Queensland

Regulatory Impact Statement for SL 2003 No. 174

Mineral Resources Act 1989

MINERAL RESOURCES REGULATION 2003

AMENDMENTS TO QUEENSLAND NICKEL AND COBALT ROYALTIES

TITLE

Mineral Resources Amendment Regulation 2003.

BACKGROUND

Mining related royalties in Queensland are administered under the *Mineral Resources Act 1989* with the royalty rates listed in Schedule 1 of the *Mineral Resources Regulation 1990.*

As there are no specific royalty rates for nickel[1] or cobalt, both are currently assessed under Section 18 "Other minerals" in Schedule 1 (effectively a "catch-all" category). This section sets the royalty for minerals not elsewhere specified in Schedule 1 at 2% of the gross proceeds of the sale, disposal or use of the mineral for each year, after deducting $30,000 from the gross proceeds. However, the nickel and cobalt royalty regime currently provides no incentive for downstream processing in Queensland.

In late 1998 industry was notified of royalty reviews planned to be undertaken over the next few years for nickel and cobalt, magnesite, kaolin and other industrial minerals.

1 Royalty is payable on nickel and cobalt <u>mined</u> in Queensland. Products refined from imported ores are not subject to Queensland royalty legislation.

A discussion paper based on the existing base and precious metals regime (covering copper, lead, zinc, silver and gold) was developed for nickel and cobalt and released to industry stakeholders in October 2000 for comment. Submissions in response to the discussion paper indicated support for the proposal. As implementation of this proposal would involve amendment to the *Mineral Resources Regulation 1990*, this Regulatory Impact Statement has been prepared for public comment.

Industry comment on various elements, including the proposed price bands, thresholds and processing discounts, was taken into account in the development of the current proposal.

AUTHORISING LAW

This amendment is made pursuant to section 321 of the *Mineral Resources Act 1989*.

POLICY OBJECTIVES

Royalties are payments to the owners of a resource for the use of that resource. The ownership of onshore mineral resources in Queensland is vested largely in the State Government.

The Department of Natural Resources and Mines (previously the Department of Mines and Energy), collects State mineral royalties under the *Mineral Resources Act 1989*. The Department regularly examines royalty regimes for mineral commodities as changes arise in the patterns of their production, and in the prevailing and prospective market and industry conditions for these commodities.

These reviews seek to ensure that the royalty arrangements meet Government policy objectives in terms of—

- developing the State's resources;
- providing a fair return to the community for the extraction of these resources;
- maintaining low administration and compliance costs; and
- encouraging downstream processing of minerals within Queensland.

The current regime does not contain any provisions to encourage downstream processing of nickel and cobalt ore mined in Queensland. The current regime also does not provide any flexibility in royalty rates in response to fluctuations in nickel and cobalt prices. This contrasts with the situation for other base metals (copper, lead and zinc), which are subject to a price-responsive regime that incorporates a royalty discount for downstream processing for ore mined and processed within Queensland.

At the time of the development of the base and precious metals regime it had been recognised that nickel and cobalt should be included in this framework should nickel and cobalt production in Queensland resume in the future.

No royalties are being collected under the current regime, as there is currently no production of nickel or cobalt ore in Queensland, although both have previously been mined in the State. Active exploration for nickel and cobalt is however currently being undertaken.

LEGISLATIVE INTENT

The proposed amendment seeks to promote the development of the State's resources by implementing a price-responsive regime that balances providing a fair return to the community for the extraction of these resources with cost-effective arrangements for administration and compliance for both Government and industry. The proposed processing discounts are intended to encourage downstream processing of minerals mined within Queensland.

Industry responses to an earlier proposal outlined in a discussion paper released in 2000 indicated support for the approach proposed.

As the current royalty arrangements are embodied in the Mineral Resources Regulation, modification to the arrangements would be achieved by regulatory amendment.

CONSISTENCY WITH THE AUTHORISING LAW

One of the principal objectives of the Mineral Resources Act is to "ensure an appropriate financial return to the State from mining." To this end section 321 allows for the making of regulations, pursuant to section 417, which may prescribe different types of royalty arrangements to apply from time to time. The proposed amendments are therefore consistent with the authorising legislation.

CONSISTENCY WITH OTHER LEGISLATION

Royalties on minerals (as defined) mined in Queensland are administered solely under the *Mineral Resources Act 1989*. Accordingly, the proposed amendment is not inconsistent with other legislation.

OPTIONS AND ALTERNATIVES

Option 1 Retain existing arrangements

As mentioned earlier in the "Background" section, there are no specific royalty rates for nickel or cobalt. They are currently assessed as "other minerals" under the regulation at a rate of 2% of the gross proceeds of the sale, disposal or use of the mineral for each year, after deducting $30,000 from the gross proceeds.

While these arrangements are relatively simple to administer, they provide no incentive for producers to add value through downstream processing of nickel and cobalt in Queensland.

Option 2 Apply the base and precious metals model to nickel and cobalt

Option 2 is the current proposal, which seeks to adopt similar arrangements to those that have been in place for base and precious metals since 1 January 1996. These arrangements were implemented following an extensive review process, which included investigations into a range of alternative royalty structures.

It is intended that from 1 January 2003, the following arrangements will apply to nickel and cobalt mined in Queensland—

- for each metal, producers may choose between a fixed royalty rate of 2.7%, or a variable royalty rate ranging from 1.5% to 4.5%, depending on the average Australian dollar price for each metal in a calendar quarter;
- the first election (between the fixed and variable rate schemes) to cover a period of up to 5 years, with the first election period ending on 31 December 2005;
- the revenue base is the value of payable metal;
- the first $4 million (generally based on $1 million per quarter) of combined payable metal revenue for nickel and cobalt (and any

metals already subject to the existing base metals regime, ie. copper, lead and zinc) is subject to a royalty rate one half of that otherwise payable for the quarter;

- royalty discounts of 20% apply if processed to 70% (nickel) or 50% (cobalt) contained metal in Queensland. (The producer still qualifies for the discount if a third party undertakes such processing.)

Further details of the proposed arrangements are set out in Appendix A.

Other alternative arrangements for nickel and cobalt

There are different types of royalty arrangements that are available for investigation as to their applicability to nickel and cobalt.

As mentioned above, the nickel and cobalt review drew on the work undertaken in the earlier base and precious metals review. This earlier review considered a range of alternative royalty arrangements including traditional ad valorem and profit-based royalties and various hybrids with ad valorem and profit components. That review concluded that these alternatives would not meet the policy objectives of providing a fair return to the community and promoting downstream processing, and in some cases, would involve considerable administration and compliance costs.

COST BENEFIT ASSESSMENT

The confidentiality provisions of the *Mineral Resources Act 1989* in relation to the disclosure of royalties preclude making available any information on the financial impacts on individual stakeholders. In addition, given the relatively small number of potential nickel and cobalt ore producers in Queensland, it would not be appropriate to present any broad estimates of financial impacts. However, the information contained in this document will allow potentially affected parties to assess the impact of the proposal on their respective prospects/projects and provide comment.

The financial impacts, both at the individual mine and aggregate level, would be dependent on a number of factors, including—

- potential future quantities of nickel and cobalt;
- anticipated nickel and cobalt prices and exchange rate impacts;

- extent of downstream processing associated with potential future production; and
- level of deductions, and future cost increases, in determining assessable value.

Several of the above components are, in turn, affected by the world economic outlook over an extended period of time and other factors such as the extent of both local and international competition in the nickel and cobalt sectors.

Some indicative estimates of royalty payable per tonne of ore mined have been prepared, based on current average prices and exchange rates and average recoveries from nickel operations currently operating or being developed in Western Australia.

Under the existing arrangements in Queensland (ie. 2% of gross proceeds, after deducting $30,000 from gross proceeds), the royalty payable would be approximately $1.63 per tonne for nickel and $0.36 per tonne for cobalt.

Under the proposed new arrangements for the fixed rate option (taking into account the $30,000 royalty-free threshold and the $4 million half-royalty threshold), the royalty payable is estimated at $2.23 per tonne for nickel (or $1.78 per tonne if eligible for the processing discount) and $0.48 per tonne for cobalt (or $0.39 with the processing discount).

Based on current average prices and exchange rates and the proposed price bands, the rates that would apply under the variable rate option would be 3.88% for nickel and 1.5% for cobalt. The estimated royalty payable (taking into account the $30,000 royalty-free threshold and the $4 million half-royalty threshold) would be approximately $3.20 per tonne for nickel (or $2.56 per tonne after the discount) and $0.27 per tonne for cobalt (or $0.22 per tonne after the discount).

The following section briefly discusses the extent to which the three options would meet the Government's policy objectives.

Option 1 Retain existing arrangements

The current arrangements are relatively simple to administer, however, they provide no incentive for producers to add value through downstream processing of nickel and cobalt in Queensland.

Option 2 Apply the base and precious metals model to nickel and cobalt

As mentioned earlier, at the time of the development of the base and precious metals regime it had been recognised that nickel and cobalt could be included in this framework should nickel and cobalt production in Queensland resume in the future.

Also, nickel is subject to similar market-place movements as base and precious metals (and is likewise listed with the London Metal Exchange), and cobalt in Australia is usually extracted as a by-product of nickel mining and potentially from copper and copper-gold mining.

The base and precious metals regime appears to have been well accepted by industry. This was evidenced by the outcome of the price band review of the base and precious metals regime conducted in 2000. The price bands used to determine the applicable variable royalty rates for base and precious metals were the subject of a discussion paper and Regulatory Impact Statement process in 2000. That review and consultation process indicated no need to amend any fundamental aspects (such as the fixed and variable royalty rates, royalty thresholds, processing discounts) of the operation of that regime.

Given these factors, the nickel and cobalt royalty review first considered the scope for extending the base and precious metals royalty regime to incorporate nickel and cobalt. On this basis, development and consideration of any alternative royalty structure proposals would be subject to the outcomes of the review and subsequent consultation process.

The nickel and cobalt royalty review discussion paper was released to industry in October 2000 on this basis. Submissions received from industry indicated support for the proposal to include nickel and cobalt in the current base and precious metals regime.

The prices bands proposed in this Regulatory Impact Statement are similar to those outlined in the discussion paper released to industry. Following consideration of industry responses to the discussion paper, the proposed contained metal trigger level has been reduced from 95% to 70% and 50% for nickel and cobalt respectively. Industry comment was also taken into account in the proposed 20% processing discount for nickel and cobalt.

This royalty regime is considered to better deliver the policy objectives, in terms of promoting downstream processing, balanced with providing a fair return to the community and ensuring cost effectiveness in administration and compliance.

Potential benefits from encouraging downstream processing through the proposed processing discounts include employment creation, regional development and increased export revenues.

Implementation of this proposal would essentially involve extending the existing regulatory provisions that currently apply to base metals.

FUNDAMENTAL LEGISLATIVE PRINCIPLES

The proposed amendments are consistent with fundamental legislative principles.

NATIONAL COMPETITION POLICY

National competition policy (NCP) principles seek to ensure, to the maximum practical extent possible, that a level playing field exists in order to foster competition.

The proposed amendments are consistent with NCP principles.

RISK ASSESSMENT

As indicated previously in the cost benefit assessment section, there are several variables involved in the determination of expected future royalty streams for potential mines. Significant changes in these variables could inevitably result in actual financial impacts varying from those anticipated.

The proposed new arrangements would allow producers to make their own selection between the fixed and variable rate scheme for each metal, to be locked in for the next five years, based on their own assessment about price forecasts.

The variable rate royalty structure is much more sensitive to operational profitability than a conventional fixed rate ad valorem royalty, much like a profit-based system, but without the associated administration and compliance costs. When prices are low the royalty cost or burden is eased, but when prices are high the royalty payments will be significantly higher.

Producers seeking certainty about the applicable royalty rate would be able to choose the 2.7% fixed rate scheme.

APPENDIX A

PROPOSED NICKEL AND COBALT ROYALTY ARRANGEMENTS

Main Features

Schedule 1, Part 1 of the *Mineral Resources Regulation 1990* sets out the reference prices for the base and precious metals currently subject to these arrangements (copper, lead, zinc, gold and silver) as well as the applicable discounts for downstream processing of base metals.

These arrangements for base and precious metals have been in place since 1996 and are proposed to be extended to apply to nickel and cobalt from 1 January 2003.

The following points summarise the main features that would apply to nickel and cobalt, with further details on specific aspects set out below—

- Producers choose for each mining project, for a five year period, between a fixed or variable ad valorem rate royalty;
- The fixed rate ad valorem royalty would be set at 2.7%;
- The variable rate ad valorem royalty would vary between 1.5% and 4.5% as set out in Table 1 below;
- Nickel royalty rates would be based on the quarterly average of the three month LME (London Metal Exchange) prices expressed in Australian dollars;
- Cobalt royalty rates would be based on the quarterly average of monthly mean Metal Bulletin European Free Market prices expressed in Australian dollars;
- For prices in the lowest band, the royalty rate would remain at 1.5%;
- For prices in the highest band, the royalty rate would remain at 4.5%;
- For prices between these two bands, the royalty rate would lie between 1.5% and 4.5% and vary linearly with prices;
- Metal price bands would be stated in nominal Australian dollar terms and reset every five years; and

- Companies would elect (for each metal) their preferred scheme (fixed or variable rate) every five years after the metal price bands are reviewed.

Price Bands and Applicable Royalty Rates

The variable rates would vary linearly in 0.02% increments between 1.5% and 4.5% with movements in the nickel and cobalt prices (expressed in Australian dollars) within the price bands set out in Table 1 below.

Table 1: Proposed Price Bands

Bands	Nickel $A/t	Cobalt $A/lb
1.5% rate applies	0 to 8,300	0 to 15
Rate increases from 1.5% to 2.5% between	8,301 to 10,400	16 to 25
Rate increases from 2.5% to 4.5% between	10,401 to 13,200	26 to 35
4.5% rate applies	13,201 and above	36 and above

Royalty Base

The ad valorem royalty rates would be applied to the free on board (F.O.B.) value of payable metal under both the fixed and variable rate options.

Election of Preferred Scheme (every Five Years)

The metal price band settings for the variable rate ad valorem system would be reviewed every five years (the first price band review is proposed to occur in 2005, to coincide with the next review of base and precious metal price band settings).

The results of the review would be communicated to existing and potential producers. Producers would then be allowed at least sixty days in which to choose between the fixed rate and the variable rate scheme for the subsequent five-year period.

For production that commences within one of the five-year periods, the election for the remainder of the five-year period may be made when the first royalty payment is due.

In default of any election, the producer would be deemed to have chosen the fixed rate option.

Royalty Discounts for Downstream Processing

Where nickel and cobalt are processed within Queensland to 70% (nickel) or 50% (cobalt) contained metal, royalty discounts would apply. Processing discounts of 20% for nickel and 20% for cobalt are proposed. A producer would still qualify for the discount if such processing were to be undertaken by a third party.

Royalty Free Threshold - $30,000

As currently exists in the base and precious metals royalty regime, no royalty would be payable on the first $30,000 of payable metal for each mining project.

Half Royalty Threshold - $4,000,000

In line with the arrangements for base metals, it is proposed that the first $4,000,000 of annual combined payable metal for a mining project be subject to only half the relevant royalty rate (whether fixed or variable). This is in addition to the general royalty free threshold of $30,000. This threshold would apply to each project and not to each metal produced from a mining project. The threshold would generally be based on $1 million per quarter, as royalties would be payable on a quarterly basis.

Phase-In Arrangements

No phase-in arrangements are proposed given that there is no current production occurring.

ENDNOTES

1. Laid before the Legislative Assembly on . . .
2. The administering agency is the Department of Natural Resources and Mines.