



GLADSTONE

REGIONAL COUNCIL

Contact Officer: Mr Larney

Our Ref: WS1/A; SCW

2 September 2008

Mr E J Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 1257
BRISBANE QLD 4001

Dear Mr Hall

RE: GLADSTONE AREA WATER BOARD (GAWB) INVESTIGATION OF PRICING PRACTICES – CONTINGENT WATER SUPPLY STRATEGIES

I refer to your letter dated 31 July 2008 in relation to pricing practices for GAWB's Contingent Water Supply Strategy.

The Gladstone Regional Council restates its support for the Fitzroy River Pipeline as the most cost effective solution to augmenting water supply to our region. However, like all customers of the GAWB, the Gladstone Regional Council is concerned to ensure that the Fitzroy River pipeline is not built before it is required, as the cost of constructing this pipeline will adversely impact on the water price for both current and future water consumers. Council would make the following comments in relation to your draft report.

Drought Management Plan

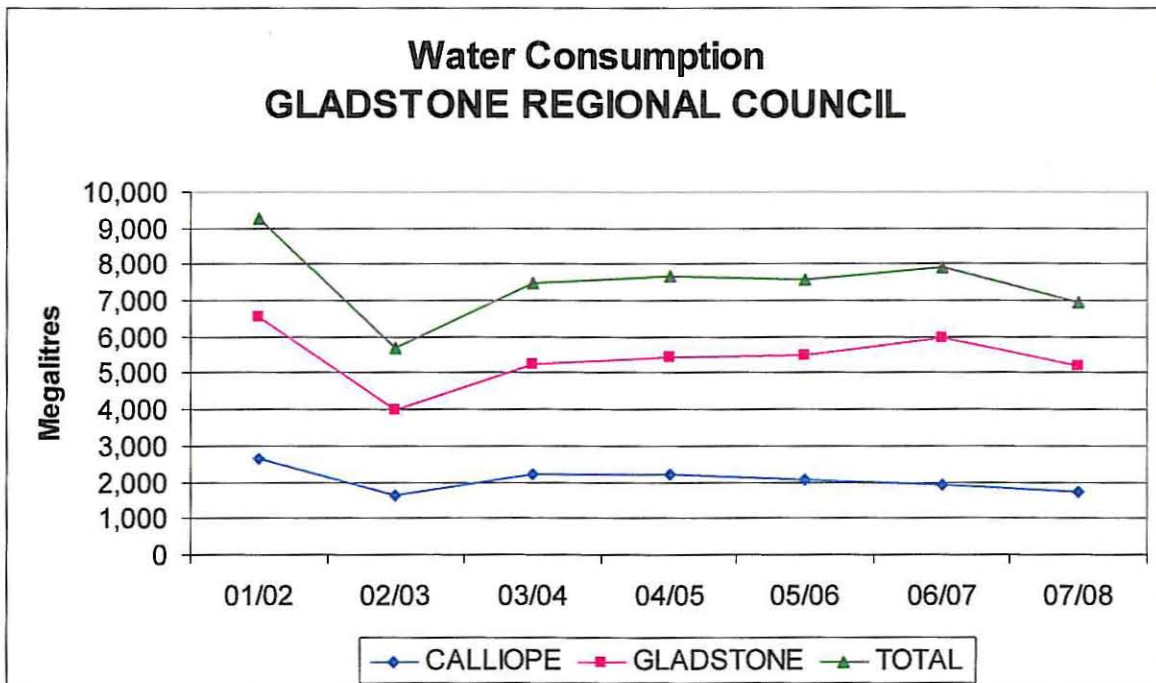
Council recognises that this region depends on major industries such as Queensland Alumina Limited, Rio Tinto Aluminium and others who could close and never reopen if they were unable to receive water. Council also recognises the fact that in response to the water restrictions in 2002 and early 2003, many consumers introduced water saving measures to achieve required restrictions, which have created a permanent reduction in consumption. Therefore the capacity may not exist for many customers to significantly reduce consumption next time the region experiences drought without major capital investments such as air cooling at power stations. Hence, the fact is that the Fitzroy River pipeline may be the only solution to keep industry operating in our region through an extended drought, however all other solution must be seriously considered at the time of a drought event. This pipeline which is rumoured to cost at least \$450M may not be utilised for 10 or more years after construction if it is only built for drought purposes. This new supply will still need to be paid for even if it is no longer required in the short term. Therefore if demand remains significantly below the 70,000ML supply augmentation threshold, other options to the pipeline must be seriously considered. To put the quantum of this decision to build a \$450M pipeline in perspective, the total equity of the GAWB as at the 30 June 2007 was less than \$192M and Total Assets was less than

\$359M. If constructed for drought management purposes only, this pipeline will more than double the assets of the board without any increase in demand. As demand approaches 70,000 ML per year, there would be a stronger argument for the construction of the pipeline during a period of drought, however, current consumption is well short of that target.

Given the fact that drought management concerns may not reappear for several years, Council believes that GAWB must, in cooperation with customers, explore all alternative options that may exist at that time, before constructing the Fitzroy River pipeline. Some possible options could include:

- Some customers taking a larger reduction and being compensated for the water they do not use;
- Major water replacement projects such as air cooling; or
- Mobile desalination plants.

While Calliope Shire Council previously indicated its support for the 50% emergency restrictions (page 13), and the new Gladstone Regional Council would continue to support those restrictions, it must be stressed that achieving a 50% restriction will be significantly more difficult next time compared to 2002/03. The following graph shows that Calliope residential consumption is lower now than in 2002/03. Gladstone Residential Consumption in 07/08, while higher than 2002/03, is significantly lower than the pre-restriction consumption. That being said, Council is far better placed to reduce consumption than major industry, as has been demonstrated in the South East Queensland corner.



Council supports the Authority's comments that *"given the differences between the cost of augmentation and of supply restrictions, different triggers that impose supply restrictions before initiating supply augmentation seem appropriate"*. The conservative inflow assumptions are very appropriate for the commencement of low level alerts and restrictions. However given the significant cost differentials, GAWB should not be using the same conservative inflow assumptions for any decision to augment supply.

The significant difference that exists between the worst 3 year average and the worst 4 year average reflects this region's rainfall pattern which is generally dry conditions interspersed with heavy rainfall events such as Cyclone Benni. Therefore it is not appropriate to ignore this normal climatic trend when considering a major supply augmentation.

Different Levels of Service

CPM suggested that different levels of service could be achieved. GAWB's solution is to allow customers to trade amongst themselves and while that has some merit, it would be difficult to see how an arms length side deal can form part of any drought Management Policy. Council would ask GAWB to investigate if such arrangements could be included in any drought management policy. If a company like CPM or the Council were prepared to accept earlier and harsher restrictions for a different water price, then that strategy could be built into a drought Management Plan and thereby delay the need to augment supply. Clearly some industries do not have the potential to cut demand, however others may have that capacity. While it is more difficult for GAWB to model and price different levels of service, that should not be a reason to dismiss such a drought management or supply augmentation delaying strategy.

Contingency

Council supports a conservative approach to water management in this region due to the critical importance of this scarce resource. However, this conservatism must be measured, because it is a real cost to all water consumers, with potentially little or only marginal benefit for those consumers.

One such cost would be the 5% contingency reserve. There is no justification for such a reserve and GAWB's reasons do not reflect current usage. The risk of a further reduction of the volumetric entitlement at this stage is unnecessarily pessimistic. If a future review of the HNFY volumes occurs, then we as a region must deal with any downgrade of the HNFY at that time. GAWB is already making extremely conservative assessments of inflows for drought management. The 5% contingency reserve is not justified.

GAWB makes much of its lumpy demand. There is no doubt that with 80% of demand coming from major industry, demand increases will reflect the establishment of major new industries or the expansion of existing industries. None of these events happen overnight, with long lead times for the EIS process and other legislative and commercial requirements. There is generally at least two years notice of any large increase in water demand. For this reason it is doubtful that there would ever be any unexpected increases in demand.

Distribution Losses

Council agrees with the authority that 3% system losses would be the most appropriate allowance for distribution losses. Layer upon layer of conservative assumptions deliver nothing but higher water prices.

While the difference between 3% and 5% may not seem substantial on its own, it still represents around 1,000ML a year which may be significant in a drought situation.

Timing Issues

If the most effective and efficient solutions are to be arrived at during a drought situation, the GAWB and all its customers must be given the time to look at all alternative options. The authority's suggested timeline of 120 days would appear to provide a greater opportunity for assessment of alternative options than GAWB's suggestion of 30 to 60 days. The Fitzroy River pipeline must be the solution to an extended drought conditions only after all other viable options that exist at that time have been considered, if the water price in this region is to be kept to a minimum.

Conclusion

The Gladstone Regional Council supports the QCA's draft report and considers that the Authority has given due weight to this issue to ensure that a pipeline from the Fitzroy River is not built before it is actually required. The construction of the pipeline before it is required will not only have an adverse effect on current consumers including all Gladstone residents but may well have a detrimental impact on potential new industries. This region's industries can not cope with significant reductions in the supply of water, however, that fear can not create an environment which sees the construction of this pipeline before it is required because no one benefits from such an overly conservative outcome.

If you require any further information in relation to this submission, please do not hesitate to contact Mr Mark Larney, Council's Director Corporate Services, or myself.

Yours faithfully,



CALE DENDLE
ACTING CHIEF EXECUTIVE OFFICER