seqwater
WATER FOR LIFE

25 January 2010

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Dear Sir/Madam

SEQ Interim Price Monitoring Draft Report

Thank you for the opportunity to comment on the QCA's *Draft Report SEQ Price Monitoring Information Requirements for 2010/11*.

Please find attached a joint submission from Seqwater, Linkwater and WaterSecure.

Seqwater welcomes any feedback or correspondence which should be addressed to the Chief Executive Officer Seqwater attention: Damian Scholz or directly to Damian on (07) 3033 5569, 0428 775100, dscholz@seqwater.com.au.

Sincerely

[redacted]

Jim Pruss
Acting Chief Executive Officer
Seqwater

LinkWater WaterSecure seqwater WATER FOR LIFE

Submission to the Queensland Competition Authority:

Draft Report SEQ Price Monitoring Information Requirements for 2010/11

LinkWater, Seqwater and WaterSecure are Queensland Government Statutory Authorities established under the *South East Queensland Water (Restructuring) Act 2007*, supplying water services to the SEQ Water Grid Manager (SEQWGM).

The Queensland Competition Authority's (the Authority) *Draft Report SEQ Price Monitoring Information Requirements for 2010/11* (Draft Report) is not applicable to these SEQ Water Grid entities. Bulk water grid entities have very different characteristics to the retail and distribution businesses, given the relationship with our customer, the SEQWGM, and the overarching market arrangements for the Water Grid. This contrasts to the retail/distribution businesses that have a large and diverse customer base, provide both water and wastewater services and have more autonomy and operation decisions than bulk water grid entities. This has also been acknowledged in various Government publications[1] for economic regulation to apply to bulk water entities in the future.

Assessments about prudence and efficiency of expenditure are common across all water suppliers, and indeed across all regulated services. In this context, we would like to make a contribution to the Draft Report.

We understand that in conducting its review, the Authority has been guided by the Minister's Direction Notice. In particular, the Authority is directed to develop and propose an interim price monitoring arrangement and to recommend the process and criteria to apply to assess capital expenditure for inclusion in the regulated asset base from 1 July 2010.

The Authority has proposed a process where an independent expert would assess whether an entity's policies and procedures represent good industry practice and reflect strategic development plans, integrate risk, are consistent with external drivers and incorporate robust procurement practices.[2]

While the Authority has discussed cost drivers and the issues that an independent expert should have regard to when assessing proposals, it would appear that the onus remains with the distribution businesses to not only provide well-evidenced forecast expenditure but to also justify the outputs with which this expenditure relates to.

While we agree that any assessment of expenditure should be couched in a prudence and efficiency framework, we consider that the Authority could provide greater transparency, clarity and predictability of how the joint assessment of prudency and

[1] For example see: Queensland Water Commission, *Urban Water Supply Arrangements in South East Queensland*, p. 70.

[2] QCA 2009, *Draft Report SEQ Interim Price Monitoring Information Requirements for 2010/11*, p.51.

efficiency of expenditure will be undertaken.

While we do not suggest that the Authority adopt an entirely mechanical approach that removes all discretion from the regulator, as we view good economic regulation should incorporate options for flexibility so that outcomes can be tailored to an individual case, we do consider that outputs of the expenditure forecasts should be agreed with the business ahead of any assessment.

Specifically, prudency objectives effectively define the outputs (or the process and principles for determining the outputs) that a business is required to produce. These objectives establish the services to be produced by a business that reflect the desired outcomes of consumers. Not only do these objectives establish the outputs related to prudent expenditure but they also effectively determine the parameters of allocative efficiency.

In terms of the assessment of efficiency, as the Authority points out, efficiency is made up of allocative, dynamic and productive elements.[3] This definition of economic efficiency is underpinned by the concept of perfect competition which implies that a business is efficient if it constantly achieves production which is least cost and an output which is optimal. That is, the business is constantly on the efficiency frontier.

However, a business' ability to achieve production optimality at least cost will vary over time and will be influenced by their specific operating environments. This is particularly true for businesses such as infrastructure companies. These businesses are capital intensive with long-lived assets.

In practical terms, it is difficult to assess a business' efficiency at a given point in time because the concept of a perfectly competitive outcome (ie the efficiency frontier) is unable to be quantified with the alternative of partial comparisons with peer businesses potentially having only limited relevance. Even if the efficiency frontier was directly observable, by definition it is not static and therefore constitutes a moving target. Given these considerations, we consider that when making an assessment of efficiency that the Authority recognise these limitations and adopt an approach to assessing costs which incentivises businesses to converge towards economic efficiency.

As the Australian Energy Market Commission (AEMC) noted, the difficulty under this approach becomes establishing a practical application of the concept of efficiency with well designed procedural requirements that assist in ensuring that the regulator administers the regulatory regime in an appropriate manner.[4]

In its Rule Determination on the economic regulation of transmission services, the AEMC adopted a decision rule that required the Australian Energy Regulator (AER) to

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[3] QCA 2009, p. 50.

[4] AEMC 2006, *Draft National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006*, Rule Determination, 16 November 2006, Sydney, p. 28.

accept a business' proposal if it is satisfied that the amount "reasonably reflects" efficient and prudent costs based on realistic estimates of forecast demand and the relevant expenditure objectives.[5]

The AEMC considered that this approach achieved an appropriate balance between the interests of businesses and customers and between the risks and costs of market and regulatory failure as the exercise of any judgment by the regulator is constrained and guided by the need to be satisfied as to the efficiency and prudency of the forecast expenditure that reflects realistic expectations.

Similar views were expressed by the Expert Panel that stated many of the inputs to derive prices cannot be estimated with precision, or pertain to future outcomes that cannot be forecast with precision. Thus there is a range (and potentially, a wide range) within which a reasonable person may consider that the relevant input may reside.[6]

In terms of a final regulatory arrangement, we encourage the Authority to consider a similar criterion for assessing the efficiency of expenditure proposals as proposed by the AEMC and subsequently adopted in the National Electricity Rules. Specifically, that the assessment of efficiency is made on a business' proposal in its totality and whether the total proposed expenditure represents an amount that is "reasonable" to meet forecast demand and input costs in the circumstances facing the regulated business.

In summary, we encourage the Authority to define expenditure outputs when assessing prudent expenditure and to accept a reasonableness approach when assessing efficient costs as part of any final regulatory arrangement.

Should you wish to discuss any aspect of our submission please contact Sean Greenup (LinkWater) on 3270 4019, Damian Scholz (Seqwater) on 3035 5569 or Sam Romano (WaterSecure) on 3015 9734.

Yours faithfully

Peter McManamon	for **Peter Borrows**	**Keith Davies**
Chief Executive Officer	**Chief Executive Officer**	**Chief Executive Officer**
LinkWater	**Seqwater**	**WaterSecure**

[5] AEMC 2006, p. 52.
[6] Expert Panel on Energy Access Pricing 2006, *Report to the Ministerial Council on Energy*, pp. 74-75.