

# Queensland Resources Council: Submission on Standard User Funding Agreements

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30 August 2013

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# 1 Background

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## 1.1 Standard User Funding Agreement (SUFA)

Aurizon Network Pty Limited (**Aurizon Network**) has proposed amendments to its approved 2010 access undertaking (**AU**) to give effect to a user funding mechanism for network expansions (**SUFA**). Aurizon Network's SUFA proposal is contained in its 2013 Standard User Funding Agreement Draft Amending Access Undertaking (the **2013 SUFA DAAU**) that was submitted to the Queensland Competition Authority (**QCA**) for approval on 22 July 2013.

As part of its assessment of the 2013 SUFA DAAU, QCA has called for submissions from interested parties.

## 1.2 Queensland Resources Council

The Queensland Resources Council (**QRC**) is a non-government organisation representing companies that have an interest in exploration, mining, minerals processing, gas and energy production. QRC is the resource industry's key policy-making body in Queensland, working with all levels of Government, interest groups and the community.

QRC's membership is comprised of all Queensland coal producer companies, and QRC also represents a number of emerging companies that hold advanced coal mine developments and are on the cusp of commencing production.

## 1.3 SUFA Documents

The individual agreements comprising the SUFA suite of documents (**SUFA Documents**) are:

- User Funding – Trust Deed (**TD**);
- User Funding – Subscription and Unit Holders' Deed (**SUHD**);
- User Funding – Rail Corridor Agreement (**RCA**);
- User Funding – Extension Infrastructure Sub-Lease (**EISL**);
- User Funding – Integrated Network Deed (**IND**);
- User Funding – Extension Infrastructure Head-Lease (**EIHL**);
- User Funding – Project Management Agreement (**PMA**); and
- User Funding – Umbrella Agreement (**UA**).

In addition, as mentioned above, Aurizon Network proposes certain amendments to the AU to give effect to the SUFA arrangement when a network expansion project becomes necessary (**Expansion Process**). QRC considers that far more extensive amendments are necessary to the SUFA Documents and the 2013 SUFA DAAU to create a workable Expansion Process, which is critical to the implementation of an effective and productive SUFA.

## 2 QRC Submission

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### 2.1 Overview

QRC has provided this submission, which identifies key issues arising from QRC's review of the SUFA Documents (**QRC Submission**).

The QRC Submission should be read in its entirety and in conjunction with the drafting notes accompanying QRC's mark-up of the SUFA Documents and the mark-up contained in those documents (**QRC Mark-up**). Some of the key issues identified in individual sections of this QRC Submission are relevant to a number of the individual SUFA Documents and this becomes clear when reviewing the QRC Mark-up.

Unless separately defined, capitalised terms used in this submission have the meaning given in the relevant SUFA Documents.

It should be noted that the QRC Mark-up does not include tax drafting. However, item 2.10 and Annexure A detail the QRC's tax comments.

### 2.2 Key challenges of the structure of the SUFA Documents

There are a number of key challenges affecting the SUFA Document structure. The QRC raises these issues not because we have ambitions of changing the structure (given that substantial effort has been invested over two years to get to this point) but to highlight the criticality of addressing the many issues highlighted in this submission and in the QRC Mark-up.

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;
- some prospect of transferring the investment to a third party (most likely at a discount to the investment cost, and only post-construction);
- no possibility of third party equity investment during the construction phase; and
- no possibility of third party debt funding at any stage, other than through corporate debt held by the individual user-funders.

The challenges of the structure include:

- the structure involves 8 agreements totalling 753 pages. These agreements are individually complex and are highly interrelated. Aurizon Network is a party to all of these agreements in various capacities, including as a project manager, sublessee of the works, lessee of the network, ordinary unit-holder, preference unit-holder, landholder, and network manager. By contrast, user-funders participate directly in only two agreements;
- the assets are not owned by the user-funders, nor by the trust in which they invest;
- raising of debt in the trust is not permitted, so any debt must be raised by individual entities which invest into the trust. Lenders are at least one step removed from the trust, and further removed from the assets;
- the source of cashflows is a number of steps removed from the providers of capital. The trust's share of access revenue is derived from the system as a whole (rather than from the access agreements signed by user-funders) and is

passed to the trust either through the “direction to pay” mechanism or through Aurizon Network. The unit-holders will then receive a distribution if the trustee elects to provide one (which is decided at the trustee’s discretion);

- the source of revenue is extremely difficult to understand, being a share of system revenue effected by matters such as the revenue cap and take or pay arrangements, under/over mechanisms such as the capital indicator, and the issues of calculating the trust’s share of this revenue; and
- the arrangement has little precedent (that is, it is novel). Novelty represents risk for investors.

The nature of the SUFA Document structure is such that it cannot bear further weaknesses beyond those inherent in its structure. For this reason, it is imperative that the remaining issues be addressed as submitted by the QRC.

### **2.3 Is SUFA a real alternative to Aurizon Network funding**

The structural issues and complexity of the SUFA Documents mean that it will only be suitable for large projects. It is not feasible to use SUFA for smaller projects.

The structural issues, complexity and novel nature of the SUFA Documents means that third party funding for projects will be difficult to obtain and, where obtainable, will be at a substantial premium to the WACC (as the third party funder will wish to be compensated for the additional risks it bears under the SUFA structure). For some miners, third party investment will not be feasible (in particular, greenfield junior miners).

SUFA costs will be on a par with or more expensive than Aurizon Network funding (noting that Aurizon Network currently seek a substantial premium above WACC for \$300M plus projects). The effect of this is that SUFA is unlikely to be a genuine alternative to Aurizon Network funding. It therefore does not achieve a significant purpose, which is to create genuine competition for expansion capital.

### **2.4 SUFA Documents require substantial amendment**

The QRC established a working group (comprised of coal company representatives, the QRC and its legal adviser) which has been working through a number of issues relating to the SUFA Documents with Aurizon Network.

The QRC working group and Aurizon Network have recently been able to come to agreement on some of the outstanding issues under the SUFA Documents identified by QRC (predominantly in respect of the TD and the SUHD). Despite this progress, it remains the QRC’s position that the SUFA Documents still require substantial amendment to be workable (or to provide a sufficient level of commercial balance which merits a coal producer being prepared to enter into the SUFA Documents). It is the QRC’s view (and the view of its members, financial advisers, and solicitors, Herbert Smith Freehills and Greenwoods & Freehills) that no “third party” investor would invest in a stand-alone SUFA project based on the current drafts of the SUFA Documents, and nor would a prudent coal producer acting alone consider entry into these documents.

The amendments proposed by QRC are not provided as some form of “wish list” or ambit position. Almost all of the amendments (or similar amendments addressing the underlying principles) are necessary to get the SUFA Documents anywhere close to being useable.

### **2.5 No commercial balance or reasonableness**

An overriding concern with the SUFA Documents is the lack of commercial balance in the SUFA Documents. The draft SUFA Documents largely only have regard to the interests of Aurizon Network and, therefore, provide Aurizon Network with significant control and

discretions. QRC recognises that Aurizon Network has an interest in the operation and maintenance of the network and that this is a valid interest to be protected. However, the drafting goes far beyond that which is necessary or remotely reasonable. The documents which in particular lack commercial balance are the PMA, RCA, EISL and UA.

## 2.6 SUFA is unnecessarily complex

In addition to the key issues noted above, and the lack of commercial balance, the SUFA Documents are unnecessarily complex. This complexity arises partly because of the structure and underlying pricing regime (which QRC is not seeking to change) but also because of the drafting. There are a number of instances where the SUFA Documents are just too complex, too convoluted or contain too many conditions and exceptions.

This complexity goes to the workability of SUFA. If the SUFA Documents are too complex and too convoluted it will be difficult to get miners' boards and third party investors comfortable with their investment. Complexity will also increase the cost of third party finance.

It is also important to note that, because of the complexity of the structure, there are many components of the SUFA model that are likely to require private rulings from the Australian Taxation Office. QRC recommends that the QCA retain, in the AU, the ability to propose amendments to SUFA in the event that relevant positive rulings are not obtained and this has a material impact on the viability of SUFA as a competitive funding option.

## 2.7 Rationale for the QRC's mark-ups

Having regard to the issues outlined above, the QRC Mark-up is based on the following three key industry objectives:

- attempting to provide some commercial balance;
- removing unnecessary complexity; and
- providing user-funders with greater certainty.

## 2.8 QRC comments on SUFA are premised on UT3

QRC notes that the QRC's submission and the QRC Mark-Up are provided on the premise that the terms of UT4 (with the exception of the Expansion Process) are substantially as provided in UT3.

For example (amongst other things), QRC notes that if the mandatory expansion obligation were deleted, an alternative funding mechanism would need to be inserted to deal with smaller expansions. Given its complexity, SUFA is not an appropriate model for smaller expansions.

## 2.9 Refinement of SUFA after a trial period

As is highlighted in this submission, SUFA is complex. Once a form has been approved, and it has operated for a period, it should be recognised that there will be a need to refine SUFA to deal with unforeseen issues. The QRC considers that the AU should include a provision requiring Aurizon Network to promptly review the SUFA Documents after the first SUFA project is executed and to propose any amendments which it reasonably considers appropriate to improve the workability of the SUFA Documents.

## 2.10 Tax issues

The tax aspects of the SUFA Documents have been the subject of prolonged negotiation between QRC and Aurizon Network. Whilst both parties have made compromises and some progress has been made, the SUFA Documents still expose Preference Unit Holders to unacceptable tax risk. Given the level of tax risk, Greenwoods & Freehills (advisors to the QRC on tax matters) consider that no third party investor would invest in a SUFA project (or even agree to it as a framework) based on the current drafts of the SUFA Documents.

The key outstanding tax issues in the SUFA Documents are:

- the scope of the tax indemnity provided by Preference Unit Holders;
- obtaining further certainty through the private binding ruling process in respect of the incremental tax risks presented by the revised SUFA ownership structure (including the tax consequences of the transfer and lease back of the Extension Infrastructure and the Trustee's ability to claim depreciation deductions in respect of the Extension Infrastructure); and
- when and how private binding rulings will be obtained from the Australian Taxation Office to confirm the income tax treatment of complex aspects of the SUFA structure (including, but not limited to the transfer and lease back and depreciation issues discussed above).

Each of these issues is addressed in detail in Annexure A. Annexure B also proposes what should be fairly uncontroversial drafting changes to address other material tax issues in the SUFA Documents. Annexure A does not address minor drafting changes.

## 3 Expansion Process

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### 3.1 Aurizon Network's position

The SUFA Documents submitted by Aurizon Network do not include an Expansion Process. Aurizon Network have however proposed an Expansion Process as a part of UT4 (Part 8) and indicated their willingness to engage with the QRC on it.

Aurizon Network have agreed to produce a new draft of the Extension Process contained in UT4. Provided that this new draft addresses all of the concerns of the QRC mentioned below, these issues will fall away.

The Expansion Process in UT4 deals with, among other things:

- network planning;
- determining demand for expansion projects;
- the process for carrying out concept, pre-feasibility and feasibility studies, their funding and the criteria for an access seeker to participate in those studies;
- expansion project prioritising; and
- negotiation and entry into access agreements.

### 3.2 QRC's position

The QRC will make detailed submissions on UT4, including the Expansion Process.

For the purposes of this SUFA submission the QRC wishes to record its view that the UT4 Expansion Process is flawed and requires substantial work, and on that basis provides some specifics (albeit limited) regarding the difficulties with the proposed Expansion Process under UT4.

The QRC has the following concerns with the UT4 Expansion Process:

- (a) A prescriptive Expansion Process is needed. The Expansion Process drafted by Aurizon Network relies upon commercial negotiation. Aurizon Network take the view that commercial negotiation will provide the optimal outcome. Implicit in the Expansion Process (and explicit in Aurizon Network's supporting submissions) is Aurizon Network's view that only light regulation is required. This view is flawed. It ignores Aurizon Network's monopoly position. Industry's experience on major projects has been that commercial negotiation has been unnecessarily protracted. Further, industry's experience has been that the negotiation of terms is one-sided and lacking commercial balance. Having an effective Expansion Process and SUFA as an alternative (as limited as it may be) is vital to regulate Aurizon Network's monopolistic position and behaviour.
- (b) The draft Expansion Process provides Aurizon Network with too much discretion – including in relation to the scope of project, how much information is shared with access seekers, when projects are progressed, which access seekers progress through a gate (note the ultimate ability of Aurizon Network to select access seekers on the basis of what is in Aurizon Network's best interests) and in what order projects progress. The effect of these provisions are to put Aurizon Network in a position to pick winners – a position which has ramifications throughout the whole of the coal chain. Providing Aurizon Network with such power and without adequate checks and balances is of great concern to industry. The QRC's view is that the process for progression of projects should be based on clear and objective criteria, with transparent decision making and an expedited dispute process where an access seeker disagrees with Aurizon Network's decision.  
  
The draft Expansion Process assumes that the SUFA Documents are always an alternative to Aurizon Network funding. For the various reasons stated above, SUFA is an alternative in small number of cases and not a real check on Aurizon Network's monopoly power.
- (c) The Expansion Process does not have regard for the conflicts of interest which Aurizon Network have at a commercial level. Since UT3, Aurizon Network have taken interests in coal networks outside of the Central Queensland Coal Network. In addition, Aurizon Network have interests in proposed coal terminals. This has great relevance for the role which Aurizon Network plays in selecting which rail projects proceed over other rail projects.

### 3.3 Why is a robust Expansion Process necessary?

A robust Expansion Process is needed for many reasons, including:

- **Process to agree “blank” parts of SUFA Documents:** There are a number of aspects of the SUFA Documents that need to be agreed before they can be executed. Examples include the Scope of Works, Target Cost and Target Available Date. The Expansion Process should set out the process to agree these things and, failing agreement, an expedited dispute process to determine them.
- **A level playing field:** Aurizon Network will be rewarded for encouraging access seekers to accept Aurizon Network funded projects. A robust Expansion Process is needed to ensure that SUFA has a level playing field. There is a greater need for transparency in project planning, studies, scope of studies and

the stage at which Access Conditions (now referred to as “commercial terms” by Aurizon Network) are discussed.

- **Post execution steps:** There are a number of post execution matters which the AU needs to deal with. For example:
  - Aurizon Network should be obliged to seek regulatory pre-approval of a SUFA project;
  - Aurizon Network should be obliged to seek the QCA’s approval to include the costs of a SUFA expansion project in the regulated asset base;
  - the standard access agreement should be amended to include the direction to pay mechanism; and
  - Aurizon Network should be obliged to review the SUFA Documents after completion of the first SUFA project and propose amendments to improve their workability.

As noted elsewhere in this QRC Submission, it is important that SUFA provide a viable alternative to Aurizon Network-funded Extensions where user-funders choose to fund the costs of an Expansion (as contemplated in clause 7.5.5(a) of the current undertaking). The framework needs to be established to support SUFA and not limit its availability.

### 3.4 What should be included in the Expansion Process?

QRC considers that the QCA should require Aurizon Network to amend the AU so as to include a detailed Expansion Process. QRC has set out at Annexure B the key principles for such an Expansion Process, as well including a suggested standard study funding agreement (Annexure C).

In addition to the matters described in Annexure B, the Access Undertaking should oblige Aurizon Network to procure tax rulings for the SUFA structure and individual project (on a project by project basis).

## 4 Trust Deed and Subscription and Unit Holders' Deed

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### 4.1 Overview

This section identifies key issues arising from QRC’s review of the TD and SUHD.

QRC acknowledges that teams representing QRC and Aurizon Network have spent considerable time negotiating and agreeing amendments to the original form of TD and SUHD proposed. QRC and Aurizon Network have agreed compromise positions on a significant number of issues. However, there are still some issues which remain outstanding and which QRC would like to bring to the attention of QCA.

### 4.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the TD and SUHD and consultation with industry. The purpose of this section is not to summarise all of QRC’s concerns with the form of the TD. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

#### (a) Number of Preference Units to be issued

QRC submits that the number of Preference Units to be issued should be 1.2 times the Target Trust Capital Cost (**TTCC**) assuming an application price of \$1.00 per Preference Unit), rather than 1.3 times TTCC as proposed by Aurizon Network. QRC's position would give a 20% buffer for cost overruns.

The higher buffer proposed by Aurizon Network is excessive and would require user-funders to obtain financial/investment approval for inflated estimates.

**(b) Stapling of Preference Units and Access Rights**

Aurizon Network has proposed that Preference Units and Access Rights should be "stapled" during the construction phase, such that they are held by the same entity (or by entities with "identical economic ownership").

The QRC has agreed to this position on the basis that the Preference Units and Access Rights are not "stapled" after the construction phase. This would enable, for example, Preference Units to be held by third party investors (which a key purpose of SUFA) or by "related entities" who may have something less than 100% common ownership.

## 5 Rail Corridor Agreement

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### 5.1 Overview

This section identifies key issues arising from QRC's review of the RCA.

### 5.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the RCA and consultation with industry. The purpose of this section is not to summarise all of QRC's concerns with the form of the RCA. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

**(a) Control: Appointment of Aurizon Network as disclosed agent**

Pursuant to clause 3.3 of the PMA, clause 3.6 of the RCA and clause 7.1 of the EISL, Aurizon Network's proposed SUFA framework requires the Trustee to appoint:

- the Project Manager as the Trustee's disclosed agent for the purposes of performing the Trustee's obligations and exercising (substantially) all of the Trustee's rights under the RCA during the term of the PMA; and
- the Extension Lessee as the Trustee's disclosed agent for the purposes of performing the Trustee's obligations and exercising (substantially) all of the Trustee's rights under the RCA after termination of the PMA,

**(Proposed Agency).**

The only carve out from the Proposed Agency is in relation to the exercise of the Trustee's rights under the dispute resolution clause. QRC's view is that the Proposed Agency is unacceptably broad as it precludes the Trustee from directly exercising its rights under the RCA. The Trustee has only the limited right to initiate dispute resolution after a right has been exercised (and, then, only in relation to those matters that are capable of being referred to dispute resolution).

QRC submits that the following approach is more appropriate:

- 1 the Project Manager and Extension Lessee be obliged to comply with the RCA when exercising rights as Project Manager or Extension Lessee; and

- 2 the Trustee retain the ability to directly exercise, or direct the Project Manager/Extension Lessee in the exercise of, rights under the RCA.

Whilst, in practice, significant rights and obligations under the RCA will be exercised by either the Project Manager or Extension Lessee, it is important that the Trustee retains a role and ultimate control (as it is the party bearing the risk). This is particularly the case in relation to:

- Non-Discrimination Provision (**NDP**) clauses; and
- negotiating any variations to the licence area.

Without amendment, Aurizon Network would have the capacity (in its dual capacities as Landholder and Project Manager/Extension Lessee) to unilaterally determine significant aspects of the operation of the licence granted under the RCA. For example, Aurizon Network would have the sole ability to negotiate and agree variations to the Extension Land or agree and negotiate Interface Management Plans (in the respective capacities of Landholder and disclosed agent). As an alternative, QRC has proposed drafting that requires the Trustee to procure that the Project Manager or Extension Lessee act as the Trustee's agent in relation to specific rights and obligations that necessarily form part of the role of Project Manager or Extension Lessee (e.g. payment of outgoings, conduct of an Interface Risk Assessment and maintenance of infrastructure).

**(b) Discretions reserved to Aurizon Network**

Under the proposed RCA, broad discretions are granted to Aurizon Network. Without the inclusion of appropriate limits, the exercise of such discretions could expose user-funders to uncertainty, additional costs and delay. To address this control imbalance, the QRC Mark-up proposes amendments to a number of clauses, including:

- **Clause 3.7(a)(viii):** As currently drafted, this clause requires the Trustee and its Associates to comply with all directions, policies, rules and procedures instituted by Aurizon Network as Landholder. There is no "reasonableness" criterion and the relevant policies and directions are not limited to matters of safety, health and environment.
- **Clause 3.8:** As currently drafted, this clause would give Aurizon Network the right to damage, interfere with or Modify the Extension in any way that is permitted (expressly or impliedly) under the Infrastructure Lease or a Sublease. Such rights are not necessarily consistent with the rights and obligations agreed between the parties under the EISL and EIHL.
- **Clause 12:** This clause imposes reporting and remediation obligations on the Trustee. As currently drafted, it would require the Trustee to comply with any direction of Aurizon Network (as Landholder) in relation to environmental damage contributed to by the Extension, irrespective of whether such damage was lawful, contemplated by the Scope of Works or caused by Aurizon Network exercising its rights as Project Manager or Extension Lessee.

**(c) Risk allocation and definition of "Associates"**

In relation to the Trustee, the RCA defines "Associates" as including the Project Manager and the Extension Lessee (for all purposes). QRC considers this to be unacceptably broad (and exposes the Trustee to unacceptable liability) as the term "Associates" is used in various cost-recovery and liability clauses in the RCA. The Project Manager and Extension Lessee are not always acting as agent of the Trustee and have their own rights and obligations under each of the PMA, EISL and EIHL. QRC submits that it is not appropriate that the Trustee be made, without qualification, responsible for all actions taken (and costs incurred) by Aurizon Network when acting as Project Manager or Extension Lessee (and not necessarily as agent of the Trustee).

**(d) Exposure to liability arising from State Leases**

The term of the RCA is dependent upon the terms of any Infrastructure Lease and any Sublease between Aurizon Network and the State (State Leases). Whilst the consequences of early termination of the State Leases is broadly addressed in the IND (the subject of a separate section of this submission), the term of the RCA also expose the Trustee to risks that it is not in a position to manage or mitigate. This is because the IND is not a standard-form tripartite agreement and the Trustee does not have full visibility of all of the terms or the operation of the relevant State Leases.

Currently, the RCA automatically terminates upon the expiration or earlier termination of either of the Sublease or Infrastructure Lease. QRC understands the general intent of this clause – i.e. to ensure alignment between all licences/leases necessary to facilitate the Extension. However, as defined, one of these State Leases could relate to part only of the Extension Land or Landholder Infrastructure. Where the termination/expiration relates to part only of the licensed land/infrastructure, it is appropriate to require the parties to consult and consider whether it is possible to continue the broader licence under the RCA. For example, it may be possible to amend the area of the Extension Land under clause 3.4.

Additionally, the termination or expiry of any Head Lease should trigger the end of the RCA, and an appropriate change has been made to accommodate this.

QRC also submits that it is not appropriate to require (as per clause 9(b)(ii)(A) of the RCA) that the Trustee not do any act, omit to do any act or contribute to any act/omission that causes a breach of the Sublease or causes Aurizon Network to incur additional costs under such lease. QRC proposes that this clause and clause 9(b)(iii) (addressing potential inconsistencies between the Sublease and the RCA) be deleted on the basis that:

- 1 The Trustee is not privy to all of the terms of the Sublease and so cannot manage its exposure under this clause. Relevant terms of the Sublease should be incorporated into the RCA as required.
- 2 The provisions are not necessary as the State agrees (in clause 4(b) of the IND) that there will be no breach of the relevant State leases arising out of Aurizon Network or the Trustee enforcing their rights/performing obligations under the RCA.

**(e) Indemnity**

The QRC Mark-up proposes the deletion of indemnities proposed to be given by the Trustee to Aurizon Network (including the indemnity in clause 16). QRC's position is that, whilst an indemnity may be negotiated in some "access arrangements", an unqualified indemnity that extends to default, negligence and design/construction failures, is inappropriate in the SUFA framework. Aurizon Network is not a passive adjoining landholder and in its role as Project Manager and Extension Lessee has the capacity to mitigate its risk relating to the transaction. QRC submits that the indemnities are also unacceptable where:

- 1 Aurizon Network, as Landholder, has not taken any risk under the RCA (i.e. it has not given any warranties in relation to the connection of the Construction Works, information to be provided to the Trustee or the status of its Authority Approvals); and
- 2 actions taken by Aurizon Network, in its other capacities under the SUFA Transaction Documents, could expose the Trustee to liability under the indemnities (e.g. by Aurizon Network exercising its rights as Extension Lessee to make Modifications to the Extension).

**(f) Limitation of liability**

QRC's primary concern with the limitation of liability proposed in clause 17 is that the limitation on the Trustee's liability (paragraph (a)) should not be confined to

circumstances where the Project Manager or Extension Lessee is acting as disclosed agent of the Trustee under the RCA. If Aurizon Network takes action under any Transaction Document that causes the Trustee to breach the RCA then Aurizon Network should not be entitled to recover damages in its capacity as Landholder.

**(g) NDP**

The NDP is proposed for inclusion in the RCA in relation to a limited number of specific actions and issues (found in clauses 3.7(b), 7.1(d) and 7.3(d)). These clauses preclude Aurizon Network from acting in a manner that is, or imposing requirements that are, materially more onerous than for a “project of the same or similar nature and size as the Extension” funded by Aurizon Network (**Reference Projects**). The NDP is not applied to other significant rights of Aurizon Network under the RCA – such as the right to “damage, interfere with or Modify the Extension Infrastructure” (clause 3.8).

QRC submits that:

- 1 the NDP should be applied more broadly to the rights and obligations granted to Aurizon Network under the RCA; and
- 2 the drafting of the NDP needs to be enhanced to ensure that can be effectively used to protect the interests of user-funders.

In relation to item 2, QRC proposes that:

- The materiality qualification should be deleted as what is “material” is open to interpretation and any discrimination (as established through the application of the dispute resolution process) should be prohibited.
- The limitations of liability contained in the RCA should not apply in the event that it is established that Aurizon Network has breached the NDP. This ensures that the NDP is an effective tool and is “taken seriously” by Aurizon Network.
- The concept of a “Reference Project” be deleted. QRC’s starting premise is that all parts of the network, irrespective of where they are located, how they are funded (e.g. under different SUFA arrangements) and their relative value, should be treated in the same manner. QRC acknowledges that there may be technical or operational constraints that are specific to the Leased Extension Infrastructure and that warrant different treatment. However, the concept of a “Reference Project” is significantly broader and could enable Aurizon Network to treat discrete parts of the network differently and in a way that, on balance, favours Aurizon Network to the detriment of User-Funders.

**(h) Approval of “Designs and Specifications”**

Aurizon Network’s proposed RCA gives the Landholder (i.e. Aurizon Network) a right of approval over all “detailed designs and specifications” for the Construction Works. Any subsequent variation to an approved design/specification must also be approved under clause 7 of the RCA. As drafted, Aurizon Network may have regard to any matter it considers relevant when reviewing the designs and specifications and its veto right is constrained only by the limited NDP in clause 7.1(d).

QRC submits that clause 7 is an unacceptable addition to the approval and variation process for Extensions included in the PMA. QRC has proposed that clause 7 be deleted on the basis that the Scope of Works appended to the PMA should address matters of design and specification and any variations to the Scope of Works should be dealt with under clause 9 (Variations) of the PMA. As currently proposed, clause 7 of the RCA effectively grants to Aurizon Network an additional veto over Construction Works that it has agreed to/approved as Project Manager under the PMA.

At a minimum, any approval rights included in the RCA should be limited to matters strictly relevant to Aurizon Network’s role as Landholder – e.g. interface management, supervision of Construction Work and Track Closures.

**(i) Insurance**

QRC is of the view that the RCA should contain an agreed set of default insurance provisions. It is standard for the licensor under licences/access agreements to commit to insuring the licenced area/infrastructure. A draft clause has been included in the QRC Mark-up.

**(j) Dispute resolution**

QRC has two key concerns with the provisions on dispute resolution:

- 1 lack of inclusion of an effective dispute resolution process for some key matters; and
- 1 limitations in the proposed methodology – particularly in relation to NDP disputes.

Under the proposed RCA, the following key issues were excluded from the dispute resolution process, leaving any disagreements to be determined by Aurizon Network:

- disputes in relation to variation of the Extension Land (which could extend to material reductions in the area of the licence); and
- disputes in relation to an Interface Risk Assessment (which would be solely conducted by Aurizon Network in its capacities as Landholder and Trustee's agent).

On the dispute resolution procedure, there are a number of instances where resolution of a dispute would be delayed because of additional rights reserved to Aurizon Network. For example, proposed clause 17.6 requires the Trustee to give Aurizon Network notice of any claim (including provision for a remedy period) in addition to the notice provision already built into clause 19.1.

Delays (and potentially circular outcomes) could also arise if the role of an expert appointed to resolve discrimination disputes is limited to determining whether there has been non-compliance in fact. This creates the potential for Aurizon Network to repeatedly act in a discriminatory way in relation to the same subject matter. In the absence of agreement between the parties, the relevant dispute would again be referred back to an Expert who would be limited to determining that there has, again, been non-compliance in fact. QRC submits that drafting should facilitate an expert considering, not only whether a NDP was complied with, but also:

- how it should be complied with to avoid discrimination; and
- whether there are additional issues arising from the fact of non-compliance (e.g. unacceptable costs imposed on the Trustee).

## 6 Extension Infrastructure Sub-Lease

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### 6.1 Overview

This section identifies key issues arising from QRC's review of the EISL.

### 6.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the EISL and consultation with industry. The purpose of this section is not to summarise all of QRC's concerns with the form of the EISL. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

**(a) Appointment of Aurizon Network as disclosed agent**

As noted above, clause 6 of the RCA and clause 7.1 of the EISL together require the Trustee to appoint the Extension Lessee as the Trustee's disclosed agent for the purposes of performing the Trustee's obligations and exercising (substantially) all of the Trustee's rights under the RCA after construction of the Extension (**Proposed EISL Agency**).

Without amendment, Aurizon Network would have the capacity (in its dual capacities as Landholder and Extension Lessee) to unilaterally determine significant aspects of the operation of the licence granted under the RCA. As an alternative, QRC has proposed drafting that requires the Trustee to procure that the Extension Lessee act as the Trustee's agent in relation to specific rights and obligations that necessarily form part of its role as Extension Lessee (e.g. payment of outgoings, conduct of an Interface Risk Assessment and maintenance of infrastructure).

**(b) Limitations on the Proposed EISL Agency**

In addition to establishing the Proposed EISL Agency, clause 7 includes a number of "carve outs" from the standard fiduciary obligations that would be expected in an agency arrangement. The QRC is fully supportive of the philosophy of ensuring that Aurizon Network is able to comply with applicable legislation and is not obligated to act in a way that would compromise its position as operator and manager of the broader network. However, QRC suggests that the current wording might be too broad as it is not limited to carving out actions that Aurizon Network is *required* (rather than permitted) to take and that could compromise its key occupational health and safety obligations. The effect of the clause is to broadly permit Aurizon Network to act in its own interest whenever the relevant actions are permitted (including under agreements to which the Trustee is not a party).

QRC suggests that the following wording may be preferable:

*"Despite any fiduciary obligations which would, but for the operation of this Agreement arise as a consequence of Aurizon acting as disclosed agent for the Trustee under the Rail Corridor Agreement, the Trustee irrevocably consents to Aurizon, when acting as disclosed agent for the Trustee under the Rail Corridor Agreement, doing acts and making omissions which are required under Legislation (including the Transport (Rail Safety) Act 2010 (Qld) and the Work Health and Safety Act 2011 (Qld))."*

**(c) Discretions reserved to Aurizon Network**

Aurizon Network's rights (as Extension Lessee) to modify and remove infrastructure are broad and generally unqualified. QRC's base position is that the applicable provisions (in clauses 4 and 5) need to be expanded to adequately protect the rights of the Trustee/user funders. As drafted, Aurizon Network has an obligation to repair and maintain (but not necessarily replace) the Leased Extension Infrastructure. This is coupled with a broad right to operate, remove and replace Leased Extension Infrastructure as desired.

The only restrictions currently imposed on Aurizon Network are that:

- the repair/maintenance must be to a standard that does not discriminate between self-funded infrastructure and comparable sections of the railway network; and
- generally, Aurizon Network must not take action that is for the **sole** (and no other) purpose of reducing Rent payable.

QRC submits that these restrictions are insufficient to ensure that Aurizon Network exercises its rights for a proper purpose. It would be difficult for the Trustee to prove that action had been taken for the "sole" purpose of reducing Rent. To ensure that actions

taken are in the best interest of user funders, the QRC Mark-up proposes additional qualifications, including that:

- operation and management of the Leased Extension Infrastructure must be to a standard that does not discriminate (when compared to the balance of the railway network);
- repair and maintenance must be in accordance with Good Operating Practice; and
- Modifications must be necessary for the use of the Leased Extension Infrastructure for a Permitted Purpose.

**(d) Access rights granted to Aurizon Network**

As currently drafted, there are few limits on the access rights granted to Aurizon Network under the EISL. Although QRC acknowledges that broad access rights are necessary under the SUFA framework, a number of qualifications/restrictions are proposed in the QRC Mark-up, including:

- Aurizon Network should be required to comply with the terms of the lease granted to the Trustee (under the EIHL) and the licence granted to the Trustee (under the RCA). QRC considers that it is standard practice to require a sublessee/sub licensee to comply with the terms of the primary lease/licence – particularly where they are given exclusive possession.
- Aurizon Network should be made responsible for the acts and omissions of its Associates and should be obligated to require its Associates to comply with the terms of the EISL.

**(e) Risk allocation**

QRC submits 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.

Recognising the fundamental nature of Aurizon Network's obligation to pay Rent, QRC is of the view that the limitations of liability proposed in the EISL are unacceptable. It is currently proposed that Aurizon Network's liability under the EISL be limited to \$1 (other than for fraud, Gross Negligence and Wilful Default). This leaves the Trustee (and user funders) exposed to liability where, for example, there has been a material breach of the EISL and Aurizon Network has failed to pay Rent that is otherwise due.

In addition to expanding the carve outs from the liability limit, clause 15.2 should be amended to make it clear that it does not relieve Aurizon Network from liability for failure to raise invoices, or any negligent conduct in obtaining access revenue payments from Customers. QRC is broadly supportive of the philosophy underlying clause 15.2 but the current wording could be interpreted as excusing Aurizon Network from liability for breaches of the EISL where such breaches indirectly impact on the receipt of/timing of receipt of Rent payments.

**(f) Rent calculation and payment**

**(i) Overview**

The rent provisions of the EISL are complex. That complexity will add to the challenge of obtaining economic funds for a SUFA project. The complexity arises in the calculation of the rent (which to some degree is unavoidable because of the complexity of the calculation of underlying access charges), as well as the rent payment provisions (this is avoidable).

Before making an investment decision, boards and investors/lenders will carefully scrutinise the rent provisions. The rent provisions are crucial to making SUFA work, as they go to the heart of a user funder's income stream. The more that can be done to provide greater certainty that the rent will be paid, that rent

calculation information is transparent and that the rent calculation methodology is understandable, the better.

(ii) **General key issues**

QRC has identified some general key issues with the current drafting of the rent provisions. These specific issues do not take away from the general comments above or the specific key issues identified below:

- Third party investors and financiers will not accept a right for Aurizon Network to set off payments against the rent. Investors and financiers need certainty that the rent will be paid. QRC has therefore proposed that there be a prohibition against set offs (which applies to both parties, and not just Aurizon Network).
- The direction to pay mechanism contains a number of steps. It relies on the Trustee to give a notice when Aurizon Network fails to give a direction to pay. That step should be deleted from the process. Where Aurizon Network fails to give a direction to pay, there should be a deemed direction to pay.
- The drafting of the rent objective (Schedule 2 of the EISL) requires refinement to ensure that the breadth of some of the language cannot be misinterpreted.

The post regulatory rent objective (item 2 of Schedule 2 of the EISL) is patently unfair. It frames the rent as the lesser of the actual rent received for the below rail assets and the rent under the regulatory regime. There is no basis for Aurizon Network to retain above regulatory returns. Further, Aurizon Network should have a positive obligation to seek a commercial return.

(iii) **Key issues with the Rent Calculation Methodology**

QRC submits that the most sensible approach to ensure the Rent Calculation Methodology (under Schedule 3 of the EISL) operates as a viable methodology, is for Aurizon Network, the QCA and the QRC to work together to further develop the methodology and requisite drafting.

Some of the concerns that the QRC has with the methodology contained in Schedule 3 include:

- **Revenue Adjustment Amount:** Each of the adjustment calculations relating to the “Revenue Adjustment Amounts” under the methodology appears to operate contrary to the direction that QRC would have expected. Where a shortfall occurs in revenue collection in accordance with the AU in a prior year, the “Revenue Adjustment Amount” as defined in the AU will be a negative amount. By referring to this definition in the Rent Calculation Methodology, this negative number is “added to” the rent, thereby reducing the rent, when in fact the shortfall from the prior year should become additional revenue (and rent) in a later period. The opposite problem (overpayment of rent) would occur when surplus revenue has been collected in a prior year.
- **AT<sub>2-4</sub> and AT<sub>5</sub> Distribution Pool:** QRC requires clarification as to where the amounts of “any approved...operating costs for the relevant mainline system for the month” from the definitions of “AT<sub>2-4</sub> Distribution Pool” and “AT<sub>5</sub> Distribution Pool” is sourced by Aurizon Network for the purpose of calculating these amounts.
- **Adjustment Charges:** “Adjustment Charges” relating to all prior years (to the extent collected in the current year) are added to the rent and

multiplied by the “Applicable Interest” in each of the relevant prior years. QRC’s main concerns with this approach are:

- the calculation is arranged so that one twelfth of each prior years’ “Adjustment Charge” is added to each month’s rent. Unlike with the calculation of the “Revenue Adjustment Amount”, it is not necessarily the case that “Adjustment Charges” are recovered through tariffs imposed throughout the year under the AU. For example, an “Adjustment Charge” relating to the previous year may be collected under the AU as a bullet payment in the first month of the new year. The QRC submits that more flexibility needs to be employed under the drafting of this methodology to allow this calculation to be varied and determined on a case by case basis; and
- an “Adjustment Charge” collected under the methodology may relate to the current rent year. QRC is unclear as to whether the proposed drafting under the methodology works in such a case. While QRC submits a solution may be for such revenue to be excluded from the deduction in paragraph (b) of each “Distribution Pool” definition under the methodology, it is still crucial for QRC to understand the intent of this calculation.
- **Relinquishment fees:** It is not clear to the QRC how relinquishment fees payable in respect of an access holder’s relinquishment or transfer of access rights, and which form part of the  $AT_{2-4}$  or  $AT_5$  revenue, will be allocated between user-funders (through the formulas contained in Schedule 3) and Aurizon Network. Additionally, subclause 3.2.4 of Part B of Schedule F of the AU allows Aurizon Network, if approved by the QCA, to reduce the amount of any relinquishment fee used to calculate “Total Actual Revenue” for a year if its inclusion will have a material effect on the “ $AT_{2-4}$  Revenue Adjustment Amount”. In this case, the amount of the reduction (including a return on capital amount) must be carried forward to a following year. It is not clear to the QRC from the drafting of Schedule 3, how the recognition of a deferred relinquishment fee amount will be allocated under the Rent Calculation Methodology. This needs to be addressed.
- **Capital indicator and tariff smoothing:** The capital indicator and tariff smoothing arranged under the AU means it is possible that revenue attributable to an expansion will be collected before the expansion exists, and perhaps even before the decision to user fund (or not) the expansion has been made. Where user funding is used in undertaking an expansion, this revenue might even be collected before the trust exists. The drafting of Schedule 3 does not include an allocation method for this revenue, nor does it deal with the corrections to payments that will be required in subsequent years. This issue must be resolved.
- **Worked example:** As discussed above, the QRC submits that Schedule 3 of the EISL is unnecessarily complex and convoluted. The QRC consider that including a worked example within the schedule would illustrate clearly the proposed calculation mechanisms in the schedule, and provide some transparency and guidance on the multifaceted calculations.

**(iv) Key issue with calculation of direction to pay amount**

The QRC submits that, as drafted, it is apparent under Schedule 4 of the EISL (Calculation of Directions to Pay Amount) that directions to pay could only occur under extension access agreements. The drafting of this Schedule must be amended to extend the issuance of directions to pay under nominated access agreements.

**(g) Post regulation rent**

The post regulatory rent objective (item 2 of Schedule 2 of the EISL) is patently unfair. It frames the rent as the lesser of the actual rent received for the below rail assets and the rent under the regulatory regime. There is no basis for Aurizon Network to retain above regulatory returns. Further, Aurizon Network should have a positive obligation to seek a commercial return.

If access charges are dramatically increased in a post-regulatory period, user-funders will not get the benefit due to the cap in the definition of "Notional Access Revenue", while Aurizon Network will capture the upside not only to the extent of its own investment in the relevant system, but also on user-funded infrastructure. User-funders invest during the regulatory period for the same returns and on the same risk profile as Aurizon Network (other than for the reduction in returns and increases in risk caused by the SUFA structure) and there is no reason why these investors should be placed in an inferior position post-regulation. An approach in which Aurizon Network takes all upside would logically be accompanied by a guarantee from Aurizon Network that they will continue to pay at least a rent amount equal to that which would have applied under regulation. This has not been offered (and we understand the difficulty of doing this).

As an example of the absurd results which Aurizon Network's methodology could provide, if access charges were to double post-regulation, and there were two access holders, one of which was a third party and the other a related body corporate of Aurizon Network, the rent would double in respect of the third party's use, and not increase at all in respect of the related body corporate's use (given that the related body corporate would be heavily incentivised to provide the service under a CITS).

In respect of a Section which is user-funded, a related body corporate of Aurizon providing a CITS in a competitive market can effectively choose to charge zero to its customers for access (as the related body corporate will first receive its Determined Other Transportation Costs). This decision will provide a competitive advantage to the related body corporate, while the entire cost of the "discount" will be borne by the user-funders. As drafted, this outcome will apply even if Aurizon Network is, at the same time, charging a much higher access charge to third party access holders for the identical service.

The QRC notes that Aurizon Network's proposed "special dispute process" would apply to disputes regarding the application of these clauses. The expert will obviously be unable to arrive at a decision which is inconsistent with the clauses. The QRC considers that the expert (or panel) should have wide discretion to assess the revenue being received as a result of the Total Extension Infrastructure. The agreement could provide a non-exhaustive list of matters to which the expert should have regard including:

- The arm's length (or otherwise) nature of the charges being levied for stand-alone use.
- Charges being levied for comparable infrastructure funded by Aurizon Network.
- The margin between CITS charge and the other costs of providing a CITS (similar concept to Determined Other Transportation Costs).
- Additional value created by the CITS which is not reflected in the DOTC which is reasonably attributable to the integrated service offering.

- The previous regulated charge (but this is not to be considered a ceiling, nor is it a guaranteed floor) and the general direction (increase/decrease) of access charges following deregulation.
- Charges which would arise under a DORC methodology (but not to be a ceiling or a floor).

**(h) Termination**

QRC is concerned that clauses 3 and 13 (as drafted) do not adequately protect user-funders in the event of Aurizon Network's insolvency/material breach. Aurizon Network has proposed that the Trustee will have a right to terminate the EISL in the case of Aurizon Network's insolvency (currently narrowly defined) or prolonged payment breach. This termination right is relatively limited and, in any event, is not coupled with an acceleration of the Trustee's rights. QRC considers that it is unacceptable that, notwithstanding that the EIHL has been terminated following Aurizon Network's insolvency/payment default, all operative clauses of the EISL continue to operate as if the termination had not occurred and the Trustee is required to wait and bear the risk of continued payment default (or, in the case of insolvency, non-payment). It would be reasonable for the Trustee to have an option to suspend the EISL, to require an accelerated return of unpaid capital costs or to continue receiving rent.

**(i) NDP**

As for the RCA, QRC submits that:

- 1 the NDP should be applied more broadly to the rights and obligations granted to Aurizon Network under the EISL; and
- 2 the drafting of the NDP needs to be enhanced to ensure that can be effectively used to protect the interests of user-funders.

**(j) Insurance**

QRC submits that the default insurance provisions (in clause 4) need to be expanded to adequately protect the Trustee's interest in the Leased Extension Infrastructure. An application of the NDP alone would not ensure that the Trustee's interest is reflected in the insurance arrangements and the QRC Mark-up proposes a number of amendments.

**(k) Dispute resolution**

As for the RCA, the dispute resolution procedure included in the EISL grants Aurizon Network additional rights that have the capacity to cause delays. The QRC Mark-Up also proposes a number of amendments to ensure that the role of the expert is not unduly constrained in the case of discrimination disputes.

## 7 Project Management Agreement

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### 7.1 Overview

This section identifies key issues arising from QRC's review of the PMA.

### 7.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the PMA and consultation with industry. The purpose of this section is not to summarise all of QRC's concerns with the form of the PMA. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

**(a) PMA is not consistent with market standards**

QRC submits that the PMA substantially deviates from a market standard project management agreement.

There is no reason why Aurizon Network must be the project manager. User-funders should, in accepting Aurizon Network as the Project Manager, not be put in any worse a position than if they had market standard terms.

**(b) Appointment of Aurizon Network as disclosed agent**

As noted above, clause 3 of the PMA and clause 7.1 of the EISL together require the Trustee to appoint the Project Manager as the Trustee's disclosed agent for the purposes of performing the Trustee's obligations and exercising (substantially) all of the Trustee's rights under the RCA after construction of the Extension (**Proposed PMA Agency**).

It is not a typical risk allocation to appoint the Project Manager as agent of the Trustee for all project management activities. In such circumstances, the Trustee is exposed to any liability incurred by the Project Manager including third party claims and other liability caused by the breach or negligence of the Project Manager. Accordingly, the QRC Mark-up proposes that the Project Manager will be obliged to undertake only certain specified obligations under the RCA.

In addition to establishing the Proposed PMA Agency, clause 3 of the PMA includes a number of "carve outs" from the standard fiduciary obligations that would be expected in an agency arrangement. QRC submits that the scope of the Proposed PMA Agency (as for scope of the Proposed RCA Agency) is too broad.

**(c) Replacement Project Manager**

QRC accepts that the Trustee will be in breach of the PMA if it wrongly appoints a Replacement Project Manager but requiring a lengthy dispute resolution process would remove much of the utility associated with the replacement/step-in right. The QRC Mark-up proposes that, where a Replacement Project Manager is appointed:

- that party should effectively "step into" the shoes of the original Project Manager and not be subject to any greater obligations; and
- neither the Project Manager nor the Replacement Project Manager will be liable for the other's acts or omissions.

**(d) Standards imposed on Project Manager/discretion**

The Project Manager should be required to meet a minimum standard of performance in accordance with industry practice. QRC submits that the mark-up proposed at clause 3.7 of the PMA reflects minimum industry practice and is therefore reasonable and does not impose an unacceptable degree of risk on Aurizon Network. It should be noted that the QRC considers it reasonable that Aurizon Network should earn a reasonable fee for the risk it bears under the PMA.

**(e) Reimbursement of costs**

The QRC Mark-up also removes what industry considers to be an unacceptable level of discretion that was associated with the proposed reimbursable costs and overheads. Remuneration of the Project Manager now consists of hourly rates for labour used, specified reimbursable costs and a corporate overhead charge calculated as a percentage of hourly rates. This is consistent with market practice for project management agreements.

The previous drafting defined reimbursable costs too broadly and allowed the Project Manager too much discretion as to what could be claimed as a "cost" (for example see the previous definitions of Internal Costs and Personnel Costs). To overcome this, reimbursable costs are now defined on an exclusive basis. This also removes the

substantial overlap in relation to what is considered a reimbursable cost and what is intended to be covered by the overhead charge.

**(f) Termination of Material Works Contract**

As QRC considers that it is in appropriate for the Project Manager to act in its own interests, QRC has removed the Project Manager's right to terminate a Material Works Contract simply because:

- an entitlement to terminate has arisen;
- the notice of such entitlement is given to the Trustee; and
- a meeting has been held to discuss the notice.

Termination may not ultimately be in the interests of the Trustee in the particular circumstances, and therefore, permitting the Project Manager to terminate a Material Works Contract without the Trustee's consent is an inappropriate power for the Project Manager to have, and exposes the Trustee to a risk that is outside of its control.

**(g) Deferred Decisions**

QRC has substantially simplified this clause. QRC considers that it is unnecessary to have the complicated regime for the determination of a Deferred Decision as proposed by Aurizon Network when a Deferred Decision can be treated similar to a variation.

## 8 Extension Infrastructure Head-Lease

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### 8.1 Overview

This section identifies key issues arising from QRC's review of the EIHL.

### 8.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the EIHL and consultation with industry. The purpose of this section is not to summarise all of QRC's concerns with the form of the EIHL. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

**(a) Certainty regarding operation of Lease and Sublease**

The QRC Mark-up proposes a number of changes to clauses 3.1, 3.2 and 3.3 of the EIHL to:

- clarify the operation of these clauses; and
- reduce the scope for disputes between the parties regarding interpretation.

QRC is of the view that these changes should not be controversial as the intent was simply to remove certain inconsistencies and increase certainty.

**(b) Deemed transfer**

In the QRC Mark-up, a new clause 3.2(e) has been included to ensure that (in the case of a deemed transfer) the obligations imposed on the Lessee are no more onerous than would be expected in a similar deemed novation/transfer. The Lessee should not be responsible for any obligations of (or breaches by) the Sublessee which arose prior to the Sublease Termination Date.

Additionally, as the Lessee is not a party to the Infrastructure Lease, QRC submits that the Lessee should not be responsible for obligations of the Sublessee in respect of the

Infrastructure Lease. Clause 3.2(e)(v) has been included in the QRC Mark-up to ensure that certain obligations under the Infrastructure Lease are not novated to the Lessee where there is a deemed novation and transfer of the Sublease to the Lessee.

The QRC Mark-up also includes a new clause 7.9 which provides that (in the event of a deemed transfer of the Sublease) the Sublessee must deliver all records, reports, plans, specifications and other information required to be maintained under the EIHL to the Lessee. The Lessee may not otherwise have direct access to this documentation and could require the information in order to comply with novated obligations of the Sublessee.

**(c) Permitted Use and authorisations**

QRC submits that the scope of the definition of “Permitted Use” should be expanded to accommodate all activities that may be undertaken by the Sublessee.

The EIHL currently contains a requirement that both the Lessee and the Sublessee obtain the authorisations necessary for the Sublessee to use the Extension Infrastructure for the Permitted Use. Only Aurizon Network, as Sublessee, should be responsible for obtaining such authorisations whilst the Sublease is on foot (this is consistent with the position in the other SUFA Documents). The Lessor should also be required to assist in obtaining relevant authorisations – in the Aurizon Network draft, the Lessor is entitled to “reasonably” withhold its consent. It should not be incumbent on the Sublessee to obtain the Lessor’s consent (reasonable or otherwise) where the Sublessee is obligated by the EIHL and/or by law to obtain such Authorisations.

Similar to the issues noted above with the RCA and EISL, the EIHL also gives too much discretion to Aurizon Network. The QRC Mark-up proposes amendments to clause 6.4 to restrict the Sublessee’s right to modify the Extension Infrastructure. Modifications proposed should be necessary for the Permitted Use and form part of the proper conduct of the Sublessee’s business – rather than being simply “at whim”.

**(d) Relationship with the EISL**

The EIHL and the EISL both provide for the sublease of the Extension Infrastructure from the Lessee to the Sublessee and they necessarily deal with similar obligations. In general, the obligations under the EIHL are more extensive and impose more restrictions on the Sublessee. The QRC Mark-Up ensures that the obligations are made consistent across the two documents.

**(e) Insurance**

The insurance provisions included in clause 9 of the EIHL are not sufficiently broad to provide appropriate protection for the Lessee. In particular, the insurance provisions should include:

- a requirement that the Sublessee take out Workers’ Compensation insurance;
- provision for the novation of relevant insurance to the Lessee;
- provision for the Lessee to take out insurance (should the Sublessee fail to do so); and
- a requirement for the Lessee’s agreement on the use of proceeds of insurance claims.

The QRC Mark-up addresses these proposed amendments.

**(f) Termination**

Clause 12.2 of the draft EIHL broadly replicated the mechanism included in clause 8 of the IND (with some procedural differences). The QRC Mark-up proposes the deletion of this clause on the basis that the transfer of (and compensation for) Excluded Extension Infrastructure should be dealt with exclusively in the IND.

On termination triggers, QRC has proposed a number of amendments to the definition of “Insolvency Event” to allow for an acceptable degree of flexibility in the Lessee’s operations. Given that an Insolvency Event may trigger a termination of the EIHL, QRC submits that it should not include:

- minor infringements;
- where the Lessee merely “threatens” to stop or suspend payment;
- where the Lessee is seeking to have an order or appointment set aside; or
- events where a Controller has not been appointed in respect of a material part of the Lessee’s assets.

**(g) Security interests and assignments**

If the Lessee seeks to create a Security Interest over its rights under the EIHL (or its interest in the Extension Infrastructure) QRC submits that the Lessor should not be able to unreasonably withhold or delay its consent or otherwise make such consent subject to unreasonable conditions. It is usual to require consent to be given on reasonable terms, and this is not an unacceptable constraint on Aurizon Network.

In addition to this change, the QRC Mark-up includes a new clause 23.4 to ensure that, where the Lessor or Lessee requires, the Sublessee will provide assistance to ensure any registration of any security interest that arises under the *Personal Property Securities Act 2009* (Cth).

In relation to assignment, the QRC Mark-up includes amendments to ensure that:

- the Lessor provides prior notice of any assignment of the rights and obligations under the EIHL (and associated rights and obligations) to the Lessee and the Sublessee; and
- the Sublessee also needs to seek consent of the Lessee (as well as the Lessor) to certain assignments of its rights and obligations under the EIHL (and associated rights and obligations).

## 9 Infrastructure Network Deed

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### 9.1 Overview

This section identifies key issues arising from QRC’s review of the IND.

### 9.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the IND and consultation with industry. The purpose of this section is not to summarise all of QRC’s concerns with the form of the IND. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

**(a) Infrastructure Lease**

Parts of the IND rely upon or refer to the Infrastructure Lease. For example, there are some provisions which seek to restrict the categorisation of Extension Infrastructure based on definitions used under the Infrastructure Lease (i.e. “Infrastructure” and “Railway Assets”). Further, under the IND, the Trustee is not permitted to have recourse against the Infrastructure Lessor for any “Losses” as defined in the Infrastructure Lease and referred to in clause 10.4(f) of that lease (see clause 7.8(f) of the IND).

As noted above in relation to the RCA, the IND is not a standard-form tripartite agreement and the Trustee does not have full visibility of all of the terms or the operation of the Infrastructure Lease. Whilst QRC acknowledges that Aurizon Network has sought to disclose discrete clauses to industry, there are a number of relevant clauses that the Trustee has not reviewed (and will not be able to mitigate its exposure under).

QRC submits that, where the terms of the Infrastructure Lease impact on the Trustee's obligations under the IND, further particulars of the relevant terms of the Infrastructure Lease should be provided to QRC to assist in the assessment of the likely consequences of such liability. Alternatively, if certain clauses cannot be provided, the relevant "linking" clauses in the IND will need to be amended to shield the Trustee from the residual risk.

**(b) Restrictions on the Trustee**

The IND purports to restrict the Trustee from terminating, rescinding or otherwise exercising certain rights under the Sublease or any land licence (i.e. the RCA) without obtaining the prior written approval of the Infrastructure Lessor. QRC submits that this is an unacceptable restraint on the Trustee's rights under the negotiated SUFA documents. This is patently so given that such a restriction could preclude the Trustee from pursuing a remedy (otherwise available to it) in the case of Aurizon Network's default.

The QRC Mark-up amends clause 5 so that approval is not required where the termination (or other relevant activity) is permitted under the terms of the IND, EIHL or relevant land licence. If the Trustee is acting in accordance with its rights under the SUFA Documents, it need only provide notification after the fact.

In any other case, the Trustee will continue to be required to seek the prior written consent of the Infrastructure Lessor. However, the QRC Mark-up proposes that such consent cannot be unreasonably withheld.

**(c) Transfer of Excluded Extension Infrastructure**

In the case of both termination/expiry of the Infrastructure Lease and termination of the EISL, the QRC Mark-up proposes the inclusion of a consultation period during which the parties consider what parts of the Extension Infrastructure should become "Excluded Extension Infrastructure". The parties can take this opportunity to consider what (if any) functional value discrete sections of the infrastructure hold.

Noting that there may be limited value in discrete parts of the Extension Infrastructure being transferred to the Trustee after termination of the underlying leases, QRC submits that the transfer of Excluded Extension Infrastructure should be at the discretion of the Trustee. If the Trustee does not elect to take a transfer of relevant infrastructure, it can then simply be disposed of in conjunction with the balance of the Extension Infrastructure.

**(d) Termination: Determination of Percentage Shares and Payment**

Clauses 7.7 and 8.8 of the IND relate to the determination of the Percentage Share of the Trustee and each "Other Funder" for the purposes of allocating funds received on disposal of Extension Infrastructure. QRC submits that the Trustee should be afforded more time to dispute Aurizon Network's determination of the Percentage Share. QRC submits that a period of 45 Business Days is reasonable.

It is also of concern to industry that the IND purports to restrict the Trustee from lodging a dispute outside of the period mentioned above. If the Trustee identified an error in Aurizon Network's calculations for the Percentage Share at some point after the period allowed for the Trustee to lodge a dispute, the Trustee should be entitled to recourse through the dispute resolution mechanism.

The QRC Mark-up also proposes a variation to the time period allowed for payment of each party's relevant Percentage Share.

**(e) Termination and overlap between IND and EIA**

As noted in section 9 above, clause 8 of the IND overlaps with the provisions for dealing with the Extension Infrastructure in the case of lease expiry under the EIHL. This causes ambiguity and uncertainty as to whether relevant Extension Infrastructure should be “dealt with” under the compensation regime outlined in clause 8, or removed as detailed in clause 12 of the EIHL.

QRC submits that a comprehensive (and exclusive) method for dealing with the removal of (and compensation for) Extension Infrastructure should be contained in the IND, and that the removal of the Extension Infrastructure should not be dealt with under the EIHL.

On this basis, QRC proposes that the IND and EIHL should operate as follows:

- clause 7 of the IND applies where the Infrastructure Lease has terminated (and the Trust has not terminated);
- clause 8 of the IND applies where the Infrastructure Lease expires (and the Trust has not terminated); and
- the EIHL only provides for the circumstances that will trigger termination of the EIHL.

**(f) Land use rights for Excluded Extension Infrastructure**

Under clause 9.4 of the IND, the Infrastructure Lessor agrees to facilitate the endeavours of the Trustee to obtain the grant of proprietary or contractual rights in respect of the Rail Corridor Land associated with the Excluded Extension Infrastructure.

The IND currently includes an acknowledgment by the Trustee that the Infrastructure Lessor cannot ensure or procure these proprietary or contractual rights.

QRC submits that if this acknowledgement is included, there is a substantial risk that the Trustee may have title to the Excluded Extension Infrastructure without the right to enter the land that it is located on or attached to. Given that tenure for the Rail Corridor Land currently exists and sits with Aurizon Network, this would provide an unjust position for the Trustee.

The QRC IND Mark-up addresses this issue by providing more assurance to the Trustee that these proprietary or contractual rights will be obtained by the Trustee in the relevant circumstances.

**(g) Disputes**

QRC submits that the IND dispute resolution provisions in clause 13 should allow for both the Trustee and Aurizon Network to bring a dispute against the State Parties.

## 10 Umbrella Agreement

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### 10.1 Overview

This section identifies key issues arising from QRC’s review of the User Funding – Umbrella Agreement (UA).

### 10.2 Key issues

This section provides an overview of the key issues identified by QRC through its review of the UA and consultation with industry. The purpose of this section is not to summarise all of QRC’s concerns with the form of the UA. Comments on individual clauses, and proposed drafting amendments, are contained in the QRC Mark-up.

**(a) Inclusion of costs in the RAB**

Under clause 6 of the UA, Aurizon Network is obliged to have costs associated with an Extension included in the Regulatory Asset Base (**RAB**).

QRC submits that:

- the clause proposed is not prescriptive enough given the importance of the inclusion of these costs (and particularly Capital Costs and Construction Interest) into the RAB; and
- Aurizon Network should be required to consult with the Trustee with respect to its RAB submissions to the Access Regulator (QCA).

The QRC Mark-up includes a number of additional consultation obligations and requires Aurizon Network to act reasonably and in good faith.

**(b) Limitation of Liability**

The UA, as currently drafted, limits Aurizon Network's liability under the UA to \$1.00. It also limits liability under other Transaction Documents to the same amount, except where expressly stated otherwise in that Transaction Document.

QRC submits that:

- it is inappropriate for Aurizon Network to seek to limit its liability under the UA given that its obligations under the UA (i.e. to act reasonably in seeking inclusion of costs into the RAB, enter into Access Agreements, and maintain confidentiality) are both basic and of fundamental importance to the Trustee; and
- it is unnecessary to limit liability under other Transaction Documents as this is already provided for in each of those documents.

Aurizon Network also seeks to exclude consequential loss. QRC submits that this is not appropriate under the UA because any loss suffered as a result of a breach by Aurizon Network will likely be consequential in nature. To include this limit would effectively allow for a complete exclusion of liability.

## Expansion Process principles

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### 1 Definitions

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Defined terms used in this principles paper have the same meaning as in the 2013 DAU, unless otherwise specified.

### 2 Funding obligations are out of scope

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The principles set out in this paper deal only with the Expansion Process, and not Aurizon Network's funding obligations in respect of a particular expansion project.

### 3 Determination of demand for an Expansion

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Aurizon Network will determine demand for an Expansion:

- (a) where requested by a threshold number of access seekers or a Customer Group;
- (b) where a coal terminal has announced it has commenced a process to expand or there is a reasonable likelihood of a new coal terminal being developed and there is likely to be demand for additional below rail capacity;
- (c) where an Access Application has been received, and Aurizon Network has determined that the required Access Rights cannot be provided without undertaking a major project [**Note: "Major Project" should be a new definition in the access undertaking and is intended to differentiate from incremental expansions. It is not intended to align with the funding obligation**].

Aurizon Network will nominate and complete the determination of demand within specified periods.

Aurizon Network will publish the results of a "determination of demand" (but will not identify individual access seekers).

The access undertaking will set out what information may be requested by Aurizon Network as a part of its assessment of its determination of demand.

The process outlined above does not prevent a single access seeker requesting that Aurizon Network carry out a study for an Expansion (in which case Aurizon Network will be obliged to follow the process outlined below). Such a request from an access seeker may result in Aurizon Network determining demand for an Expansion in accordance with the process above.

## 4 Concept studies

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Concept studies will be undertaken and funded by Aurizon Network through the Network Development Plan/[CRIMP] process.

Results of concept studies will be published in the Network Development Plan/CRIMP. The NDP/CRIMP will be kept up to date. The NDP/CRIMP will have regard to system constraints and will identify the base line for capacity prior to the study and proposed as part of the study.

Aurizon Network will promptly undertake concept studies as is necessary to reflect the reasonably anticipated future demand for below rail capacity (as determined by Aurizon Network acting reasonably and in good faith and in consultation with current and potential coal producers and operators).

## 5 Pre-feasibility and Feasibility studies

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Pre-feasibility and feasibility studies are to be funded by access seekers and not by Aurizon Network unless otherwise agreed (with all relevant access seekers).

Aurizon Network will be obliged to promptly (and in accordance with good operating practices) undertake pre-feasibility and feasibility studies where access seekers meet the Required Criteria (as defined in paragraph 7 below) and agree to fund on the standard study funding terms. Unreasonable delay in the commencement or progression of a study by Aurizon Network will be a breach of the Access Undertaking.

Access seekers that satisfy the Required Criteria will have a right to fund studies and enter into a standard study funding agreement on terms attached to the Access Undertaking. **[Note: the ability to enter into such an agreement is important to access seekers because it provides a degree of input to the study and certain information which is important to mine feasibility studies. The loss of input and transparency which could result from Aurizon Network electing to fund studies itself and not entering into an agreement is not acceptable].**

Access seekers that are participants in a study will be entitled to full transparency of information under the relevant study funding agreement (other than for mine specific information).

Separately (and for the benefit of access seekers generally) Aurizon Network will be required to publish general details of studies being undertaken (but not identifying the mines or users that they relate to).

Aurizon Network will be obliged to coordinate its study activities with other participants in the coal chain (provided that Aurizon Network must not disclose any confidential information, including identifying the mine or users except that Aurizon Network can disclose the mine or users to other rail network or port developers/operators where that party has executed a confidentiality undertaking in favour of Aurizon Network and the relevant mine or user and that party has a legitimate reason to require that information). Aurizon Network will use best endeavours to ensure that the study progresses according to a timeline not later than the timeline of the access seeker's mine/expansion development.

An access seeker may join a study (and study funding agreement) after it has commenced provided that:

- (d) the project will not be delayed (or if it will be delayed, all affected access seekers consent);

- (e) they fund their share of the study costs including costs already incurred; and
- (f) the later joining access seeker will have a lower priority for the purposes of allocating capacity than those parties that originally participated.

## 6 Right to step-in to undertake studies

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Where:

- (g) Aurizon Network unreasonably fails to enter into a study agreement in circumstances where it is obliged to do so;
- (h) Aurizon Network unreasonably fails to commence a concept study, pre-feasibility study or feasibility study that it is obliged to undertake;
- (i) Aurizon Network unreasonably delays the progression or completion of a concept study, pre-feasibility study or feasibility study;
- (j) Aurizon Network abandons a study other than with the approval of all relevant access seekers; or
- (k) Aurizon Network, in breach of the study funding agreement, exceeds the approved target cost estimate for the relevant study,

an access seeker or access seekers may with the approval of the QCA step-in and procure the undertaking of the relevant study.

Where a party or parties step-in to undertake a study, Aurizon Network will be obliged to provide the relevant access seeker with all information that may be reasonably required to undertake the study.

Where a study has already commenced, the relevant party or parties will undertake the study/studies as the agent of Aurizon Network and will be entitled to exercise the rights of Aurizon Network under any relevant contracts let by Aurizon Network for the study (provided however that the access seekers must comply with those contracts). Access seekers will not be required to comply with the directions of Aurizon Network (or act in the interests of Aurizon Network) where a step-in requires the access seekers to act as agent.

The QCA's approval of a step-in may be conditional on such conditions that the QCA consider to be appropriate including that the access seekers procure the undertaking of a study through an independent third party and for the benefit of all relevant access seekers.

## 7 Required Criteria for studies

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Access seekers that wish to benefit from a pre-feasibility or feasibility study must satisfy the following criteria (being the **Required Criteria**):

- (l) In respect of a pre-feasibility study, the access seeker must:
  - (1) be participating in an outloading process (such as an expressions of interest or study funding in relation to a coal export terminal or domestic power station or other equivalent out loading type facility) or otherwise has a reasonable likelihood of obtaining outloading capacity;

- (2) have a mining tenure at least equivalent to an exploration permit for coal and have a credible schedule for development of its mine or mine expansion which schedule supports its access request, which schedule it is diligently implementing (although it is recognised that given the fluid nature of approvals, departure from the schedule will be necessary in some cases); and
  - (3) demonstrate an ability to fund its share of the pre-feasibility study (by satisfying the security requirements under the study funding agreement).
- (m) In respect of a feasibility study:
- (1) be participating in an outloading process (such as an expression of interest or study funding in relation to a coal export terminal or domestic power station or other equivalent out loading type facility) or otherwise has a reasonable likelihood of obtaining outloading capacity;
  - (2) have mining tenure and have a credible schedule for development of its mine or mine expansion which schedule supports its access request, which schedule it is diligently implementing (although it is recognised that given the fluid nature of approvals departure from the schedule will be necessary in some cases);
  - (3) subject to paragraph (4) demonstrate that the relevant mine has marketable coal reserves at least equivalent to 10 years worth of the annual capacity sought under the Access Rights; and
  - (4) if the access seeker meets criteria (1) and (2) but cannot meet criteria (3), the access seeker is given an option to continue on the basis of an undertaking that should they progress to execution of an access agreement the term of that access agreement will not be less than the term of the standard access agreement and that should they subsequently seek to sign an access agreement of shorter term, Aurizon Network must offer their prospective capacity to other participants in the feasibility study or pre-feasibility study prior to executing an access agreement or agreeing to execute an access agreement for such shorter term; and
  - (5) demonstrate an ability to fund its share of the pre-feasibility study (by satisfying the security requirements under the study funding agreement).

An access seeker will be entitled to dispute Aurizon Network's determination that an access seeker does not meet the Required Criteria.

## 8 Standard study funding agreement

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The standard study funding agreement should:

- (n) be on industry standard terms for engineering study agreements (including a prudent balance between risk and reward);
- (o) allow the relevant access seekers rights to information (as is relevant to their mine project);
- (p) oblige Aurizon Network to consult regularly and provide complete transparency (other than for the information of miners);

- (q) provide cost certainty with a capped funding commitment (Aurizon Network not being obliged to complete a study if the capped cost is exceeded, other than where arising from the breach or negligence of Aurizon Network or its related bodies corporate).

## 9 Priority of projects

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Projects should not be prioritised because of limitations of resources. Projects may only be prioritised where it is necessary to do so because of scope.

Where the scope of work is such that it is not prudent or feasible to progress an Expansion project at the same time, Aurizon Network will prioritise the projects on the basis of a timeline that meets the reasonably likely time that output capacity will be available.

Aurizon Network will be obliged to publish its reasons for prioritising one project over another to all relevant access seekers and the QCA.

In very limited circumstances Aurizon Network may change the order of a project. Before Aurizon Network effects such a change it must give reasons to the affected access seekers and the QCA.

Any affected access seeker may dispute Aurizon Network's determination of the priority of projects. The QCA will determine such a dispute.

## 10 Allocation of capacity

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Negotiations for the funding of the Expansion must commence no later than the commencement of a feasibility study.

Capacity will be allocated on a non-discriminatory basis to those access seekers that:

- (r) meet the following Required Criteria:
- (1) have sufficient outloading capacity or a reasonable likelihood of obtaining outloading capacity;
  - (2) have mining tenure and have a credible schedule for development of its mine or mine expansion which schedule supports its access request, which schedule it is diligently implementing (although it is recognised that given the fluid nature of approvals, departure from the schedule will be necessary in some cases);
  - (3) subject to paragraph (4) demonstrate that the relevant mine has marketable coal reserves at least equivalent to 10 years' worth of the annual capacity sought under the Access Rights; and
  - (4) if the access seeker meets criteria (1) and (2) but cannot meet criteria (3), the access seeker is given an option to continue on the basis of an undertaking that should they progress to execution of an access agreement the term of that access agreement will not be less than the term of the standard access agreement and that should they subsequently seek to sign an access agreement of shorter term, Aurizon Network must offer their prospective capacity to other participants in the feasibility study or pre-feasibility study prior to

executing an access agreement or agreeing to execute an access agreement for such shorter term; and

- (s) are willing to sign up to an access agreement on the terms of the standard access agreement; and
- (t) (where Aurizon Network is not obliged to fund the Expansion) if Aurizon Network is entitled to seek access conditions and does, are willing to commit to either accept the access conditions or fund through SUFA (with the election between the options required at a defined stage) [**Note that this principles paper does not deal with funding options and regulation of access conditions**].

An access seeker may dispute Aurizon Network's determination that they do not meet the criteria above.

Where all access seekers meet the criteria above, but there is insufficient capacity to be allocated to all access seekers, Aurizon Network will allocate capacity having regard to the following matters<sup>1</sup>:

- (u) access seekers that funded the pre-feasibility study and feasibility study will be given priority over those that did not (and among those access seekers that did fund, priority will be given to those access seekers that originally participated in the pre-feasibility and feasibility study funding);
- (v) so as to maximise the allocation of capacity;
- (w) prioritising those projects that more strongly meet the Required Criteria described above (in this case, Aurizon Network must give reasons, report to the QCA, and access seekers will be provided with all information submitted by Aurizon Network in regard to their application/mine and may dispute this information); and
- (x) prioritising those projects that have mining leases and key environmental approvals.

Aurizon Network will provide an access seeker and the QCA with complete details of Aurizon Network's assessment of the access seeker's compliance with the principles above. An access seeker may dispute Aurizon Network's assessment of the criteria above (so far as relevant to that access seeker) and the allocation of capacity (or not) to that access seeker.

## 11 Completing blank spaces in SUFA documents

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While the SUFA Documents are intended to be ready to use there are a number of parts of the SUFA Documents which require completion by the parties and agreement on how to complete those details (for example, the scope of work, estimate and deferred matters under the PMA). A significant concern which the QRC has is that the process to agree and complete the SUFA Documents should be short. Where the parties cannot agree they should be able to submit the matter to determination by the QCA. The current dispute resolution process in the AU is not set up for this sort of expedited dispute resolution. The QRC therefore suggests that a special dispute resolution mechanism be developed in the AU for these types of disputes.

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<sup>1</sup> The above is not intended to deal with or cover renewals.

## 12 Amendments to support SUFA

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A number of amendments to the AU are needed to support a SUFA project. They include:

- requiring Aurizon Network to seek regulatory pre-approval of a project;
- obliging Aurizon Network to include the costs of a SUFA project in the regulated asset base;
- including the direction to pay mechanism in the standard access agreements;
- requiring Aurizon Network to review the SUFA Documents after execution of the first SUFA project. It is inevitable that enhancements could be made to the documents once they have been put into practice.