



QUEENSLAND ALUMINA LIMITED

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Mr John Hall
Chief Executive
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

19 February 2010

Dear Mr Hall

QAL appreciates the opportunity to make a submission to the Queensland Competition Authority ("QCA") in response to Gladstone Area Water Board Submission 2; Expenditure Proposals, dated December 2009 ("GAWB Submission") and makes the following response:

1. RAB

GAWB is seeking an opening regulated asset base (RAB) for the 2011-2015 period based on a roll forward of a revised 2005 valuation that is higher than the QCA approved 2005 RAB. The proposed change will increase the approved RAB from \$355.63 million to \$371.67 million.

GAWB has advised that the upward revision of the previously approved 2005 RAB is due to the inability to assess the details underpinning the 2005 QCA decision.

Acceptance of GAWB's proposal would represent the acceptance of a principle that there is an indefinite period in which previous pricing decisions can be challenged and reconsidered. The RAB determined in 2005 must have been analysed in detail to arrive at the final value and therefore QAL believes it is unreasonable to base RAB on any value different to that determined and approved by the QCA in 2005.

2. Demand Forecast

QAL understands that GAWB's current proposal to reduce the demand forecast (base case) is based on concerns that an over estimation of demand will lead to an under recovery during the next pricing period. The impact of reducing demand forecast in line with GAWB's proposal will be to increase present customer's prices to the benefit of any new customers. It is highly unlikely that any demand not realised as a consequence of the recent global

financial crisis and drought will be repeated during the next 5 years. This appears unreasonably conservative especially considering the forecast industrial growth prospects for Gladstone. QAL recommends that any demand forecasts approved by the QCA should take account of forecast growth to ensure fairness for both current and future users.

3. CSS (Contingency Supply Strategy)

GAWB is seeking approval for the inclusion of \$37m in CSS expenditure in its pricing model during the next 5 year pricing period. QAL understands that the QCA supported more expenditure on the CSS based on the possibility of failure of inflows in the 2007/08 wet season. It appears that GAWB continued to spend money on the CSS notwithstanding the inflows in February 2008 and the probability that augmentation would not be required in the foreseeable future. In addition it is QAL's understanding that the EIS undertakings are only valid for a 4 year period and in the event the augmentation is not commenced within this time frame that the EIS may need to be updated at best or at worst, redone. Considering these issues any expenditure on the CSS after February 2008 should not be included in the next price review.

4. Projects

a) *Dam Safety Regulatory Requirements (Saddle Dam No 3)*

GAWB is seeking \$27m for the construction of the Saddle Dam to be completed in 2012/13. The Appendix shows the cost at \$22m not the \$27m being sought. Insufficient data has been provided to demonstrate that the Saddle Dam needs to be completed within this timeframe. Regardless in the event it is demonstrated that the dam upgrade is required it is understood that the QLD government has subsidised upgrades elsewhere and so a similar subsidy should be factored into any case to upgrade the Awoonga Dam number 3 Saddle Dam abutment. Prior to any approval being given by the QCA it is recommended that the business case be made available for review, the subsidy issue resolved and appropriate priority for this project is considered in the context of other dam safety projects in QLD. The costs and benefits associated with deferring the project until the next economic downturn should also be assessed.

b) *System Storage*

GAWB has provided insufficient supporting data to justify both the scale and the need for this investment. GAWB maintains that there is a relatively immaterial cost associated with 14 days storage as compared to 2 days storage. However given the 30% contingency of the cost to construct homogenous fill embankment, which itself represents 42% of the total cost, the increase in storage term could have a material effect on total pricing. In addition the Due Diligence Report conducted by R2A Pty Ltd (Appendix 16 to the GAWB Submission) found that either the desalination or Gladstone-Fitzroy pipeline project address the long term credible threats that the system storage project is also intended to address, including drought and dam failure. QAL suggest that this risk is sufficiently mitigated by these other projects and the risk of pump failure sufficiently mitigated by the installation of back up pumps at a much lower cost. QAL would like to see clear evidence of the prudence of this project both in terms of scale and necessity.

c) *Land & Catchment Management*

GAWB is seeking QCA endorsement of an expenditure program involving the purchase and management of certain properties adjacent to the Awoonga dam storage. GAWB has provided no evidence in the submission that this project represents best practice, that it will reduce water costs, or that it is a requirement of legislation or government regulation. GAWB's suggestion that 200 metre wide buffers are necessary for water storage operational purposes is inconsistent with more recent EIS findings for proposed dams including Wyaralong Dam and Traveston Crossing Dam, which indicate that buffers of 100 metres or less are suitable for water storage operational purposes. In addition, according to appendix 3 to the GAWB Submission, 80 percent of GAWB water supplied is represented by untreated raw water for industry. In this context, the benefit of additional catchment management expenditure aimed at reducing water treatment costs is considered highly questionable. QAL submit that without sufficient supporting evidence the land and catchment management expenditure should not be reflected in GAWB prices.

5. Operating Expenditure

a) *Staffing cost allocations*

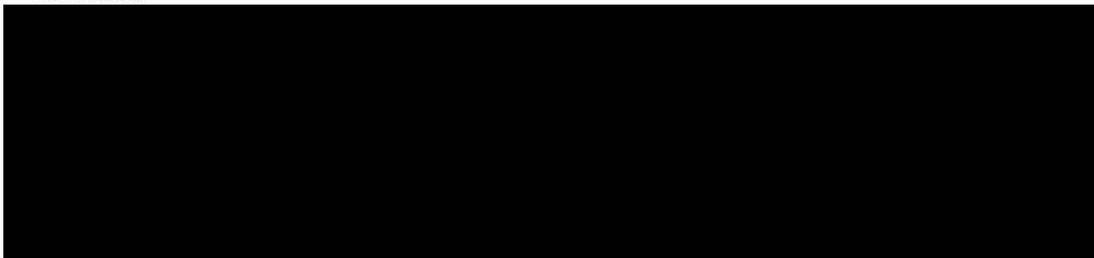
GAWB's proposed staffing cost allocation appears high in proportion to the operational budget. It also appears a high proportion of the additional Operational Business Unit FTEs are required to address issues in relation to the treatment of water. GAWB does not demonstrate how this increase adds value to raw water users. QAL would like to see a detailed breakdown of cost allocation methodology between service areas to confirm growth of operational staff costs required for water treatment activities is correctly allocated to treated water customers.

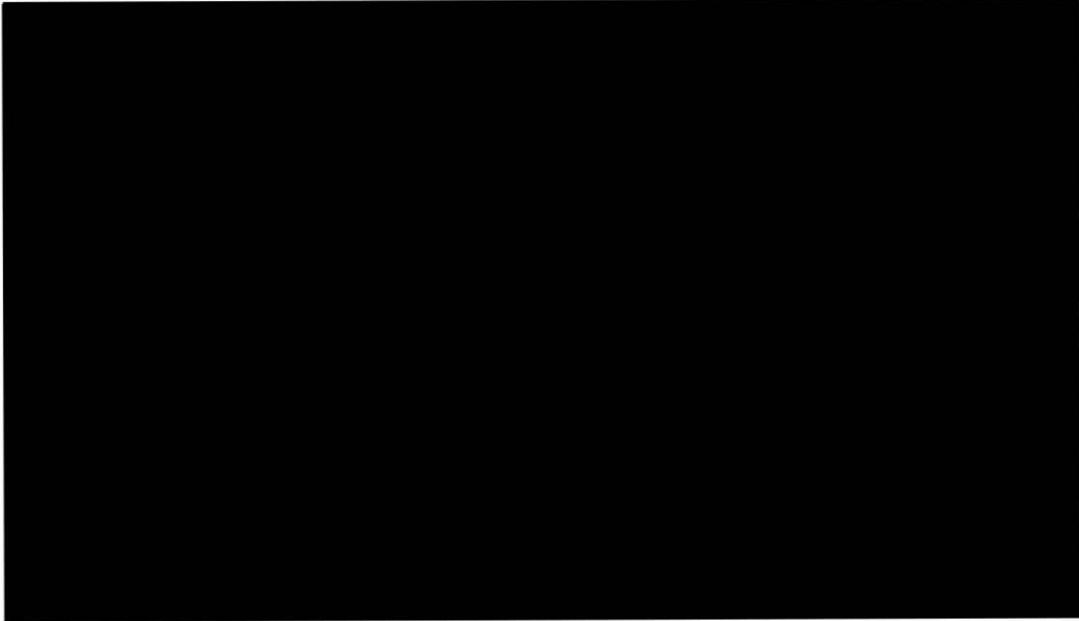
b) *General*

Operating costs on the whole increased substantially over the previous pricing period to 2010 and this trend is being carried into the 2010/11 – 2015/16 pricing period. Furthermore the expenditure in 2009/10 exceeded forecast expenditure by 85%. QAL would like to see detail on the value added by this proposed expenditure increase. QAL also suggest the QCA commission independent examination of the appropriateness of the escalation factor for employment costs of 5%, a comparison of operating expenses as proportion of the RAB, and the impact of projected staffing cost increases on benchmarked performance.

In addition to the above response to the GAWB submission QAL wish to raise two additional issues at this stage – contract terms and conditions, and WACC.

6. Contract





7. WACC

At a presentation to QAL by GAWB just prior to Christmas it was indicated that the WACC is expected to be revised upwards in 2010 from its existing rate of 7.73%. The WACC rate has a significant impact on price and one of the key factors used in determining WACC is risk.

QAL believes that the present WACC rate is high considering the actual risk profile for the supply of water to QAL; refer comments in 1 above.

QAL's requirement for water for the alumina process is not discretionary. QAL understands that 80% of GAWB's customer base are industrial users (non discretionary water user's) and this being the case there is a very low risk to GAWB therefore QAL cannot see any justification for an increase in WACC.

In closing, we would like to thank you for giving QAL the opportunity to comment on GAWB's proposals. If you would like any clarification on any of the comments please contact either the undersigned or Kym Lowery on direct line (07) 4971 7142.

Yours Sincerely



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