

SUBMISSION TO THE QUEENSLAND COMPETITION AUTHORITY

RESPONSE TO THE DRAFT DECISION REGARDING THE 2013 STANDARD USER FUNDING AGREEMENT DRAFT AMENDING ACCESS UNDERTAKING

JANUARY 2015

1. Executive summary

Anglo American Metallurgical Coal Pty Ltd (**Anglo American**) welcomes the opportunity to make a submission to the Queensland Competition Authority (**QCA**) in respect of the QCA's Draft Decision on Aurizon Network Pty Limited's (**Aurizon Network**) 2013's Standard User Funding Agreement Draft Amending Access Undertaking (**SUFA**) (**Draft Decision**). Anglo American appreciates the complexity of this process, especially in light of the fact that SUFA is an innovative and unique development for the purpose of minimising "economic hold-up". Anglo American wishes to express its support for the thorough and detailed analysis that the QCA has undertaken in relation to SUFA at this important stage of its development.

As it has previously stated, Anglo American believes that SUFA is essential for the future operation of the Queensland coal industry and the competitiveness of Queensland coal in the global supply market.

Anglo American supports the QCA's comments in relation to the security and the need for SUFA to provide certainty. Financiers looking to invest in projects of the magnitude that SUFA is likely to for all stakeholders be used for will require stability and long-term certainty to underpin their investments. As it will be Funding Users that will be obtaining finance for SUFA projects, it is therefore Funding Users that require certainty for their financiers. Anglo American agrees with the QCA Draft Decision that, as it is currently drafted, SUFA "does not provide security over and certainty in respect of rental cash flows" and that without these key principles "third party financing is not viable and SUFA cannot function effectively."¹

Anglo American also supports the QCA's work to increase the simplicity through a more direct structure of SUFA. Anglo American supports the QCA's restructuring of the agreements towards a more market standard Project Management Agreement with a simplified standard Construction Agreement. Anglo American believes that unnecessary complexity in the structure and contractual framework around SUFA will only deter ~~from~~ its use, meaning that it will be unable to fulfil the infrastructure financing and development role that it was designed-to achieve.

Bearing these comments in mind, Anglo American wishes to reiterate its comments from previous submissions that SUFA should not operate as a replacement for mandatory expansion requirements. Anglo American notes that some of these requirements are being considered in relation to the 2014 Draft Access Undertaking (**UT4.2**) and continues to stress that until such time as a SUFA has been successfully completed and integrated into the

¹ Queensland Competition Authority, *Draft Decision: Aurizon Network's 2013 Standard User Funding Agreement Draft Amendment Access Undertaking* (October 2014) x.

Central Queensland Coal Network (CQCN) there is no assurance that this will operate to protect Access Seekers' interests in the expansion of the CQCN. Mandatory expansion requirements protect against "economic hold-up" by monopoly infrastructure owners and retain an important role in access regulation, with or without the presence of a workable and functioning SUFA. In particular, SUFA will not be suitable for small expansions and in respect of these types.

2. Continuing regulation of the CQCN and SUFA assets

Anglo American notes that the QCA has dealt in detail in its Draft Decision for a situation where Aurizon Network's assets become unregulated. Anglo American notes that whilst it agrees that the most likely scenario of deregulation will be where the QCA has recommenced revocation, this is not absolutely certain. For example, Part 5 and section 250 of the QCA Act could be repealed. Also, it is not entirely clear to Anglo American that just because the private profitability test is satisfied (leading the QCA to recommend revocation) means that there is effective competition. For example, just because BHP could afford to duplicate the Goonyella truck line if it wished, doesn't mean that there is effective competition if no-one else could make a profit doing so.

Anglo American supports the QCA's Draft Decision that the SUFA contracts should remain in place as a regulated agreement, even if the CQCN is to be deregulated. This is because both the Funding Users and Aurizon Network will be entering long-term SUFA contracts based on a certain commercial structure and significant investment decisions will be based on this understanding.

However, Anglo American stresses that this should be the default position, that is, that the commercial arrangements will continue unless both parties agree to change the arrangements. This ensures that in situations of deregulations where there is not effective competition the Funding Users cannot be put in a situation where they are forced to accept a new arrangement.

3. Approach to risk allocation

Anglo American strongly supports the QCA's findings in relation to the allocation and acceptance of risk throughout the SUFA. A fundamental rule of contract negotiation that "the party that controls the risk generally carries the risk" has been highlighted by the QCA.²

Anglo American supports this approach to risk allocation, particularly in light of the control that Aurizon Network intends to retain over the construction and operation of SUFA assets.

² Queensland Competition Authority, *Draft Decision: Aurizon Network's 2013 Standard User Funding Agreement Draft Amending Access Undertaking* (October 2014) xi.

Anglo American also agrees with the QCA's comments that risk in relation to SUFA must be considered by reviewing the broader suite of SUFA documents, rather than looking at each contract in isolation.³ The nature of the risk borne by each party is mitigated across the various contracts, and while the Trust controls major aspects of some of the SUFA documents, on the whole it is Aurizon Network that will design, construct, operate and eventually own the SUFA assets; therefore, it is Aurizon Network which on the whole has the ability to manage and control the major risks related to a SUFA.

Anglo American supports the QCA's Draft Decision that Aurizon Network should control the construction process involved in a SUFA. Aurizon Network is the best placed entity to design, construct and operate SUFA assets with its wealth of experience in similar projects as well as the practical implications arising from the fact that the SUFA assets will become part of the CQCN. In saying that, because of the financing aspects of SUFA projects, Funding Users also have a right to know and understand the various elements of SUFA developments. Anglo American believes that this means as complete transparency as is possible in order to ensure that SUFA represents valuable, cost effective use of industry finance and creates an efficient aspect of the supply chain for Queensland coal producers competing in the difficult global market.

Anglo American understands that there are some aspects of projects which Aurizon Network must maintain a level of confidentiality around because of the nature of commercial business. On the other hand, however, Anglo American notes that by the very nature of its natural monopoly business, Aurizon Network does not have any direct competitors that would benefit from receiving detailed information about the developments of expansions on the CQCN (and because of the monumental cost that would be involved in duplicating the CQCN, Aurizon Network is also unlikely to have any direct competitors in the near future). Further, because of the level of equity and debt that Funding Users will have invested in SUFA projects, Anglo American believes that Funding Users should be entitled to a level of information giving transparency regarding Aurizon Network's expenditure, and allowing for accountability in relation to the project. Because of this need for information, Anglo American supports the QCA's Draft Decision in relation to the requirement for clarity and certainty surrounding the outcome of the expansion process.⁴

³ Queensland Competition Authority, *Draft Decision: Aurizon Network's 2013 Standard User Funding Agreement Draft Amending Access Undertaking* (October 2014) 90.

⁴ Queensland Competition Authority, *Draft Decision: Aurizon Network's 2013 Standard User Funding Agreement Draft Amendment Access Undertaking* (October 2014) xi.

4. Limitation of liability

Anglo American agrees with the QCA's Draft Decision that it is not appropriate to limit liability to \$1 where a party, in this instance Aurizon Network, is able to manage risks.⁵ This again shows the imbalanced position that has been proposed by Aurizon Network through its 2013 SUFA submission. Aurizon Network's liability should reflect the ability that it has to control the course of construction, as well as its ability to mitigate risks when and where they arise. As such, Anglo American believes that through the SUFA contracts Aurizon Network's liability should be altered to reflect the damage caused.

Further, post the construction phase Anglo American agrees with the QCA's Draft Decision that Aurizon Network's risk should be similar to the liability that Aurizon Network bears in relation to the rest of the CQCN, as any created SUFA assets will effectively be CQCN assets. Because of this, Anglo American supports the QCA's recommendation that there should not be a limit on Aurizon Network's liability at any stage of a SUFA project.

In a similar vein, Anglo American agrees with the Draft Decision that the Trustee should also be liable for the risks that it has the ability to control. In that manner, this includes (as noted by the QCA) any instance where the Trustee has committed wilful default, gross negligence or fraud. Other than these limited instances, the Trustee is on the whole a passive participant in the process controlled by Aurizon Network and its exposure to risk and liability should reflect this position.

It should be noted that the fundamental aim of natural monopoly regulation is to mimic as closely as possible the outcomes of a competitive market. The limitation of liability clause bought by Aurizon Network is not market standard nor reflective of a competitive market.

5. Introduction of a capacity guarantee

Anglo American has previously cautioned against the introduction of a capacity guarantee, but only insofar as that guarantee is likely to cause Aurizon Network to over-scope or over-cost assets in order to ensure that it continues to maintain its extremely minimal risk level. However, Anglo American notes that the QCA's Draft Decision held that Aurizon Network should be required to provide a capacity guarantee which would also be subject to a pre-approval process.

Anglo American does not disagree with the Draft Decision. Rather, Anglo American supports the Draft Decision to the extent that alongside a capacity guarantee, it also requires Aurizon Network to provide Funding Users and the QCA with enough appropriate information to

⁵ Queensland Competition Authority, *Draft Decision: Aurizon Network's 2013 Standard User Funding Agreement Draft Amending Access Undertaking* (October 2014) 91.

ensure that the pre-scoping of the SUFA project (and therefore the pre-approval) is adequately informed. The follow on of this is that the pre-approval is also adequately informed, rather than (as has happened in the past with developments such as GAPE and WIRP) users being forced to withdraw from the project because they are unable to satisfy themselves or financiers that the scoping is accurate or efficient.

Specifically, Anglo American notes that it is essential that stakeholders are provided with clear information in relation to the baseline capacity of the CQCN so that it is possible for them (be that Funding Users, the QCA, or an appointed expert assessor) to determine whether the SUFA project is necessary, will deliver the required capacity (efficiently and not above the level reasonably required), and has been accurately scoped by Aurizon Network. Without this detailed information in relation to capacity Anglo American notes that Funding Users may be forced into funding a SUFA project simply to unlock any capacity without knowing whether the SUFA project proposed is economically efficient, subjecting them to "economic hold-up" albeit in a different form.

Further, if the QCA continues to support the requirement for up front commitments, Anglo American believes that SUFA must include a mechanism to allow Funding Users, the QCA or an expert to determine an appropriate pre-approval scope in instances where Aurizon Network refuses to provide an efficient or economic scope for the project. Otherwise, it is possible for Aurizon Network to delay the commissioning or commencement of any SUFA project simply by over-scoping. This ability for a party other than Aurizon Network to determine the appropriate scope for a SUFA project goes hand in hand with the requirement that Aurizon Network provides adequate levels of information to the QCA and Funding Users.

As such, Anglo American agrees with the QCA's Draft Decisions at 5.1 and 5.2 on the understanding that Aurizon Network provides adequate information for Funding Users and the QCA to assess the scope provided, or to request an expert review of the scope if Funding Users believe that Aurizon Network has not scoped either efficiently or economically.

6. Consequential loss

Anglo American notes the QCA's request for further comments in relation to the definition of "consequential loss" within SUFA and, importantly, what the definition operates to exclude. In particular, Anglo American notes that the QCA is interested in stakeholders' opinions regarding narrowing the definition of consequential loss so as not to exclude the recovery of losses that a lender would expect to recover. In principle, Anglo American supports this concept.

As the QCA has noted a number of times in the Draft Decision, SUFA is primarily intended to be a funding tool for the expansion of the CQCN or construction of new rail assets where Aurizon Network has elected not to do so itself. By the very nature of such construction work (ie, involving significant sunk cost investments over a period of time) some stakeholders will inevitably be required to acquire third party financing. Any third party that is investing in a SUFA project will require a certain level of security surrounding its investment and, as the party managing the majority of the risk, Aurizon Network is best placed to ensure that security (and will be rewarded for its actions through the final ownership of the assets).

Anglo American believes that recoverable loss should include such areas as interest on finance that accrues because of delays to the construction process, losses incurred because the construction manager did not take reasonable steps to mitigate damage, and any other forms of potential damage to lenders that the QCA feels is appropriate and is within the control of Aurizon Network. To achieve this definition, Anglo American agrees with the QCA's suggestion to narrow the definition of consequential loss so that it does not broadly exclude all losses, but rather permits the security that third party lenders will require to take part in funding a SUFA.

7. OPRA

Anglo American strongly supports the QCA's approach to Aurizon Network's so-called "Operating Performance Risk Allowance" (**OPRA**); ie, to exclude the operation of OPRA. In particular, Anglo American agrees with the QCA's consideration of how SUFA assets should work as part of the CQCN, attracting the same operation and maintenance payments that Aurizon Network would be entitled to in relation to existing assets. Aurizon Network should not be permitted to receive a premium payment for work that it is already being rewarded for (where OPRA will inevitably become a form of double-recovery on top of the operation and maintenance charges that will be included in the Reference Tariff for the relevant SUFA assets).

As such, Anglo American supports the Draft Decision in relation to the exclusion of OPRA.

8. Termination of SUFA contracts

Anglo American supports the Draft Decisions that the QCA has recommended at 7 in relation to the termination of SUFA contracts.

9. Issues relating to discrimination

Anglo American agrees with the QCA that an extension of the conditions based assessments to SUFA funded assets is an appropriate method of dealing with discrimination in respect of

the maintenance of SUFA funded assets. It also agrees with most of the proposals outlined at 8.1.1 of the Draft Decision, being:

- (a) an access seeker or the Trustee be allowed to seek an audit of conduct considered by them to be discriminatory;
- (b) a SUFA user (or its customer) or a Trustee be permitted to bring a dispute to the QCA; and
- (c) discrimination to be arbitrated by the QCA and multiple breaches to be considered a wilful breach.

The only reservation that Anglo American has in relation to the proposals at 8.1.1 is that the party bringing the discrimination dispute bears all of the costs if no discrimination is found. Discrimination is a notoriously difficult allegation to prove. This is because discrimination is a state of mind of the person accused of discrimination and, generally speaking, a person who seeks to discriminate will not reduce that strategy to writing. It is perfectly foreseeable that discrimination may occur but sufficient evidence of that discrimination is not able to be found. It may even be that the evidence is finely balanced and that, on balance, the QCA determines that there is insufficient evidence. Anglo American believes that it would be appropriate for a party who alleges discrimination to bear the costs where the QCA forms the view that the allegation of discrimination was frivolous, vexatious or made in bad faith. Otherwise, each party should bear their own costs.

In ensuring the success and suitability of the approach of broadening the conditions bases assessment to SUFA assets, it is essential that the consultant appointed be truly independent. The current approach seems to have worked well as the initial conditions based assessment seems to have been done thoroughly by Evans & Peck. However, it is important to ensure for the future that there is no capture of the consultant by Aurizon Network. In this regard, Anglo American believes that the undertaking should require Aurizon Network to place in its Letter of Engagement with the consultant that the consultant must disclose to the QCA and industry any other engagements that company has with Aurizon Network and the global amount paid to the consultant. This would be consistent with the approach of the QCA to its obligations under section 138(2)(h) of the QCA Act to ensure that SUFA is robust, transparent and certain.

In respect of discrimination arising from matters other than asset maintenance, Anglo American notes that the QCA has deferred its consideration of asset discrimination to its broader decision on UT4. Anglo American urges the QCA to ensure that the issue is addressed through the UT4 process and is not lost in the broader and complex issues dealt with under the UT4 decision. In one sense, it could be argued that Aurizon Network has

already attempted to discriminate against SUFA assets by applying the OPRA to SUFA funded assets.

Further, Anglo American continues to maintain its position that SUFA assets should be separately monitored from other parts of the CQCN to ensure that they are treated with at least the same maintenance care and attention that is provided to Aurizon Network-funded assets. Although it is not entirely clear how Aurizon Network intended to apply the 97% threshold to SUFA funded assets, Anglo American opposes the threshold.

10. Tax incentive

Anglo American understands that the QRC will be making a submission in respect of the taxation issues relating to SUFA.