RioTinto

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Queensland Competition Authority
GPO Box 2257
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Dear Sirs

GLADSTONE AREA WATER BOARD REGULATORY SUBMISSION

We refer to the current price monitoring investigation being conducted by the Queensland Competition Authority ('QCA') in relation to the Gladstone Area Water Board ('GAWB') for the period 1 July 2020 to 30 June 2025.

Rio Tinto has significant operations which are customers of GAWB including the Yarwun alumina refinery (Rio Tinto 100%), the Queensland Alumina Limited alumina refinery (QAL) (Rio Tinto 80%) and the Boyne Smelters Limited aluminium smelter (BSL) (Rio Tinto 59.4%). These operations have collectively been significant contributors to the Gladstone and Queensland economy over an extended period of time. [redacted]

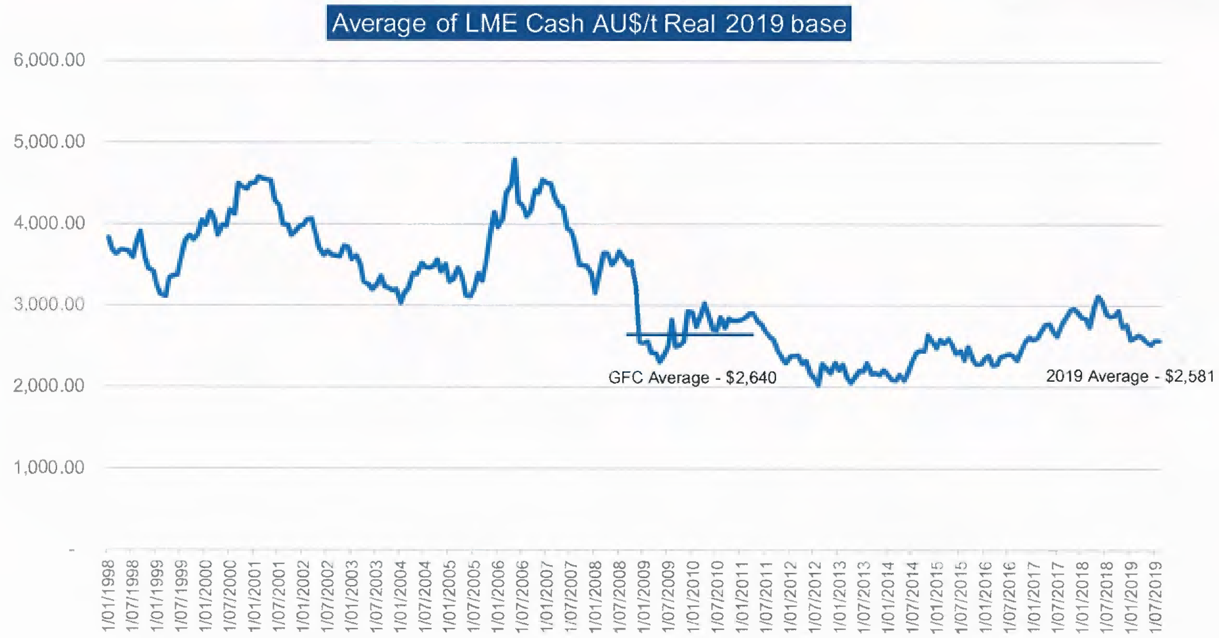
Rio Tinto appreciates the opportunity to comment on the submission prepared by GAWB in relation to the proposed pricing methodology and in particular, GAWB's proposed measures to reduce the existing balance of accumulated under recoveries. In this regard, Rio Tinto has significant concerns about the proposed annuities which GAWB is seeking and their potential impact upon its businesses in the Gladstone region.

By way of background, Rio Tinto wishes the QCA to initially note the following challenges being faced by these industries:

Aluminium Smelters

Since the global financial crisis, the Australian aluminium industry has been facing some well publicised challenges from depressed aluminium prices and rising energy costs. In this time, two Australian aluminium smelters have closed (Norsk Hydro's Kurri Kurri and Alcoa's Point Henry).

In terms of the aluminium market itself, aluminium is a product which is traded internationally and whose price is determined by reference to the price of metal published by the London Metal Exchange. Accordingly, producers of aluminium are not price setters but price takers. When input costs rise in the production process, such producers generally have limited recourse to pass these costs onto end purchasers. The table below demonstrates the LME aluminium price over the past twenty years and reflects the current challenges being faced by Australian producers.



As is currently well documented in the business press, the aluminium industry is currently facing very challenging circumstances, with lower demand given global trade issues, as well as excess supply from offshore manufacturers.

Alumina Refineries

From 2017-2019, our refineries have weathered steeply rising input costs for key raw materials, and seen several economic shocks impacting the alumina refining industry resulting from the U.S sanctions on the Russian company Rusal and Alunorte disruption. Alumina prices are currently at a 25 month low.

GAWB Submission

Part B, clause 1.3 of the Referral Notice requires the QCA to provide advice on measures that prevent the further accumulation of under recovered revenue and to reduce the existing balance of under recoveries. In this regard, the GAWB submission asserts that as a result of the pricing methodology previously adopted by the QCA, GAWB has under-recovered its annual revenue requirements in most years. This accumulated under recovery has grown exponentially in recent regulatory periods; reaching $124.7 million as at 1 July 2020.

GAWB's proposal to manage this issue is to seek the full recovery of the under recovery amount from existing customers by payment of an annual annuity. In the particular case of the alumina refineries, these annuity payments are substantial additional sums to the significant amounts already paid to GAWB.

Rio Tinto Concerns

As major customers of GAWB, Rio Tinto's operations have significant concerns about the cost impact of the GAWB pricing proposal if the under-recovery methodology was to be accepted. In particular, Rio Tinto submits the QCA should have regard to the following in considering the proposal:

1. The proposed under recovery methodology represents a substantial cost increase for businesses that are already experiencing challenging market conditions. As an example, the proposed annuity for one of the alumina refineries amounts to an approximately [redacted] increase of the refineries total annual water costs. In this regard, it is noted that part of the

QCA's reasoning for approving the original 20 year price smoothing methodology in 2005 was as follows:

a. Price efficiency grounds: the need to provide appropriate signals for long term planning by customers; and
b. Fairness grounds: the need to avoid significant price shocks.[1]

Rio Tinto respectfully submits the GAWB proposal represents a significant departure from this position. An approximate [redacted] increase in water costs would appear plainly to be a price shock which the original pricing model was designed to avoid. Rio Tinto submits that price stability for users should be a key consideration of the QCA in conducting its investigation into GAWBs pricing for the period 1 July 2020 to the 30 June 2025.

2. Rio Tinto notes that under section 26(1)(m) of the Queensland Competition Authority Act 1997 ('the Act'), the QCA must have regard to economic and regional issues, including employment and investment growth. As detailed above, alumina refineries and aluminium smelters are facing challenging market conditions that are likely to continue in the foreseeable future. While these businesses have undertaken significant business transformation in recent years to remain globally competitive, a strong focus on costs and efficiencies is required going forward to ensure the long term future. Rio Tinto submits that the QCA should consider that price jumps of the magnitude proposed by GAWB have the potential to undermine the competiveness of customers in the Gladstone area, which may in turn detrimentally impact the opportunity to attract capital to create further investment and employment opportunities at these sites.

3. Rio Tinto further submits the QCA needs to consider the degree to which allowing GAWB to obtain full recovery from existing users accords with the principles of ensuring efficient capital allocation by monopoly businesses and protecting end users from inefficiencies[2]. As an example, it is noted that approximately 40-45% of the under recovery amount relates to the raising of the Awoonga Dam wall[3]. In considering whether it is appropriate or fair to allow GAWB to obtain full recovery of these amounts from existing users, Rio Tinto submits the QCA should have regard to:

   a. Excess capacity concerns. The Awoonga Dam was significantly expanded in the early 2000s increasing storage capacity from 283,000 ML to almost 777,000 ML with a corresponding increase in the then assessed Historical No Failure Yield (HNFY) from 49,400 to 87,900 ML[4]. While there has been some increase in demand and reserved amounts over the past fifteen years since the augmentation, it is noted there is a gap of approximately 20,000 ML between HNFY of the Awoonga Dam and the current water reserves. While Rio Tinto appreciates inherent difficulties in modelling future demand for infrastructure projects, Rio Tinto submits the QCA should consider the degree to whether it's fair and equitable that current users should compensate for all capital costs incurred for a service that is significantly in excess of what is required by the current users.

   In this regard, Rio Tinto submits that GAWB should bear a degree of utilisation risk associated with capital projects to ensure capital is deployed in an efficient manner. If a capital or augmentation project by a monopoly provider has benefits which are far beyond those then required by the users, then it should be considered whether the monopoly provider should have some responsibility for funding such excess.

[1] GAWB 2020-25 Bulk Water Price Review Submission, Part A, p54.
[2] Section 26(1) (a) of the Act.
[3] GAWB Bulk Water Price Review Submission Part A p.59.
[4] GAWP Bulk Water Price Review Submission, Part A, p 66.

Under the GAWB pricing proposal, GAWB bears little to no risk associated with inefficient capital allocation if all such costs can simply be recovered from the end user.

b. Inter-generational equity considerations. While Rio Tinto appreciates it is difficult to allocate costs between current and potential future users of an asset, Rio Tinto submits that the proposed methodology places too much responsibility on current users for an asset that will potentially provide GAWB with economic opportunity until 2135 (being the estimated end life of the recent augmentations). It's noted that as part of GAWBs submission that the proposed recovery should be consistent with economic principles; that is the user of the service, or the individual that caused the costs to be incurred should pay the relevant costs[5]. While Rio Tinto is obviously a large user of GAWB's services, it is submitted that given the long life and significant capacity of the Awoonga Dam asset (compared to current reserves and demand), the QCA must consider whether it's appropriate the full amount of the under recovery is to be recovered from the current users.

We would be happy to discuss any of the above in further detail with the QCA.

Please contact Joseph Carey on (07) 3625 3368 should you wish to arrange a meeting or if you have any queries.

Yours sincerely

Kellie Parker
Managing Director
Rio Tinto Aluminium - Pacific Operations

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[5] GAWB Bulk Water Price Review Submission, Part B Page 7