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DATE RECEIVED

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Dear Sirs,

RE: GLADSTONE AREA WATER BOARD
INVESTIGATION OF PRICING PRACTICES

We refer to your draft report (December 2004) and provide commentary thereto in the attachment to this letter.

We will be willing to discuss these matters in further detail with you if required.

Yours faithfully,

Alan Hustwick
General Manager – Procurement

Attachments

ATTACHMENTGladstone Area Water Board (GAWB)
Investigation of Pricing Practices, December 2004**Comments****1. GOVERNANCE**

There are three matters where we provide comment.

a) Board Composition

Although not specifically addressed in your draft report nor within the scope of your review, we recommend a change in the composition to GAWB's Board of Directors. Currently the Board is comprised of the CEO, Government appointees and council representatives. This neither reflects the interests of GAWB's entire customer base, nor is it necessarily representative of the skills required to provide oversight and direction to a significant enterprise with a substantial asset and revenue base. Further, there are many long-term strategic issues that need to be addressed in the near term to ensure GAWB's long-term business success.

Two models are available e.g.

- (i) A 'Co-operative' style Board where Board composition is representative of GAWB's user base. This would necessitate a change in that this would require 2 (possibly 3) members from significant Gladstone industrial enterprises.
- (ii) A 'Competency' style Board similar to the way Government Owned Corporations (GOCs) are run. This change would necessitate having Board members experienced in the affairs of running water utilities and/or engineers and finance professionals.

GAWB's stakeholders (users, lenders, government) need the assurance that the Board is acting in the interest of the entire community and having this demonstrated through the transparency of Board composition.

b) Investment Review Panel

We note in your draft report (Page 71) of GAWB's proposal to the formation of an Investment Review Panel (IRP). This does not appear to carry the support of the QCA.

We strongly recommend that such a panel be established. Consistent with sound governance and control procedures, is the need for oversight and review of major capital expenditure of an enterprise. An IRP can have the authority to set investment hurdle criteria and review capital proposals to ensure consistency thereto, that value is being generated to GAWB's users and that capital spend proposed is aligned with GAWB's long term strategic objectives. The IRP would be a committee of the Board (similar to the way many publically listed companies operate) and chaired by the Government Minister responsible for GAWB.

c) Monitoring of Pricing Practices

We note in your draft report (page 126) QCA's recommendation for ongoing monitoring of pricing practices in contracts.

Given the relatively small customer base, it is our view this recommendation provides an unnecessary layer of bureaucracy and cost for minimal value add. One of the key drivers of GAWB is to migrate and align its customers onto a common contractual framework; with that authority provided, there is little value in providing further oversight, as all contracts would be subject to Board scrutiny and approval. An accountable Board (refer our comment in para (a) above) would fill the role suggested by the QCA.

2. WACC

We note in your draft report that you support Comalco's proposals on the methodology for WACC determination.

It is our view that the premium proposed over the risk free rate is too large given the certainty over GAWB's future revenue stream and its risk profile as a supplier of an essential service.

For example GAWB as a provider of water to the community is not in a position to guarantee supply or reliability, nor can it guarantee water quality. Different to private enterprise, GAWB has no incentive to identify opportunities for cost reduction over time and thereby lower its fixed overhead base, nor reduce its variable overhead cost structure by reduction in water consumption through conservation initiatives shared by the community.

Whereas we respect the limitations and constraints under which GAWB operate, the foregoing does represent a significant transfer of risk to the user base. In negotiating an arm's length commercial contract in a competitive market environment such risks would be compensated to the customer through a low pricing regime.

We therefore recommend that the QCA reconsider this aspect and reflect a lower premium over the risk free rate in its WACC determination.