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By email

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Email:

Dear George,

Aurizon Network – Annual review of Reference Tariffs (2022 Tariff Review): Goonyella Abbott Point Expansion (GAPE) and Newlands tariff issues

We are grateful for this opportunity to respond to the 2022 Tariff Review.

Rio Tinto no longer owns or operates coal mines in Queensland. However, through a wholly owned Rio Tinto entity, Queensland Coal Pty Limited, Rio Tinto holds approximately 7.8mtpa of rail access rights on the GAPE System. Our comments in response to the 2022 Tariff Review are therefore limited to the reference tariffs for the GAPE System and, to the extent cost allocation is relevant, the Newlands System.

We also refer to earlier Rio Tinto correspondence with the Queensland Completion Authority (QCA) in relation to the issues set out in this submission, dated 28 November 2018 and 17 June 2020. The QCA will note that those letters canvas several of the concerns set out in this letter, albeit on a confidential basis.

Summary of submission

In short, Rio Tinto welcomes the 2022 Tariff Review because it provides an opportunity for the QCA to finally and squarely address significant issues and concerns that have dogged the GAPE and Newlands Systems (and users) for over a decade. Indeed, resolving the historical treatment of the allocation of costs as between both systems, and as between existing and new Newlands users, is a longstanding piece of unfinished business for the QCA and Aurizon Network (**AN**).

In summary, Rio Tinto submits as follows:

- Throughout its history, the GAPE System and associated cost allocation arrangements have been unsatisfactory because they are governed both by regulated tariffs and an unregulated set of underwriting deeds that are neither transparent nor assessed by the QCA (i.e. GAPE Deeds and Newlands Abbott Point Expansion (**NAPE**) Deeds). The QCA, to this point, has therefore not had an opportunity to consider the GAPE Deeds and NAPE Deeds – this is despite the fact that they strongly influence the approach and incentives that AN has adopted to cost allocation. Indeed, to the extent that GAPE Users have already been required to pay substantial costs that have been identified as NAPE infrastructure, the QCA should have regard to this when considering whether the cost of that infrastructure should now be levied on them again, through inclusion in the GAPE RAB, or be allocated to the Newlands RAB.
- The imminent arrival of Adani as a significant and new user of the Newlands System also raises the important issue of how the cost of Newlands enhancements will be treated for regulatory purposes. When first considered by the QCA, the issue was effectively "parked" and AN was permitted to allow the cost of those improvements to be capitalised at its regulated Weighted Average Cost of Capital (**WACC**), pending future recovery. The value of these assets (being 19 percent of the total cost of the Newlands System enhancements) is now estimated at over $120 million and Rio Tinto submits that it is important that the QCA forms a view as to how this amount will now be treated for regulatory purposes.

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- Rio Tinto considers that the following issues therefore need to be assessed and dealt with by the QCA in considering the 2022 Tariff Review:

  (a) <u>The historical position taken in relation to original GAPE expansion capital expenditure within the Newlands System (Newlands Capex)</u>

  This Newlands Capex delivered benefits to the existing Newlands users and will deliver significant future benefits to Adani and other new Newlands users (amongst other things, through an increase in train length and axle load). Rio Tinto submits that whilst the current incremental expansion approach can continue for existing Newlands System users, this is not justified or appropriate for new users. For new users of the Newlands System, including Adani, a system premium should be applied to commence recovery of Newlands Capex.

  (b) <u>Replacement capital expenditure associated with Newlands expansion infrastructure (Newlands Renewals).</u>

  In its submission, AN proposes that the entirety of the cost of Newlands Renewals would be recovered from Newlands users on a socialised basis. Rio Tinto submits that a tonnage-based renewals activity should be socialised equitably across GAPE and Newlands users on the basis of forecast throughput.

Finally, the QCA should consider what adjustments may be necessary to the cost allocation questions above based on current and historical cost recovery by AN under the GAPE Deeds. Specifically, Rio Tinto submits that this needs to be done in a holistic way and the QCA needs to have regard to the cost recovery and incentives associated with both regulated tariffs and GAPE and NAPE Deeds, which also deal with cost allocation issues.

Rio Tinto has been deeply concerned, for a number of years, that the nature of the cost allocation arrangements under the GAPE Deeds, and delayed commencement of paths in the Newlands System, has combined to create a substantial risk of double recovery of GAPE project costs by AN (under unregulated payments in GAPE Deeds and separately from Newlands System users or potentially GAPE system users in the future through regulated tariffs).

Rio Tinto submits that QCA should obtain copies of the Deeds (either from AN or GAPE users) so as to fully understand the implications of the Deeds. We would then welcome the opportunity to meet with the QCA to discuss the concerns that RTCA (and potentially other stakeholders) has with Newlands/GAPE cost allocation and recovery (and the potential for double recovery of costs by AN, under both the regulated and unregulated frameworks).

Further details in relation to each of the matters raised above is set out in Annexure A.

Rio Tinto would welcome the opportunity to discuss the issues raised in this submission with the QCA, including its wider concerns regarding the cost allocation approach adopted by AN under the GAPE Deeds and its implications for this process.

Rio Tinto does not object to publication of this submission by the QCA.

Sincerely

Rio Tinto

ANNEXURE A DETAILED COMMENTS

1. Tariff approach to Newlands enhancements – and existing Newlands System users

As the QCA is aware, the original GAPE System tariffs were approved in 2013[1], however the pricing structure and cost allocation as between the GAPE and Newland Systems was not addressed until the UT4 final decision in 2016.[2]

Whilst AN proposed to socialise the costs of the Newlands Capex across all users, including Newlands users, the QCA rejected that approach. It found that, consistent with the incremental expansion methodology, original Newlands users were not required to contribute to Newlands Capex.

For the purpose of the current process, Rio Tinto acknowledges that this decision has been settled and it does not seek any change to the position of Newlands System users, who were operating at the time of the GAPE Reference Tariff Draft Amending Access Undertaking (DAAU).

2. Cost recovery of Newlands Capex from new Newlands users

At the time of the UT4 final decision the QCA agreed to "park" the Newlands Capex (19 percent of the cost of Newlands upgrades) for later recovery from new Newlands users (based on tonnes associated with non-GAPE traffic on the Newlands System at the time).

In Rio Tinto's view, this approach was appropriate. The policy rationale of incremental expansion pricing can only apply to existing users, given that it is based on the likely adverse effect of an expansion on tariffs paid by users that are already using a service. It also acknowledges that existing users may not be in a position to take advantage of the infrastructure – given that they would be more likely to have an existing rail fleet. However, new users should meet the full efficient cost of infrastructure that they use, particularly, as in this case, where they obtain a direct and material benefit from the expansion (through the ability to run larger consists).

Rio Tinto understands that, given there is over $120 million of costs that have been ear-marked for recovery from future "NAPE" users, and for which a decision must now be made. Rio Tinto believes that a decision can no longer be delayed, given the imminent commencement of Adani as a significant new user of the Newlands System.

Rio Tinto therefore submits that the capitalised NAPE amount should be allocated for recovery through a 'system premium' payable by new Newlands Systems users (including Adani). This is equitable, remains consistent with the original QCA tariff approach in UT4 and provides for recovery of efficient costs from those Newlands users that have the benefit of the expansion infrastructure consistent with the pricing principles in section 168A of the *Queensland Competition Authority Act*.

However, if the QCA determines not to recover the full amount of the capitalised NAPE costs from new Newlands users, a final decision is needed that rolls the current amount into either the Newlands RAB or the GAPE RAB. This amount cannot continue to be left to roll forward with uncertainty about how it will be recovered in the future.

3. Newlands Renewals

In relation to recovery of Newlands Renewal costs, Rio Tinto submits that a tonnage-based renewals activity should be socialised between GAPE and Newlands users on the basis forecast throughput. This approach is equitable and cost-orientated.

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1 QCA Final Approval, June 2013 GAPE DAAU, 26 September 2013.

2 See section 17.4 of the QCA Final Decision – UT4 DAU, Volume III, Pricing & Tariffs, April 2016.

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4. Consideration of cost allocation and recovery by AN under the GAPE and NAPE Deeds

Finally, Rio Tinto notes that the GAPE Deeds entered into between foundation GAPE customers and AN, also deal with cost allocation and recovery issues.

While the specific terms of the GAPE Deeds are confidential, they deal with a number of issues including:

- cost recovery through agreed commercial payments that take into account, but are not limited to, regulatory revenues;
- the commercial allocation of cost recovery as between GAPE System users and NAPE users (although this allocation was designed based on the originally forecast commencement dates for all users).

Rio Tinto notes that AN has permitted a delay in commencement of paths by NAPE users and this has had a material impact on how costs have been allocated and recovered as between GAPE System users and NAPE users. The manner in which AN applies cost recovery under the GAPE Deeds has resulted in strong incentives for AN to continue to roll forward NAPE amounts (and not to include these in either the Newlands System or GAPE System RABs). Rio Tinto notes this roll forward strategy raises a substantial risk of double recovery by AN over the next decades – as it recovers costs twice (once from GAPE users under their GAPE Deeds and, separately, from regulated users in the future through regulated tariffs).

Amongst other things, the QCA should consider the extent to which GAPE users have already been required to cover the cost of NAPE infrastructure (through the cost allocation mechanism in GAPE Deeds), before deciding whether to allocate those costs to the GAPE RAB, rather than the Newlands RAB – with the potential effect of requiring GAPE users to pay for them again.

Rio Tinto submits that the QCA will not be able to form a fully-informed view of the appropriate tariff structure and cost allocation within the GAPE System and Newlands System, without first obtaining copies of GAPE Deeds and NAPE Deeds and familiarising itself with the relevant provisions.