

Mr Brian Parmenter
Chairperson
Queensland Competition Authority
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18 March 2011

Our ref 14118/80110549

Dear Mr Parmenter

WICET Stage 1 coal customers - submission to QR Network draft Access Undertaking

We act for the stage 1 Wiggins Island Coal Expansion Terminal (WICET) customers. The stage 1 users are:

- Aquila Resources Limited;
- Bandanna Energy Limited;
- Caledon Coal Pty Limited;
- Cockatoo Coal Limited;
- Northern Energy Corporation Limited;
- Wesfarmers Curragh Pty Ltd;
- Xstrata Coal Queensland Pty Ltd; and
- Yancoal Australia Limited,

(Stage 1 Users)

We refer to the invitation by the Queensland Competition Authority (QCA) for written submissions from interested parties in relation to the draft amending access undertaking (the 2011 DAAU) and a proposed standard user funding agreement (2011 SUFA) submitted by QR National Network (**QR National**).

We have been instructed to make the following submission on behalf of the Stage 1 Users.

1. **Preference for industry wide model**
 - 1.1 In making this submission we emphasise that the Stage 1 Users support an industry wide user funding model. However, the circumstances associated with the development of WICET have resulted in the Stage 1 Users commencing the negotiation of a user funding arrangement with QR National.
 - 1.2 Due to the time constraints associated with the WICET project, any user funding arrangement made between the Stage 1 Users and QR National may result in an arrangement which may not

be appropriate for an industry wide model, even though it will meet the needs of the Stage 1 Users.

2. **Issues to be addressed**

2.1 In making this submission, we note that there key differences between QR National funding an upgrade of its infrastructure and customers funding an upgrade which needs to be accommodated into a user funding model:

- (a) A feasible user funding model must be a model that will be accepted by the boards of the customers, their banks and, if the customers are listed, the market. As the customers are not in the business of investing in infrastructure, the expectations of these various stakeholders will be different to the expectations of the stakeholders QR National must satisfy. The stakeholders QR National must understand that QR National is in the business of investing in infrastructure.
- (b) The model must be 'bankable' by the customers.
- (c) The model must recognise that customers are making a significant upfront financial investment and, as a result, there must be contractual certainty that the required capacity will be delivered by the upgrade paid for.

2.2 In developing a user funding model the key concerns for the Stage 1 Users are:

- the model must be tax effective for both the Stage 1 Users and QR National (we have assumed that the model will include a tax indemnity in favour of QR National);
- there must be security from QR National to ensure that the long term return to the Stage 1 Users is secure particularly if there were an insolvency event within QR National;
- the size of the financial commitment by the Stage 1 Users requires an element of control and collaboration in the scope development, procurement and construction of the upgrades by the Stage 1 Users;
- that the model is acceptable to third party lenders;
- that there is timely provision of information by QR National to enable the Stage 1 Users to be engaged, understand the scope development and the timelines for project development all assist Stage 1 Users with their funding requirements; and
- that the model can co-exist with QR National funding part of the infrastructure.

3. **QR National's current proposal**

3.1 QR National has provided a draft Participation Agreement and a draft User Funding Construction Agreement as part of their 24 December 2010 submission to the QCA. Under the Agreements:

- customers pay for cost of rail upgrade by making payments directly to QR National;

- funding customers have a right at the end of the construction to enter into an access agreement with QR National for use of the rail upgrade; and
- once the rail upgrade is in use, the funding customers are paid a proportion of the access charges paid to QR National as a return for their investment.

3.2 The structure contains some fundamental flaws:

- first, direct payment to QR National of the funding by the customers may be treated as QR National income and the cost of the construction may not be deductible by QR National as those costs could be treated as capital or capital in nature. This means the deduction of the construction costs occurs over time rather than in the year the 'income' is received. This is a potential taxation cost for QR National due to the mismatch in timing of when the income is recognised and the costs are deductible. Due to the requirement of a tax indemnity from the customer, this is an unacceptable risk to be borne by the customer and potentially creates a double tax regime for the customer.
- second, under the proposed construction agreement, QR National controls all aspects of construction including timing and costs. The agreement contains minimal opportunity for the customer to limit or influence:
 - the final cost of the project;
 - the final time for completion of the project; or
 - whether the project will deliver the capacity requirements being sought by the customer.

The construction risk is borne by the customer but it has no ability to limit that risk. QR National is the only party with the ability to limit the construction risk, but there are no real incentives in the agreement to encourage QR National to limit that risk as, ultimately, the customer must pay for any cost overrun, bear the consequences of delay and suffer the consequences of any capacity shortfalls. Further, the customers have no entitlement to typical contractor remedies such as liquidated damages and step-in rights in relation to construction of the infrastructure.

- thirdly, the payments under the Participation Agreement are subject to QR National credit risk. There is no guarantee for the users that the payment stream under the Participation Agreement would continue to be paid to the customer in the event QR National becomes insolvent.
- fourthly, QR National (and its financiers) receive the benefit of the payment stream owed under the Participation Agreement, being paid to QR National under the Access Arrangements for the infrastructure, but provide no guarantee (in the form of security) that the payments will be made to the customer. In the event of insolvency QR National (and its financiers) may have a right to continue to receive the revenues owed under the Access Agreements but may be able to avoid the obligation to pay under the Participation Agreement.

- fifthly, the combination of the above factors make the agreements un-bankable and represent unacceptable risk for customers and any third party lenders.

4. Customer proposal

4.1 In order to address these fundamental structural issues the Stage 1 Users propose that an alternative user funding structure is adopted (which is illustrated in attachment 1). Under this model:

- Customers enter into the construction contracts directly with the construction contractors and pay the contractors direct (thereby avoiding the potential double taxation scenario posed by the QR National structure).
- Customers and QR National enter into an umbrella agreement ("Project Management Agreement") under which the parties agree scope, timing and cost of construction. The customers appoint QR National as 'Construction Manager' and pay QR National a market rate performance based fee to manage the construction process. This agreement would deal with the relationship between QR and the customers and allocate construction risk. It could, for example, include provisions requiring QR National to carry out the procurement process and provide the customers with draft construction contracts with the preferred suppliers for signing by the customers.
- Tripartite Agreements would be between each of the construction contractors, the customers' funding company and QR National to enable QR National to enforce the terms of that construction agreement against the Contractor after commissioning. The construction contractors would acknowledge QR National's role as construction manager in this agreement.

4.2 Note that the Stage 1 Users favour the use of a funding special purpose vehicle (SPV) under which they are each shareholders in the SPV and the SPV is the main contracting party with the construction contractors (the attached diagram uses an SPV). The Stage 1 Users believe the structure can be utilised with or without an SPV depending on the particular requirements of the funding customers.

4.3 The overall structure and approach taken in the QR National model Participation Agreement (subject to some drafting changes) would fit within this proposed structure, as would standard access agreements. However, the Participation Agreement would require additional mechanisms to protect the customer's income stream should QR National become insolvent. The solution is not simple and may require a form of security to be given to the Users by QR National which could be difficult for QR National to accept.

4.4 Customers should have the ultimate flexibility of choosing to provide user funding or accepting QR National Access Conditions. The procurement and construction arrangements should enable the enhancements to be delivered taking into account the multiple sources of funding (QR National and customers).

Closing comments

Should the QCA wish to discuss any aspect of this submission please contact me on my contact details below.

Mr Brian Parmenter, Queensland Competition Authority

18 March 2011

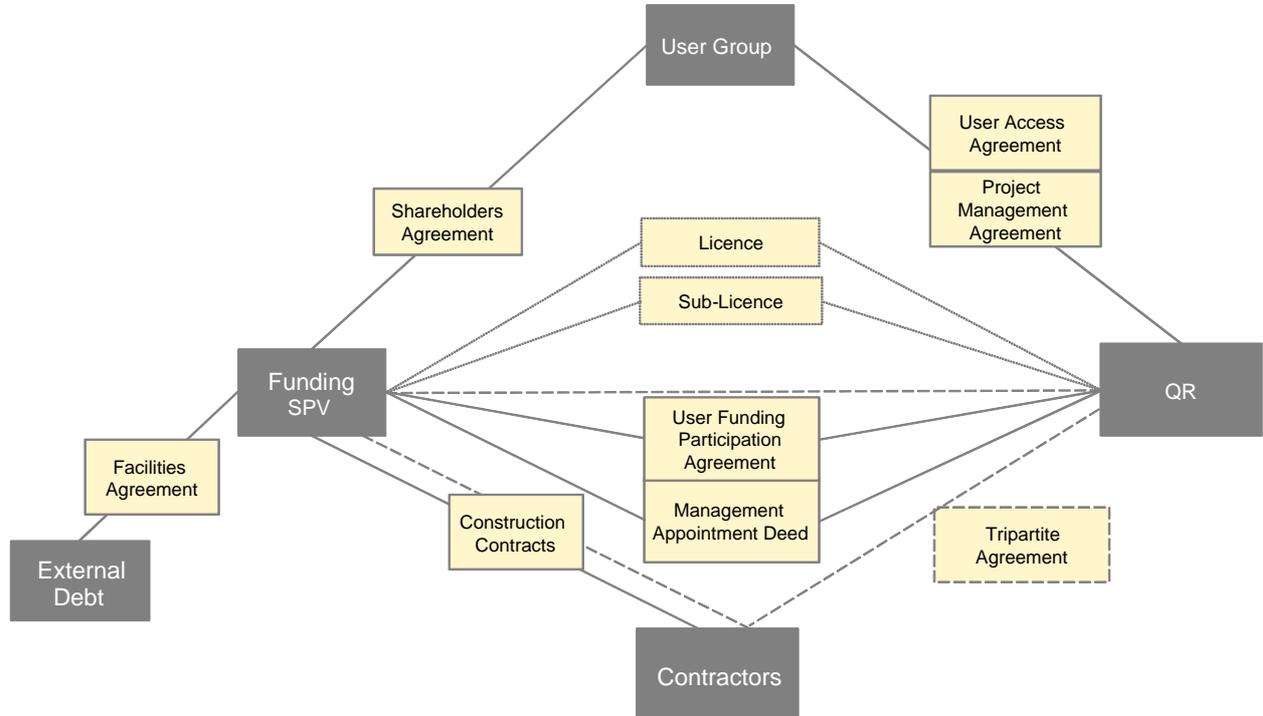
Yours sincerely



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User Funding Structure



Agreement	Parties	Description
Project Management Agreement	QR and Users	<p>This is the "user funding agreement" and will have scheduled to it all of the documents listed below. The Agreement will:</p> <ul style="list-style-type: none"> • provides mechanism for determining project management fee to QRN • sets out the scope of the project and QRN's services • sets out decision making processes for interaction between QRN and Users.
Management Appointment Deed	SPV and QR (only necessary if SPV not a party to the Project Management Agreement)	SPV appoints QR as the Construction Manager. The Management Fee and scope of the engagement will be as per the Project Management Agreement.
Construction Agreements	SPV and Contractors	The construction agreements to construct the rail upgrade.
Tripartite Agreements	QR, the SPV and each Contractor	Give QR the ability too enforce the terms of that construction agreement against the Contractor after commissioning. Under this agreement the Contractor also acknowledges QR's construction

WICET Stage 1 Users QCA Submission: ANNEXURE 1

Agreement	Parties	Description
		management role.
Standard User Access Agreements	QR and each of the Users	These agreements set out the terms of access to the upgraded rail network. The obligation to enter into this document will sit in the Project Management Agreement, but as no variations will be required to it, there is no real requirement for the document to be annexed to the Project Management Agreement.
User Funding Participation Agreement	QR and SPV	These agreements set out the obligation on QR to pay back the capital component to the SPV in return for funding the construction of the upgrade.
Non-exclusive licence	QR and SPV	A non- exclusive licence to access the track and carry out the upgrades is given to the SPV for the construction period.
Non-exclusive sub-licence	QR and SPV	SPV grants a sub-licence to QR to access the track as the Construction Manager during the construction period.