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*By Email*  
Mr EJ Hall  
Queensland Competition Authority  
PO Box 2257  
BRISBANE QLD 4001

30 October 2009

Our reference 091030 GAWB 2010 Price Review – Submission 1  
Your reference

Dear Mr Hall

Thank you for the opportunity for Rio Tinto Alcan (RTA) to review GAWB's Commercial Framework and Pricing Principles for the 2010 price review. Our specific comments are detailed in the attached submission.

We understand that GAWB's submission is the first of three to be made to the QCA for the 2010 price review. We look forward to further participation in the QCA review process and appreciate the opportunity to provide this submission for your consideration.

Yours sincerely



Paul Arnold  
General Manager - Energy

**Rio Tinto Alcan (RTA) Submission to the Queensland Competition Authority**

**Gladstone Area Water Board (GAWB) Commercial Framework and Pricing Principles for the 2010 Price Review  
September 2009**

*Form of Regulation*

The proposal by GAWB to change the form of regulation from a price cap to revenue cap passes demand risk to customers. If actual demand volumes are below forecast demand then customers' water costs must increase to meet the revenue cap. As the sole custodian of the total demand forecast GAWB is best placed to manage this risk. Customers have no means through which to manage or mitigate this demand forecast risk and do not have access to the detailed information supporting the demand forecast.

The transfer of demand and volume price risk to the customer does provide GAWB with revenue certainty. Any benefit to customers through lower water costs has not been demonstrated.

From a customer's perspective, a move to a revenue cap further reinforces the need for accurate demand forecasts to be applied over the regulatory control period. Customers will benefit from greater understanding of water demand forecast assumptions and the potential impact on short and long term water costs, particularly with any future augmentation. We note that GAWB's planned second submission on the 2010 price review is to review demand forecasts. RTA will provide additional comments at that time.

*Planning Period*

The reduction in planning period passes price risk and volatility to customers and erodes the value of long term contracts to customers that seek stability and certainty in water supply arrangements. GAWB's investments are of a long-term nature and should be priced accordingly.

*Demand Forecasting Methodology*

As discussed above, demand forecasting is a critical element of the service provided by GAWB. RTA encourages greater transparency on the key assumptions on which the demand forecasts are formulated. It is in the interests of all stakeholders to have a clear understanding on the basis of any demand forecast.

*WACC Parameters*

The capital structure of 50% equity and 50% debt does not appear to optimise the cost of capital and, therefore, the resultant water price charged to GAWB's customers. RTA expects that a monopoly utility, with 'blue chip' customer companies effectively underwriting the significant proportion of the business through contracted purchases, allows a more aggressive capital structure be applied to reduce the WACC. Moreover, the proposal for a 'revenue' cap in place of a 'price' cap further reduces GAWB's margin and returns risk. This reduction in risk is not priced into the cost of equity or debt financing.

We note that the calculation of the post tax nominal WACC (refer section 4.4.9 of the GAWB submission) does not appear to consider the tax benefits of debt financing.

The application of a zero gamma factor also increases the equity rate of return for the WACC calculation. There is wide ranging debate on this issue and in our view it is an extreme and potentially flawed view that the marginal investor is an international investor that attributes no value to imputation credits.

#### *Price Differentiation*

A mechanism that differentiates water costs according to contract term is supported. However, the proposed price differentiation surcharge methodology should be structured as a discount for long-term contract customers as opposed to a premium for shorter term contracts. A surcharge style structure may just invite new costs to accommodate short-term contract flexibility.

GAWB's submission clearly states that GAWB's preference for longer term contracts is to better support its ability to plan and finance the water system. Reflecting this intent, the price differentiation structure should seek to reward those customers entering long-term contracts rather than overtly penalising those on shorter terms.

Whilst acknowledging the difficulty in determining the appropriate surcharge or discount, the quantum of the price discount over longer terms requires greater examination.

#### *IFR Pricing*

Setting water prices on a single, one second, high flow event for the period may not necessarily be an accurate reflection of a customer's utilisation of the system. By virtue of the number of customers and inherent variation in instantaneous demand, GAWB's network will see a degree of modulation of any actual 'peak' on GAWB's service provision and infrastructure capability. As described, IFR pricing does not acknowledge the potential offsetting effect that may occur during a peak event from other customers simultaneously presenting less demand.

Under IFR pricing, customers will construct local buffer capacity to avoid high flow events. Such investments may not be efficient, particularly if all customers undertake this expense independently. IFR pricing may create the perverse outcome where customers install buffer capacity to avoid higher water costs for peak consumption events that ordinarily may not have caused additional costs to be incurred on the network.

The fundamental reasoning and underlying business case for the proposed change in approach, and consequential impact on customer's water costs, is unclear.