18 March 2011

Mr John Hall
Chief Executive Officer
Queensland Competition Authority
Level 19 12 Creek Street
Brisbane QLD 4000

Dear Sir

QR National Network - 2011 Draft Amending Access Undertaking

1. INTRODUCTION

Thank you for the opportunity for Xstrata Coal Queensland (**Xstrata**) to comment on the Draft Amending Access Undertaking to the QR National Network (**QRNN**) 2010 Access Undertaking (**UT3**) – Implementing the Investment Framework (**2011 DAAU**).

Xstrata wishes to generally endorse the submission provided by the Queensland Resources Council (QRC) (and the accounting and tax expert reports that accompany the submission) and the submission made on behalf of the Wiggins Island Coal Export Terminal Pty Limited (WICET) users. The reports provide detailed analysis of the key tax and financial issues that are a concern for industry in connection with the 2011 DAUU.

Xstrata also draws the QCA's attention to the information previously provided to the QCA on behalf of the WICET Stage 1 Users (of which Xstrata is a participant) which generally support and reinforce the views outlined in the QRC Submission and this submission by Xstrata.

In addition to those submissions, Xstrata wishes to raise a number of specific concerns it has with the 2011 DAUU.

In particular Xstrata considers that:

- *the User Funding model proposed by QRNN does not provide a workable, credible and competitive alternative to situations where QRNN declines to invest or seeks to invest at effective rates of return in excess of the regulatory settlings; and*
- *the processes for triggering and conducting feasibility studies under the 2011 DAUU should be significantly strengthened to enable both a workable User Funding model and efficient investment in coal projects. It is critical that rail infrastructure costs are identified in the studies with as much certainty as the costs of underlying coal projects to allow an informed decision to make a commitment to invest or to contract for access.*

[redacted]

Xstrata Coal Queensland Pty Ltd (ABN 69 098 156 702)
Level 10 Riverside Centre 123 Eagle Street Brisbane Queensland Australia 4000
GPO Box 2587 Brisbane Queensland Australia 4001
Tel +61 7 3115 5300 Fax +61 7 3115 5412 www.xstrata.com

Xstrata's recent experience is that the provisions in UT3 regarding the negotiation framework where QRNN seeks to earn a rate of return in excess of the regulatory return are ineffective and impede User Funding. In this regard we draw the QCA's attention to correspondence provided to the QCA by the WICET Stage 1 users and responses provided by QRNN. This experience highlights the absolute imperative for a competitive and credible User Funding framework that is based on an ability to source competitive third party finance and a risk position for User Funders that is commensurate with QRNN's position as an investor given both will earn the same regulated return. Xstrata believes that the User Funding framework presented by QRNN does not meet the requirements of Schedule J and fundamentally, it is not viable in terms of attracting competitive financing and presents an unacceptable risk profile for coal producer boards.

This submission is provided in the context of the announcement by the Queensland Competition Authority (**QCA**) that:

(a) the 2011 DAAU does not fully implement the principles set out in Schedule J of UT3; and

(b) at least certain of QRRN's departures from the principles were intentional,

and as a consequence, the QCA intends to exercise its rights under clause 7.6(b) of UT3 to develop its own Standard User Funding Agreement and User funding amendments. Xstrata commends the QCA on this decision as facilitating a constructive way forward for the Queensland coal industry to develop major rail infrastructure in Queensland. Xstrata is willing to work constructively with the QCA and other industry participants in relation to that process.

2. USER FUNDING FRAMEWORK

Xstrata believes the following principles must be key features of a User Funding framework/standard agreement and that delivery of these is entirely consistent with the Schedule J principles:

(a) **Tax Effective & Efficient**: the structure of the arrangements must be such that the effective after tax (and after tax indemnity) cost of the User Funded investment is not a deterrent to User Funding. Xstrata supports the Direct Construction Contract model and, given that the most efficient tax structure may change over time, Xstrata believes that the 2011 DAAU and the Standard User Funding Agreements should include an obligation on QRNN to negotiate in good faith in relation to working with the QCA and industry to adopt an optimal structure from time to time;

(b) **Security of Cashflows:** the long term returns to the User Funders must be secure (or at least as secure as they are to QRNN's investors) and QRNN should not be in a position to benefit (directly or indirectly) from User Funded investments. User Funders should not be put at risk of paying for their investment in an Extension/Expansion twice in the event of an insolvency event within QR National.

(c) **Ability to Manage Expansion Delivery Risk:** the requirement that QRNN must construct Expansions exposes User Funders to the perverse outcome that they must incentivise QRNN to manage construction without any ability to ensure that the incentive matches the risks that would typically be accepted by industry participants performing such roles. Moreover, unless the cost of that incentive is included in the RAB User Funding will be less attractive to industry than Access Conditions.

Xstrata favours an approach under which:

- QRNN accepts a reasonable level of risk for managing the project delivery (for reasonable charge out rates and margins);
- an Independent Engineer is appointed to assess claims under the construction contract(s);
- User Funders (and QRNN where the expansion is jointly funded by QRNN/User Funders) have rights to make representations to the Independent Engineer and joint dispute resolution processes apply; and
- where QRNN's performance as construction manager is not acceptable, the User Funders have the ability to step in and appoint an alternative construction manager (subject to specific rights retained by QRNN related to safety and operational integrity of the network).

(d) **Effective Hybrid Funding**: The User Funder model can co-exist with QRNN funding part of an Expansion in a manner that does not subordinate the User Funders or expose them to any greater level of risk (from a whole of life of project perspective) than the QRNN funded portion of the Expansion. In this regard, Xstrata favours an approach whereby jointly funded Expansions must be undertaken via QRNN entering into the same project delivery and contracting structure as the User Funders (ie QRNN must enter into a Participation Agreement and joint Construction Agreement in the same way the User Funder)

3. THE PROCESSES FOR FEASIBILITY STUDIES FOR PROJECTS SHOULD TO BE STRENGTHENED

The ability to manage Expansion delivery risk (and obtain competitive funding) relies on a robust feasibility study process. The QRNN proposed process for undertaking feasibility studies should be significantly strengthened to ensure that industry is given certainty around the scope, cost and timeframes of the study and the capital cost, schedule and project delivery risks for Expansions are adequately developed before funding commitments are required to be made for construction.

QRNN must be required to complete feasibility studies to industry accepted norms (ie "bankable feasibility study") and adopt competitive procurement processes (that provide an effective risk allocation between the parties) for the construction of the Extensions. These activities must be completed by the time the User Funding agreements need to be entered into to ensure User Funders have certainty as to funding and project costs requirements. Xstrata supports "user funded" feasibility studies undertaken by and in collaboration with QRNN as a means of ensuring these objectives can be met. However, the funding of feasibility studies should not lock producers into User Funding the actual investment.

Whether rail infrastructure developments are to be User Funded or QRNN funded, a number of key issues need to be included in the feasibility study process:

- QRNN should be required to undertake feasibility studies if Users agree to fund the cost of the studies. The scope of the study and the timeframes for completion of the study need to stipulated to avoid delay;
- the feasibility study must include a clear scope of work and deliverables by QRNN;

- there should be clear timeframes for completion of each stage of the study (concept, pre feasibility and feasibility);

- decision points at each stage whereby the study funder(s) can opt out or elect to continue funding the next stage;

- QRNN must be obliged to cooperate with the relevant port and users/potential users to ensure feasibility studies are completed at least 3 months prior to the time port users are required to make any contractual commitments to the port in order to ensure time to arrange finance/approvals for the rail component;

- the feasibility study must be informed by system assumptions and system wide modelling for the coal chain to avoid over contracting and the risk that User Funders pay for an asset that they are unable to fully utilise if there is capacity shortfall.

Appendix 1 sets out Xstrata's concerns with the QRNN 2011 DAUU in more detail. We look forward to working with the QCA and other stakeholders in ensuring that these critical elements of UT3 are addressed in a manner that facilitates and realises the benefits from the ongoing expansion of the coal industry in Queensland.

Yours sincerely

[redacted]

Reinhold Schmidt
Chief Operating Officer
Xstrata Coal Queensland

Appendix 1

1. USER FUNDING – KEY CONCERNS

QRRN has proposed a User Funding model under its 2011 DAUU and the draft User Funding — Participation Agreement and User Funding — Construction Agreement which has a number of fundamental deficiencies. Xstrata considers QRNN's proposal to be uncommercial and ultimately unfundable (via third party funding either directly with such funders or by way of users seeking to securitise the agreement in order to finance their own commitments). In addition it is unlikely that the boards of coal producers would regard the risks under the Standard User Funding Agreements as acceptable. The key areas of concern are:

- **Taxation risk** – the tax risk to Users who are funding construction costs of rail infrastructure and the fact that QRNN is demanding a full tax indemnity from the Funding Users.

- **Security of Funds** – the differences in financial security available to QRNN equity, QRNN lenders and User Funders (and their third party investors or debt providers) and the unnecessary exposure of the User Funders to unsecured credit risk of QRRN for the returns generated (including reimbursement of amounts paid by the User Funders in standard access charges) from the User Funder's capital expenditure. QRNN stands to benefit from User Funded investments while User Funders notionally receive the same returns as QRNN investors (ie regulated tariffs) but User Funders must accept a substantially increased risk without any of the usual forms of protection that lenders/funders enjoy.

- **Procurement and construction risk** – the QRNN model does not provide adequate control and security for User Funders to ensure the timely and efficient delivery of track infrastructure. Given this lack of control, the QRNN model creates unnecessary risk in securing internal and external approvals and therefore funding.

- **Restrictions on sources of capital** –the presumption that all User Funder financing will be provided initially as corporate funding is too inflexible and inconsistent with Schedule J. It fails to consider that User Funders should have the right to seek the most efficient sources of capital to fund the upgrades including third party capital.

- **Inequitable pricing principles** – the proposed changes relating to Reference Tariffs for services that utilise Expansion capacity result in an inequitable allocation between existing users and new users due to the degree and scope of socialisation of incremental costs.

A. Taxation risk

QRNN expects User Funders to accept all taxation risk with respect to a User Funded extension. Taxation risk primarily arises due to the payment of the construction costs by the user to QRRN who will then incur construction costs in building the network. It appears likely (and we understand that the QCA has been separately provided with expert taxation advice) that the payments for construction from the User Funder would be treated as ordinary income in QRNN 's hands. This creates a risk that the construction costs for an Expansion will not be immediately deductible to QRRN as they are likely to be considered to be capital or capital in nature.

QRNN's position is that if the costs of construction are not immediately deductible to QRNN, the User Funder is to bear this risk and QRRN would be compensated under a tax indemnity, the result of which would be a 'grossing up' of the cost of the works so as to leave QRNN in no worse off position on an after tax basis. This would likely result in all up cost of a User Funded model project being commercially unacceptable and almost certainly significantly more costly than Access Conditions.

Xstrata is of the view that the proposed QRNN structure does not appropriately and commercially deal with the taxation risk element. If the taxation risk is not mitigated then User Funding is not a viable alternative. Xstrata considers that alternate structures should be considered in order to mitigate the taxation risk.

Solution – User Funders' direct engagement of contractors

Funding parties (either User Funder(s) on their own or User Funders and QRNN if hybrid funding is used) to directly engage the contractors as principal(s) under the construction agreements. QRNN would be appointed as a construction manager to manage the construction process for a performance based fee (subject to step in rights for non performance and oversight by an Independent Engineer).

Given the potential for changes to taxation and contemporary financing practices, we believe that while the above solution may be optimal now it may not be the best structure through time. Accordingly the 2011 DAUU should include a good faith obligation for QRNN to negotiate structures that enable efficient and effective tax structures.

QRNN should also be obliged to collaborate with User Funders to develop submissions for tax rulings where required. This process must be advanced in a timely manner.

Direct engagement of contractors by the User Funders or User Funders and QRNN (in the case of hybrid funding) deals with the taxation risks between QRNN and User Funders and also serves to allocate construction risk (see our comments below). The structure would allow QRNN to manage the construction on behalf of the User Funders but under a clear framework where the User Funders retain a level of control/decision making and can step in and replace QRNN if it is not performing. As part of the structure, an independent engineer role should be included to confirm payments and variation certifications in respect of the construction works.

In addition, to ensure the best tax outcome is achieved, Xstrata considers that the Access Undertaking should include a specific requirement that QRRN is obliged to act in good faith in negotiations with User Funders to find the most tax effective and tax efficient structure.

B. Security of funds

Xstrata is concerned that there is insufficient recognition of the risks that User Funders face through the interaction of the funding regime and the other financing arrangements which may be entered into by QRNN. Under QRNN's proposed User Funding framework, the User Funding – Participation Agreement and User Funding – Construction Agreement does not provide sufficient security over the User Funded assets or the revenue generated by these assets.

The QRNN model anticipates that the only form of security available to Users and the only basis to guarantee access to the underlying assets for future use, is in respect of the rights under the User Funding – Participation Agreement. There is no security available against the underlying assets or any other form of security that is standard for third party funding providers for project finance developments to cover QRNN's liability to pay the share of revenue to User Funders if QRNN becomes insolvent. Moreover, there is no clear understanding for User Funders (or their third party financiers) as to the commitments that QRRN has under its debt arrangements or any cross-guarantees with the rest of the QRRN group, making it uncertain as to what other security priorities may be in existence.

Solution – Access charges to be segregated and charged in favour of User Funders

Access charge revenues from the User Funded Extensions (less operation and maintenance amounts) to be placed into an escrow account. Where the allocation methodology is a share of the System Allowable Revenue, the full revenue from the system should be placed into the escrow account and the User Funder share and QRNN share then transferred out on a pre-agreed ratio. In addition, a range of security measures must be put in place (such as charges) over the payments due under the Access Agreements, User Funding — Participation Agreement, the part of the rail infrastructure that has been User Funded and any interest accrued in the escrow account.

Xstrata proposes that:

(a) The cash flows from all Access Agreements that give rise to the pool of System Allowable Revenue from which a User Funder is entitled to an amount in respect of a relevant Expansion should be placed in an escrow or trust account with fixed proportional distribution to QRNN and the User Funders. The proportional share of revenues under all Access Agreements (User Funded or non User Funded) should be secured in favour of the User Funder under the User Funding — Participation Agreement. The User Funder — Participation Agreement should provide that such cash flows are not subject to any security in favour of any other provider of finance to QRNN or the QR Group, and that the cash flows should be segregated into the separate escrow account which is only utilised for the collection of such sums, and the payment to QRNN of its operating and maintenance charges, its share of System Allowable Revenue and to the User Funder of their share under the User Funding — Participation Agreement.

(b) QRNN should be obliged to ensure that any other person which holds any security over part of the network which is used to provide the capacity funded under the User Funding — Construction Agreement should enter into customary and commercial agreements with the User Funder to govern what would occur upon the enforcement of any such security, including provisions that:

    (i) the User Funding — Construction Agreement will survive any receivership of QRNN and if the network is sold by a receiver then the User Funding — Construction Agreement will be novated to the new owner of the network assets (along with the tripartite arrangements with the new financiers of the network assets);

    (ii) the capacity which is funded under the User Funding — Construction Agreement must continue to be operated and made available to Access Holders on the same basis as capacity which is not funded that way, to ensure that payments from the Access Holders who utilise that infrastructure continue to be made for the benefit of the funder under the User Funding — Construction Agreement; and

    (iii) the rights to a "rebate" under the User Funding — Participation Agreement will take priority to any other security over any payments made in respect of the capacity to which the User Funding — Participation Agreement applies.

C. Procurement and construction risk

Under the proposed User Funding — Construction Agreement, QRNN controls all aspects of construction including timing and costs. This effectively passes on any risks that QRNN would ordinarily bear during the construction phase to User Funders without providing any control over the management of these risks to User Funders. There is a misplacement of economic risks which rewards inefficient use of scarce resources. In an environment where there will be high demand for labour and materials, this approach is inflating and will lead to over time and over budget projects.

Xstrata's concerns are that:

- Investors or lenders, or corporate boards will not (or at the very least be highly unlikely to) advance funds against an open cheque book for a construction project (including alliance-style contracts).

- User Funders should not be in a position where QRNN has limited financial incentive to complete Extensions on time and within the projected budget (or to having to pay QRNN a non market competitive premium in order for QRNN to be so incentivised, as provided in the amendments to the User Funding Agreements).

- Corporate (ie User Funder) or third party debt and equity will require sufficient control of the construction process to have the confidence that the projects can be completed and start to generate the expected revenues before advancing any funding. This will include satisfaction of the construction entity itself and will also require standard financial penalty structures that incentivise the key contractors to complete on time and in budget and permit the User Funders to access liquidated damages that would typically be available from contractors (as QRNN would suffer no loss under its arrangements with the contractor if the extension were all User Funded).

Solution – Standard Feasibility Study Agreement & Steering Committee

A number of key control mechanisms to be included in a Standard Feasibility Study Agreement to ensure User Funders have adequate approval rights under a project Steering Committee for procurement and packaging recommendations, contractor selection and key construction contract terms.

Solution – Control mechanisms for project construction to be included for User Funders

The User Funding — Construction Agreement should also include mechanisms to ensure User Funders have adequate approval rights for variations and claims, inclusion of an Independent Engineer to verify key elements of construction, step-in rights to the Construction Management Agreement if there are delivery problems, and rights to liquidated damages and security arrangements over the rail infrastructure.

Xstrata considers it is necessary to have:

- Access Seeker sign-off and approval of scope and cost estimates and a competitive contractor selection as part of the procurement process regardless of whether a decision to User Fund the actual expansion has been made;

- A project control group/steering committee under which feasibility study funders have decision rights in the management of the feasibility study and key decisions based on recommendations from QRNN;

- A project control group/steering committee under which User Funders and/or financiers have decision rights in the management of the construction project;

- Inclusion of an independent engineer to verify to certify key elements of the construction contract (including payment and variation certifications);

- Step-in rights that permit User Funders to take control of the construction process if there are substantial problems;

- Disputes would need to be resolved in a manner that is consistent across contracts with the decision binding on User Funders, QRNN and contractors; and

- Liquidated damages and bonding in the contracts with provisions that allow the User Funder to access these security elements.

These types of arrangements would be contained in a Feasibility Study Agreement in respect of pre-commitment decisions and, once a decision to User Fund an Expansion has been made, the User Funding — Construction Agreement or a tri-partite deed between QRNN, the User Funder and the contractors would be in place to govern the rights and obligations of each of the parties.

Additionally, Xstrata notes that QRNN is seeking an incentive fee payment of up to 8% of target cost in the User Funding — Construction Agreement to incentivise QRNN to reduce costs or otherwise improve productivity. QRNN states that the construction incentive fee is intended to effect an alignment of the economic interests of the User Funders and QRNN. Xstrata considers this notion is rendered useless where QRNN is seeking to avoid any standard penalty provisions that would be applicable in construction management agreements (eg EPCM contracts) and are also intended to align economic interests of the funding and construction positions. Xstrata considers that any fees User Funders may need to pay QRNN to incentivise them to manage the construction should not be open to exploitation by QRNN and should be subject to standard penalty provisions for rail infrastructure construction management contracts. The most appropriate approach it to replicate EPC-style rights typical in infrastructure construction projects.

D. Restrictions on sources of capital

Xstrata is concerned that the funding process is insufficiently flexible as to the identity of the funder. The QRNN model is predicated on QRNN having no involvement in any funding arrangements that User Funders put in place. This is an unnecessary restriction on the ability of User Funders to source funding on commercially acceptable terms and at competitive rates.

Solution – Access Undertaking to allow a range of funding options

Access Undertaking should make it clear that User Funders are able to utilise the most appropriate for of funding (subject to appropriate protection of QRNN's interests) and include an obligation on QRNN to implement reasonable changes to the User Funding arrangements to enable User funders to utilise the preferred sources of capital.

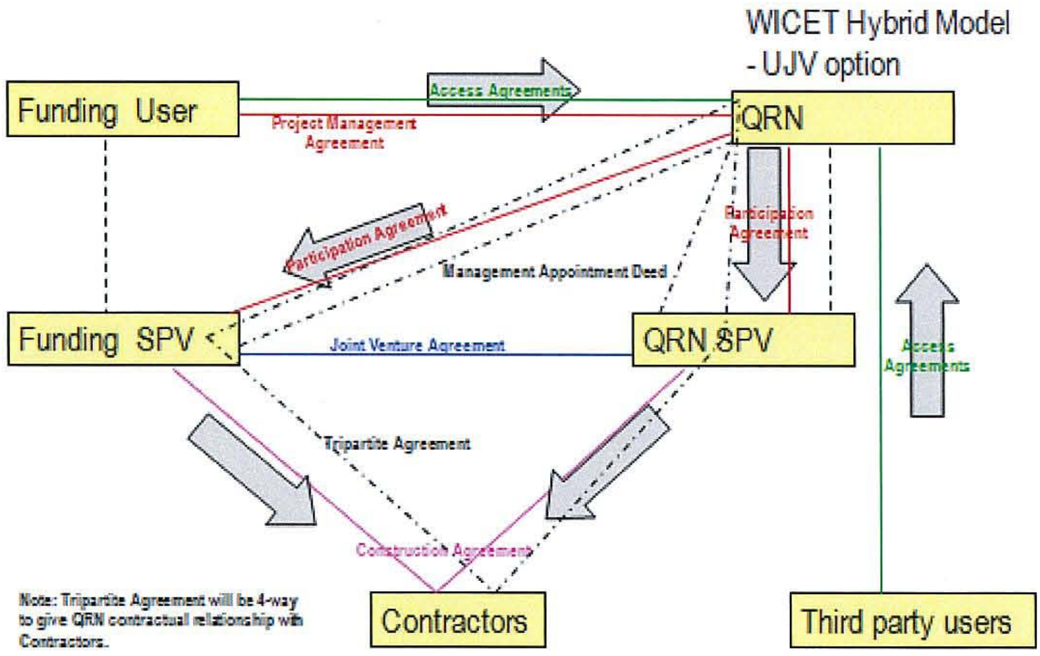
A viable User Funding model should allow flexibility for User Funders to determine the most appropriate and efficient capital structure rather than being required to work within a model that proscribes how User Funders should allocate capital. Whether this is corporate style debt or project finance debt, User Funder equity or third party equity, or a hybrid funding arrangement with QRNN it should be a decision for individual User Funders based on their preferred capital structure. QRRN should be indifferent as to whether it deals with User Funders or third party financiers (or a combination) in Expansions.

2. AN ALTERNATIVE USER FUNDING MODEL

Industry has been considering a number of alternate User Funding models to that proposed by QRRN, ranging from seeking State involvement to alter the lease arrangements held by QRRN to facilitate workable tax outcomes to requiring QRRN and its secured lenders to provide full recourse security rights to User Funders in respect of Expansions. These options (and others) need to be carefully considered to ensure that the User Funding model can be what it is intended to be – a genuine prompt for industry to develop rail infrastructure to meet industry driven needs where QRNN seeks to extract monopoly rents or refuses to undertake Expansions.

An alternate model that Xstrata considers is capable of achieving this aim involves a structure which facilitates direct funding with construction contractors and is intended to operate to ensure that User Funders are on an equal footing with QRRN in terms of project control, security rights and returns. This approach can be achieved through a number of structures. Where User Funding is the only source of funding, contractual arrangements between User Funders, QRNN and relevant third parties (construction contractors and/or third party financiers) can be entered into to address tax risks, security risks and constructions risks. Alternatively, Expansions that are jointly funded by User Funders and QRNN could be structured with an SPV or unincorporated joint venture to more easily fund the Expansions and to contract with third parties in order to address taxation risks and a number of the financial security and project control concerns identified above. The basic structure can be developed depending on the specific requirements of the Expansion project and the needs of funders.

Xstrata favours the following structure for hybrid funding (ie QRNN and User Funders):



3. THE PROCESSES FOR TRIGGERING FEASIBILITY STUDIES UNDER THE 2011 DAAU SHOULD BE STRENGTHENED

There is a risk that the processes in the 2011 DAAU for triggering and conducting feasibility studies enable QRNN to delay and frustrate the expansion process, both under a User Funding model or where QRNN would fund an expansion. This is a key area of concern for Xstrata. It is essential that, regardless of whether an expansion is to be User Funded or funded by QRNN, the scope, capital cost schedule and project delivery risks of an expansion are adequately identified and developed at the time at which Access Seekers are required to enter into either a User Funding Agreement or an Access Conditions Agreement with QRNN. The QCA should be mindful that there will always be information asymmetries that practically prevent Users from undertaking a feasibility study. Hence, there is a need for greater obligations and regulation to be imposed on QRNN in this area.

Xstrata's specific concerns and proposed solutions are provided below.

(a) **A decision by Users to user fund a feasibility study should not create a commitment by the User to participate in user funding of the actual construction of the expansion.** As currently drafted, there is a risk that the 2011 DAAU could be interpreted to combine a decision by Users to fund a feasibility study with a commitment to proceed with a User Funded expansion. This is not appropriate, nor was it the intention of Part 7.5 of the 2011 DAAU. A decision by Users to user fund an expansion should only be made at the conclusion of the Feasibility Study. The final scope of the expansion should be determined by the actual users that wish to proceed with obtaining access rights, which may not be all of the parties that fund a feasibility study.

(b) **Feasibility studies must be bankable.** Whether an expansion is User Funded via corporate debt or third party funding sources it is critical that a 'bankable' feasibility study is complete at the point at which the User Funding Agreement is entered into. To achieve this QRNN should be obliged to undertaking feasibility studies 'to an industry standard' or 'good industry practice' with specified deliverables for each stage of planning based on industry standards. In this regard Xstrata provides the following as indicative standards required at each stage of the study:

	Study Phase				
	Conceptual		Pre-feasibility	Feasibility	Execution
	Concept	Order of magnitude			
Estimate class	5	4	3	2	1
	Capacity factor estimate	Equipment factor estimate	Semi-detailed estimate	Detailed estimate	Definitive estimate
	± 30% to 100%	± 30% to 35%	± 20% to 25%	± 10% to 15%	± 5% to 10%
Expected contingency range	25% - 40%	20% - 30%	15% - 20%	10% - 15%	5% - 10%
% of total engineering at each phase	0% to 2%	1% to 5%	10% to 30%	30% to 70%	70% to 100%
Engineering Tasks					
General					
Project scope	General	General	Defined	Defined	Defined
WBS	Outline	Outlined	Preliminary	Complete	Complete
Technology selection	Industry typical option	Industry typical option	Selected project specific options	Complete	Complete
Operating & control plan	None	None	Outlined	Detailed	Complete
Design criteria	Outlined	Outlined	Preliminary	Optimised and Final	Complete

	Study Phase				
	Conceptual		Pre-feasibility	Feasibility	Execution
	Concept	Order of magnitude			
Estimate class	5	4	3	2	1
Volumetric capacities	None	None	Preliminary	Detailed	Detailed
Location Constraints	General considerations of topography, access, elevation, climate, etc.	General considerations of topography, access, elevation, climate, etc.	Consideration of location constraints for each selected option - build into design options.	Detailed design of areas impacted by location (e.g. power lines, access routes, flood protection).	
Interfacing Projects	Only consider if serious risk of conflicting interest.	Identify any potential opportunities or conflicts of interest.	Consider impact of project on other projects in the area and potential benefits of shared infrastructure, etc.	Possibility for agreements on shared facilities, access rights, water/power sharing, etc.	
Project Considerations	Define scope for order of magnitude study.	Define scope for pre-feasibility study.	Define scope for feasibility study.	Define EPCM scope and select owner's team and contractors.	
Design Considerations	No design work Site visit Where necessary	Simple designs, organisation of layouts, etc. Identify significant items which may involve complex technology, advanced design or research.	Initial site layouts. Designs developed in response to, power requirements.	Detailed layouts.	
Engineering Effort	No engineering	No engineering	Basic drawings with all major components, to scale but with limited detail.	Preliminary detailed drawings.	
Civil					
Civil and Earthworks Specs	None	None	Preliminary	Detailed	Complete
Structural					
Structural Specs	None	None	Preliminary	Detailed	Complete
Mechanical					
Mechanical Datasheets & Specs	None	Preliminary (major items)	Preliminary List	Preliminary/ Detailed	Purchase orders
Electrical & Signalling					
Electrical Datasheets & Specs	None	None	Preliminary	Detailed	Complete
Health safety & Environmental					
Identification of air, water, solid, noise, visual impacts	Screening	Screening	Detailed	Detailed	Complete
Statutory requirements	Screening	Screening	Detailed	Detailed	Complete
Permitting	Screening	Screening	Detailed	Detailed	Complete
Design	None	None	Conceptual	Detailed	Complete
HAZOP	None	None	Fatal flaw analysis	Preliminary, Detailed by area	Complete
Drafting Tasks					
Overall site plan	Assumed	Sketched	Preliminary	Detailed	Complete
Plot plans	None	None	Preliminary	Detailed	Complete
Ground contours	None	None	Preliminary	Final Arrangement	Complete

	Study Phase				
	Conceptual		Pre-feasibility	Feasibility	Execution
	Concept	Order of magnitude			
Estimate class	5	4	3	2	1
Civil Drawings	None	None	None	Preliminary/ Detailed	Complete
Structural Drawings	None	None	None	Preliminary/ Detailed	Complete
Mechanical Drawings	None	None	Preliminary	Approved for Design	Complete
Single Line Diagram	None	None	Preliminary	Preliminary/ Detailed	Complete
Electrical Drawings	None	None	None	Preliminary/ Detailed	Complete
Signalling & Telecommunications Drawings	None	None	None	Preliminary/ Detailed	Complete
Cost Estimation					
Contracting strategy	Assumed	Assumed	Preliminary	Defined	Complete
Earthworks/Civil/Structural Bulk pricing	None	None	Preliminary	Vendor Budgetary	Vendor bids/PO's/Tenders
Mechanical Pricing	None	Vendor budgetary	Vendor budgetary	Vendor Bids	Complete
Electrical Pricing	None	None	Preliminary	Vendor Budgetary	Vendor bids/PO's/Tenders
Capital Costs	Estimated capital costs from similar types/sizes of projects.	Apply lump sum capital cost estimates based on similar situations modified for location etc.	Preliminary capital cost estimates by cost centre. Cost alternative options and resolve recommendations.	Detailed capital cost estimates to confidences limits prescribed by working practices based on supplier quotes for major items/areas.	
Project Management					
Contractor selection	None	None	Identified	Selection for packages	Detailed
Schedule	Outlined	Outlined	Preliminary	Detailed	Actual to date & detailed to go

Various industry bodies and engineering services firms have guidelines on the level of engineering effort required at each stage of a project. It is recommended that the Standard Feasibility Study Agreement for a project contain pre-agreed minimum scope definitions for each phase but that participants in the study group be able to agree variations to the scope (based on stipulated timeframes to ensure resolution of study agreements does not become protracted and frustrated).

Typically and bankable feasibility study is defined as a class 2 estimate.

(c) **The 2011 DAAU should provide for QRNN and Funding Users to enter into Feasibility Study Agreements.** QRNN and Funding Users (which may not be User Funders at this point) should enter into Feasibility Study Agreements. This would have the function of protecting QRNN from exposure to spurious requests to undertaking feasibility studies and to provide Funding Users with certainty of the quality of the study, cost of the study and completion of the study by agreed timeframes, in return for funding the studies.

> ***Solution - The Feasibility Study Agreement should include:***
>
> - *A clear scope of work and deliverables by QRNN, including that the scope of a feasibility study will be referable to whole of coal chain capacity modelling;*
> - *A timeframe for completion of each stage of the study (concept, pre feasibility and feasibility)*
> - *Decision points at each stage whereby the study funder(s) can opt out or elect to continue funding the next stage*
> - *Shared intellectual property rights arising from the feasibility study*
> - *Joint feasibility study stewardship via a steering committee/project control group which would make decisions at each stage based on recommendations prepared by and justified by QRNN*
> - *A requirement that the feasibility study complies with generally accepted industry standards*

(d) ***The 2011 DAAU should provide clear t*****imeframes for agreement on the scope of a feasibility study.** The 2011 DAAU should ensure that the process to reach agreement on the scope of a Feasibility Study cannot be permitted to be held up by either QRNN or other potential Access Seekers. There needs to be specific timeframes stipulated by which the scope and agreement must be collectively agreed (assuming more than one interested access seeker).

(e) **The triggers for feasibility studies under the Expansion Process in the Undertaking should provide for co-ordination within the context of feasibility for the remainder of the coal chain.** There is a need for any feasibility studies conducted under the 2011 DAAU to take into account the interaction of projects with other elements of the coal chain. Feasibility studies should be informed by system assumptions and system wide modelling to avoid over contracting and the risk of User Funders paying for an asset where they are unable to obtain full access rights if there is a capacity shortfall.

(f) **The 2011 DAAU should require any feasibility study to be completed at least 3 months prior to any mine/port expansion commitment date.** Where a port expansion or new port triggers the need for an expansion of the QRNN network, it is necessary that the 2011 DAAU require QRNN to co-operate with the relevant port users or potential users to ensure that any feasibility study is completed at least 3 months before users are required to decide to commit to a port expansion project, so as to ensure time to arrange necessary finance and approvals for the rail component. The Undertaking should create a framework around the timely completion of any feasibility study to ensure that Access Seekers then have an ability to negotiate both Access Conditions and User Funding.

In addition to the above comments, Xstrata provides the following specific comments on the 2011 DAUU:

(g) **Clause 7.5.2(a) is inadequate.** Clause 7.5.2(a) currently provides that where the need for an Expansion is *reasonably anticipated*, QRNN must undertake the necessary scoping and planning studies. The term 'reasonably anticipated' is unclear in this context and Xstrata submits the clause should be amended to state that where increased Capacity is reasonably required by an Access Holder or Access Seeker (or their customers), QRNN must carry out pre-feasibility studies with a view to determining the smallest efficient Extension of the Rail Infrastructure, but still subject to the costs of the studies being met in accordance with clause 7.5.2(f).

(h) **The interaction between clause 7.5.2(a) and 7.5.2(b) is unclear and the provisions should be strengthened to ensure that QRNN cannot delay a feasibility study on the basis that demand for Planned Capacity is unknown.** Xstrata raised its concerns in its 30 September 2010 submission in relation to the interaction of paragraph 49 and 47 of the Investment Framework in Schedule J. These concerns continue where paragraphs 49 and 47 have been incorporated into clauses 7.5.2(a) and (b) of the 2011 DAAU. Xstrata's key concerns are:

   (i) It appears that clause 7.5.2(a) should operate whether or not an Extension Process has been commenced in accordance with clause 7.5.2(b). However, given clause 7.5.2(a) is part of the Expansion Process triggered under clause 7.5.2(b), this is not clear.

   (ii) Clause 7.5.2(b)(iv) envisages that QRNN is obliged to commence an expansion process by issuing a request for proposal where it has received Access Applications which would utilise in excess of 70% of the Planned Capacity to be created by an Expansion. The Planned Capacity will not be known until after the completion of a pre-feasibility and feasibility study process. For this to be workable, and not circular, the 2011 DAAU must require the necessary scoping and planning studies to occur under clause 7.5.2(a). However, this is not clear as the 2011 DAAU is currently framed. The current drafting crates a risk that QRNN will be able to delay or refuse to undertake a feasibility study.

4. INEQUITABLE PRICING PRINCIPLES

Xstrata is concerned with the potential impact of QRNN's proposed approach to new Reference Tariffs and the varying of existing Reference Tariffs under the 2011 DAUU. Xstrata endorses the comments made in relation to pricing matters in the submission provided by the QRC and supports the further investigation of the issues that arise in respect of Reference Tariffs, including pricing for Expansions and providing further clarity and boundaries on the degree of socialisation for Users as part of the Access Undertaking.

5. WICET STAGE 1 RAIL PROJECT

5.1 WICET User Funding – A Test Case

Xstrata considers that the WICET Stage 1 rail project that is intended to connect the QRNN rail network to the new industry owned terminal being constructed at Gladstone port should effectively be a case study for the QCA to consider the operation of the User Funding model under the Access Undertaking and the effectiveness of the negotiation framework for Access Conditions.

In respect of User Funding Xstrata considers that the SPV Direct Contracting model proposed by the WICET user group provides a useful model for User Funding – it seeks to give User Funders an effective tax treatment through direct funding by the SPV to third parties such as contractors and to enable control to be shared over the construction process.

The SPV model, however, needs to be adapted to the specific needs of the particular Expansion project – what works for the WICET user group will not necessarily be the most effective approach for a single User Funder elsewhere. The QCA should seek to ensure that there is sufficient flexibility in the User Funding model to allow different structures to be employed to fit the needs of the User Funders involved.

5.2 Xstrata's Concerns Regarding QRNN's Approach to the WICET Test Case

The QCA has received correspondence from the WICET user group and is aware of the problems that have arisen with the WICET user group's negotiations with QRNN in relation to negotiations for the WICET rail project.

Xstrata is very concerned with the approach taken by QRNN in its dealings with the WICET user group and supports the QCA in its intervention in the negotiation process to ensure that QRNN complies with the requirements of the 2010 Access Undertaking. It is critical that the commitment to construct the rail expansions is synchronised with the commitment to financing and construction of the terminal. The lack of certainty of the WICET rail project and the delays caused by QRNN could potentially cost industry significant losses in lost exports and even jeopardise the progress of the WICET port development.

Xstrata believes that the QCA must use the opportunity presented by the WICET rail project to better understand the needs of industry in terms of commercially viable and tax effective funding arrangements and the need for QRRN to negotiate in good faith to enable User Funding to be a workable alternative to existing process for ensuring the Queensland rail network operates as part of the coal chain. The WICET rail negotiations also provide an opportunity for the QCA to review the effectiveness of the DAUU in implementing fully the intent of Schedule J.

6. REFORM IS NEEDED - RECENT CONDUCT BY QRNN

This submission is made having regard to the background of Xstrata's recent experience with QRNN, primarily:

(a) negotiating with QRNN around Access Conditions and user funding in relation to the Wiggins Island Coal Export Terminal. Through this process it has come to light that the DAAU is flawed if QRNN approach the negotiations in the manner experienced to date. There is a need for significant tightening to provide Users with the protections in respect of negotiation of Access Conditions contemplated under Schedule J and in ensuring there is a genuine alternative to investment by QRNN where QRNN seeks to achieve returns above the regulatory settings or declines to invest;

(b) QRNN's recent approach to the 2010 CRIMP meant that Users had to vote on expansion projects in February 2011 in circumstances where they did not have visibility into up-to-date capacity modelling or up to date system assumptions and where serious doubts exist as to whether the current system can deliver contracted capacity;

(c) Xstrata believes that there must be obligations on QRNN to undertake feasibility studies in a timely manner and to industry standards to allow informed transparent decisions which support significant investment decisions by coal producers in mines (such as Xstrata's proposed Wandoan Coal Project) for which rail infrastructure costs are becoming a significant component ; and

(d) QRNN's over contracting by entering into track access contracts in circumstances where Xstrata believes there could have been no reasonable expectation that those contracts could be fulfilled. At the very least prior to QRNN contracting additional capacity, QRNN under the UT3 should have been under an obligation not to enter into additional contracts until it was confirmed that there was Available Capacity. Xstrata notes that capacity modelling which became available through the

Independent Logistics Centre Pty Limited (**ILC**), of which QRNN is a shareholder, has indicated to us that there is the potential for overcontracting to result in a shortfall of approximately 15 mtpa of available capacity, equalling approximately $7 billion in lost export revenue in Queensland and the loss of actual contracted volume for Users.

Xstrata believes that under UT3 there needs to be clear obligations on QRNN as the party with the knowledge of below rail Actual Capacity to work with industry logistics organisations such as ILC to calculate Actual Capacity before QRNN can issue new contracts.

This recent experience demonstrates that, in its current form, the 2011 DAAU is not working efficiently and does not facilitate the timely delivery of much needed coal chain capacity and access to the rail network.