Minerva Draft Amending Access Undertaking: Explanatory Notes

1.0 Introduction

Following cessation of the operation of coal carrying train services from the Minerva mine project from FY23, the Rail Transport Infrastructure (**RTI**) in the Central Queensland Coal Network (**CQCN**) Regulatory Asset Base (**RAB**) from Burngrove to Nogoa Junction and from Nogoa Junction to Wurba Junction is no longer utilised by coal carrying train services. It is therefore necessary to consider, having regard to the relevant circumstances[1], whether the assets comprising the line segments from Burngrove to Wurba (**Suspended Assets**) included in the Blackwater component of the pricing RAB should continue to be reflected in the calculation of Blackwater Coal System Reference Tariffs.

In the preparation of the FY23 Maintenance and Renewal Strategy and Budget (**FY23 MRSB**) maintenance costs associated with the provision of declared services for non-coal carrying train services on the RTI west of Burngrove have been excluded on the basis that those costs would not be incremental to coal carrying train services.

In determining the appropriate approach to the treatment of these Suspended Assets, consideration has been given to the background and circumstances associated with their inclusion in the RAB.

2.0 Background

Prior to the commencement of coal carrying train services from the Minerva mine in November 2005, the RTI west of Burngrove was used exclusively for the provision of 15.75 tonne axle load (**TAL**) non-coal carrying train services and was supported by Transport Services Contract revenue relating to the Central West rail corridor. In order to facilitate Minerva mine train services on the mainline, a minimal upgrade of the rail infrastructure from Burngrove to Wurba was undertaken (included in the Minerva Coal Rail Project) to allow for the operation of 20TAL train services at a volume level of 2.5Mtpa. However, the line remained a predominantly timber sleeper track with relatively light rail.

The scope of the Minerva Coal Rail Project broadly included the following:

- The construction of a new balloon loop (3.63km long) located at 42.592km on the Springsure branch line;
- Upgrading the existing railway line between Burngrove and Wurba to suit the 20TAL operation and additional 2.5Mtpa over the line, more specifically including:
    - Track upgrade to allow for 20TAL operation;
    - Reconditioning of Nogoa angle;

[1] Including the requirements under clause 138(2)(f) of the *Queensland Competition Authority Act 1997* (**QCA Act**) to have regard to the effect of excluding existing assets for pricing purposes.

- Targeted upgrade of level crossings to ensure compliance with TAL and project longevity requirements;
- Comet River bridge upgrade to allow for 20TAL;
- Upgrade of 5 timber bridges; and
- Extension of DTC signalling to the Springsure branch.

These improvements were funded by the project's proponent through Access Conditions and have been subject to appropriate rebate arrangements as required under clause 6.5.2(f) of the 2005 QR Access Undertaking (**UT2**):

> *If an Access Condition results in QR earning revenue from the Access Seeker's Access that is in addition to the ongoing Access Charge (e.g. an upfront contribution or Access Facilitation Charge), QR will:*
>
> *(i) negotiate an agreement separate from the Access Agreement with the party who agreed to pay such additional revenue (or their nominee Access Seeker) which will provide for payment of a rebate to that party or their nominee, where the rebate is equivalent to the amount provided in the Access Charge for a cost component to the extent that this component is separately funded through the additional revenue (e.g. depreciation and the non-diversifiable component of the return on any relevant additional Rail Infrastructure, or modification of existing Rail Infrastructure); or*
>
> *(ii) …*

In addition, consistent with the provisions of UT2, the introduction of a new coal carrying train service required:

> *Clause 6.4.2(b)*
>
> *Where a new coal mine is developed and Train Services servicing that mine will utilise Rail Infrastructure in the Central Queensland Coal Region or Western System, the Train Services travelling between the mine (or where the mine is or will be located on Private Infrastructure, the point where that Private Infrastructure connects to the Rail Infrastructure) and its most common destination will be incorporated in a new or existing Reference Train Service in a manner consistent with the requirements of Schedule F.*
>
> *Schedule FB, clause 1.3*
>
> *The value of assets contained in the Regulatory Asset Base may be increased by QR Network if:*
>
> *(a) …*
>
> *(b) additional sections of existing Rail Infrastructure are incorporated into the Central Queensland Coal Region, in which case the additional sections will be initially valued in accordance with the Depreciated Optimised Replacement Cost methodology,*

As the new coal carrying train service would be utilising existing RTI it was necessary to develop a new Reference Tariff which incorporated the RTI into the CQCN RAB. Aurizon Network also notes that once assets were included in the RAB, UT2 limited the circumstances in which the value of those assets could be reduced including:

> *Schedule FB Clause 1.4*
>
> *The QCA will not require the value of assets contained in the Regulatory Asset Base to be reduced unless:*
>
> *a) …*
>
> *b) circumstances arise in the future where demand has deteriorated to such an extent that regulated prices on an unoptimised asset would result in a further decline in demand;*

For clarity, a reduction or cessation in the utilisation of a section of QR Network's Rail Infrastructure within an Individual Coal System Infrastructure will not result in a reduction in any asset values in the Regulatory Asset Base for that Individual Coal System Infrastructure unless it triggers the criteria above.

On 30 October 2008, Aurizon Network submitted a draft amending access undertaking (**DAAU**) to the Queensland Competition Authority (**QCA**) to:

- establish a West Blackwater pricing cluster for the Minerva coal mine alone; and
- increase the value of the CQCN RAB by $75.4 million to account for the depreciated optimised replacement cost (**DORC**) value of the assets used by coal carrying train services between Burngrove and Nogoa.

On 9 March 2009, the QCA made a draft decision to accept the inclusion of these amounts in the RAB. Following release of the draft decision, Aurizon Network worked constructively with Felix Resources (the owner of the Minerva mine) to develop an alternate pricing proposal that would better reflect and align to the commercial practicalities of valuing a 109 km written-down asset for a rail corridor with proportional coal and non-coal utilisation.

Aurizon Network submitted an amended DAAU to the QCA on 30 June 2009. The revised DAAU applied an allocative approach to the original DORC valuation and included only the coal allocation in the derivation of reference tariffs for coal carrying train services. This approach reduced the amounts to be included in the reference tariff from $75.4 million to $47.4 million as per breakdown in Table 1.

Table 1. Coal DORC Allocations

Asset category	Total DORC Valuation ($M)	Proportion Relating to Coal Utilisation	Capital Value ($M)
Burngrove to Nogoa	36.4	55.7%	20.3
Nogoa to Wurba	16.3	53.4%	8.7
Minerva Project Costs	18.4	100.0%	18.4
Total Allocated RAB			**47.4**

As the inclusion of part of the DORC valuation comprised the revaluation of substantially written down accounting values and capital investment funded through an Access Facilitation Deed, the DAAU to implement the West Blackwater Reference Tariff included several risk sharing arrangements. These risk sharing arrangements included:

- an increase in the allocation of the excluded DORC valuation amounts where contracted coal tonnages on the relevant route section increased above the 2.5Mtpa;
- access facilitation payments for the Minerva project costs with associated rebates in respect of those mine volumes;
- appropriate access conditions such as accelerated depreciation of customer funding of corridor investment; and
- the application of an economic life in excess of the expected 14-year Minerva mine life for the purpose of depreciating the assets (which was consistent with the QCA-endorsed asset lives at the time).

In respect of the applied economic life, the DAAU explicitly acknowledged:

> *QR Network considers that, due to the existence of additional deposits that could utilise the rail infrastructure from Burngrove to Nogoa, it is reasonable to assume a remaining economic life for this section of track consistent with that used for the remainder of the Blackwater System. QR Network accepts the uncertainty of whether the Burngrove to Nogoa Junction Rail Infrastructure will continue to be used for coal carrying train services beyond the life of the Minerva Mine and Athena deposit.*

In approving the DAAU the QCA noted:

> *The earlier and the revised tariff are also consistent in that neither will fully recover the value of the Gindie-Minerva line over the likely life of the Minerva Mine.*
>
> *In this respect, the Authority notes that QR Network has adopted a conservative approach to assessing the value of the Gindie Minerva line. Moreover, the reduction in the proposed reference tariff can be fully attributed to the extent of the likely under-recovery of the value of the existing assets which has increased from around $21 million to $36 million. As the 2008 undertaking does not allow this under-recovery to be paid for by other users of the network, the discount to the Minerva reference tariff does not involve a cross-subsidy from other users of the Blackwater System*.

Aurizon Network notes that a recent information paper prepared by the Australian Energy Regulator (**AER**) on addressing demand uncertainty for gas pipelines[2] recognises risk sharing as one option to address asset stranding risks where those arrangements have been agreed upfront between the service provider and its customer(s).

> *By agreeing on how to share some stranded asset costs explicitly and upfront, it removes some uncertainty of cost recovery and allows gas access prices to be more predictable in the future, thus promoting efficient use of the gas networks.*
>
> *A cost-sharing mechanism can be more flexible in dealing with the costs associated with a decline in gas demand, compared to regulatory depreciation that is subject to specific criteria and the regulator's assessment.*

In developing this DAAU, Aurizon Network has had regard to the risk sharing arrangements and allocations assumed in the development of the original West Blackwater Reference Tariff, including:

- that the recovery of the Minerva project costs are applicable only to the output from the Minerva mine and the customer assumed the risk associated with the applied 30 year economic life;
- the role and purpose of the access conditions is to financially mitigate this risk as opposed to transferring costs or risks to other users of the CQCN; and
- the expectation that Aurizon Network would be able to recover the economic value of the asset comprising the Burngrove to Wurba rail corridor from future coal mine developments.

Note: In 2007-08, Aurizon Network spent $4.9 million replacing 43,000 sleepers that was not funded under access conditions. In addition, it was a like-for-like timber replacement with a technical life of 15 years. However, a Modern Engineering Equivalent (**MEE**) asset life was applied in the RAB roll-forward meaning a residual value of ~$3.3m remained even though those sleepers will have now either been replaced or require replacement.

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[2] AER Information Paper - Regulating gas pipelines under uncertainty - 15 November 2021.pdf

3.0 Managing Reductions in the Utilisation of Customer Specific RTI

Aurizon Network notes that there are various approaches to the financial management of assets specific to an individual coal customer which have been included in the CQCN RAB and subsequently cease to be utilised by coal carrying train services. Aurizon Network considers the following arrangements are relevant to mitigating asset utilisation risks of customer specific RTI:

- matching the asset lives to the expected mine life;
- accelerating the depreciation to front-load recovery of the invested capital and align the recovery to when the asset is expected to be most heavily utilised;
- ex-ante compensation where the business is compensated for the risk of cessation of use;
- ex-post compensation where the residual costs are socialised other network users; or
- allocating risks between the access provider and the user of the RTI on a basis consistent with the understanding regarding the investment in the RTI and the development of the relevant pricing arrangements.

As discussed in Section 2.0 above the determination of the economic life and depreciation profile was established in the development and approval of the relevant Reference Tariff for coal carrying train services operating from Burngrove to Wurba. Similarly, the Reference Tariff was calculated with respect to the Approved WACC which reflects the utilisation risk of the CQCN more broadly and is exclusive of any ex-ante compensation for asset stranding risk.

Having regard to the expected and assumed allocation of risks between Aurizon Network and the developer of the Minerva project, ex-post compensation should:

- not include assets which are the subject of Access Conditions where the express purpose of those conditions is to avoid the transfer of those costs and risks to other users of the declared service; and
- extend only to recovering the net present value of the residual value of the RTI from Burngrove to Wurba in the RAB from future coal carrying train services which will utilise those assets as contemplated in the economic life assumptions.

Aurizon Network notes that the arrangements for managing the reduction in utilisation of RTI from Burngrove to Wurba are specific to the unique circumstances relevant to the inclusion of these assets within the RAB. The assets from Burngrove to Wurba represent the only circumstance where existing RTI has been subject to a DORC revaluation and included in RAB since the initial valuation of the CQCN. In addition, the assets were reflected in the only Reference Tariff in which Aurizon Network has implicitly assumed the risk of cessation of coal carrying train services and where the applied economic lives and depreciation profiles explicitly depended on further coal resource development.

Aurizon Network also notes these risk sharing arrangements are consistent with the capital redundancy arrangements outlined in section 85 of the National Gas Rules which state:

> *A full access arrangement may include (and the AER may require it to include) a mechanism to ensure that assets that cease to contribute in any way to the delivery of pipeline services (redundant assets) are removed from the capital base.*
>
> *An applicable access arrangement may include a mechanism for sharing costs associated with a decline in demand for pipeline services between the service provider and users.*

4.0 Future Demand

Whilst there are several prospective mine developments within the Burngrove to Wurba geographical region, it is considered unlikely that these areas will be developed and commence production prior to 2027.

Table 2. Prospective Mine Developments

Project	Development Prospects
Valeria Coal Project	A metallurgical and thermal coal replacement project targeting the expiry of Clermont in 2027. Currently has a coordinated project status (application for rail and infrastructure corridor submitted under MLA 700068) but is expected to favour connection at Oaky Creek bypassing the Blair Athol and Burngrove to Nogoa lines.
Athena	The adjacent Athena has remained undeveloped following closure of the Minerva mining operations which suggests its development has not been economic (EPC2413 expiring 29 January 2023).
Springsure Creek Coal Mine Project	A thermal project in the vicinity of the existing Minerva loadout and rail infrastructure. Most probable project capable of utilising the Nogoa to Wurba branchline (comprises MDL3002, EPC1674 and EPC1103).
Taroborah Coal Project	An open-cut and underground thermal coal project within the Bowen Basin (MDL467). The mine is awaiting approval having secured acceptance of its Final Environmental Impact Statement in March 2015.

Aurizon Network will conduct a reassessment of the foreseeable demand for the Suspended Assets during the development of UT6. Aurizon Network also anticipates that the recommencement of coal carrying train services between Burngrove and Wurba that is dependent on the development of any future mines will include the negotiation of appropriate risk sharing arrangements covering the carrying value of the assets in the RAB and any necessary corridor investments to facilitate the commencement of those services.

The Burngrove to Nogoa corridor continues to support ongoing non-coal operations as discussed further in Section 7.0.

5.0 Proposal for Suspended Assets

The RTI from Burngrove to Wurba had a RAB value of $49.4 million on 1 July 2022. Noting that the RTI from Burngrove to Wurba is not anticipated to be utilised by coal carrying train services prior to 2027, Aurizon Network proposes the following strategy:

- That the user funded rebate assets ($12.4 million) be permanently removed from the RAB as of 1 July 2022;
- That the remaining non-rebate coal allocated assets ($22.1 million) be deferred and thus not reflected in the calculation of Blackwater Coal System Reference Tariffs as of 1 July 2022. Accordingly, these non-rebate assets will have a depreciation value of zero and will be indexed each year based on the Approved WACC. Interest and any appropriate asset replacement expenditure relevant to these non-rebate assets will be capitalised;
- That the remaining non-rebate non-coal allocated assets ($14.9 million) continue to be depreciated and indexed annually by the Consumer Price Index and will continue to be considered in non-coal pricing arrangements; and
- Blackwater Coal System Reference Tariffs will be correspondingly adjusted from 1 January 2023 to reflect the revised FY23 Blackwater System Allowable Revenue (which will reduce by $4.5 million).

Aurizon Network will periodically review foreseeable coal demand up to 2027 with an assessment to be made at such time regarding the future treatment of the deferred assets. The non-coal allocated asset value represents an allocation of the initial DORC valuation and will be relevant to the Stand-Alone Costs of providing access to the prospective coal carrying train services discussed in Section 4.0.

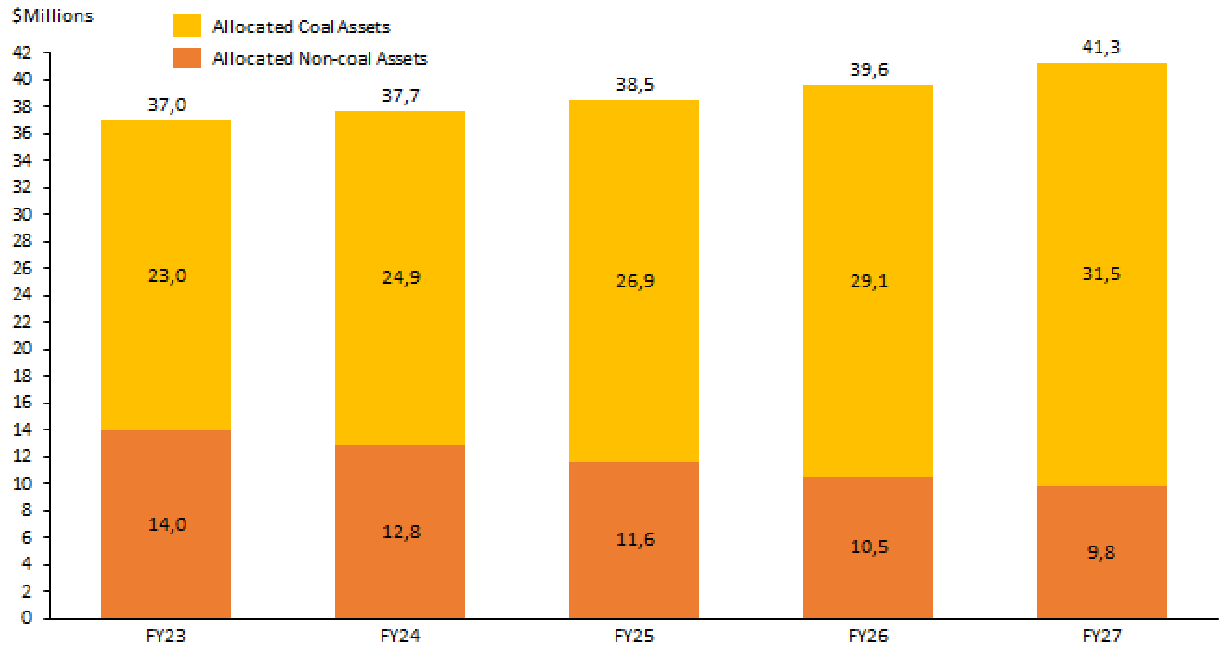
6.0 Regulatory Assessment

Aurizon Network notes the QCA's concern regarding capitalised losses as expressed in the Queensland Rail 2020 draft access undertaking decision which states:

> *Our view, subject to further consultation and consideration when the matter comes up, is that the capitalised losses should have a limited life, to prevent the accumulated amount in the under recovery account from ballooning to a level at which there is no reasonable prospect of recovery. This is to address our concern—shared by Queensland Rail and its stakeholders—about the effect on future demand of a large overhang of capitalised losses.*

The implications of the proposed term of the deferral are not anticipated to impede future demand with a forecast coal allocated RAB roll forward value of $31.5[3] million as of 30 June 2027 as shown in Figure 1 below. This is likely to be considered an immaterial value for approximately 100km of RTI particularly in relation to the project costs associated with the prospective mine developments discussed in Section 4.0. As a consequence, the proposed deferral and capitalisation of non-rebate assets would not create a material financial disincentive to the development of mineral resources that would utilise the Suspended Assets.

Figure 1. Forecast coal vs non-coal RAB roll forward values as of 30 June 2027



Aurizon Network also notes the deferral of the current asset values in the RAB roll-forward provides greater certainty and transparency to prospective coal carrying train services relative to the scenario of removing those assets from the RAB and undertaking a subsequent DORC valuation of existing assets to include those assets within the RAB if coal carrying train services recommenced.

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[3] This has been forecast using the current the Preliminary Reset WACC

In seeking approval for this proposal, Aurizon Network has engaged with stakeholders via the FY23 MRSB whereby it was approved that maintenance costs associated with the provision of declared services for non-coal carrying train services on the RTI west of Burngrove would be excluded on the basis that those costs would not be incremental to coal carrying train services.

7.0 Implications for Non-Coal Users

Following the cessation of coal carrying train services west of Burngrove in FY22, all ongoing maintenance and asset renewal costs for the Burngrove to Nogoa corridor are considered incremental costs attributable to non-coal train services. Incremental costs are defined in UT5 as:

> *Those costs of providing Access, including capital (renewal and expansion) costs, that would not be incurred (including the cost of bringing expenditure forward in time) if the particular Train Service or combination of Train Services (as appropriate) did not operate, where those costs are assessed as the Efficient Costs and based on the assets reasonably required for the provision of Access.*

The ongoing maintenance and sustaining capex would be avoidable if not for the ongoing use of that infrastructure by the relevant combination of non-coal Train Services. The current Access Charges for non-coal services have not needed to include sustaining capex due to the original Minerva project investments and subsequent access conditions.[4] As these Access Charges would not be sufficient to meet the ongoing costs of maintaining and operating non-coal services on this corridor, Aurizon Network commenced a review process with affected non-coal Access Holders in May 2022.

Aurizon Network notified the affected non-coal Access Holders of its obligation to sufficiently increase Access Charges for non-coal services operating west of Burngrove from 1 January 2023 to ensure ongoing compliance with the price floor limits. In accordance with clause 6.6.2(a)(i) of UT5, Aurizon Network must set Access Charges for the train services that use this RTI at "no less than the level that will recover the expected Incremental Cost of providing Access for that Train Service or that combination of Train Services (as applicable)".

Prior to consultation, Aurizon Network revised the corridor asset management strategy and optimised the maintenance and asset renewals scope to align to the material change in use. Aurizon Network also engaged the Department of Transport and Main Roads (**TMR**) to understand potential options to reduce impact to non-coal Access Holders and support non-coal service levels.

Consultation between TMR and affected non-coal Access Holders regarding potential Transport Services Contract revenue support is ongoing.

8.0 Consequential Amendments

Noting Aurizon Network's proposal for the Suspended Assets as detailed in Section 5.0 above, included within this submission is a mark-up of UT5 displaying the following amendments:

- Addition of clause 1.1(f) within Schedule E. This clause deals with the broader issue of assets that have been included within the RAB but not included within a Coal System Reference Tariff and accordingly require management within the annual RAB roll-forward subject to their capital deferral;

[4] Include reference to Minerva access conditions approved by QCA

- Addition of clause 1.2(d) within Schedule E. This clause allows Aurizon Network (subject to obtaining the QCA's approval) 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;
- Addition of clause 1.3(b)(vii) within Schedule E. This clause deals with the reporting of assets that have been deferred in accordance with clause 1.1(f) of Schedule E;
- Removal of references to Minerva as a load point within clauses 7.1(b)(ii), 7.1(b)(iii), 7.1(d), 7.2(c) and 7.2(f)(iii) of Schedule F;
- Variation of the Allowable Revenue for the Blackwater Coal System to reflect the exclusion of the asset in the RAB relating in the RTI between Burngrove and Wurba for pricing purposes; and
- Variation of the Blackwater System Reference Tariff commencing 1 January 2023 to account for the reduction in the System Allowable Revenue (as detailed in Table 3 below). Note an adjustment charge will not be required as the Reference Tariff reductions from 1 January 2023 account for the full year impact.

Table 3. Impact of Minerva DAAU on Blackwater Reference Tariff

Reference Tariff Input	FY23 ARRT	Minerva DAAU	
	FY23	1 Jul – 31 Dec 22	1 Jan – 30 Jun 23
AT1	1.01	1.01	1.01
AT2	2,487.34	2,487.34	2,487.34
AT3	7.15	7.15	6.94
AT4	2.56	2.56	2.49
AT5	3.56	3.56	3.56

Table 4. Impact of Minerva DAAU on Blackwater Allowable Revenue

FY23 Allowable Revenue	FY23 ARRT ($000)	Minerva DAAU ($000)
AT2 – AT4	353,333	348,870
AT5	92,801	92,801