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By email

Mr George Passmore
Queensland Competition Authority
Level 27, 145 Ann Street
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Dear George

Aurizon Network — Annual review of Reference Tariffs (2022 Tariff Review) – response to Draft Decision Notice.

Queensland Coal Pty Limited (**Rio Tinto**) welcomes this opportunity to respond to the Draft Decision Notice.

The issues raised by the Queensland Competition Authority (**QCA**) are significant to Rio Tinto and other Goonyella Abbott Point Expansion (**GAPE**) System and Newlands stakeholders – and Rio Tinto submits that the QCA cannot safely proceed to a final decision that approves Aurizon Network's (**Aurizon**) proposal without resolving the issues which have been raised.

In particular, Rio Tinto submits that the QCA must make a decision regarding the allocation of Newlands Abbott Point Expansion (**NAPE**) costs that have, to date, been permitted to be capitalised and rolled forward by Aurizon as part of the NAPE RAB. As the QCA is aware, from correspondence with Rio Tinto over a number of years, the current unsatisfactory arrangement imposes substantial and inequitable costs on Rio Tinto (and other GAPE System users) and gives rise to a significant risk of double recovery by Aurizon in the future.

Proposed steps to resolve the issue of cost allocation and replacement Newlands capex

Rio Tinto submits that the issue of cost recovery and the resulting inequity of tariffs in the GAPE System needs to be dealt with now.

In the circumstances, Rio Tinto therefore submits that the QCA should take the following course:

a. **First**, to the extent that any capital indicator is approved, as appears to be proposed in the Draft Decision Notice, this should be identified as a provisional decision (to permit tariffs to be updated) and subject to addressing the issues raised by stakeholders regarding the regulated recovery of historical NAPE capital expenditure and allocation of replacement capital expenditure.

b. **Second**, the QCA needs to both:

    (i) obtain copies of the GAPE and NAPE Deeds and meet with stakeholders to understand their perspectives on historical cost recovery under those agreements, as they relate to regulatory tariffs. As Rio Tinto has previously noted, we consider that the QCA cannot finalise a decision in this process without properly understanding how capital costs are allocated and recovered by Aurizon under the GAPE Deeds (and NAPE Deed); and

    (ii) determine if it is reasonably likely that any of the allocated NAPE capacity will be taken up by the original NAPE customer.

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c. **Third**, once this information has been obtained, we support the QCA publishing a position paper to facilitate consultation between stakeholders and the QCA. This will need to provide information regarding the status of the NAPE customer usage of the NAPE assets, to facilitate engagement between Aurizon and other users.

d. **Finally**, the QCA should publish a final decision addressing the allocation and recovery of capitalized NAPE assets.

The QCA has indicated it would be keen to see Aurizon work with stakeholders to agree an approach to this issue. While Rio Tinto is open to trying to agree an equitable solution with Aurizon, Rio Tinto has spent a number of years attempting to do so, without success. Primarily because of the uncertainty with respect to the take-up of NAPE capacity. We therefore welcome the proposal by the QCA to publish a position paper on the issue of cost allocation (between GAPE and Newlands) and to use that as a basis to resolve the issues.

Rio Tinto suggests that a stakeholder forum may also be warranted to ensure that the issues are understood and ventilated. The QCA will need to discuss with GAPE users, as well as Aurizon, the history of cost recovery under the GAPE Deeds, to appreciate the approach that Aurizon has adopted to date and its economic incentives in terms of cost allocation moving forward.

Rio Tinto does not wish in this letter to reiterate points previously made in relation to the issue of replacement capex. However, we set out below a number of brief additional points on the issue of cost allocation of historical NAPE infrastructure costs, that have been permitted to be capitalized but are not yet recovered through either the GAPE or Newlands RABs.

There is an urgent need for the QCA to resolve allocation and recovery of NAPE infrastructure costs

The GAPE infrastructure was funded and constructed at a point in time before the regulatory framework was sufficiently mature to properly address issues of cost allocation and the interaction between the underwriting arrangements and the regulatory tariff framework.

From Rio Tinto's perspective, the following critical issues are relevant to the QCA's consideration of the issue of cost recovery of NAPE capex (both historical and replacement):

1 As was made clear in Aurizon's public documents at the time (and referred to in the submission made by Bravus to the QCA), under the GAPE Deeds, Aurizon is guaranteed recovery of <u>**all**</u> of its GAPE infrastructure costs and has been recovering those costs (including the NAPE capex allocation) from GAPE users through GAPE Fees (and associated annual take or pay amounts) under those agreements for over a decade. This is the case because the cost allocation mechanism under GAPE Deeds only reallocates costs to NAPE customers (reducing payments from GAPE Deed customers) when NAPE railings commence. Despite the NAPE assets being excluded from the GAPE regulatory asset base.

2 Evidence arising now suggests that Aurizon would be aware that the NAPE Deed customer has changed its operations to ensure that all volumes from the relevant mine were not subject to the NAPE Deed and therefore that it would <u>**never**</u> contribute to GAPE costs. In effect, this arrangement has permanently transferred the burden of NAPE costs to GAPE users through the period of the GAPE Deeds while the NAPE infrastructure costs have been "parked" for regulatory purposes.

3 This means the Aurizon has been recovering NAPE infrastructure costs under GAPE Deed payments, despite these amounts also having been allowed to be capitalized for regulatory

purposes in the Newlands asset base – effectively setting up a significant 'double recovery' risk by Aurizon, when those amounts are rolled into a regulatory RAB. Some of this capitalized interest has already been included in the GAPE regulatory asset base, when the Byerwen NAPE capacity was transferred to GAPE. Rio Tinto understands that the value of NAPE assets being funded under GAPE Deeds, while also being capitalized by Aurizon, is valued at approximately $120 million. It is therefore both significant and growing each year.

4 In short, due to arrangements between Aurizon and a single user (which were not made transparent to Rio Tinto (or, we assume, other GAPE users)):

(a) Rio Tinto has, for over a decade, been paying significantly higher GAPE payments than was reasonably contemplated at the time the GAPE Deeds were entered into – because GAPE expectations were based on an understanding that GAPE and NAPE users would rail in accordance with their agreements; and

(b) at the same time, based on the current treatment of the NAPE assets by the QCA for regulatory purposes, those higher payments appear likely to result in a windfall gain to Aurizon in the future (i.e. a double recovery of a portion of NAPE costs), when the NAPE amounts are rolled into either the GAPE or Newlands RABs.

5 Given the unfairness associated with this outcome, it is not appropriate for any further deferral of these amounts to be allowed by the QCA. Any failure by the QCA to address this issue now compounds the problem.

6 Rio Tinto contends that the most appropriate course would be for NAPE asset costs to be recovered from the NAPE customer, or new users of the NAPE infrastructure, either through NAPE tariffs or through an adjustment or premium to their Newlands tariffs. However, at a minimum, the QCA must determine if it is reasonable to continue to allocate a proportion of the NAPE project costs to GAPE users. If it is found that it is no longer reasonable to expect a NAPE customer to rail (so that the NAPE costs are never allocated to NAPE users), then a decision needs to be made as to who will pay for the remaining value of the NAPE assets. In making this decision it will be essential that the QCA takes into account how, and the extent to which, those assets have been funded under the GAPE Deeds to date.

7 Finally, and separately, Rio Tinto strongly objects to the continued capitalization of all GAPE/Newlands renewals capex as Newlands assets.

Rio Tinto acknowledges that the issues raised above are complex and interact with the GAPE Deed and other commercial arrangements. We would therefore welcome the opportunity to meet with you and the QCA team to discuss directly Rio Tinto's concerns and strong objection to any further delay in resolving the issue of regulated recovery of NAPE costs.

Yours faithfully