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16 April 2008

Mr John Hall
Chief Executive
Queensland Competition Authority
GPO Box 2257
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Dear Mr Hall

Re: Response to customer submissions – Augmentation Triggers Part (b)

The webpage for the Authority shows three submissions relating to GAWB's proposed criteria for triggering construction of supply augmentations in response to drought or unexpected demand Part (b) of the Referral Notice.

These submissions have been provided by Rio Tinto Alcan (RTA), Callide Power Management (CPM) and CS Energy (CSE). Each of these customers is of substantial importance to GAWB.

Specifically, GAWB acknowledges the comments of CSE that it and CPM are associated (CSE owns 50% of CPM) with these two customers collectively accounting for approximately half of GAWB's 2007 water sales and just under a quarter of revenue derived for that period.¹

GAWB also notes that these two customers are advocating investments to retrofit their respective power stations to reduce demand as an alternative to supply augmentation. GAWB also notes, however, that neither CS Energy nor CPM has provided any detailed information in support of this position (either via their submissions or more generally to GAWB). For clarity, GAWB will consider any documentation provided to better inform it as to the prospects for demand reduction via conversion to air-cooling (or other methods) regardless of whether an augmentation is imminent.

GAWB submits that the Authority should afford due regard to the fact that the majority of GAWB's existing customers, each of which is a commercially sophisticated entity, elected not to respond after having been provided with GAWB's part (b) submissions.

GAWB also submits that it has a duty to efficiently meet the requirements of both its existing and also its future customers. As was observed by CPM in 2002:

*It is **aggregate** consumption that drives the needs for and timing of capacity upgrades. This suggests that all users are **jointly** responsible for any requirement to augment system capacity and should therefore share jointly in any increased (or decreased) costs of supply that may result.²*

The purpose of this letter is to respond to certain matters raised in these submissions that are within the Part (b) terms of reference, to assist the Authority in its preparation of its report. These are set out below.

¹ CSE and CPM were responsible for 23.7% of revenues derived by GAWB in 2006/07

² As extracted in the Authority's Final Report (2002) at p36.



1. Terms of reference

A number of issues were raised in these submissions that fall outside the terms of reference for part (b) of the Referral Notice. Many of these issues – for example preparatory expenditure for the Gladstone-Fitzroy Pipeline – have already been dealt with in Authority's part (a) Final Report. As such, GAWB submits that it is not appropriate for the Authority to revisit these recommendations in the present investigation.

Similarly, GAWB submits that the Authority does not need to (nor has a direction to) publish any further reports in relation to the matters considered in Part (a) of the Referral Notice.

I now turn to the matters relevant to the Part (b) terms of the referral notice, namely:

- the drought trigger;
- triggers for unexpected demand; and
- determining the appropriate augmentation

2. Drought trigger

2.1. Differentiated levels of service

Issue raised: CPM suggested that the management and planning framework surrounding augmentation should both include a definition of the level of service being provided, and recognise that individual customers may require different levels of service. CPM also submitted that it bears drought risk, and therefore should be free to determine its own response. CPM thus submits that drought-related supply augmentation should be on an "opt-in basis" by willing customers.

GAWB response: GAWB accepts the importance of providing customers with flexibility concerning the level of service, specifically security of service, to be provided. GAWB however submits that this objective can be achieved by other strategies than that proposed by CPM. GAWB has previously detailed alternate strategies that place emphasis upon the terms of the contractual arrangement that it has with its respective customers.

Such arrangements are buttressed by GAWB's commercial framework that permits customers to trade between themselves (more likely to occur during periods of relative scarcity) facilitating the use of water to its highest economic use thereby facilitating the provision of differing levels of service.

Also, GAWB's Part (b) submissions (at p19, 4.1.3) details GAWB's intention to canvass customers' support for the inclusion of terms governing short term demand curtailment in their respective supply agreements. If pursued, this framework would provide customers with greater discretion about their level of service. As the Authority is aware, GAWB has written to customers to determine their interest in negotiating an individual restriction regime, thereby tailoring levels of service - particularly in relation to severity and duration of restrictions. CPM's submission may have predated this letter from GAWB.

At a higher level, the planning and management regime that applies to GAWB is centralised – that is, a central agency (GAWB) is charged with developing responses and managing supply risks for present and future customers. This was recommended by the Authority in previous investigations:

Drought management planning is designed to minimise supply risks to customers. While it affects customers, responsibility typically falls to the service provider as the service provider has the best information on the availability of supply and is best

placed to prioritise overall supply in consultation with all customers. Flexible trading and pricing arrangements proposed by GAWB can, within limits, minimise the impact of drought by allowing customers a direct role in managing this risk.³

The Authority further recommended that:

- *planning and infrastructure risks are best managed by GAWB, as the owner and manager of infrastructure;*
- *hydrology risk is not manageable by any party as it is essentially unpredictable and the cost of changes should be to the account of customers;*
- *drought risk is best allocated to GAWB as it is in the best position to manage overall supply options and any relevant restrictions;...*

The Authority considers that:

- *contractual arrangements should be put in place which promote the efficient allocation of risks ...⁴*

The 'opt-in' arrangement proposed by CPM suggests that individual customers are responsible for managing these supply risks. In contrast to the above, this would suggest that GAWB should adopt a limited role in supply planning, with customers responsible for developing and committing to measures to improve their supply reliability.

GAWB submits that CPM's proposal for an 'opt-in' arrangement does not in accord with its commercial framework that has been developed in accordance with the decisions of the QCA Ministers' arising from the 2002 and 2005 investigations.

2.2. Conservatism of inflow assumptions

Issue raised: CSE submitted that GAWB is presenting an unrealistically conservative short-term measure for expected inflows in its Drought Management Plan (DMP). CS Energy also claimed that GAWB had developed inflow assumptions based on a false premise of climate change. CSE also submitted that major inflows occur at a sufficient frequency to sustain a far higher inflow assumption than that adopted by GAWB.

GAWB response: The inflow assumption used in the DMP is referenced from historic inflow data – that is, the lowest three-year sequential inflow (which occurred from 2004 to 2007). As set out in the submission, this compares with inflow assumptions used for similar purposes in Southeast Queensland (the single worst year), and Melbourne (average of the lowest three years)

For the reasons that have been advanced by GAWB at numerous junctures in the course of the Part (a) aspect of the Authorities investigations, GAWB believes that the inflows assumptions employed in its DMP are appropriate for the purposes of this document.

As sought to be emphasised by GAWB previously, the operation of the hydrological model in the DMP is not intended to represent GAWB's prediction of the future, but rather to act as a platform upon which prudent responses can be developed as circumstances actually develop.⁵

³ Refer to the Authority's Final Report (March 2005). p20.

⁴ Ibid. p23

⁵ For example, see GAWB's letter to QCA dated 5 November 2007 at p14, responding to the Authority's Part (a) draft Report.

2.3. Probabilistic approach

Issue raised: CPM submitted that the inflow assumption did not allow for any probabilistic assessment of inflows, and as a result the drought inflow assumption was embedded into the determination of the supply response. RTA also submitted that probabilistic based analysis be undertaken to assess various options.

GAWB response: The Drought Management Plan (DMP) by its very nature requires GAWB to make forecasts about demand and supply. It is necessary for the DMP to develop a scenario from which actions can be set and timeframes established – the inflow assumption is critical for this purpose.

This scenario used for drought planning does not preclude other probability-based assessments being made for augmentation options. For example, GAWB would expect that the probabilities of certain inflows will be a factor for determining augmentation options into the future including that larger capacity options, deployed later, may on balance be more attractive than smaller capacity options, deployed earlier, to provide more time for greater inflows to occur.

GAWB agrees with CPM and RTA that a probabilistic approach to inflows should be considered when selecting the capacity and timing of source augmentation. However, the DMP requires a prudent inflow forecast to ensure positive actions are taken in sufficient time to manage the risk of inflows being lower than expected.

2.4. Demand-side measures

Issue raised: CSE stated that GAWB had moved from a demand response to a supply response for drought, and does not believe that this is justified.

GAWB response: GAWB's submission clearly provides for demand-side measures to be employed to defer or avoid the need for supply measures (triggering augmentation). For example, restrictions or curtailment measures are maintained, and provision is made for customers to submit alternative proposals, including for further demand reduction. Supply-side measures are needed to avoid supply failure in the event demand reductions are inadequate.

3. Unexpected Demand

3.1. Definition of capacity

Issue raised: CPM submitted that the augmentation trigger should be based on GAWB's ultimate water entitlement of 78GL, not its current entitlement of 70GL. Should demands emerge beyond 70GL, the least cost option might be to "defer entering into new contracts until such time as the full 78,000MLpa yield is realised...".

GAWB response: GAWB submits that it is unreasonable to expect further growth and industrial development in the region to be postponed whilst it awaits inflows to Awoonga Dam that enliven its full 78GL entitlement. As noted previously, seemingly at variance with the approach of CPM, GAWB's objectives are to meet the needs of both current and future customers.

Secondly, there are statutory limits imposed on GAWB in relation to the water that can be diverted under its entitlement. Put simply, GAWB cannot enter into commitments to supply beyond the 70GL which is presently permitted in the Boyne River Basin Resource Operations Plan, for any reason including statistical arguments

derived from a probabilistic assessment of inflows. Indeed, an agreement to sell water in excess of the allocation that GAWB holds would be unlawful.

3. Appropriate augmentation

3.1. Timetable

Issue raised: CPM submitted that GAWB should restate the timetable for considering the appropriate augmentation to take account of inflows. RTA also expressed concern over this timeframe, and in particular for customers to submit alternative proposals.

GAWB response: GAWB concurs, and has written to all customers to this effect (letter dated 21 February 2008).

For clarity, GAWB submits that the generic process set out in its submission (section 10.1) would apply going forward. Moreover, GAWB is currently preparing an update to its strategic water plan (which it anticipates will be published early in 2008/09) to incorporate information current at 30 June 2008 (including any updated information on alternative proposals such as air cooling).

GAWB acknowledges the comments concerning the relatively short period of time contemplated in its submission to the QCA for assessment of the comparative merits of the proposed augmentation and possible demand reduction initiatives from customers.

This process is not, however, intended to be exclusive of the consideration of such initiatives by GAWB, but instead represents the period in which such considerations must be concluded to facilitate a timely response to either drought or emergent demand.

This plan will be updated following conclusion of the preparatory works currently underway, including ascertaining a Risk Adjusted Price of the Gladstone Fitzroy Pipeline and updated cost and feasibility information for a desalination plant. Any further information on alternative proposals – such as air cooling – would be welcomed at any time.

3.2. Other options

Issue raised: CSE expressed concerns that GAWB had failed to consider alternative measures to the Gladstone-Fitzroy Pipeline, and has “appeared dismissive of dry cooling as an alternative to meet the drought and demand requirements”.

CSE also stated that GAWB had made a decision “to not pursue water trading as a demand management tool”.

GAWB response: GAWB's submission is clear on both of these points. For example, GAWB has set out a detailed process (refer figures 6 and 7) for determining the appropriate augmentation, at the relevant trigger point. This provides for customers to submit proposals for alternatives that might enable deferment. GAWB has also submitted criteria for assessing these alternatives (see Annexure A).

This process also provides for trading as an option for meeting growth in demand, thereby deferring augmentation. For clarity, GAWB's submission on page 46 states:

Where ... planning reveals that an augmentation may be imminent, GAWB will commence a formal process of notifying customers of this event, its proposed augmentation response, and the estimated pricing implications.

GAWB would also invite customers to submit firm proposals for alternatives, for example to invest in process improvements that reduce water consumption, or by pass GAWB's supply system.

Where augmentation was driven by unexpected demands, GAWB would actively facilitate trading between existing customers and new entrants to the extent this was possible, within any commercial in confidence constraints.

It should also be noted that trading is not a demand-side response to drought. Whilst it can efficiently allocate scarce water, it does not reduce demand and thereby defer or avoid augmentation for drought. Nonetheless, GAWB's current policies provide a mechanism for customers to trade (refer section 7.1.2 of the submission), should they elect to do so as commercially .

3.3. Recovery of any contributions to customers to reduce demand

Issue raised: CPM noted its intention to submit a proposal for conversion to air cooling, in accordance with the process proposed in GAWB's submission. CPM noted that this proposal would have sought partial funding from GAWB towards the cost, with GAWB's costs to be recouped as it would for a supply augmentation.

GAWB response: Reduction to demand by one customer is expected to have implications for prices for those who remain, as fixed costs are distributed across a smaller base. This is a matter that would be considered in the evaluation of alternative proposals (Annexure A). GAWB highlights to the QCA the need for its report to clearly provide for the recovery of these costs, should they be prudent, from customers (refer also to Annexure A of GAWB's submission).

3.4. Discretion for GAWB in evaluating of alternative proposals

Issue raised: CPM observed that the evaluation process for alternative proposals was generally reasonable, but left significant discretion with GAWB, with CPM's major concern relating to a broader economic assessment being applied where competing options generated a similar quantum of benefit.

GAWB response: In suggesting this approach, GAWB has simply sought to apply a further criterion where two options were otherwise equal. In doing this, GAWB was simply proposing a regime that ensured a preferred option could be clearly identified – it does not consider this to be biased in favour of one option over another.

3.5. Accounting for enduring benefits from alternative proposals

Issue raised: CPM also sought clarification as to how GAWB would account for costs and benefits that might endure beyond a 20-year assessment period.

GAWB response: GAWB submits that this does not introduce any further discretion to GAWB in evaluating alternative proposals, as these costs and benefits need be no different in nature to those that might arise within the 20 year period.

GAWB strongly submits that the QCA should either endorse the evaluation criteria proposed by GAWB, or in recommending any changes ensure that the criteria are clearly expressed, can be applied expeditiously and will enable a decision to be made between competing options.

3.6. *Bias towards the Gladstone-Fitzroy Pipeline*

Issue raised: CPM refers to the project information on GAWB's website as demonstrating bias towards the pipeline.

GAWB response: This is simply not correct. This information has been published to inform landholders and other external parties who may be affected by the investigation and other preparatory work of the nature of the project. Such content is functionally based and the interpretation afforded by CPM is not soundly based.

3.7 *Project delivery risks*

Issue raised : RTA submitted that GAWB should prepare a detailed project development plan to manage the cost and delivery risks for preferred project.

GAWB response: GAWB has previously agreed to provide such a document, and confirms that this will be made available to customers by June/July 2008.

Thank you for the opportunity to provide this response, and I look forward to receipt of the Authority's draft report.

Yours sincerely



Jim Grayson
Chief Executive Officer