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Mr EJ Hall
Chief Executive
Queensland Competition Authority
PO Box 2257
BRISBANE QLD 4001

Proposed Pricing Practices of the Gladstone Area Water Board (GAWB)
Part (b) Investigation – Triggers for Construction
Invitation for Submissions

Dear Mr Hall

Thank you for the opportunity for Rio Tinto Alcan (RTA) to review GAWB's Part (b) Augmentation Triggers submission. Our specific comments are detailed in the attached submission.

RTA is a significant investor in the Gladstone region. We manage operations at the Yarwun Alumina Refinery (100% owned) and Boyne Smelters Limited (59.39%), and also hold significant equity positions in Queensland Alumina Limited (80%) and the Gladstone Power Station (42.125%). In July 2007, Rio Tinto announced that the Yarwun Alumina Refinery would be expanded to more than double its current capacity at a capital cost of US$1.8 billion.

Without uninterrupted access to reliable water supplies, the ability to meet our customer requirements is compromised. This is an unacceptable position for both RTA and its customers.

The recent drought conditions and subsequent low supply alert have again demonstrated that GAWB is presently unable to provide customers with the certainty of supply required.

Although the recent falls and resultant lift in Lake Awoonga stocks will most likely temporarily defer any impending triggers for augmentation and, therefore, any near-term critical decision points, RTA remains concerned about the long-term cost and sustained reliability of water supply to our Gladstone area operations.

RTA encourages GAWB, its customers and various stakeholders to use the additional time provided by the recent rainfall fruitfully.

While not specific to the Part (b) review, our primary concern is the uncertainty regarding the capital cost of augmentation and the consequential effect on water prices.

Rio Tinto Alcan

We look forward to further participation in the QCA review process and appreciate the opportunity to make this submission.

Yours sincerely

[redacted]

Paul Arnold
General Manager, Commercial Development

Rio Tinto Alcan

Rio Tinto Alcan Submission to the Queensland Competition Authority

Proposed Pricing Practices of the Gladstone Area Water Board
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Target Outcomes
We note that GAWB submits that the target outcomes seek to achieve avoidance of emergency restrictions under the DMP and that the period of supply should be extended by 2 years.

RTA strongly supports the target outcome of emergency restrictions avoidance. Being a non-municipal customer, the imposition of emergency restrictions means that RTA's supply is entirely curtailed.

However, the rationale supporting the nominated 2 year extension to supply is not explicitly clear. Moreover, in the case whereby augmentation is triggered (at 48 months or less from failure) and on the basis that a minimum 24 month construction period is required for augmentation, then the planned augmentation will only return the time frame to failure to the 48 month trigger point. Customers may still be under supply restrictions even following augmentation.

This outcome, based on rainfall events during augmentation construction following the worst 3-year average, would leave customers in the perverse position of being effectively no better off than at the point augmentation was triggered.

RTA is concerned about the adequacy of the target period of supply, particularly when set against possible increases in unexpected demand and the probable higher cost of incremental supply from any further subsequent augmentations.

Given the recent rainfall, RTA suggests that additional probabilistic based analysis is undertaken on the various augmentation options. This analysis should consider the incremental costs of subsequent augmentation so as to evaluate the efficiency of a larger augmentation relative to a staged augmentation triggered by further drought and/or increased demand.

Construction Trigger Process
The Part (b) submission foreshadows a relatively small window of approximately 3 months between the imposition of supply restrictions and commencement of augmentation. Although somewhat alleviated by the recent rainfall events, RTA is concerned about the limited time for customers to present demand (or supply) side alternatives.

Furthermore, as the capital cost of augmentation has a direct impact on the ultimate cost of water to RTA's operations, RTA is concerned about the price risk that customers inevitably bear on the execution of any major augmentation project.

Consistent with capital projects of the scale contemplated by the Fitzroy River Pipeline, and in light of the price risk exposure presented to customers, RTA recommends that GAWB prepare a far more detailed project development plan for augmentation. This plan should describe the progressive steps in project development through pre-feasibility and feasibility that demonstrate further definition and refinement of the project scope, cost estimate, execution strategy and implementation plan.

At each step in the project development plan, GAWB should be requested to submit the outcomes for customer and peer review.

Demand Side Management
We note that demand side options may present an effective means to defer lumpy, high capital cost augmentations and provide time for above average inflows to address the low supply conditions causing the augmentation requirement.

GAWB refers to the rights that customers may have under the standard water contract to reduce its demand or alternatively trade with other customers.

Customers' existing discretion to reduce demands is constrained given that financial penalties may be applied by GAWB to those customers who reduce water consumption below reservation levels. Clearly, this presents as a disincentive to customers to actively reduce water demand as it may be penalised for reducing water consumption below its reservation level.

RTA believes it is reasonable that if a customer participated in the curtailment initiative:

(a) to prevent or delay augmentation; or
(b) during a low supply alert or supply restrictions;

then the customer would not be penalised for reducing consumption below its reservation levels even where the low supply alert or supply restrictions are lifted.

Inflows – variance and risk
RTA acknowledges that the assumption of the worst three years of inflows is a conservative estimate. Nonetheless, RTA accepts the prudence of this assumption although subject to the efficiency of any cancellation costs borne where augmentation has commenced but is no longer warranted.

Staging of Commitment
RTA acknowledges that circumstances may require suspension of the augmentation project at a point in time after commencement, particularly if drought conditions end. As such RTA is of the view that it is reasonable for GAWB to mitigate costs by suspending further construction works although suggest a framework for this project suspension process be detailed in the Part (b) report.

Distribution Losses
GAWB's submission states that historical network losses are of the order of 10%, although only 5% has been allowed in the consideration to the trigger level. RTA is concerned that the proposed operational improvements to reduce losses from 10% to 5% may not be implemented. This outcome would result in the delayed commencement of triggered augmentation.

Augmentation trigger
The DMP prevents GAWB from contracting for new demand once supply restrictions are announced. RTA recommends that GAWB be limited in its ability to contract for new demand that would result in acceleration of dam failure and interruption to supply of water for existing customers (assuming augmentation is delivered as planned).

Adequacy of the 30GL Augmentation Option

It is difficult to assess the long-term suitability of a 30GL augmentation (as opposed to other volumes) without an understanding of water forecasts put forward by other existing and future customers. RTA suggests that customer demand forecasts are made available to customers to facilitate assessments of external augmentation options and internal demand curtailment projects.