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5<sup>th</sup> February 2010

Mr John Hall  
Chief Executive  
Queensland Competition Authority  
GPO Box 2257  
**Brisbane Qld 4001**

Dear Mr Hall,

**Submission to the Queensland Competition Authority (QCA) in response to Gladstone Area Water Boards Expenditure Proposals (for the 2010 review)**

Callide Power Management Pty Ltd (CPM) is the Manager of the Callide C Power Station in Biloela, Queensland, and contracts for the supply of water from the Gladstone Area Water Board (GAWB) on behalf of the owners (Callide Energy Pty Ltd and IG Power (Callide) Limited).

CPM has been invited to respond to the expenditure proposals submitted by GAWB to the Queensland Competition Authority (QCA), which are intended by GAWB to form the basis of the 2010 price reset process.

Attached to this cover letter is CPM's submission to the QCA regarding GAWB's Expenditure Proposals.

Should you have any queries in relation to this submission, please contact Jamie Maione, Commercial Manager, Callide Power Management Pty Ltd on 07 3001 7153.

Yours Sincerely,

A solid black rectangular box redacting the signature of Jamie Maione.

Jamie Maione  
Commercial Manager  
Callide Power Management



Submission to the Queensland Competition Authority (QCA)

Gladstone Area Water Board Expenditure Proposals

(2010 Price Review)

February 2010



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## 1. Introduction

Callide Power Management Pty Ltd (CPM) is the Manager of the Callide C Power Station in Biloela, Queensland, and contracts for the supply of water from the Gladstone Area Water Board (GAWB) on behalf of the owners (Callide Energy Pty Ltd and IG Power (Callide) Limited).

CPM has been invited to respond to the expenditure proposals submitted by GAWB to the Queensland Competition Authority (QCA), which are intended by GAWB to form the basis of the 2010 price reset process.

## 2. Executive Summary

CPM submits that the recommendations contained in the GAWB expenditure proposal, prepared for the purposes of the 2010 Price Review (GAWB Expenditure Proposal) in its current form, should be rejected on the basis that it has no reasonable foundation and is inappropriate as the basis for pricing for a monopoly business.

The GAWB Expenditure Proposal represents a significant and fundamental departure from prior expenditure proposals, and if approved, this proposal will result in a significant 'price shock' for GAWB's current customer base.

For CPM specifically, a price increase of this nature and magnitude will have a substantial and material impact on the competitiveness of the Callide C Power Plant. This large operational cost increase will affect only a limited number of power stations and not the vast majority of the Queensland or national electricity generation market, which places the Callide C Power Plant at a competitive disadvantage relative to other market participants.

CPM is not in a position to recover any of this cost increase through the national electricity generation market. It is inappropriate for a monopoly service provider to be seeking to recover this level of price adjustment from its customers who are operating in a competitive market.

The following summarises the main objections by CPM regarding GAWB's Expenditure Proposal:

- i) **Unreasonable Impact on Legitimate Business Interests of Water Users** – The expenditure proposal GAWB has tabled will lead to unacceptable price increases (potentially more than doubling in price) in what is effectively a "steady state" environment. No significant augmentation is being implemented and there is no forecast catastrophic change in terms of regulatory or customer landscapes during the planning period. The Callide C Power Station has a long term supply contract for water and investment and funding is provided on a long term basis with assumptions as to probable and realistic input price increases. No business can viably operate in a competitive market environment where its major costs can increase by such a significant amount with limited ability to recover the costs.
- ii) **Need for Stability and Protection against Abuse of Monopoly Power** – The regulatory framework was meant to provide a level of certainty and price stability to customers and protect consumers against abuses of monopoly power. Customers accepted large price

increases at the time of the last augmentation in 2002, within a framework that provided for relatively stable, CPI-linked pricing outcomes in future periods. CPM accepts that any price trajectory may need occasional resetting and adjustment, but the scale of proposed price increase is unacceptable.

- iii) **Insufficient Connection to Efficient Water Supply Activity** – There is insufficient evidence in the Expenditure Proposal, or the accompanying appendices, of any significant benefit to customers from the proposed expenditures. Most activities/expenditure initiatives are presented as necessary to meet certain regulatory or other requirements or 'correct' past practices (such as operational inefficiencies and poor demand forecasting). There appears to be little reference back to enhanced efficiencies in water supply, customer service standards or lower risk outcomes for the customer. CPM would expect for a price rise of this magnitude that these issues would be addressed.
- iv) **Prior Investigations** – The proposal shows a disregard for the direction of preceding QCA investigations. GAWB has proceeded to incur significant Contingent Supply Strategy (CSS) costs without customer approval and despite augmentation works not being required in the near term. This has resulted in a price increase from CSS-related expenditures significantly in excess of the range initially indicated by GAWB.
- v) **Fundamental and inappropriate risk transfer while providing for a price adjustment for such risk** – GAWB is seeking to reduce its risk by employing a revenue cap approach, which in principle may be acceptable, yet at the same time increasing the rate of return (which implicitly provides for compensation for risk) and incorporating direct compensation for 'self insurance' costs without any offsetting risk adjustment.

### 3. Demand Forecasts

The Base Case Demand scenario represents the lowest risk profile to GAWB. If the QCA are to endorse this demand scenario, which CPM does not support, the benefit of this lower risk (i.e. risk premium reduction) needs to be articulated/quantified, and passed through to major customers. It is apparent from the expenditure proposal that this is not the case.

In the past decade GAWB proposed and undertook a significant storage augmentation, at a time when demand growth was very uncertain and indeed some customers were cautioning that smaller, lesser cost augmentation options should have been considered given the substantial spare capacity that would result from the expansion. Since raising Awoonga Dam in 2002, GAWB's demand forecasts have repeatedly been shown to be overly optimistic. This is supported by the QCA's final report investigating GAWB's Pricing Practices - September 2002<sup>1</sup>. At one point it time, GAWB was forecasting demand for 2009/2010 to be 81,425ML<sup>2</sup>.

<sup>1</sup> Chapter 4 – Demand Projections for GAWB, QCA Final Report Gladstone Area Water Board: Investigation of Pricing Practices, September 2002.

<sup>2</sup> QCA's March 2001 report "Gladstone Area Water Board: Projected Demand for Water - 2000/01 to 2019/20" (Appendix B)















