

**RIO
TINTO**

ALUMINIUM

8 June 2007

Queensland Competition Authority
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Brisbane QLD 4001

Email: gawb.investigation@gca.org.au

Dear Sirs

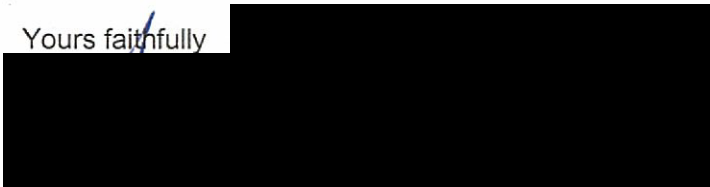
PROPOSED PRICING PRACTICES OF THE GLADSTONE AREA WATER BOARD

We refer to the invitation to provide comment to the investigation by the Queensland Competition Authority regarding the appropriateness of proposed pricing practices in relation to a contingent supply source strategy which involves the supply of water, by pipeline, from the Fitzroy River to Gladstone.

We attach our submission to this letter. Our commentary has been kept necessarily brief so as to retain a focus on matters of a substantive nature only.

We thank you for the opportunity of providing commentary and look forward to discussing these matters with you later in some greater detail.

Yours faithfully


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Submission from Rio Tinto Aluminium (*RTA*) on QCA Investigation regarding the appropriateness of proposed pricing practices in relation to a contingent supply source strategy which involves the supply of water, by pipeline, from the Fitzroy River to Gladstone.

General Comments

RTA provides the following context and general comments with respect to its specific responses to the 4 areas that the QCA investigation specifically has regard to. The general comments are:

1. Approximately 80% of water consumption in Gladstone is by heavy industrial users. RTA has interests in four of these large assets. The cost and reliability of supply of water to these operations is essential for ensuring reliable, cost competitive and sustainable long-term operation.
2. For the above reasons, RTA is a strong supporter of GAWB's plan to develop a contingent water supply from the Fitzroy River. However, RTA is very concerned about the continuing escalation in the cost of this project. The two issues which underpin RTA's concern are:
 - The project is now of such a significant size that there is concern about GAWB's ability to manage a project of this size in a difficult construction environment.
 - The higher the capital cost of the Fitzroy project the more impact it will have on water prices in Gladstone. RTA is concerned not only about the magnitude of these costs to its businesses but is also concerned that the current pricing mechanism is such that if industry as a whole reduces its water usage, this reduces the revenue pool for GAWB, which results in an even higher unit charge to its customers.

For these reasons RTA believes that it is prudent for GAWB to have processes in place for continuing to review other options, at an appropriate level of detail, to ensure that the Fitzroy River option remains preferred whilst continuing its progression. Options under review should include not just those available to GAWB but also, through consultation with key water users, options that they might have to either significantly reduce water consumption or provide alternative sources themselves. RTA also believes that there must be further assessment of the scope and cost of the Fitzroy project and the proposed execution strategy to ensure the capital cost is minimised to the greatest extent possible.

3. RTA notes the Queensland Government's plans for a water grid connecting key water supply assets in the State so as to further mitigate supply risk. RTA acknowledges that this is recognition of the need to be able to share water resources for the greater good of the State. RTA supports this principle. In this context however, RTA questions whether the Fitzroy proposal can any longer be viewed as a contingent strategy.
4. Availability of water in Gladstone has been a key feature in attracting the significant industrial base. Water supply is genuine common user infrastructure. The State Government has in the past provided support to

major project investment through provision of common user infrastructure support.

5. If Gladstone is to become part of a broader State solution, then RTA believes that any additional costs that GAWB customers are asked to bear should reflect this including recognising that this water may be directed away from Gladstone at some point in the future.

Specific RTA Comments on GAWB's recovery of proposed preparatory expenditure

1. The prudence of GAWB's contingent source supply strategy, including selection of supply from the Fitzroy River as an appropriate contingent source.
 - RTA continues to support GAWB's efforts to develop the contingent source supply from the Fitzroy River including the need for preparatory expenditure.
 - RTA's ability to comment on the prudence of preparatory expenditure is to some extent dictated by the view it takes about the prudence of the Fitzroy River project itself. In its submission, GAWB has not provided any indication, other than the capital cost, of the likely impact of the additional Fitzroy River supply source on the long-term cost of water in Gladstone.
 - Without an understanding of the long-term cost of water in Gladstone following a Fitzroy River augmentation, RTA is not able to assess the value of its own options for drought proofing its assets as alternatives to the GAWB proposal.
 - RTA recognises the size of the Fitzroy River project and also the nature of the current construction environment and believes that this significantly increases cost and schedule risk for the project. To that extent, RTA supports the prudence of preparatory expenditure as mitigation for these risks.
 - Whilst confirming its support for preparatory expenditure, RTA is strongly of the view particularly with the significant increase in cost, that GAWB and its key industrial customers should continue to review and discuss alternative(s) drought mitigation options so that the prudence of the Fitzroy River solution is continually challenged.
2. The level of efficient costs associated with the development of GAWB's contingent supply strategy that should be included in prices.
 - RTA recognises the prudence of continuing engineering investigations and acquisition of land and approvals for the project so that schedule risk for delivery of the contingent supply source can be mitigated.
 - RTA does not understand, based on its own project management and financial control systems and our understanding of the project trigger points, why it should be necessary to purchase long lead time equipment ahead of a decision to trigger the augmentation. GAWB's submission supports RTA's view in stating that 'whilst it is known that these costs are likely to be required, insufficient information is yet available to allow precise quantification and the estimates are therefore nominal.' RTA does not support the cost efficiency of this aspect of the preparatory expenditure.
3. The timing of expenditures, which are related to the implementation of the contingent supply strategy.
 - RTA notes that the triggers for implementation are well defined in GAWB's Drought Management Plan (*DMP*).
 - The *DMP* triggers are based on the time to supply failure. Calculation of the time to failure requires assumptions to be made about the inflow to the Awoonga dam. RTA believes increased transparency and visibility is required from GAWB about the assumptions it will apply so that its customers can be more aware of the conservatism or otherwise of those

assumptions and therefore about the prudence of timing for implementation of the contingent supply source.

- RTA is of the view that a detailed execution schedule for the Fitzroy River project should be developed as a priority by GAWB based on current understanding of the scope. The schedule should highlight key uncertainties and risks and be shared with customers such that the need for future implementation expenditure can be well understood and broadly supported when required.
4. The means by which efficient costs of the contingent supply strategy should be included in prices for subsequent years.
- RTA believes that proposed augmentation should attract State Government support on the basis that this is key common user infrastructure for the Gladstone area and its industries. Such support should be designed to mitigate the cost impact of drought proofing on GAWB's existing customers.
 - RTA is concerned that in the absence of market pressure for water prices in Gladstone, there is no commercial pressure on GAWB to ensure effective management of the capital cost of the contingent supply source. While RTA is not able to recommend any alternative, RTA is concerned that increased costs will just pass through to consumers.