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8 September 2014

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
Level 27, 145 Ann Street
BRISBANE QLD 4000

Emailed to: research@qca.org.au

Dear Dr Roberts

Submission to Position Paper: Long-term framework for SEQ water retailers – WACC

Thank you for the opportunity to provide a submission in response to the Position Paper on the weighted average cost of capital (WACC) for the long-term framework for SEQ water retailers. Queensland Urban Utilities considers this an important aspect for the long-term framework that requires clear guidance from the QCA to ensure a degree of regulatory certainty for the businesses.

In addition to this letter, the Queensland Treasury Corporation (QTC) are providing a submission in response to the Position Paper that will outline the technical concerns that it has with the QCA's proposed approach. We support the QTC's position in relation to the risks associated with the QCA's proposed approach and the view that a longer-term view should be adopted by the QCA in the setting of a WACC.

While the QTC submission will principally focus on the technical aspects of the Position Paper, we have some broader concerns that we feel need to be considered by the QCA. These broader issues are:

- The QCA has repeatedly acknowledged that there has been no misuse of market power and that as such there needs to be a pragmatic approach to regulation of the sector. In order to achieve a pragmatic outcome in the interests of all parties, it is critical that similar pragmatism is extended to setting the WACC. The Position Paper does not match the expected pragmatism that the QCA has indicated that it is trying to achieve.
- The application of a 1-year term to maturity ignores the fact that both pricing and investment decisions are made for the long-term. Queensland Urban Utilities does not agree with the proposed approach as it assumes that we re-set our business each year and completely disregard any future years from these decisions. In most cases, the decision to invest occurs at least 1 year before construction starts, and potentially a number of years before a project is commissioned, therefore essentially re-setting the WACC

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calculation on a yearly basis with a 1-year term to maturity ignores the type of businesses that we are.

- In our view, a regulator that is operating a light-handed framework should not prescribe a WACC to the regulated businesses for pricing purposes. While the QCA characterises its SEQ water sector WACC as a non-binding benchmark WACC, the approach that the QCA has adopted has, in essence, prescribed the approach for the businesses to use by having a prescriptive approach to the setting of a benchmark WACC that the businesses will be assessed by.
- The consequences of adopting a different WACC are unclear. If the adoption of a different methodology for setting a WACC results in a higher WACC than the benchmark WACC, but it is an approach that is accepted by economic regulators as being a common approach to setting the WACC, what are the potential consequences for the businesses? The methodology should provide regulatory certainty and not impede entities future investment decisions.
- Adopting an on-the-day approach to the estimation of the cost of debt has two critical implications for SEQ water businesses:
 - It fails to pragmatically recognise the reality of the manner in which the QTC manages water business debt based on regular go-to-market arrangements for a proportion of the total debt (a basis which QTC and QUU continue to argue as being best practice debt management). This approach has been endorsed by the AER and as such in adopting a similar approach the QCA would be following the precedent established by Australia's preeminent regulatory body.
 - it increases the volatility of the WACC calculation each year – which would lead to more volatile prices. From a customer perspective, this also leads to a pro-cyclical impact – when interest rates rise and have an impact on mortgages, water bills will also be rising, putting further financial pressure on households.

The most important aspect of this submission is that where the businesses are responsible for setting the prices, the QCA needs to be mindful of being too prescriptive in the setting of the WACC – thereby giving no alternative but to adopt a “QCA WACC” – as the QCA may inadvertently be seen as implicitly having a hand in the setting of prices within the light-handed framework. By setting a prescriptive approach and methodology whereby the onus will be on the businesses to justify any departure from the QCA's benchmark approach, this in effect applies a prescriptive approach to the businesses.

Queensland Urban Utilities considers that ideally, under a light-handed framework, the QCA would nominate commonly accepted methodologies for determining the WACC parameters with the decision on which approach left to the regulated business.

If you have any questions or concerns with this submission, please contact Tim Ryan on 3855 6161 or Tim.Ryan@urbanutilities.com.au.

Yours sincerely

A handwritten signature in blue ink that reads "Louise Dudley". The signature is written in a cursive style with a long, sweeping tail on the final letter.

LOUISE DUDLEY
Chief Executive Officer
Queensland Urban Utilities