CMT Solutions
20 April 2016

Response to specific points raised by Anglo American

1. *Anglo American has reviewed the findings made by the consultants reviewing the claim on behalf of the QCA and finds it difficult to understand how there are no shortcomings identified in prudency of scope, standard or cost in a total of 84 projects worth in excess of $0.5B.*

The final (published) report illustrates a summary position reached following an extended period of review of the initial draft claim submission put forward by Aurizon Network and, to some extent, conceals the volume of queries raised by the Review Team on each of the projects reviewed.

Questions or concerns regarding each project were put to Aurizon Network via a formal Request for Information process managed by the Review Team and, for selected key projects, site visits were also undertaken.

Although this process clarified many queries there were still some projects where the Review Team held remaining concerns regarding prudency and in these cases further discussion was held with Aurizon to advise them that the value of these projects would not be recommended for inclusion in the RAB.

After these discussions a revised 'formal' claim for a smaller number of projects was submitted by Aurizon the value of which, with one minor deduction, all parties were able to recommend for inclusion in the RAB.

The Review Team's report outlines the risk based approach taken to the assessment and the way in which projects were scored using this approach (refer Section 3.4 and Table 3). As is shown in Table 3 it is possible for a project to be considered prudent overall even when shortcomings have been identified, as is the case with a number of the projects contained within the review sample. As the logic behind the allocated scores and recommendation of prudency is shown on the individual project review forms an additional detailed case by case commentary was not provided within the report.

2 *'Anglo American notes that there are findings made by the consultants in relation to issues identified in Section 5.4.2 of the report. However, these do not appear to have any implications for the existing capital expenditure claim and are merely stated as recommendations for the future'*

It is noted that Section 5.4 of the report considers the use of signalling alliances for the execution of projects included in the Aurizon Network FY15 Capital Expenditure claim.

The signal alliances were established by QR, before the disaggregation of the overall business into Queensland Rail and QR National (subsequently Aurizon), to provide expertise and delivery capability not available in-house but required to upgrade the Queensland rail network to accommodate the minerals boom being enjoyed at that time.

It is acknowledged that one of the drawbacks of the alliance delivery model is that outturn costs are typically higher than would be expected from more traditional delivery vehicles, but one of the advantages gained for the higher cost is expedited delivery. Against a backdrop of strong demand for minerals and customer desires for additional capacity the establishment of this delivery model is therefore considered to be prudent.

One of the fundamental principles of the annual capital expenditure review process is that a project should not be proposed for inclusion in the RAB until the project works are commissioned and available for use.

Projects of a sufficient size and value to warrant the use of the signal alliances take many years to plan and complete, with the key decisions about project viability and appropriateness of delivery models being made in the early stages of the project life cycle using the information available to the decision makers at that time. Another key consideration is the need to dovetail delivery with associated project works and customer expectations.

It is noted from the Anglo American submission (page 2), that 'Alliances have been used (with limited pricing proposal requests) without subjecting projects to the competitive tension of either an open tender of wider RFP process', also that 'pressure to reduce pricing has been made evident to Aurizon Network since 2011 by industry'.

For the purposes of the FY15 Capital Expenditure Review the projects where the Alliance delivery model was used form part of the WIRP1 system expansion program which was conceived against the background of a strong minerals market and growing demand for rail services, and for which investment approval was granted in 2011. The WIRP1 rail system expansion was also staged to match the additional port capacity created by the incremental development of the Wiggins Island Coal Export Terminal at the Port of Gladstone.

It is understood that Aurizon Network staff were unable to deliver the expansion workload in addition to business as usual activities such as network maintenance, thereby creating a delivery risk at a time when expeditious system growth to meet the demands of the customer group was a key driver. The signal alliances therefore offered a means for the delivery of additional expansion capacity to meet the needs of Aurizon Network's customers.

It is also acknowledged that in more recent times the market price of coal has declined, causing a number of coal mine expansion projects to be deferred. This, in turn, has led to a reduction in the demand for further railway system expansion projects and an associated change in the nature of the railway engineering market place. That, however, does not change the purpose of the review of the Aurizon Network's FY15 Capital Expenditure claim, which is to determine whether the works can be considered prudent in scope, standard and cost given the information the decision makers had available to them, and the prevailing market conditions, at the time the relevant decisions were being made.

For the WIRP1 program, in the context of the 2011 market place, speed and reliability of delivery were seen as major imperatives. There were still two Aurizon Network based signal alliances in existence, each able to offer known quality of workmanship and ability to deliver within agreed parameters. As such, it is considered prudent to have delivered this work using the alliance model, noting that both alliance organisations were invited to price the works. Thus, while there was a lack of the competitive tension associated with open market tendering, there was still a competitive tension generated by the knowledge shared by all parties that whichever Alliance was the unsuccessful bidder would not have any alternative work and was therefore likely to be wound up.

It should also be noted that in the interim the unsuccessful Synergy Alliance has, indeed, been disbanded due to lack of work.

The Review Team therefore stands by its original findings that use of the alliancing model in this instance was prudent given the market conditions early in the project lifecycle, but that with the changing market conditions seen since that time other delivery models would be more appropriate for future works.

3 ‘The report does not show any cost benchmarking of different elements of projects against other similar organisations, e.g. ARTC. Without this information there is no assurance that the costs are prudent or reasonable.’

The Review Team is only able to review the information made available for that purpose by Aurizon Network. During the review period a Request for Information process was established and maintained to seek further information from Aurizon Network where this was considered necessary by the Review Team. Where appropriate the Review Team also undertook site visits to gain an understanding of the unique features of each project location.

As a result of this comprehensive process the Review Team was able to form a considered view regarding the prudency of each project. Where it was possible, from the level of information provided, to benchmark individual elements of a project this was done. Where the supplied information did not facilitate this, the Review Team used its professional judgement and knowledge of the wider Australian and international railway industry to satisfy itself that the scope, standard of cost of each project was prudent.

The Review Team therefore believes that the application of its industry knowledge and professional judgement provides the necessary assurance that Aurizon Network’s costs are both prudent and reasonable given the market conditions prevailing at the time of the works.

4 ‘There is little discussion regarding prudency of a project’s scope being tested by consideration of alternative scopes or alternate project delivery. This contemplation is usually undertaken at the project stage gate process and it is expected that this would be part of the auditable process.’

Review of a project’s scope and any alternatives considered during the development phase certainly does form part of the auditable process and is covered by the questions contained on the review form completed during the consideration of each project, with queries arising being managed via the RFI process. Depending upon the result of these queries and its opinion regarding the prudency of the definition of a project’s scope, consideration of alternatives, etc., the Review Team may, or may not, feel it necessary to amplify their views in the text of the final report.

Some works, such as rail or sleeper replacement, use standard type approved components obtained via standing contract arrangements and which are installed using standardised mechanical methods. In such cases it is beyond the remit of the Review Team to audit Aurizon Network’s asset maintenance records and the proposed volume of work is accepted as being appropriate.

For other low value and/or low risk non-major projects where there may be compatibility issues between different types of equipment the options considered by Aurizon Network are thoroughly reviewed when considering the overall prudency of the work, and pertinent comments entered on the relevant project review form(s).

In other cases a particular project may have been considered in some depth in a previous year's submission. Where this is the case the Review Team will satisfy itself of the ongoing prudency of the project works but will not re-cover areas previously considered to have been prudent. The exception to this is where there seems to have been significant additional expenditure incurred by the project or concerns have been raised for other reasons.

Where a project under consideration is of a high value or high risk a great deal of consideration was given to the issue raised above and whether the final project scopes and work delivery methods were indeed prudent in the contemporary market context. In the case of the Rocklands – Stanwell duplications, for example, the Review Team raised a number of concerns regarding the project scope chosen and the phasing of this scope within two separate segments of the overall WIRP project. Further, as only the first of these segments was presented as part of the FY15 Capital Expenditure claim, the Review Team experienced difficulties gaining access to all of what it considered to be the relevant information providing the necessary justification for Aurizon Network's actions. To resolve these issues, Aurizon Network organised a briefing session to enable the Review Team to access information deemed to be confidential. A commentary outlining the situation can be found on page 38 of the report.

5 *The report tends to contradict itself. For example, the claim for $162.4M for the Blackwater duplications at page 3 (M2) of Appendix 3 details that there was no written Project Plan for these works provided to the consultant for review. However, the main body of the report at page 38 states that a Project Plan was provided.*

It is noted that passages of the report may appear contradictory. By way of clarification for the example cited above a written Project Plan was not received within the information provided for review. Notwithstanding this some additional information was made available during the review process, both verbally and by the sighting of additional documentation during interviews with the relevant Aurizon Network staff which provided the information normally included in the Project Plan and hence satisfied the review team.

6 *There is insufficient information provided within the report and appendices released for comment to provide any meaningful feedback from Stakeholders on possible errors, omissions or suggestions.*

The Review Team's terms of reference cover the assessment of the capital expenditure claim submitted by Aurizon Network. The current reporting format, including a review form for providing comments on each of the projects reviewed, provides significantly more detail than was made public under previous reporting methodologies. It is unfortunate that certain stakeholders believe that the report and appendices are not sufficiently detailed, and this may be something which could be addressed in future years.

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7 The split of Austrak's costs for concrete sleeper supply is unclear between Queensland Rail and Aurizon (refer page 31). This would infer that the costs attributed to the 84 Aurizon projects are not auditable and therefore difficult to justify.

The manner in which Austrak split its costs between Aurizon Network and Queensland Rail is beyond the scope of the Review Team's brief and, it is understood, outside of the terms of the supply contract.

To address the specific comment, however, the supply contract would have been negotiated by QR and novated to Aurizon Network, complete with penalty clauses for early termination. Although the contract as novated may not have provided the best match for the Aurizon Network business model, the key issue here is that the review highlighted that Aurizon Network had undertaken an analysis of their existing terms and approached the market to understand what alternative supply options may be open to them and whether any of these would offer an improved commercial outcome.

While the original contract may not have provided Aurizon Network with an optimised arrangement, breaking the contract at an earlier time is likely to have had significant cost and supply implications, ultimately impacting on Aurizon Network's ability to provide the system safety and reliability expected by their customers.

8 Alliances have been used (with limited pricing proposal requests) without subjecting projects to the competitive tension of either an open tender or wider RFP process. This has most likely led to higher and inefficient pricing for project elements than would otherwise have been achieved, even though pressure to reduce pricing has been made evident to Aurizon since 2011 by industry.

This has been covered above.

9 Some project costs do not leave stakeholders feeling reassured that these are efficient or reasonable costs. For example, the project delivery cost of ~$19M for the Rocklands to Stanwell project seems excessive in relation to the balance of the project elements and costs (refer page 38).

As stated above the costs of each project are considered in the context of the market conditions prevailing at the time key project decisions were made.

The WIRP program is broken down into segments of work, the Blackwater duplications forming Segment 4 of the whole. This segment is then further sub-divided into Segment 4a (Rocklands – Stanwell) and Segment 4b (Dingo – Bluff). The FY15 capital claim only includes Segment 4a, with Segment 4b expected to be included in the FY16 claim. Due to this division and the phased nature of the overall claim Aurizon Network stated that they were unable to release information pertaining to the full duplication works, citing confidentiality concerns and the non-commissioning of Segment 4b at the time of assessment.

Upon first review of Segment 4a the Review Team, similar to Anglo, formed a view that prudency of the Rocklands – Stanwell duplications work could not be proven, due to the lack of information provided for review, queries over the executed scope and costs which appeared to be higher than industry norms for this type of work.

In a bid to resolve the situation Aurizon Network arranged for the Review Team to meet key project personnel to review/discuss key documentation which had not been released for consideration by the Review Team due to the confidentiality issues cited above. As a result of this meeting and the information received the Review Team concluded that the Rocklands – Stanwell works were prudent, given the site conditions, and therefore within reasonable industry expectations of cost.

Notwithstanding this, and as noted on the project review form, completion of this work will not create any system capacity until Segment 4b has also been completed.

Consequently the Review Team considered the appropriateness of phasing the works in this manner and concluded that the geographical location of the two segments was such that it would have been uneconomic, and therefore not prudent, to stage the works in such a way that the additional capacity could be made available before both Segments of work had been completed.

Given this, the Review Team also considered whether or not the expenditure on Segment 4a should be recommended for inclusion in the RAB as part of the FY15 claim, or whether this should be deferred until the year in which the Segment 4b expenditure is approved. Upon further consideration of Schedule A of the Access Undertaking, however, the Review Team formed the view that as the Segment 4a works were commissioned and available for use it would not be appropriate to defer inclusion of the project costs into the RAB.