QUEENSLAND ALUMINA LIMITED

ABN 98 009 725 044
PARSONS POINT GLADSTONE QUEENSLAND 4680 AUSTRALIA

Ref: PM\smc

8 June 2007

Queensland Competition Authority
GPO Box 2257
BRISBANE Q 4001
Email: gawb.investigation@qca.org.au

Dear Sirs:

GLADSTONE AREA WATER BOARD
2007 INVESTIGATION OF PRICING PRACTICES
CONTINGENT SUPPLY STRATEGY

Queensland Alumina Limited (QAL) appreciates the opportunity to make this submission to the first stage of the Authority's investigation into the appropriateness of the Gladstone Area Water Board's (GAWB's) proposed pricing practices for a contingent supply source strategy through the supply of water, by pipeline, from the Fitzroy River to Gladstone.

QAL Water Supply Requirements

As with its other major production inputs, QAL requires a water supply that is:

- uninterruptible;
- of appropriate minimum quality;
- priced appropriately, transparently and predictably

This submission assesses the Lower Fitzroy pipeline against QAL's water supply requirements to establish its appropriateness for QAL's purposes.

Uninterruptibility of Supply

The pipeline will connect to the new Aldoga Reservoir to service new industry to be located on the Gladstone State Development Area and projected to require 20,000 ML/a of additional supply. The additional supply will not directly reinforce the security of QAL supply and indirect reinforcement (if any) would be extremely marginal.

Water is fundamental to QAL's production process – a 5% reduction in supply results in a 5% reduction in alumina output. It is not possible for QAL to purchase uninterruptible high priority supply from GAWB - GAWB simply does not offer the product. The water supply is always subject to unfettered restriction contractually, including cessation of supply in stage 3 emergency restrictions. As with its water allocation from the Boyne, GAWB's water allocation from the Lower Fitzroy will be high priority but that level of priority will not be available to industrial customers in Gladstone.

The suggestion the deficiency can be addressed and the customer able to manage the risk by customers being contractually entitled to trade either their capacity or their water reservation is unlikely to be borne out in practice. The contractual entitlement is inferior in title, negotiability and procedure to that allowed for water allocations under the *Water Act 2000*.

Irrespective of the pipeline benefiting only new customers, the connection of the Fitzroy and Boyne catchments creates a single system. The connection could allow enhanced trading opportunities and these should not exclusively remain with GAWB. The connection may also allow the operation of a competitive market with water retailing.

It is also of concern to QAL that the contracts being offered allow GAWB an unfettered right to restrict supply, in excess of the powers given to it as a water service provider under the *Water Act 2000*.

Supply of Minimum Quality

The contracts proposed by GAWB allow GAWB to supply water from not only Awoonga Dam but also, at GAWB's discretion, one or more additional sources of water of comparable quality. QAL's alumina production process relies on a water supply of a minimum quality, so that more turbid water, whether from the Boyne or Fitzroy systems, would require QAL to modify its production process to remove the additional impurities at additional cost.

GAWB has not yet entered into discussions with QAL to define the base quality of its water for QAL use for contractual purposes. In its proposed storage contract, GAWB explicitly excludes any warranty that the water supplied is of any particular quality or fit for any particular purpose.

Appropriateness, Transparency and Predictability of Pricing

The pipeline will benefit new industrial users without any direct benefit to QAL and is in advance of demand. Existing users that derive no direct benefit should not have to contribute to the capital cost through increased water charges as proposed. The projected 9.1% average annual cost increase is a substantial cost impost on existing industry, especially considering the cost increase is only for recover of preparatory costs of $24.8 million. If existing industry is to bear the capital cost of $345 million for the whole pipeline project, GAWB acknowledges a further, but unspecified, 'significant price increase' will be required.

The new infrastructure will not be common, but benefit only the new customers. It is consistent with the Authority's pricing principles for the cost of the pipeline and associated works to be allocated to the new customers only. Until the new customer demand is fully realised, the Queensland Government as the promoter of the Gladstone State Development Area should underwrite the cost of providing a secure water supply and supporting infrastructure in advance of demand.

QAL can see some argument for existing users to contribute to ongoing maintenance and operating costs of the pipeline, where reinforcement of supply security can be demonstrated.

The application of the pricing principles allow GAWB to recover the actual cost of the pipeline and associated works, whatever the final cost may be. The straight pass through of costs to the customer removes all financial risk to GAWB and eliminates any incentive for GAWB to produce a least cost outcome.

Under the current regulatory regime, the Authority recommends only minimum prices. The actual final prices are determined by GAWB's assessment of commercial judgments and public interest considerations.

From a customer perspective, GAWB's actual pricing lacks transparency and certainty. Public interest considerations are nebulous and, in any event, inconsistent with the statutory requirement for GAWB to operate on a commercial basis in a competitive environment. QAL would prefer the Authority to become a fully empowered economic regulator and act as it does, for example, in setting access prices for a defined period and service standards in the regulated electricity distribution businesses.

Moreover, even the actual final prices can be further increased by GAWB under its contracts if:

- the price review methodology is adjusted at any time;
- there is, or is reasonably expected to be, a sustained variation in aggregate revenues derived from the storage and reservation of water (or the delivery of water) by GAWB of at least 15%;
- there is a change in law or exogenous event;
- to recover from a force majeure event

Further, regulatory decisions made by the Authority, the QCA Act Ministers or the Minister are contractually enabled to override the terms of each contract.

Issues of transparency also arise in the implementation of demand side management measures. Despite making a substantial capital investment and incurring on going operating and maintenance costs to reduce demand by some 3,850 ML/a since June 2001, QAL has not received an apparent pricing benefit – QAL's total annual water charges have actually increased in this period by approximately 16% over and above CPI for the same period. QAL incurred the expenditure to reduce consumption in good faith in the expectation that reduced consumption would yield commensurate reductions in water costs, but that value has not materialised. GAWB has recouped its lost revenue from QAL's reduction in consumption across the whole of its customer base, including, in part, from QAL itself. Such a perverse outcome provides no pricing signal to modify consumption behaviour.

If QAL can provide clarification or further explanation that might assist the Authority, please call me on (07) 4976 2775.

Yours sincerely

[redacted]

Peter Mouna
Principal Buyer – Raw Materials and Energy