Transport Asset Holding Entity

Mike Smart

Chief Economist
Independent Pricing and Regulatory Tribunal
PO Box K35
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Email: [redacted]

16 April 2024

Dear Mr Smart

Re: IPART Consultation Paper: Review of Mine Life and Rate of Return

The Transport Asset Holding Entity of New South Wales (**TAHE**) welcomes the opportunity to provide comment on the Independent Pricing and Regulatory Tribunal (**IPART**) February 2024 Consultation Paper on the Review of Mine Life and Rate of Return.

TAHE owns various NSW rail network assets which are regulated by the NSW Rail Access Undertaking (the **Undertaking**) and as indicated in the Consultation Paper, these assets will be subject to the IPART Final Decision on Mine Life and Rate of Return.

TAHE is seeking that the IPART decision on mine life be based on current information on the expected lives of Eraring and Vales Point powers stations, which are both currently expected to be closed by 2033. When the power stations close, coal volumes and revenues are likely to fall to a level that will limit TAHE's ability to recover the depreciation costs of the TAHE Hunter Valley Coal Network (**HVCN**)[1]. The IPART 2024 mine life decision should seek to mitigate potential price shocks and cost recovery risks arising from the uncertainty associated with the lives of these power stations.

The 2019 IPART Final Report on Rate of Return and Remaining Mine Life established a 5.3% per annum real post tax rate of return and a terminal date for mine life at 2040. These two parameters are inputs to the calculations which estimate TAHE costs[2] and are used by IPART to assess the compliance of TAHE rail access prices on the various TAHE rail networks with the requirements of the Undertaking.

IPART assesses TAHE's compliance with:

- the asset valuation roll-forward principles as set out in the Undertaking.
- the revenues derived from rail access charges for each network are below the price ceiling thresholds for that network.[3]

TAHE comments on specific issues raised in the consultation paper are set out below.

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[1] The HVCN is the section of TAHE rail network between Newstan Junction and Woodville Junction. This track is approximately 21 route kilometres long.
[2] The terminal date for mine life is a driver of the TAHE Hunter Valley Coal Network depreciation calculations. The rate of return is a driver of the cost of capital calculation for TAHE rail networks.
[3] NSW Rail Access Undertaking, Schedule 3, cl 5.

Rate of Return

TAHE understands IPART will be using its standard weighted average cost of capital (**WACC**) methodology to calculate the rate of return, (subject to any modifications required by the Undertaking or the particular circumstances of the rail industry).

TAHE seeks that in applying the methodology IPART continue to select appropriate transport infrastructure comparators when estimating the rail access equity beta and gearing parameters and continue to use robust and timely real-world financial data.

When considering relevant asset specific factors IPART should consider debt financing associated with coal and coal transport. There is some evidence that coal and coal infrastructure providers incur a debt risk premium above other similarly rated businesses[4].

In relation to the WACC, IPART should consider if the change in TAHE's operating model is relevant. The NSW Government is intending to change TAHE from a State Owned Corporation to a Public Non-Financial Corporation by 1 January 2025. IPART should consider if this change in TAHE operating model has an impact on any financing variables such as gearing and tax treatment, and whether the changed operating model impacts the appropriate WACC methodology.

Economic Life of Coal Traffic on the TAHE HVCN

The bulk of coal freight movements on the HVCN are coal movements from:

» Hunter Valley mines to Eraring and Vales Point power stations

» Western and southern coal fields to coal port facilities at Newcastle.

As indicated in the IPART 2019 Decision[5] the western and southern coal fields are not likely to be substantial or long lived, and in addition, these mines are price sensitive and ports at Port Kembla and Newcastle are substitutable[6]. Consequently, in 2019 IPART7 took the position that the "more relevant factor for determining the depreciation rate for RailCorp's HVCN is how long the power stations would continue to have demand for coal".

Thus, a key input to assessing the remaining mine life[8] is the expected life of the Eraring and Vales Point power stations. These two power stations are supplied with coal via trains which use the TAHE- HVCN. These power stations are the main coal customers for coal freight on the TAHE HVCN and are therefore the major drivers of coal freight on the TAHE HVCN.

Since 2022 there has been increasing coal movement to Eraring and Vales Point driven by NSW Government directions:[9]

» to NSW coal fired power stations to maintain coal stockpiles greater than expected demand for 30 days

» to coal mines to sell coal to the stations, to reserve a proportion of coal production for NSW coal fired power stations, and to prioritise coal supply to stations with low stockpiles.

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[4] See for example https://www.qca.org.au/wp-content/uploads/2019/05/31162_Debt-Risk-Premium-of-Coal-Transporters-Competition-Economics-Group-1.pdf

[5] IPART 2019 Rate of Return and Remaining Mine Life 2019-2014 p24.
[6] IPART 2019 Rate of Return and Remaining Mine Life 2019-2014 p20.
[7] IPART 2019 rate of Return and Remaining Mine Life 2019-2014 p23.
[8] While the matter is described as "mine life" the matter is essentially assessing the economic life of coal traffic on the HVCN
[9] https://www.energy.nsw.gov.au/nsw-plans-and-progress/regulation-and-policy/nsw-coal-market-price-emergency

These directions are currently set to end on 30 June 2024.

Factors that Impact the Economic Lives of Eraring and Vales Point

There is currently uncertainty over the closure date for the Eraring and Vales Point power station. However, the IPART assessment of the mine life has significant consequences for TAHE's ability to recover the costs of the TAHE HVCN, with the potential for asset stranding if mismanaged.

The Eraring power station, commissioned in 1982, is owned by Origin Energy. It has a technical life to 2032[10], and currently provides approximately 20% of NSW's electricity. The station has a capacity of 2880 MW.

Any decision to close Eraring requires a minimum of 42-months notice.[11] In February 2022, Origin Energy provided notice to the Australian Energy Market operator (**AEMO**) that it intended to retire Eraring[12]. Under the terms of the notice Eraring could be retired from any time from August 2025.

In May 2023, the NSW Government commissioned Marsden Jacob to undertake a review of the New South Wales energy policy to deliver reliable clean energy and identify any additional steps that were required. The Marsden Jacob Report recommended that the state government engage with Origin Energy on a temporary extension of the Eraring power station.[13] The Marsden Jacob Report indicates that Eraring has a technical life until 2032, and Origin Energy bringing the Eraring closure date forward (potentially to 2025) will create issues for NSW energy transition, particularly as potential renewable energy projects are not expected to be delivered until after 2025. We might expect that negotiations to extend the life of coal power stations are complex, with a number of factors needing to be balanced to agree to extend the closure date of Eraring. This might include energy security, the speed of renewable energy deployment, the need for capital investments, safety and environmental constraints, labour, finance, and insurance considerations.

The Vales Point power station, commissioned in 1978, is owned by Delta Electricity. It currently provides approximately 10% of NSW's electricity. In July 2023, the original planned closure of 2029 was revised to 2033.[14] The station has a capacity of 1320 MW.

While there is uncertainty, TAHE considers that an assumption of the economic life of Eraring between late 2025 (its announced retirement date) and 2032 (technical life) is reasonable and an assumption of the economic life of Vales Point at 2033 is reasonable.

TAHE considers that any assumption that these power stations continue beyond these respective dates would need strong factual support. Given current policy settings focussed on the 2030 emission reduction target there are drivers for these power stations to close prior to their technical life.

Impact on HVCN Pricing and Cost Recovery

TAHE has developed an Unders and Overs policy for the HVCN which is currently being considered by IPART. This policy addresses the management of revenue over-recovery against ceiling costs for the HVCN.[15] These HVCN ceiling cost calculations are part of the annual TAHE annual compliance

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[10] Marsden Jacob NSW Electricity Supply and Reliability Check Up August 2023 p 73.
[11] National Electricity Rules Chapter 2 Registered Participants and Registration Section 2.10.1 c2)
[12] See for example.
https://www.originenergy.com.au/about/investors-media/origin-proposes-to-accelerate-exit-from-coal-fired-generation/
https://aemo.com.au/newsroom/media-release/response-to-eraring-power-station-closure

[13] Marsden Jacob NSW Electricity Supply and Reliability Check Up August 2023 p 11.
[14] Marsden Jacob report.
[15] NSW Rail Access Undertaking, Schedule 3, cl 4. Other than the TAHE HVCN, the Undertaking (Schedule3 Clause 5 (f)) does not require IPART to assess compliance for networks where TAHE can reasonably demonstrate that access revenue is less than 80 percent of the ceiling.

submission to IPART. The rate of return and mine life determined by IPART are components of this ceiling cost calculation.

The 2019 IPART Final Report on Rate of Return and Remaining Mine Life has assumed a mine life until 2040. This directly impacts TAHE's depreciation costs for the TAHE HVCN, which are included in the ceiling test. The maximum prices charged and ability to recover our costs is therefore, in part, driven by this mine life.

The TAHE 2022-23 estimates of HVCN costs submitted to IPART[16] are based on a mine life assumption of 2040. These costs are used to determine the balance of the HVCN Unders and Overs account, which in turn, determines TAHE's HVCN revenue. The 2040 mine life results in a relatively lower current depreciation cost and thus a relatively lower current ceiling threshold. This lower ceiling means that HVCN revenue is more likely to exceed the ceiling. A mine life assumption that is longer than the actual mine life will place a lower price ceiling on rail access and potentially prevent recovery of depreciation costs. Under the Undertaking IPART makes decisions on mine life every five years with the decision following this 2024 decision being due in 2029.[17] At the time of the 2029 decision it is likely that the lives of Eraring and Vales Point will be known with substantially more certainty, in particular there is the potential for Eraring to be closed by the time of the 2029 review, with the date of the closure likely to be impacted by discussions between Origin and the NSW Government.

Given the 2029 timing of the next scheduled mine life review and the current level of uncertainty, it is worth exploring the potential for reducing the time period until the next mine life review (separate from Rate of Return).

In considering the 2024 mine life decision, IPART should recognise the impact this will have on TAHE recovery of its depreciation costs. If IPART maintain the mine life at year 2040, or do not reduce it sufficiently in this 2024 decision, then a substantial depreciation cost may need to be recovered over a substantially shorter period of time than the 11 years between 2029 and 2040 given the actual closure dates of the power stations. This shortened time frame risks:

- TAHE having stranded assets within the HVCN, which means that the costs of these assets will not be recovered from the asset users.
- driving price volatility for coal rail operators and their customers.
- non-equitable customer outcomes, with greater contribution to costs being borne by the final coal rail operators (and their customers)
- the true cost of coal electricity generation not being reflected in near term prices, potentially impacting the efficient dispatch of coal within the National Energy Market.

TAHE is seeking that IPART recognise the potential impact the mine life decision will have on:

- TAHE HVCN access pricing, including the potential for access pricing shocks if depreciation needs to be recovered over a short period of time from 2029.
- TAHE HVCN depreciation costs and the potential for TAHE to recover these costs.

TAHE considers that the decision on mine life should be based on current information about the expected lives of Eraring and Vales Point and should take into account future HVCN pricing and cost recovery impacts. TAHE's position is that decision on mine life should have an upper limit of 2033, which is the current planned retirement date of Vales Point power station, but could also reasonably be driven by

[16] TAHE Access pricing Compliance Submission to IPART 2022-23 pp31-38
[17] NSW Rail Access Undertaking, Schedule 3. cl 3.2 (c) (iv).

Eraring's closure, which would appear to have an outer limit of 2032. Coal usage by the power stations drives the HVCN coal freight volumes. When the power stations close coal volumes and coal revenues are likely to fall below the level needed for the Unders and Overs account to operate[18], which in turn will severely limit TAHE's ability to recover the depreciation costs of the HVCN.

Any decision to establish the mine life beyond 2033 requires strong evidence of substantial and ongoing coal operations on the HVCN beyond this date, such that depreciation cost recovery remains highly likely.

Overall, TAHE recognises that the mine life decision depends on a number of uncertain variables, including future decisions by power station owners, and governments. TAHE is seeking that IPART take an approach in this current 2024 decision which will mitigate potential price shocks and cost recovery risks in the future which may arise from this uncertainty.

TAHE's contact for this submission is [redacted]

Yours sincerely,

[redacted]

Lyndal Punch
Acting Chief Executive Officer
Transport Asset Holding Entity

[18] TAHE, Unders and Overs Account Policy for the TAHE Hunter Valley Coal Network Section 8 sets out the circumstances where the Unders and Overs Policy will cease to operate. These circumstances include when revenue falls below 80% of full economic cost and this revenue fall is permanent.