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16 February 2023

Ms Pam Bains
Group Executive Network
Aurizon Network Pty Ltd
GPO Box 456
Brisbane Qld 4001

Dear Ms Bains

Aurizon Network's Minerva DAAU—final decision

On 16 February 2023, the Queensland Competition Authority (QCA) decided to approve Aurizon Network's draft amending access undertaking relating to the closure of the Minerva mine (the Minerva DAAU), seeking to revise the Blackwater coal system reference tariffs and propose amendments to the undertaking as a consequence of the Minerva mine cessation, having regard to the information Aurizon Network provided, stakeholders' comments the QCA received in response and the relevant provisions in the QCA Act.

This letter and decision notice will be published on the QCA website for stakeholders' information.

Should your staff have any specific queries on the attached decision notice, please direct these in the first instance to George Passmore on (07) 3222 0545, or by email george.passmore@qca.org.au.

Yours sincerely



Charles Millstead
Chief Executive Officer

cc: *Dan Kearney, Head of Finance and Regulation*
Jon Windle, Manager Regulation—Network Finance and Regulation

Queensland Competition Authority

Decision notice

AURIZON NETWORK'S Minerva DAAU—final decision

16 February 2023

The Queensland Competition Authority approved Aurizon Network's Minerva DAAU, under section 142(2) of the *Queensland Competition Authority Act 1997*.

Background

Minerva coal mine is an open-cut mine located in the Bowen Basin. Coal is transported from Minerva to Burngrove, which then connects via the Blackwater main line to the export terminals at Gladstone.

With the closure of the Minerva mine, the line segments in the Blackwater system of the Central Queensland coal network (CQCEN) from Burngrove to Nogo Junction, and from Nogo Junction to Wurba Junction, will cease being used for coal-carrying services.

The closure of the mine has implications for the recovery of the costs associated with the relevant assets, and results in changes to the reference tariffs for the Blackwater system and consequential changes to tariffs for non-coal access holders.

Aurizon Network's proposal

In October 2022, Aurizon Network proposed to amend the 2017 access undertaking (UT5) to reflect its proposed approach to managing the assets that are included in Blackwater pricing but have ceased to be used for coal-carrying services (suspended assets).¹ The amendments include revising the Blackwater system reference tariffs and allowable revenues included in Schedule F (to in effect remove Minerva from UT5), as well adding new clauses to Schedule E, to reflect its proposed approach.

Aurizon Network proposed to suspend the Minerva assets, pending potential mine developments, which Aurizon Network considered unlikely to commence production before 2027. Aurizon Network said it would propose a more detailed assessment of foreseeable demand as part of the upcoming UT6 process.²

In respect of the suspended assets, assessed as having a regulated asset base (RAB) value of \$49.4 million as at 1 July 2022, Aurizon Network proposed³ that:

- (a) the user-funded (mine-specific) assets of \$12.4 million be permanently removed from the RAB as at 1 July 2022

¹ Minerva has stopped raiing and Aurizon Network does not expect other coal-carrying train services will start using that infrastructure in the near future.

² Aurizon Network, *Minerva DAAU Explanatory Notes*, September 2022, p. 6.

³ Aurizon Network, *Minerva DAAU Explanatory Notes*, September 2022, p. 6.

- (b) the remaining non-rebate coal allocated assets (\$22.1 million) be deferred and not be reflected in the Blackwater reference tariffs as of 1 July 2022. These assets will have a depreciation value of zero and will be indexed each year at the approved WACC
- (c) the non-coal allocated assets (\$14.9 million) continue to be depreciated and indexed annually at CPI and continue to be considered in non-coal pricing arrangements
- (d) Blackwater system reference tariffs be adjusted from 1 January 2023 to reflect the revised 2022–23 allowable revenue, which will reduce by \$4.5 million.

Aurizon Network considered the RAB roll-forward values resulting from the proposed deferral of allocated coal assets would not be material enough to deter prospective mine developments.⁴

In Aurizon Network's view, the deferral of asset values in the RAB roll-forward provides greater certainty and transparency to prospective coal-carrying services, when compared to the alternative of removing those assets from the RAB and later undertaking a new DORC valuation if coal-carrying services recommence in the future. Aurizon Network proposed amendments to the undertaking to support this proposal.⁵

In regard to the implications for non-coal rail users, Aurizon Network indicated that it had notified non-coal access holders of its obligation to increase access charges for non-coal services west of Burngrove from 1 January 2023. Aurizon Network said this approach was consistent with the price floor limits set out in clause 6.6.2(a)(i) of UT5—that is, that prices are set no less than the level required to cover expected incremental costs of providing access for those train services.⁶

Aurizon Network did not provide any detail on the magnitude of the expected price increases for non-coal access holders. It indicated that it had optimised the maintenance and asset renewals scope to align to the material change in use. Aurizon Network said that it had engaged with the Department of Transport and Main Roads to understand the potential options to reduce the impact on non-coal access holders—but did not provide details on any such options.

Statutory obligations

Under the *Queensland Competition Authority Act 1997* (QCA Act), Aurizon Network can submit a voluntary DAAU to amend the approved access undertaking (s. 142(1)).

We are required to consider the DAAU and either approve, or refuse to approve, the DAAU (s. 142(2)), having regard to the matters in s. 138(2) and other conditions in the QCA Act, including that the DAAU has been published and submissions have been sought and considered (s. 143).

If we refuse to approve the DAAU, we must provide our reasons and views on the amendments we require, in order for it to be appropriate for us to approve the DAAU (s. 142 (3)).

Stakeholder submissions

Stakeholders had an opportunity to comment on the proposals in Aurizon Network's DAAU.

We received submissions from the Queensland Resources Council (QRC), GrainCorp, Central Highlands Regional Council, Seaway Holdings Pty Ltd, AgForce Queensland Farmers Limited, Watco Australia, CQ Inland Port and Central Highlands Development Corporation.

⁴ Aurizon Network, *Minerva DAAU Explanatory Notes*, September 2022, p. 7.

⁵ Aurizon Network, *Minerva DAAU Explanatory Notes*, September 2022, p. 7.

⁶ Aurizon Network, *Minerva DAAU Explanatory Notes*, September 2022, p. 8.

The QRC supported Aurizon Network's general approach of excluding assets that are no longer being used from the asset base⁷ but objected to the approach proposed by Aurizon Network to roll forward the RAB. The QRC also did not agree with the amendments to Schedule E that were proposed to give effect to the roll-forward approach, because they appear 'to preclude the QCA from considering the facts and circumstances which are relevant to future situations'.⁸

In line with these views, the QRC submitted that the proposed amendments to clauses 1.1(f) and 1.2(d) of Schedule E are unnecessary and inappropriate.⁹ It supported the proposed amendment to clause 1.3(b)(vii) of Schedule E.

The non-coal users were concerned that Aurizon Network's proposed response to the cessation of coal-carrying train services would significantly increase tariffs and make rail transport uneconomic—resulting in significant negative impacts on users and regions. They said that more should be done to address these issues.

QCA assessment

Treatment of suspended coal-allocated assets

Aurizon Network proposed a capital deferral approach to the treatment of coal-allocated assets affected by the closure of the Minerva mine. Based on an indexation of the WACC rate and zero depreciation, the RAB for coal assets will increase from \$23 million in FY23 to \$31.5 million by 30 June 2027, when new coal railings may potentially begin. Aurizon Network suggests this RAB value is immaterial in the context of 100 km of rail line and should not create a disincentive to prospective new developments.¹⁰

The QRC objected to Aurizon Network's proposal to maintain the Burngrove to Wurba infrastructure within the RAB and be escalated at the WACC rate and not depreciated; rather than be escalated at CPI and depreciated, as currently applies to the non-coal allocated assets. The QRC said that its preference was for the assets to be removed from the RAB, consistent with the pre-2005 position when the assets were not included in the RAB. The QRC noted that Aurizon Network had acknowledged that it had accepted the risk that demand for coal services could end before the assets were fully depreciated.¹¹

Aurizon Network's approach appears appropriate in the Minerva case, as it allows for full recovery of the revenue requirement over the life of the asset. This would be in the legitimate business interests of the owner of the service (s 138(2)(b) of the QCA Act) and also satisfies the pricing principles (in s. 168A of the QCA Act). Importantly, Aurizon Network's approach is in the interests of existing access holders (s.138(2)(h)), as it does not shift the risk of stranded assets to other users in the Blackwater system. Further, the approach provides clarity and transparency to future access seekers (s. 138(2)(e)), and in the event of new coal developments, there would be no need for a DORC revaluation.

Another stakeholder concern is that the RAB value for the coal-allocated assets could continue to grow until 2027 (and beyond if there are delays in new coal railings) and balloon to a level where there is no reasonable prospect of recovery.¹² However, the increase in the RAB value is immaterial, as the Minerva assets make up only about 1% of the total RAB value of the Blackwater system, and the implications are immaterial for the life of UT5.

⁷ QRC, *Minerva DAAU submission*, p. 1.

⁸ QRC, *Minerva DAAU submission*, p. 2.

⁹ QRC, *Minerva DAAU submission*, pp. 3–4.

¹⁰ Aurizon Network, *Minerva DAAU Explanatory Notes*, September 2022, p. 7.

¹¹ QRC, *Minerva DAAU submission*, p. 4.

¹² QRC, *Minerva DAAU submission*, p. 2.

Given that there are implications for all access holders in the Blackwater system, Aurizon Network should consult with relevant stakeholders on the regulatory treatment of suspended assets beyond the life of UT5.

In the Minerva circumstances, and for the life of UT5, we consider it is appropriate to approve Aurizon Network's approach to the treatment of suspended assets.

Proposed amendments to Schedule E

A new clause 1.1(f) in Schedule E

Aurizon Network proposed to add a new clause in Schedule E (cl. 1.1(f)), which requires that the value of any assets in the RAB that are not included within a reference tariff will have a depreciation value of zero and will be indexed for the year based on the approved WACC.

The QRC considered that the amendment is unnecessary and inappropriate,¹³ given:

- this style of indexation has been applied in the past and can be accommodated without the amendment
- the proposed drafting could preclude us from considering relevant circumstances. The QRC cited the example of Queensland Rail, where we considered that capitalised assets should have a limited life to prevent the accumulated amount from ballooning to a level for which there is no prospect of recovery
- where access conditions exist, we may need to take into account any returns on (and of) an investment even if the assets are 'suspended'.

We consider that the proposed amendments provide clarity and certainty in the circumstances where assets are 'suspended' from the RAB, pending future increased utilisation. Also, the approach is consistent with the requirements of section 138(2) of the QCA Act, by addressing the legitimate business interests of Aurizon Network while providing certainty to future access seekers (s. 138(2)(e)). Further, the proposal is consistent with the pricing limits as set out in clause 6.6.2(a) of the 2019 access undertaking (UT5). Aurizon Network is entitled to recover a return on and of capital invested. This is consistent with the pricing principles (s. 138(2)(g) of the QCA Act).

On this basis, we consider it is appropriate to approve the amendment.

A new clause 1.2 (d) in Schedule E

Aurizon Network proposed to add a new Schedule E clause 1.2(d) requiring that subject to Aurizon Network obtaining the QCA's approval, Aurizon Network may elect to remove assets that are subject to access conditions from the RAB in the event that such assets cease to be utilised by coal-carrying train services.

The QRC questioned whether this amendment was necessary, given that retaining assets within the RAB does not necessarily require that charges relating to the assets be reflected within reference tariffs. It was also concerned that the amendment would result in user-funded assets under access conditions being treated differently to Aurizon Network assets. It said that if user-funded assets are removed but are later used, user-funders will have no power to seek the assets to be reincluded in the RAB. The QRC's view was that this transfers the risk to user-funders and will discourage user funding. Further, the QRC suggested there was no clarity about the QCA's approval process.¹⁴

Aurizon Network, in a response to the QRC's submission, acknowledged the QRC's concern and indicated that the clause was not intended to capture user funding on mainlines or common use infrastructure. It

¹³ QRC submission, 2022, p. 2.

¹⁴ QRC submission, 2022, pp. 2–3.

said that removal of assets from the RAB that are subject to access conditions should be limited to customer-specific branch lines and remains subject to QCA's approval.¹⁵

We consider it is appropriate to approve the proposed amendment, given that it remains subject to QCA approval. For example, if there is any prospect that the user-funded assets, which are typically specific to a particular user, could be used in the future, we have the option of not approving removal of assets. The circumstances of each case can be taken into account in any such decision.

Again, this approach satisfies the s.138(2) criteria by meeting the legitimate business interests of Aurizon Network (s.138(2)(b)), while the requirement for QCA approval is in the interests of access seekers (s.138(2)(e)).

A new clause 1.3(b)(vii) in Schedule E

Aurizon Network proposed to add a new clause in Schedule E (cl.1.3(b)(vii)), which requires that the annual roll-forward of the RAB should include details of the aggregate value of assets for each coal system subject to clause 1.1(f). The QRC supported this new clause, citing an improvement in transparency about deferred assets. The QRC suggested it should apply to any assets that are within the RAB but are not currently reflected in reference tariffs.¹⁶ Our view is that the clause provides greater transparency and is in the interests of access holders and access seekers.

We consider it is appropriate to approve the clause.

Schedule F reference tariffs

Aurizon Network's DAAU included amended reference tariffs for the Blackwater system, and removal of references to the Minerva loading facility and line.

This clause is consistent with the removal of coal-related assets; therefore, it is appropriate to approve it.

Non-coal pricing

In the explanatory notes to the Minerva DAAU, Aurizon Network made reference to potential implications of the closure of the Minerva mine for non-coal pricing. We note that non-coal pricing issues are not integral to the Minerva DAAU and there are no proposed amendments to UT5 in respect of non-coal pricing. For the purposes of our Minerva DAAU decision, non-coal pricing is a separate issue and does not impinge on our decision whether or not to approve the amendments set out in the DAAU.

While non-coal services are declared under the QCA Act, UT5 does not include reference tariffs for non-coal services—instead, non-coal access charges are negotiated separately and are not set by us. Nevertheless, should negotiations fail, we may have a role in any subsequent dispute resolution process which may require arbitration.

We received seven submissions that raised concerns relating to the impact of the closure of the Minerva mine on non-coal users. These stakeholders were broadly concerned that non-coal users would be required to bear all the operating and maintenance/renewals costs of the Burngrove to Nogoia segments as well as non-coal allocated depreciation costs, and this would cause rail transport to become uneconomic, causing a shift to road transport. GrainCorp estimated that its network costs would increase by a factor of 500%, and railing costs by 170%¹⁷. The CQIP likewise identified a potential 500% increase in tariffs for non-coal services using the section from Burngrove to Yamala. Watco also indicated that access charges for grain and

¹⁵ Aurizon Network, supplementary submission, 2023, p. 1.

¹⁶ QRC submission, 2022, p. 3.

¹⁷ GrainCorp submission, p. 3.

livestock services would increase by 350% on current levels, and even with higher volumes, grain access charges could still increase by 300%.¹⁸

GrainCorp suggested that some flexibility could be applied around the UT5 price floor limits. It proposed that a prudent discount could be provided to maintain the efficient use of the infrastructure with costs being deferred for later recovery.¹⁹ AgForce supported the GrainCorp submission. Watco proposed that capping non-coal prices below bypass levels is justified to diminish the risk of a 'death spiral'.²⁰

The CQIP argued that the assets may more appropriately sit with Queensland Rail as a government-owned entity, as it already owns the rail line west of Nogoia. It said that regular passenger and freight services to the west are subsidised by the government, in recognition of the current imbalance between road and rail asset pricing policies.²¹ There was also concern that investments in strategic rail-centric assets, such as the Yamala inland port facility and industrial estate, could become stranded.

UT5 (cl. 6.6.2(a)) requires that tariffs are set within the pricing limits—that is, at a floor price of at least incremental costs and below a ceiling of standalone costs.²² Under clause 6.7.1(a), Aurizon Network may establish different access charges for non-coal carrying services serving different markets or commodities to maximise the commercially viable use of capacity while meeting in aggregate the common costs. Access charges for non-coal services are not quantified in the explanatory notes to the DAAU, and we understand that assessment of costs to be allocated to non-coal services, and negotiations with non-coal users, remain ongoing.

As noted above, should negotiations fail, the option remains for non-coal users to raise a dispute under Part 11 of the QCA Act.

¹⁸ CQIP submission, p. 3.

¹⁹ GrainCorp submission, p. 4.

²⁰ Watco submission, p. 3.

²¹ CQIP submission, p. 4.

²² The explanatory notes to Aurizon Network's DAAU indicate that Aurizon Network is proposing to comply with this requirement. (p. 8)