

Date: 29 January 2010
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Mr. E J Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4127

Dear Mr. Hall

ALLCONNEX WATER FEEDBACK TO SEQ WATER & WASTEWATER INTERIM PRICE MONITORING FRAMEWORK

Further to your letter dated 18 December 2009, Allconnex Water appreciates the opportunity to provide comment to the Queensland Competition Authority's (the Authority) in its development of the SEQ Water and Wastewater Interim Price Monitoring Framework.

The predominant focus of this submission is to discuss the remaining issues not previously dealt with as part of the comments to the *Information requirements for 2010-1* submitted to the Authority on 11th December 2009. This submission includes the views from the three Councils Water Business, Gold Coast, Logan and Redland City Councils, that will form the operations of Allconnex Water from 1 July 2010.

Attached to this submission are some more detailed comments which Allconnex Water provides to the Authority for its consideration prior to finalising its report by 30 April 2010. In this letter Allconnex Water raises some of the higher level issues which the Authority will need to consider during its deliberations on developing the interim price monitoring framework.

Information requirements

As a general comment, the framework identified is more information intensive than a typical price monitoring framework. This will impose additional resource requirements and costs on the business operations during its establishment period. Allconnex Water believes that a more appropriate framework would involve a less information intensive framework during the interim period to minimise the effort and costs during the business establishment phase. Allconnex Water could then work towards establishing information systems, processes and capabilities to prepare for the regulatory framework post 1 July 2013. The attached document provides more detailed comment on the areas identified of particular concern.

Efficiency and prudence of capital expenditure

Allconnex Water would like to reinforce that the review of capital expenditure must avoid creating planning uncertainty which results in delays in the commencement of projects and/or introduces financial risk to the water authority. Any review of capital expenditure should be limited to projects above a certain threshold of materiality and Allconnex Water has previously suggested that a materiality threshold of \$10m be applied.

The Authority should consider and base its reviews on any independent reviews and analysis completed by the water authority to avoid costly and timely duplications of such reviews.

Revenue Glide Path

Allconnex Water requires greater clarity and certainty that the interim price monitoring framework will allow, if required, an appropriate revenue glide path to transition significant price increases over a period of time. This issue has a significant bearing on the pricing policy to be adopted by the business. Such a glide path would permit any under recovery of revenues below maximum allowable revenue (MAR) to future years so that on an NPV basis Allconnex Water is able to recover the cumulative MAR over the revenue glide path period. This is common practice in other regulated industries and jurisdictions and is an important regulatory tool to manage customer impacts associated with significant price changes.

Treatment of contributed, donated and gifted assets and cash contributions

With respect to the appropriate treatment of contributed, donated and gifted assets and cash contributions, Allconnex Water requests more time for it to better understand the options available and impacts on the business operations. This issue has significant operational and financial impacts on the new business and more time is required by Allconnex Water to consider this issue in more detail. Allconnex Water will endeavour to provide further views on this matter by the end of February 2010.

Director's Responsibility Statement

Allconnex Water acknowledges the removal of the word 'true' from the Director's Responsibility Statement based on representations from the water authorities when providing comments previously. However as previously stated in its submission, Allconnex Water believes that it is unreasonable that the Directors of the water authority must sign a statement verifying that the price monitoring information returns 'fairly represent' the results of the entity based on historical information from Council operated businesses prior to 1 July 2010 and forward looking information is based on forecasts prepared prior to the establishment of a new business. A more appropriate statement for the interim period from the directors would involve 'best endeavours' being applied in preparing information in accordance with the Authority's requirements.

Allconnex Water looks forward to working closely with the Authority over the coming months to establish an interim price monitoring framework which finds an appropriate balance between the Authority meeting its objectives and the new water authority establishing its business operations efficiently and seamlessly as possible.

Please contact Sandro Marin, WB3 Project Manager- Finance, Asset Transfers & Corporate Services on 3412 4423 should you require further information.

Yours faithfully


Kim Wood
Chief Executive Officer

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WATER BUSINESS THREE

Specific Comments on Interim Price Monitoring Draft report

Page 17

"The issue of the imposition of rates on unconnected properties and vacancy land referred to in respect of water supply services will also need to be addressed for the provision of wastewater services."

Allconnex Water is concerned by this comment as water businesses across the region have traditionally charged properties where water and/or wastewater infrastructure is available, but not connected. Revenue received by these customers is considered material. The water and/or wastewater network has been established to provide water to all properties for the area concerned and therefore all properties should contribute to the cost of providing the service. A change in this pricing policy whereby only connected properties are subject to an access fee will involve a price decrease to unconnected properties and an increase to connected properties to ensure revenue neutrality was maintained for the water business.

Page 23 Section 3.4

"..detailed segmentation of the customer base to ensure that there are no cross-subsidies and that competitive services are not regulated. This can require ring-fencing, to ensure the regulated entity is not unfairly competing by shifting costs to be recovered from services where it has market power."

It is considered that the ring fencing of competitive services will be an added cost on the business. The extent of the ring fencing is not clear and it may see duplication in activities and costs such as administration and related structures.

Page 24 Section 3.4

"..pre approval of individual capital expenditure projects has been applied in other sectors to address incentives to invest..."

Pre approval of individual capital projects would be heavy handed regulation and extends beyond the price monitoring scope. This can be seen as encroaching on the bounds of the management and expertise of the business. Any approval process to remove the uncertainty of investments should be limited via a dollar threshold and limiting the scope of the review and not result in significant time delays.

Page 24 – 25

"In the Authority's view, by no later than 1 July 2013, the entities should have completed their internal restructuring. They should be able to produce information that fully explains how prices will be set for at least three to five years on a cost-reflective basis"

The Authority believes that entities should have completed their internal restructuring by 1 July 2013. It is difficult to predict at this stage how the structure of the business would progress by 2013.

From internal discussions it is unlikely that an ERP computer system can be introduced within such a timeframe as well as implement robust processes and quality systems to produce the required standard of information.

As a result it may be necessary to use a temporary set of systems with the final system solution being introduced at a later date. This will result in additional transitional costs on the business.

Page 28 Section 3.6

“Excessive returns are achieved where revenues are higher than needed to meet standards of service provided.”

Revenue can be exceeded for many reasons, such as increased demand outside the direct control of the entity, increased standpipe sales, fines, meter installations, trade waste discharges and so forth which may have nothing to do with service standards. The reason for higher than needed revenues must be understood before conclusions can be reached.

Page 29 Section 3.6

“The authority recommends that the entities standard/s of service, as approved by other agencies, be adopted for the purposes of interim price monitoring.”

The standards of service to be adopted for the purposes of interim price monitoring should be either as approved by other agencies or at the current levels if above those standards. This maintains the current service levels to protect customers from any reduction in service standards.

A further issue is the timelines of these service standards being approved by other agencies and the impacts on price monitoring preparation.

An issue for the Authority is how comparisons can be made of consecutive years with different service standards?

Page 31 Section 3.6

“ (a) the interim price monitoring framework focus on revenues (including average revenues and the relationship between revenues and costs at the aggregate level), and a review of pricing policies, rather than specific tariff levels and structures;”

The Authority needs to be cognisant of some of the deficiencies in high level and average based analyses. For example, as the entities are now purchasing bulk water from the SEQ Water Grid Manager, other water distribution and retail costs have become less variable. This leads to cost increases generally being independent of volume changes, excluding bulk water purchase expenditure. Using methods such as Average Unit Cost of Supply and similar measures creates anomalies when comparing low volume years followed by a high volume years and so forth. This is exacerbated when taking into account the low “variability”, apart from bulk water purchases, of the entities expenditure.

Page 32 Section 3.7

“The Authority recommends that it report any instance where revenues significantly exceed, or are considered likely to significantly exceed the MAR for a sustained period.”

It is unclear what constitutes significantly exceeding MAR and some guidance or quantitative measure needs to be included in the definition to ensure all parties are clear when such an event occurs.

Page 35

The Authority recommends that:

- o *By the end of the interim period, each entity should have developed information systems to provide timely and transparent information systems about the costs and other factors underlying each price;*

As raised in Allconnex Water's initial submission, made under the Water Business 3 banner, to the information requirements that within the interim timeframes, this will be a difficult task for categories such as trade waste being separated from sewerage costs as well as separating residential and non residential costs. This disaggregation would largely be achieved through either greater granularity of expenditure recording, which will involve significant accounting system and procedure changes, or cost allocation which may be difficult to substantiate. Allocating expenditure by catchment is also problematic and will require system changes, particularly when prices are allocated on a whole area basis. These issues create complexities and will result in increased costs due to system changes and increased administrative activities associated with the more detailed cost capture.

Page 36 Section 3.8

"The level of disaggregation to apply over the balance of the interim period is to be progressively increased... This will require information to be provided by relevant customer groups and any other category as required by the pricing principles (yet to be developed)."

Allconnex Water is unsure about the timeline that these progressive information requirements and disaggregation is to occur within. Allconnex Water is currently designing and building a financial model and its chart of accounts for the new corporate financial management system. The timelines will require these activities to be completed by mid February to meet critical timeframes leading into the 1 July 2010 go live date. A major risk and concern to Allconnex Water is that the Authority has yet to specify its detailed information requirements which may not be captured in the system changes currently underway. Making changes to accommodate the Authority's information needs once they are defined will involve further costs and system changes.

Page 38 Section 3.10

"An important influence on the frequency of Authority reporting is timeliness and adequacy of information provided by the entities. Thus, to facilitate the timing of reporting, the Authority recommends that:

- a) *the entities set and publish a list of prices on their websites for water and wastewater services as soon as these are determined and before 1 July of each year; and*
- b) *the entities provide any information relating to price and revenues that may be reasonably required by the authority."*

Allconnex Water remains concerned regarding the timelines of the price monitoring exercises to produce a report to the QCA by 1 July of each year considering that the entities budgets will only recently been completed and endorsed and that end of financial year activities are commencing.

Furthermore, actual outcomes for the most recent financial year are yet to be finalised and cannot be fully incorporated into the report.

Page 39:

"Taking all these factors into account, MJA (2009) recommended that, by no later than 1 July 2013, the entities should have completed their internal restructuring program and developed the systems need to effectively and efficiently run their business, and they should be expected to have the capability to demonstrate the costs underpinning individual prices to customers and to an economic regulator.

Given the challenge involved in making this transition and the level of detail in information requirements, the Authority recommends that the final regulatory arrangements should commence on 1 July 2013. Further, that the Authority should report to Government on the entities progress in achieving the systems and information needed for informed pricing and reporting."

As previously raised, Allconnex Water has concerns that it may not have all the systems and processes implemented by this date. Refer to comments regarding Page 35 above.

Page 40 Section 4.1

"Not all the information will be required for 2010/11, but is outlined in order to provide a context for the information returns as well as indicating further information requirements envisaged in future years... Substantial further effort is required, and is recommended, over the interim period, to determine the most appropriate categories of capital and operating expenditure for price monitoring purposes."

Allconnex Water appreciates that the Authority will take a pragmatic approach and not require all the information by 2010/11, however uncertainty regarding the roll out of the information requirements over the interim period is creating significant planning uncertainty for Allconnex Water in designing its financial model, chart of accounts and corporate financial management system. As previously indicated, further costs will be incurred to meet these requirements as they currently not specified and cannot be incorporated into the system changes currently underway.. Further information is requested on what is required for 2010-11, and each subsequent year, so that system and business processes can be understood. Allconnex Water appreciates that the Authority will work with the new water authorities during February 2010 to further specify these information requirements at which time the business will better understand how and when the information can be provided.

Page 41:

"In subsequent years of the interim period, the degree of disaggregation of revenues according to services can be expected to increase. For example, a wider range of non-core services can be expected to be subject to more detailed review. Further, while price monitoring does not typically require revenues to be forecast for an extended period, there is a case for entities to establish systems to do so."

Again, Allconnex Water are unsure about the timeline that these progressive information requirements and disaggregation is to occur within. Further information is requested on what is required for 2010-11, and each subsequent year, so that system and business processes can be established.

Allconnex Water does not support the requirement that unregulated revenues be separated into water and wastewater as it does not understand the need for this.

Page 43

The Authority and relevant agencies work together to establish an integrated performance monitoring framework (incorporating standards of service) relevant to the new entities by 1 July 2011.

Allconnex Water would like to reiterate that the Authority will be relying on information provided by entities under the National Performance Reporting framework through the SWIM database until the service standards and integrated performance framework is completed. The main issue is that not all of the indicators are reported as adequate due to systems not being in place to provide such. It is likely that each district will have separate set of information using different systems. It may be difficult to consolidate this information to produce a single report.

Page 45

In subsequent years, it can be expected that more sophisticated demand forecasting will need to be developed to substantiate the increased disaggregation of costs and to improve the accuracy of forecasts.

The timelines associated with more sophisticated demand forecasting is not specified by the Authority and Allconnex Water would like to understand the objectives and the degree of granularity required. Allconnex Water seeks that adequate timeframes are provided by the Authority to develop and implement a more sophisticated demand forecasting approach.

Page 56 Section 4.8

"The Authority recommends that a review of the appropriate basis for treating capital contributions and contributed, donated and gifted assets be undertaken as part of the current remit and reported on no later than the date that the Authority's final report is due 30 April, 2010."

Allconnex Water requests more time is provided for it to better understand the options available and impacts on the business operations. This issue has significant operational and financial impacts on the business and more time is required to consider this issue.

Page 65:

It should be noted that an increased level of disaggregation over the interim price monitoring period will increase the number of categories of costs. It is envisaged that a far greater focus be placed on cost drivers over the balance of the interim period.

As previously raised, Allconnex Water appreciates that the Authority will take a pragmatic approach and not require all the information by 2010/11, however uncertainty regarding the roll out of the information requirements over the interim period is creating significant planning uncertainty for Allconnex Water in designing its financial model, chart of accounts and corporate financial management system. As previously indicated, further costs will be incurred to meet these requirements as they currently not specified and cannot be incorporated into the system changes currently underway.

Further information is requested on what is required for 2010-11, and each subsequent year, so that system and business processes can be understood. Allconnex Water appreciates that the Authority will work with the new water authorities during February 2010 to further specify these information requirements at which time Allconnex Water will better understand how and when the information can be provided.

Page 82 Appendix E- Section 1.4.3

"...Information in respect of the reporting year is to be submitted by 1 July of that year for each of the next three financial years;"

Allconnex Water is still concerned with 1 July timeframes as discussed on feedback to page 38.

Page 84

"From the 2011/12 reporting year onwards, the entity will also provide the Authority with audited information in respect of the immediately prior year by 30 September of the reporting year."

On some occasions, the immediately prior year audited information may not be available by 30 September of each year and Allconnex Water will provide the information as soon as the audit process is complete.

Page 86 Appendix E- Section 3.4

"...disaggregation of each... non-core service"

The disaggregation of non-core services will require effort and involve additional costs. As previously indicated, Allconnex Water does not support the requirement that unregulated revenues be separated into water and wastewater as it does not understand the need for this.

Page 96 Appendix E- Section 5.11.4

"For subsequent years, a greater level of disaggregation of operating expenditure may be required. For that to be affected, a substantial effort may be required to allocate costs to their appropriate category."

Allconnex Water agrees that the disaggregation of operating expenditure will require substantial effort. This is particularly true of instances such as separating trade waste from wastewater. Allconnex Water is keen to work with the QCA on this issue.