force Majeure – if QR Network is prevented from performing any obligation under the Funding Participation Agreement then it will be excused from performing that obligation for the period that it is so prevented.	<p>The principle obligation of QR Network under the agreement is the payment of monthly amounts. It is unusual in a financing context to have a force majeure protection in relation to payment obligations.</p> <p>Financiers will want to ensure that it is not open to QR Network to use an argument that it is prevented by force majeure from meeting its payment</p>

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			<p>obligations.</p> <p>For this reason, this provision should be deleted.</p>
<b>Limitations on liability</b>			
9	9	Limitation of Liability – liability for consequential loss is excluded and the Funder is required to provide notice to QR Network of any non-performance and a ‘reasonable period’ to rectify any default.	<p>The requirement for the Funder to provide notice to QR Network of any non-performance and a ‘reasonable period’ to rectify any default creates uncertainty. This provision should be deleted.</p> <p>In addition, QR Network should be liable for any losses that arise as a result of a breach of the agreement so the carve out for consequential loss should be deleted (and clause 8.2 modified accordingly).</p>
<b>Termination</b>			
10	10	<p>Termination – the agreement continues until the ‘Distribution End Date’ unless terminated earlier in accordance with the agreement.</p> <p>It will automatically terminate if the construction agreement terminates under clause 9.3 of the construction agreement or is terminated by QR Network under clauses 9.5 or 9.6 of the construction agreement.</p>	<p>A third party financier would most likely require QR Network to agree not to terminate the contract without first notifying the lender and giving it an opportunity to rectify any circumstances giving rise to the right to terminate the agreement.</p> <p>A provision should be included in the document under which QR Network agrees that, if required by a financier that provides financing to the Funder, QR Network will enter into a financier side deed in a form reasonably required by the financier which provides (among other things):</p> <ul style="list-style-type: none"> <li>• that QR Network will advise the financier of any default under the agreement or related documents by the Funder;</li> <li>• that QR Network will not terminate the agreement or related documents without first giving the financier a reasonable opportunity to cure any default or other event giving rise to QR Network’s right of termination;</li> </ul>

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			<ul style="list-style-type: none"> <li>that QR Network will agree, for the benefit of the financier, to observe its obligations under the agreement and related documents; and</li> <li>that the parties will not amend the agreement or any related documents (including the calculation methodology) without the financier's consent.</li> </ul>
<b>Assignment and charges</b>			
11	14.1, 14.4	<p>Assignment – any assignment or other dealing requires consent from the other party.</p> <p>Creation of charges – any chargor is required to execute any reasonable form of deed of covenant required by QR Network under which it agrees to comply with clause 14.</p>	<p>It is typically not acceptable for financier's rights of enforcement to be subject to any fetters. Financiers would be likely to object to any requirement for consent to a transfer/assignment to apply to an assignment/transfer effected upon enforcement of their security.</p> <p>This provision needs to be modified to make it clear it will not apply to an assignment by a financier under its security and the requirement for the chargee to comply with clause 14 in the exercise of its rights under any charge should be deleted.</p> <p>The requirement for a 'deed of covenant' would be encapsulated in the financier direct deed concept referred to above.</p>
<b>Schedule 2</b>			
12	Schedule 2	QR Network has proposed that it can retain a portion of the revenue it earns from a user funded Extension for 'regulatory and performance risk'.	The retention of an amount for 'regulatory and performance risk' should be deleted. There is no justification for QR Network to profit from a user funded Extension in this way.