

APPENDIX H

Final Assessment

Transition to annual performance monitoring – Redland Water

September 2014

We wish to acknowledge the contribution of the following staff to this report:

Geetu Anthonisz, Catherine Barker, William Copeman, Keith Hutchinson, Shannon Murphy, George Passmore and Rick Stankiewicz

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1 INTRODUCTION

1.1 Purpose

This assessment outlines whether Redland Water should transition to the recommended annual performance monitoring regulatory framework. The assessment is based on the information available to the QCA from its price monitoring investigations and the transition criteria outlined in the QCA's final report on the *SEQ Retail Water Long-Term Regulatory Framework - Annual Performance Monitoring - Part B* (QCA 2014a).

The QCA invited submissions on a draft assessment, and these have been taken into account in this final assessment.

1.2 Background

The Ministers have directed the QCA to investigate and report on a long-term regulatory framework for the monopoly distribution and retail water and sewerage activities of the five south east Queensland (SEQ) distributor-retailers (the retailers) — Unitywater, Queensland Urban Utilities (QUU), and the Logan, Redland and Gold Coast City Councils. If accepted, the framework would apply from 1 July 2015.

The overarching regulatory objective is to protect the long term interests of the users of SEQ water and sewerage services by ensuring the prices of these services reflect prudent and efficient costs, while promoting efficient investment in and use of these services, having regard to service reliability, safety and security over the long term.

SEQ water retailers have been subject to different forms of price monitoring since 2008. Over 2010–15 the QCA has reviewed the costs of water and sewerage services, and monitored changes in prices and compared the retailers' revenues against the maximum allowable revenue (MAR). The MAR reflects the QCA's assessment of prudent and efficient costs.

Allconnex Water provided services to the Gold Coast, Logan and Redland areas in 2010-12. On 1 July 2012, Allconnex Water ceased operations and its participating councils became responsible for retail water and sewerage services in their respective areas. The councils were not referred to the QCA for review for 2012-13.

The Ministers required that the form of prices oversight should minimise the administrative burden on the retailers and facilitate a move to a more light-handed framework over time.

1.3 Transition to long-term framework

The QCA recommends an annual performance monitoring regulatory framework which it considers is light-handed (in terms of the costs and level of detail required) and which 'tracks' retailers' performance against:

- (a) CPI-X and certain financial information
- (b) recommended pricing principles
- (c) desired customer engagement practices
- (d) a strategic approach to long term investment
- (e) service quality indicators (including performance targets).

1.4 Criteria

Criteria for immediate transition

The QCA outlined the following criteria for an immediate move to long-term performance monitoring as including:

- (a) an absence of public interest or equity issues that may warrant regulatory review
- (b) regulated services are clearly defined and separated from non-regulated services
- (c) evidence that market power is not being exercised
- (d) absence of imminent material changes in circumstances or major infrastructure costs
- (e) demonstrated capacity to provide the required information accurately and on time.

Performance in customer engagement, strategic planning for long-term investment, service quality and application of pricing principles should also be taken into account in assessing whether annual performance monitoring is appropriate.

2 ASSESSMENT

2.1 Introduction

The QCA has assessed Redland Water against the criteria using the outcomes of the 2013-15 investigation and information from publicly available sources.

2.2 Assessment against core criteria

2.2.1 Public interest and equity

Draft assessment

The criteria require that there is an absence of public interest or equity issues that may warrant regulatory review for a retailer to transition to long-term performance monitoring.

The QCA is not aware of any public interest or equity issues that would warrant regulatory review and prevent Redland Water from transitioning to long-term performance monitoring.

The QCA is not aware of any rebates provided by Redland City Council on water and sewerage bills, or any likely changes to these arrangements.

The Department of Energy and Water Supply (DEWS) is undertaking a review of the Water and Sewerage Services Code for Small Customers in South East Queensland (SEQ Customer Code) and will consider the water businesses' policies (including hardship) in relation to supporting customers.

Final assessment

No submissions on this matter were received in response to the draft assessment. The QCA has not identified any other related issues to impede Redland Water moving to annual performance monitoring.

2.2.2 Regulated services are defined

Draft assessment

The criteria require that regulated services be clearly defined and separated from non-regulated services.

In the 2013-15 price monitoring review, the QCA requested retailers to list all regulated services, their tariffs and corresponding volumes and revenues. Redland Water complied with this requirement, providing the tariffs, volumes and revenues from their price setting process. Further, Redland Water provided a detailed price list for its services.

The QCA also requested retailers to exclude the revenues and costs of non-regulated services, with only the regulated revenues and costs falling under review. In addition, the retailers were required to provide explanation of the basis of any allocations made to non-regulated services that would assist the QCA in its assessment of their submissions. Relevant definitions were as follows:

- (a) A non-regulated service was defined to mean a service provided by a retailer that is not required to satisfy any specified legal obligation or is provided by other service providers in a competitive market in which the business has no legal power to influence a customer's selection of the business as the service provider. For example, this could

include laboratory services. Non-regulated services are not to be disaggregated between water and wastewater.

- (b) Non-regulated revenue includes interest on investments, but not interest paid by customers on overdue accounts.

In the 2013-15 review, the delineation between regulated and non-regulated services was not specifically investigated by the QCA: non-regulated services have not been a material segment of costs and revenues. The precise boundary of regulated and non-regulated services may change over time as the nature of relevant services and markets develops.

In its 2013-15 submission Redland Water did not identify any non-regulated services, costs, revenues and assets.

Overall, the QCA considered that regulated services were clearly defined. The revenues and costs of non-regulated services were not material enough to warrant further investigation.

However, the QCA has not reviewed whether costs have been appropriately allocated between service categories. The QCA needs to be confident that prices reflect the cost of providing services. This is an issue to be addressed in assessing retailers' compliance with pricing principles.

Final assessment

No submissions on this matter were received in response to the draft assessment. The QCA has not identified any other related issues to impede Redland Water moving to annual performance monitoring.

2.2.3 Market power

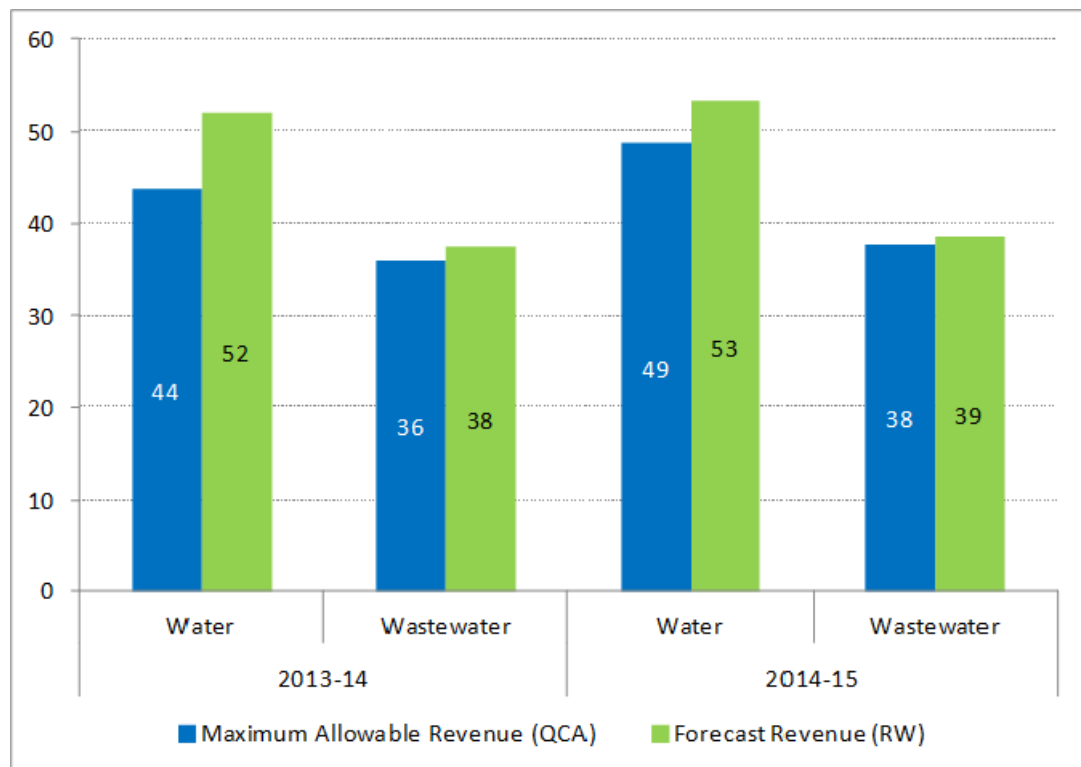
Draft assessment

The criteria require evidence that market power is not being exercised.

In the 2013-15 review, the QCA found that Redland Water's revenues lie above the QCA's MAR in both years, largely because Redland Water has smoothed price increases over 10 years. This means that over-recoveries in the 2013-15 period are forecast to be gradually returned to users from 2017-18 onwards.

The QCA supports the principle of price smoothing. However, the QCA had concerns with the 10-year model applied by Redland Water and the negative retail-distribution prices in future years.

In view of these concerns, the QCA could not establish whether there was an exercise of market power by Redland Water in 2013-15. Setting 2014-15 prices provided an opportunity for Redland Water to address these concerns and demonstrate there was no exercise of monopoly power. Redland Water advised it would take the QCA's concerns into account in setting 2014-15 prices.

Figure 1 Forecasts of Redland Water costs (MAR) and revenues (\$m)

Source: QCA 2014

It was noted that:

- QCA's estimates of total prudent and efficient costs (the MAR) were higher than Redland Water's estimate by 4.0% in 2013-14 and 8.3% in 2014-15. However, Redland Water revenues were forecast to be above the QCA MAR (and its own estimates of costs) in both years.
- Redland Water's capital expenditure proposal was reviewed by independent consultants. The sample of capital projects subject to prudence and efficiency review accounted for 48% of forecast capital expenditure (excluding contributed assets). Over 2013-15, the QCA's prudent and efficient capital expenditure was lower than Redland Water's by 26.4%, this reduction being mainly due to deferral of a major capex item until after the 2013-15 period.
- The QCA opening regulated asset base (RAB) value as at 1 July 2010 was \$24.99 million (5.5%) lower than Redland Water's submitted value. The QCA closing RAB as at 30 June 2015 was (6.92%) below that of the Redland Water. The difference arose due to the use of the QCA RAB as at 1 July 2010 and the use of actual data for 2010-12 from the most recent Allconnex Annual Report.
- Non-bulk operating expenditure was also reviewed by an independent consultant in the 2013-15 review. The QCA's estimate of prudent and efficient non-bulk operating expenditure was lower than Redland Water's by -13.7% and -10.4% in 2013-14 and 2014-15 respectively, largely as a result of differences in tax (QCA 2014b).

Overall, the QCA could not conclude that market power was not being exercised. The key issues related to the Redland Water pricing model and future prices.

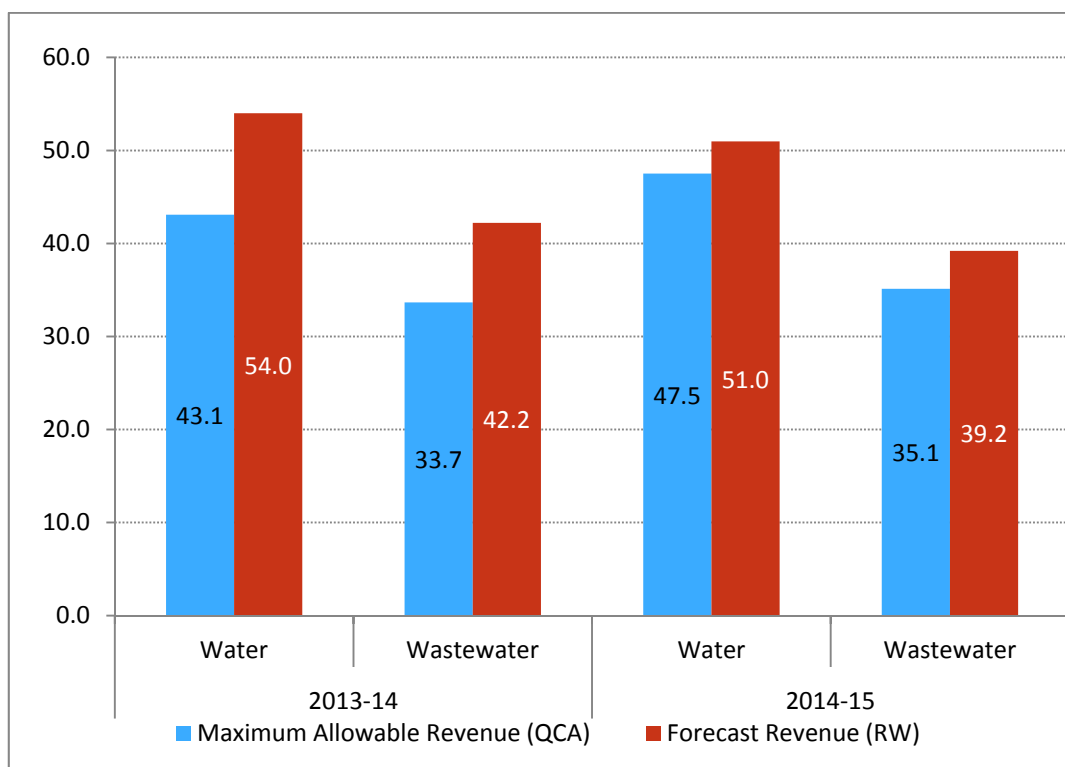
Stakeholder submissions

Redland Water contended it is ready to transition to the annual performance reporting framework. Redland Water noted that it has eliminated negative future prices by adopting a one-tier pricing structure. Further, Redland Water stated that the QCA's concerns with the QTC pricing model were being addressed, with implementation of a robust model expected for 2015-16 prices. The new pricing model was expected by Redland Water in August or September 2014.

Final assessment

Since the publication of the final 2013-15 Price Monitoring Report, QCA has revised Redland Water's RAB and MAR to take account of missing asset lives in their 2013-15 submissions. For Redland Water, the revised RAB resulted in the MAR being 5% lower. Further, the QCA has updated the 2014-15 revenue estimates in the final assessment based on the announced 2014-15 prices. Compared to our previous revenue forecasts, Redland Water's revenue forecast decreased from \$91.8 million to \$90.2 million.

Figure 2 Forecasts of Redland Water's costs (MAR) and revenues (\$m)



Source: QCA 2014

The QCA recognises that Redland Water attempted to but could not meet the proposed 15 August 2014 deadline for addressing the data and modelling problems previously identified.

In the interim, Redland Water provided the QCA with a spreadsheet it used to calculate 2014-15 prices. The QCA's comments on this were that:

- (a) much of the information is hard-coded and varied from the pricing model submitted as part of the 2013-15 investigation
- (b) a discount rate has not been applied to under/over recovery, making the net present value of the price path greater than zero

- (c) to make revenues equivalent to costs (in a non-discounted sense), there was a \$7.5 million balancing item in the revenue estimate in 2023-24. There was no justification for this adjustment
- (d) the increase in bulk water charges after 2017-18 of 5% per year appeared high.

For Redland Water we are unable to conclude that Redland Water are not exercising market power due to the evident shortcomings of its price modelling (and potentially the pricing principles being applied - these are yet to be reviewed for all retailers). That is, it is not the prudence and efficiency of Redland Water's costs that is the issue and therefore another cost of service review is not useful or warranted.

2.2.4 Imminent change in circumstances

Draft assessment

The criteria require that there is an absence of imminent material changes in circumstances or major infrastructure costs.

Redland Water's pricing model included information on post 2015 costs and revenues as it implemented a ten-year smoothed model in setting prices. The price path was first published in the QCA's draft price monitoring report for 2013-15 (January 2014).

However, Redland Water only provided two years of data in its price monitoring submission for 2013-15. Bulk water prices until 2017-18 are publicly available on the DEWS website.

The QCA noted significant inconsistencies between the two sources of information. This partly reflected that the Redland Water pricing model was prepared at the time of setting prices while information in the price monitoring submission was prepared after prices were set. Further, issues were identified with the calculation of costs in the Redland Water pricing model.

Therefore, and as required under the Ministers' Direction, the QCA used the price monitoring submission as the basis for its review of prudent and efficient costs.

The QCA was not aware of any imminent material changes in circumstances or major infrastructure costs that would impede Redland Water's transition to the long-term framework.

Final assessment

No submissions on this matter were received in response to the draft assessment. The QCA has not identified any other related issues to impede Redland Water moving to annual performance monitoring.

2.2.5 Information provision

Draft assessment

The criteria require that there is demonstrated capacity to provide information accurately and on time.

Redland Water had provided all submissions to price monitoring on time. Redland Water had responded to further requests for information in a reasonable timeframe but had not addressed the identified concerns expressed above relating to revenues for 2013-15.

As noted above the QCA identified inconsistencies between Redland Water's pricing model used to set prices for 2013-15 and the information return submitted for price monitoring. The QCA indicated Redland Water should ensure consistency in its information provision.

However, the QCA considered there was demonstrated capacity to provide available information accurately and on time.

Final assessment

No submissions on this matter were received in response to the draft assessment. The QCA has not identified any other related issues to impede Redland Water moving to annual performance monitoring.

Summary of assessment against core criteria

On the basis of the above assessment, Redland Water should be permitted to move to annual performance monitoring but address the information and modelling requirements identified above.

2.3 Assessment against other criteria

2.3.1 Introduction

Performance in customer engagement, strategic planning for long term investment, service quality and pricing principles are relevant to the assessment. Only a partial assessment can be made in relation to many of these criteria, as some were not monitored in the past and complete information is not readily available.

The QCA has sought to identify whether there is any information on these criteria that would delay or impede transition by assessing the retailers' performance to date and predisposition to further improvement. To assist retailers' improve their performance, areas of potential improvement that would be expected to be addressed in subsequent annual performance monitoring are identified.

2.3.2 Customer engagement

Excerpt of recommendations

- 5.1 Each retailer, in consultation with its customers, develop a strategy for customer engagement based on best practice principles.**
- 5.2 Customer engagement:**
 - (a) promote understanding of customers' needs and be representative and responsive of customer views**
 - (b) be relevant, evidence based, open and transparent, timely, collaborative, and cost-effective.**
- 5.3 The customer engagement strategy include a customer consultation committee.**

Draft assessment

In its Annual Performance Plan for 2013-14, Redland Water stated that it would collect community feedback and participate in community consultations. Feedback from surveys and consultation would be used to gauge acceptance of service levels. Customer feedback may be collected through some or all of the following forms:

- (a) recording unsolicited complaints and comments
- (b) management or staff attendance at community consultation sessions

- (c) formal surveys by a third party consultant or formal surveys by in-house staff as part of council process.

In its 2013-15 review, the QCA noted that retailers should explain the reasons for the change in each part of the bill as well as the overall change.

Redland Water does not have a customer consultation committee. However, Redland Water does have a framework for customer consultation and processes for customer research through surveys. The QCA considered that based on available information Redland Water's activities incorporated many of the desired attributes of effective customer engagement.

Accordingly, performance should not impede Redland Water moving to annual performance monitoring.

Final assessment

The regulatory framework final report (QCA 2014a) states that, as a minimum, the QCA would expect a retailer's customer engagement strategy would incorporate transparent and timely provision of information to customers through relevant media - newsletters, websites and local press releases.

The QCA considers Redland City Council did not meet these expectations at the time of the price announcements in regard to its 2014-15 prices, made in July 2014. Specifically, the council's website still showed 2013-14 prices for the purpose of calculating average daily use and the previous year's bulk and retail water prices.

2.3.3 Strategic planning for long term investment

Excerpt of recommendations

- 6.1 The legislative and regulatory planning requirements for council water businesses be reviewed with a view to reducing any duplication of the requirements applied to the DRs.**
- 6.2 Retailers provide evidence of board/council approval and Ministerial endorsement of their relevant Water Netserv Plans to the QCA.**
- 6.3 Retailers annually report to QCA on their annual capital works plans or annual performance plans.**
- 6.4 Part A Water Netserv Plans and any updates for minor and major amendments be submitted.**
- 6.5 Retailers annually report to the QCA, details of their compliance with the asset management standard they have implemented and progress in addressing areas of improvement to achieve good industry practice.**
- 6.6 Should a cost of service review be triggered, the QCA assess retailers' asset management practices against PAS-55.**
- 6.7 Retailers annually report to the QCA details of the project evaluation practices used for significant capex projects.**
- 6.8 Retailers submit details of project evaluation, including options analysis and risk analysis, for up to the 6 largest capex items, where required as part of a request for further information.**

Draft assessment

In the 2013-15 price monitoring review, the QCA made adjustments to two of Redland Water's capital expenditure projects, based on its consultant SKM's (2014) advice following its detailed

review of six sampled projects. However, the overall reduction of \$7.69 million was predominantly due to a deferral of \$7.50 million for a project (Point Lookout STP) to be commissioned after 2013-15.¹

SKM (2014) also reviewed Redland Water's policies and procedures for capital expenditure, including in its Water Netserv Plan. SKM noted that Redland City Council has not yet endorsed its Water Netserv Plan, nor submitted it to the Planning Minister for endorsement for consistency with the SEQ Regional Plan, pending advice from DEWS on legislative amendments to the requirements for Water Netserv Plans.

A summary of SKM's findings are provided in Table 1.

Table 1 Capital expenditure policies and procedures

| <i>Criteria</i> | <i>Findings</i> |
|--|--|
| Standardised approach to cost estimating | Redland Water's cost estimating processes were not consistent with good industry practice, due to the absence of a procedural document setting out a requirement to use a standardised approach to cost estimating. |
| Gateway review | Redland Water's project 'phasing' did not meet the requirements of a gateway process but the council's new processes for delivering operating and capital programs contain a benefits realisation assessment which is consistent with good industry practice. |
| Detailed analysis of options for major projects | Redland Water has processes in place which provide for detailed analysis of options for major projects. |
| Commissioned capital expenditure from 1 July 2010 in the RAB | For Redland Water, the QCA adopted data from the Allconnex Annual Report for July 2011 - September 2012 to populate capital expenditure on an as-commissioned basis from 2010-12. |
| Compliance | As there was no connection between Redland City Council's draft 'Programme and Project Management Framework' (and associated documents) and Redland Water's Netserv Plan Part B, Redland Water's policies and procedures were not consistent with good industry practice. |
| Considers regional perspective | Redland Water participates in the SEQ Water Service Provider Partnership, SEQ Operations Committee, and SEQ Strategy and Planning Committee. Redland Water's documents did not comply with the need to address regional requirements at key decision points While Redland Water is committed to participating in regional initiatives, the QCA considered that the realisation of benefits due to a regional perspective should be captured and reported, to demonstrate regional efficiencies are being pursued and achieved. |
| Asset management system | SKM identified a range of issues with Redland Water's asset management system; for example, coverage of various requirements was found to be 'too preliminary' to comply with good industry practice, documentation requirements were not addressed or referenced adequately, and management review was not addressed. SKM also reported, however, that Redland City Council's 'Enterprise Asset and Services Management Strategy' (March 2011) has a comprehensive program of (30) planned improvements to asset management processes. The improvement opportunities align with the Asset Planning and Management sub-framework of the National Framework for Local Government Financial Sustainability, endorsed by the |

¹ In July 2013, Redland Water included expenditure on the Point Lookout STP of \$15 million for 2013-15 (\$0.5 million in 2013-14 and \$14.5 million in 2014-15) in the 'RCC 10 Year Capital Programme' provided to the QCA for selection of projects for prudence and efficiency review. In October 2013, Redland Water advised SKM and the QCA that the Point Lookout STP expenditure profile in its (September 2013) information return was incorrect: budgeted expenditure in 2014-15 is \$14.5 million, not \$7.5 million as per the information return.

| Criteria | Findings |
|-----------------|--|
| | Local Government and Planning Ministers' Council in 2009. |
| Procurement | Procurement in Redland Water is conducted in accordance with legislative requirements of the respective local governments. |

Source: SKM (2014).

The QCA noted Redland Water's capital planning policies and procedures were not always consistent with good industry practice but Redland Water was generally aware of, and plans to address, these issues. Overall, while Redland Water has a Netserv Plan, and demonstrated good practice in options analysis and procurement procedures, there are some shortcomings in cost estimating processes, compliance procedures, requirements relating to regional planning and asset management practices. However, the shortcomings were not considered material enough to prevent Redland Water moving to annual performance monitoring.

The QCA proposed to seek evidence that the issues raised by SKM (Table 1) are being progressed as part of future annual performance monitoring.

Final assessment

No submissions on this matter were received in response to the draft assessment. The QCA has not identified any other related issues to impede Redland Water moving to annual performance monitoring.

2.3.4 Service quality

Draft assessment

The regulatory framework position paper recommended 38 service quality indicators to be used as a basis for initial service quality reporting: 8 on baseline information, 13 on water and sewerage reliability and service, 4 on water quality, 5 on water consumption, recycling and reuse, 4 on customer responsiveness and service, and 4 on the environment.

These indicators were released after the price monitoring reviews from 2010-15 were finalised. Therefore, the price monitoring reviews to date have not investigated Redland Water's service quality against these principles and have not requested relevant information to do so.

However, a preliminary assessment was made based on information that is publicly available for Redland Water's service standards (Table 2).

Table 2 Redland Water service standards

| | KRA and Goals | RW SCORECARD WATER & WASTEWATER INDICATORS – 2012/13 | Monthly Target | Unit | Reporting Frequency | Annual Target |
|--|--|---|-----------------------|--|----------------------------|--|
| Community and Customers | Natural Environment Ensure the enhancement of koala and wildlife habitat including bushland, greenspace, waterways, catchments, air and coastal ecosystems | Average residential water consumption per person a day | max 200 max 230 | litres/ day/ person | Monthly | max 200 (Medium QWC) max 230 (Perm QWC) |
| | | Nitrogen load from effluent discharge | max 110 | avg kg/ day | Monthly | max 110 |
| | | Average response or reaction time to wastewater incident | max 60 | minutes | Monthly | max 60 |
| | | Average response or reaction time to water main breaks within the distribution system | max 60 | minutes | Monthly | max 60 |
| | | Number of poor pressure complaints | max 3 | # | Monthly | max 36 |
| Financial | Financial Management Ensure the long term financial viability of the city and provide public accountability in financial management. | Earnings before interest tax & depreciation (EBITD) | 0-5% | % | Monthly | 0-5% |
| | | Operating costs per megalitre of water treated | max 2400 | \$ | Monthly | max 1289 |
| | | Operating costs per property serviced (wastewater) | max 330 | \$ | Monthly | max 274 |
| | | Operating performance (expenditure to budget) | +/- 5 | % | Monthly | +/- 5 |
| Internal Processes | Deliver Essential Services Provide and maintain water, waste services, roads, drainage and support the provision of transport and waterways infrastructure to sustain our community. | Number of dry weather overflows | max 7 | # | Monthly | max 84 |
| | | % wastewater service interruptions restored within 5 hrs | min 95 | % | Monthly | min 95 |
| | | Number of wastewater odour complaints | max 3 | # | Monthly | max 36 |
| | | Number WWTP non conformances with EPA licence over compliance year | max 0.5 | # | Monthly | max 6 |
| | | % compliance with Australian Drinking Water Guidelines within distribution system. Does not include non compliant water received at the point of transfer to the distribution system, i.e. from the bulk water authority or the bulk transport authority. | min 98 | % | Monthly | min 98 |
| | | Number of water main breaks and leaks within the distribution main | max 8 | # | Monthly | max 96 |
| | | Unplanned water interruptions caused by the distribution network restored <5hrs | min 97 | % | Monthly | min 97 |
| | | Number of water quality incidents caused by the distribution network | max 12 | # | Monthly | max 144 |
| % capital works program practical completion - % of planned project milestones achieved this quarter | max 95 | % | Monthly | max 95 | | |
| People and Learning | People Management Development of organisational cultural values and people behaviours in order to meet agreed community expectations. | LTI hours | max 10 | Hours lost due to injuries incurred in the workplace | Monthly | max 20 |

Source: Redland Water 2013.

Redland Water's Customer Service Standards outline its commitments, responsibilities and standards for water and sewerage services. Based on these, Redland Water has identified 20 key performance indicators (KPIs) in relation to service quality for reporting purposes. Redland Water reports to council on its performance against 18 KPIs set out in its Annual Performance Plan to Redland City Council as shown in Table 2.

While some of the Redland Water KPIs overlap with some of those identified by the QCA for annual performance monitoring, some of the precise indicators and measures differ. Redland Water's customer service standards and KPIs represent 11 of the QCA's 38 recommended indicators.

Therefore, 27 additional indicators were recommended by the QCA. Many of these were captured in the NWC performance reporting process. Redland Water has previously participated in this process, but has not taken part in the 2012-13 reporting (NWC 2014).

The QCA has not previously monitored service quality performance and Redland Water has not been required to report against all of the QCA's indicators.

Having regard to Redland Water's commitment to service quality performance monitoring, the QCA considered that the identified shortcomings should not impede Redland Water moving to annual performance monitoring.

However, the QCA proposed that Redland Water would be required to report against the full range of indicators as part of annual performance monitoring. Redland Water should also resume participation in national performance reporting.

Final assessment

Since the draft assessment, the QCA revised the recommended service quality indicator list in line with DEWS (2014) and taking account of submissions from stakeholders.

Redland Water's reported indicators include seven recommended by the QCA in its revised list.

No submissions on this matter were received in response to the draft assessment. The QCA considers that Redland Water's commitment to service quality performance monitoring supports a transition to annual performance monitoring.

2.3.5 Pricing principles

Draft assessment

The QCA position paper *SEQ Long Term Regulatory Framework - Pricing Principles* (QCA 2014c) recommended a range of pricing principles to apply to urban water, sewerage, trade waste, recycled water and stormwater reuse.

These principles were released after the price monitoring reviews from 2010-15 were finalised. Therefore, the price monitoring reviews to date have not investigated Redland Water prices against these principles and have not requested relevant information to do so.

The QCA has not previously reviewed Redland Water's pricing practices and there was insufficient available information in many instances to allow a detailed assessment (see Table 3 which includes the slightly revised final report recommendations).

Pricing is important both to ensure customers are aware of the implications of their consumption and to allow Redland Water to manage its risks.

Nevertheless, previous detailed price monitoring has not required adherence to the proposed pricing principles. It was therefore considered inappropriate to impede Redland Water from moving to annual performance monitoring.

The QCA noted that for all retailers pricing principles were considered a priority issue for attention.

Table 3 General pricing objectives and principles

| | | <i>Recommendations - Redland Water assessment</i> |
|--------------------|-----|---|
| Pricing objectives | 1.1 | That pricing of urban water, sewerage, trade waste, recycled water and stormwater re-use services provided by retailers should: <ul style="list-style-type: none"> (a) promote economic efficiency (b) ensure revenue adequacy (c) take account of the public interest (including fairness and equity) (d) be transparent, predictable, simple and cost-effective to apply. <p><i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i></p> |
| Pricing principles | 1.2 | Retailers seek to apply the pricing principles or advise of any departure, the reasons for the departure and provide relevant supporting analysis. <p><i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i></p> |
| | 1.3 | Prices reflect marginal cost, together with a two-part tariff where necessary to achieve revenue adequacy. <p><i>Comment: Insufficient information for assessment. Redland Water has a fixed charge and a three-block inclining block tariff for residential customers for 2013-14, with a two-part tariff (fixed charge and a single block) for non-residential customers. Fixed water charges vary by meter size for residential and non-residential connections.</i></p> |
| | 1.4 | Prices be set between incremental (marginal) cost and stand-alone cost. <p><i>Comment: Insufficient information for assessment.</i></p> |
| | 1.5 | Prices reflect the LRMC of providing a particular service. <p><i>Comment: Insufficient information for assessment.</i></p> |
| | 1.6 | Prices reflect SRMC when SRMC for a particular period exceeds the LRMC for a particular service. This is sometimes referred to as scarcity charging. <p><i>Comment: Insufficient information for assessment. Bulk water prices are set by the Queensland Government (not Redland Water) and do not vary with supply constraints.</i></p> |
| | 1.7 | LRMC be estimated on the basis of the perturbation or AIC method. <p><i>Comment: Insufficient information for assessment.</i></p> |

Table 4 Application of pricing principles

| Chapter | Topic | No | Recommendations - Redland Water assessment |
|----------------|---------------------------------------|-----------|---|
| Urban water | Demand forecasting | 2.1 | Long-term forecasts used for capital planning be based on projected regional average urban demand as published in the SEQ water security program. <i>Comment: Redland Water uses population and employment projections from council planning models. Capital planning employs the parameters in the SEQ Design and Construction Code.</i> |
| | | 2.2 | Short-term demand forecasts be based on estimated water use per customer/connection and population forecasts (number of connections) and take account of any bounce-back effect as well as local circumstances. <i>Comment: Redland Water has broadly applied this principle in setting sewerage prices, as noted in past price monitoring reports. Redland Water did not include bounce-back in its assumptions in 2013-15.</i> |
| | | 2.3 | Demand forecasting practices and alternative models (including demand elasticities) be reviewed by a working group including the retailers, QCA and other relevant parties. <i>Comment: Insufficient information for assessment.</i> |
| | Volumetric charges | 2.4 | The volumetric charge for urban water services reflect LRMC. <i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i> |
| | | 2.5 | Where prices exceed average costs, short-term over-recovery of revenues be addressed by ex-post rebates with adjustments made to the fixed charge. <i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i> |
| | Fixed charges | 2.6 | Fixed charges for urban water services be set to recover the MAR not covered by the volumetric charge. <i>Comment: Insufficient information for assessment. Fixed water charges vary by meter size for residential and non-residential connections.</i> |
| | | 2.7 | Charges not encourage customers to by-pass or disconnect from the network. <i>Comment: No information to indicate customers are seeking to by-pass or disconnect from Redland's network. Past price monitoring has not investigated cost allocation, including to customer types.</i> |
| | Inclining and declining block tariffs | 2.8 | Inclining and declining block tariffs not be introduced, and where already in place be phased out over time to a single volumetric charge. <i>Comment: Redland Water has a three-block inclining block tariff for residential customers for 2013-14, with a single block usage tariff for non-residential customers.</i> |
| | Location-based or nodal pricing | 2.9 | Location-based or nodal charges for urban water services be applied where there are significant differences in costs between locations or between nodes. <i>Comment: Redland Water does not apply nodal pricing.</i> |

| Chapter | Topic | No | Recommendations - Redland Water assessment |
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| | Peak period and seasonal charges | 2.10 | <p>The QCA notes that peak-period or seasonal charges for water are not in use in Australia. Responses from retailers show little interest in introducing such charges. The QCA recommends that retailers only consider peak period or seasonal charges where clear net benefits are likely.</p> <p><i>Comment: Redland Water has no peak-period or seasonal charges.</i></p> |
| | Self-selecting tariffs | 2.11 | <p>Self-selecting tariff options be considered where there is sufficient information for customers to make choices, provided they do not result in cross-subsidies or introduce unmanageable revenue risks for the retailer.</p> <p><i>Comment: Redland Water does not offer self-selecting tariff options.</i></p> |
| | Service quality differentials and interruptible tariffs | 2.12 | <p>Price/service quality tariff options be adopted, where material cost differentials are associated with different levels of service.</p> <p><i>Comment: Redland Water does not have any service quality differentials and interruptible tariffs.</i></p> |
| | Metering and billing arrangements | 2.13 | <p>Individual metering of flats and units be adopted where economic and practical.</p> <p><i>Comment: As of 1 Jan 2008 all new unit/apartment complexes are required to be fitted with individual meters per dwelling.</i></p> <p><i>For existing complexes, Redland Water takes instructions from the owner of the complex or body corporate as to the method of billing (either individual invoices or a single invoice to the owner or body corporate). If individual invoices are chosen, the owner or body corporate also advises of an appropriate apportionment.</i></p> |
| | | 2.14 | <p>Where water is separately metered, subject to legislative constraints, tenants be billed the fixed and variable charges for water and sewerage.</p> <p><i>Comment: Landlords are entitled to pass the volumetric proportion of a bill to a tenant provided the premises are individually metered and meet water efficiency standards.</i></p> |
| | | 2.15 | <p>Customers with unmetered connections be charged a deemed amount for usage, reflecting average use for similar property types.</p> <p><i>Comment: Insufficient information for assessment. No published tariff for unmetered connections.</i></p> |
| | | 2.16 | <p>Customers with unmetered connections be given the option of paying for meter installation.</p> <p><i>Comment: Insufficient information for assessment. No published tariff for unmetered connections.</i></p> |
| | | 2.17 | <p>For vacant and non-connected properties where water and sewerage services are available for connection, the water and sewerage access charges that apply to connected properties (the relevant domestic or commercial charge) be applied.</p> <p><i>Comment: Redland Water charges vacant land the same water and sewerage access charge that applies to connected properties.</i></p> |
| | | | |

| Chapter | Topic | No | Recommendations - Redland Water assessment |
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| | | 2.18 | <p>Concessions and rebates:</p> <ul style="list-style-type: none"> (a) reflect a consistent approach between the retailers (b) be set to apply to either the fixed charge or as a total direct adjustment to the gross invoice amount (c) be capped so as not to subsidise discretionary use (d) be transparent with acknowledgement of the source of, and purpose for, particular concessions/rebates. <p><i>Comment: Redland Water implements Qld Government Pension subsidy under which pensioners can receive a subsidy of up \$120 (maximum) each year off the cost of water access and usage charges. The pensioner subsidy is applied as a direct adjustment to the total bill.</i></p> |
| | | 2.19 | <p>Concessions associated with excess water use caused by leaks, be determined by the retailers in consultation with customers.</p> <p><i>Comment: Redland Water has a form to apply for a remission in relation to a concealed leak that is publicly available (Redland Water 2014a).</i></p> |
| | | 2.20 | <p>Hardship arrangements be consistent with legislative or operating requirements and avoid cross-subsidies where practical.</p> <p><i>Comment: Redland Water's website states that customers that cannot pay their bills should contact council as soon as possible to discuss payment options, as noted in 2013-15 price monitoring. DEWS is undertaking a review of the SEQ Customer Code and will consider the water businesses' policies (including hardship) in relation to supporting customers.</i></p> |
| | | 2.21 | <p>Meter-reading and billing be undertaken at least quarterly.</p> <p><i>Comment: Redland Water applies quarterly billing.</i></p> |
| | Tradeable water entitlements | 2.22 | <p>Tradeable urban water entitlements be considered where the efficiency gains are sufficient to justify the administration and transactions costs.</p> <p><i>Comment: No tradeable urban water entitlements.</i></p> |
| Sewerage | Demand forecasting | 3.1 | <p>Demand for sewerage services be based on forecast growth in connections, linked to population growth.</p> <p><i>Comment: Redland Water has applied this principle in setting sewerage prices, as noted in past price monitoring reports.</i></p> |
| | Efficient pricing | 3.2 | <p>For residential customers:</p> <ul style="list-style-type: none"> (a) sewerage charges be based on a single part tariff with a fixed charge per customer or connection (b) volumetric charges be applied where these can be effectively measured (including by discharge or return factors). <p><i>Comment: Redland Water applies a single part sewerage tariff for residential connections.</i></p> |

| Chapter | Topic | No | Recommendations - Redland Water assessment |
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| | | 3.3 | For non-residential customers: (a) fixed sewerage charges be based on the impact of the customer on the system. In the absence of direct metering, water connection size be accepted (b) volumetric charges be applied where these can be effectively measured (including by discharge or return factors). <i>Comment: Redland Water applies a single part sewerage tariff for non-residential connections.</i> |
| | Nodal pricing | 3.4 | Location-based or nodal pricing for sewerage services be applied where there are significant differences in costs between nodes. <i>Comment: Redland Water does not apply nodal price to sewerage services</i> |
| Trade waste | Demand forecasting | 4.1 | Where the customer base changes in line with growth, trend information be used to provide reasonable forecasts of demand for trade waste services. <i>Comment: Insufficient information for assessment.</i> |
| | | 4.2 | Retailers consult with large customers to monitor any step changes in demand for trade waste services. <i>Comment: Insufficient information for assessment.</i> |
| | Efficient pricing | 4.3 | Trade waste prices be based on the impactor pays principle. <i>Comment: Insufficient information for assessment.</i> |
| | | 4.4 | Charges be based on the LRMC of transport, treatment and disposal of trade waste, with variable charges based on volume and contaminant load. <i>Comment: Redland Water's trade wastes charges are comprised of a fixed access charge, a volume charge and contaminant load charge.</i> |
| | | 4.5 | Specific charges for the management of trade waste services (inspection and monitoring) be applied on a cost reflective basis. <i>Comment: Insufficient information for assessment.</i> |
| | | 4.6 | Charges be differentiated according to customer type and risk factors, and by location (as part of risk assessments) if considered cost effective. <i>Comment: Redland Water's trade wastes charges are comprised of a fixed access charge, a volume charge and contaminant load charge.</i> |
| | Compliance | 4.7 | Consistent with regulations, retailers apply penalty charges for non-compliance and recover the efficient costs associated with breaches. <i>Comment: Insufficient information for assessment.</i> |
| Recycled water | Efficient pricing | 5.1 | The revenue requirement for recycled water services be based on the total additional cost of recycling less avoided costs and less developer contributions. <i>Comment: Insufficient information for assessment.</i> |
| | | 5.2 | Where there are costs associated with recycling that cannot be recovered from recycled water customers, direct and avoidable costs be allocated between relevant parties on a beneficiary pays basis. <i>Comment: Insufficient information for assessment.</i> |
| | | 5.3 | Recycled water volumetric prices be based on LRMC for the established recycled water scheme where possible, based on marginal operating costs less marginal avoided costs. If necessary, recycled |

| Chapter | Topic | No | Recommendations - Redland Water assessment |
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| | | | water volumetric charges be set lower than LRMC to ensure demand clears supply (where the recycled water volumetric charge is higher than the potable water volumetric charge). <i>Comment: In 2013-14, Redland Water provided Class B recycled water at \$2.20/kl.</i> |
| | | 5.4 | Where volumetric charges do not ensure revenue adequacy, fixed charges in a two-part tariff be set to recover remaining revenues, subject to willingness to pay. <i>Comment: See above, no fixed charges apply for recycled water.</i> |
| | | 5.5 | If the revenue requirement is still not achievable (that is, where fixed and volumetric charges exceed willingness to pay), unrecovered amounts be allocated to potable and sewerage charges in proportion to avoided cost allocations. <i>Comment: Insufficient information for assessment.</i> |
| | | 5.6 | The approach and charges be periodically reviewed, as customer acceptance increases. <i>Comment: Insufficient information for assessment.</i> |
| | Sewer mining | 5.7 | Charges for sewer mining be set on a case-by-case basis to reflect relevant direct costs, a share of sewerage system common costs, service costs for any returns, less avoided/avoidable costs. <i>Comment: No sewer mining takes place in Redland.</i> |
| Stormwater | Stormwater reuse | 6.1 | Stormwater reuse pricing be subject to the same pricing principles as recycled water. <i>Comment: Redland Water does not provide stormwater re-use services.</i> |
| | Stormwater drainage | 6.2 | Rate-based charges continue to be used for recovery of stormwater drainage costs. <i>Comment: Stormwater drainage charges are incorporated in Redland City Council general rates.</i> |
| | | 6.3 | Charges for stormwater drainage be transparently identified on customer bills. <i>Comment: Insufficient information for assessment.</i> |
| Industry-wide issues | Externality pricing | 7.1 | The inclusion of externality prices be supported where material impacts can be valued accurately and cost effectively. <i>Comment: Insufficient information for assessment.</i> |
| | | 7.2 | Prices incorporating estimates of externalities avoid duplication with other mechanisms and be transparent. <i>Comment: Insufficient information for assessment.</i> |
| | | 7.3 | Licences and market mechanisms be considered where the benefits are considered to justify the costs. <i>Comment: Insufficient information for assessment.</i> |
| | Third party access | 7.4 | Third party access prices be based on the cost of service methodology, and take account of relevant joint or common costs. Any departure from this methodology (such as applying the retail minus methodology) is to be justified. <i>Comment: Insufficient information for assessment.</i> |
| | | 7.5 | Where retail prices are averaged across user groups (postage stamp tariffs) access prices be adjusted (where required) to ensure costs are |

| Chapter | Topic | No | Recommendations - Redland Water assessment |
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| | | | not increased for remaining customers. <i>Comment: Insufficient information for assessment.</i> |
| | Price paths | 7.6 | Price paths be implemented where there are substantial price increases, having regard to customers' ability to pay and the impacts on the service provider's financial viability. <i>Comment: Redland Water is seeking to smooth prices over ten years in its pricing model but has not published a future price path. QCA had concerns with the pricing model and future negative retail-distribution future prices as stated in 2013-15 review.</i> |
| | | 7.7 | Price paths be set on a revenue neutral basis. <i>Comment: Insufficient information for assessment. Redland Water has not published a future price path. In previous price monitoring the QCA noted Redland Water has developed a 10-year pricing model. The QCA had a number of concerns with this model as noted above.</i> |

Source: QCA 2014c.

Stakeholder submissions

In response to pricing principle 2.8, Redland Water advised that it has adopted a single volumetric tariff in place of an IBT.

In response to pricing principle 3.1, Redland Water submitted that it has differing views to QCA on the real population growth in Redland. Redland Water suggested real population growth is 0.5% per year rather than the 1.7% increase estimated by the QCA in its 2013-15 price monitoring investigation

In response to pricing principle 7.6, Redland Water suggested that it is implementing a ten-year price path to address a 31% increase in bulk water prices in 2017-18.

Final assessment

In response to Redland Water:

- (a) Price reform involving removal of IBTs is welcomed.
- (b) In the 2013-15 review, the QCA proposed that connections growth from 2013-14 be based on the OESR population low series forecast adjusted for changes in occupancy rates (giving 1.7% in connections growth). Redland Water was invited to provide historical connections growth data to support its contention that population growth is only 0.5% but did not provide the data.
- (c) The QCA's position paper (2014c) indicated in-principle support for price paths. The data and modelling issues with Redland Water preclude a conclusion on this matter.

2.4 Conclusions and recommendations

Draft assessment

On the basis of its assessment against core criteria (see Table 5), Redland Water needs to provide a convincing case that it is not exercising market power, before it can transition to the annual performance monitoring framework.

To meet this objective, Redland Water should address the QCA's concerns with regards to the data and methodology underpinning its pricing model and resultant negative future prices.

Setting 2014-15 prices provided an opportunity for Redland Water to address the QCA's concerns and demonstrate there is no exercise of monopoly power. Redland Water advised it would take the QCA's concerns into account in setting 2014-15 prices.

Redland Water should therefore have provided to the QCA by 15 August 2014:

- (a) revised pricing model addressing the QCA's concerns (including sufficient details relating to forecast capital and operating costs to enable the QCA to assess their appropriateness)
- (b) 2014-15 prices and supporting information.

The QCA stated it would review this information and release its final recommendation in its September 2014 final assessment.

It was also noted that apart from the application of proposed pricing principles (where a detailed assessment had yet to be undertaken), Redland Water had showed a commitment to and performed well against other elements of the proposed annual performance monitoring framework.

Potential areas of improvement with respect to the non-core criteria were identified in Table 5.

Table 5 Summary of draft assessment - Redland Water

| <i>Criteria</i> | <i>Achieved?</i> |
|--|--|
| Core criteria | |
| Absence of public interest or equity issues that may warrant regulatory review | Yes |
| Regulated services are clearly defined and separated from non-regulated services | Yes |
| No evidence of an exercise of market power | Given concerns with the Redland Water pricing model and future prices, the QCA could not establish whether there is an exercise of market power by Redland Water in 2013-15. In setting 2014-15 prices Redland Water failed to address the QCA's concerns and demonstrate there is no exercise of monopoly power. |
| Absence of material changes in circumstances or major infrastructure costs | Yes |
| Demonstrated capacity to provide information accurately and on time | Yes – notwithstanding inconsistencies between 2013-15 submission and pricing model as these reflected a lack of familiarity with information requirements that can be addressed in future. |
| Other criteria | |
| Performance in customer engagement | Existing customer engagement practices are consistent with many desired features. Redland Water is well placed to build on these to achieve best practice. |
| Strategic approach to long term investment | Broadly addressing many desired elements. Capital planning policies and procedures not always consistent with good industry practice but Redland Water was generally aware of, and plans to address, these issues. |
| Service quality | Redland Water has committed to and is reporting on a limited number (11) of the QCA's recommended measures. |

| <i>Criteria</i> | <i>Achieved?</i> |
|--------------------|---|
| Pricing principles | Insufficient information for full assessment. Concerns with pricing model and future negative retail-distribution future prices. This is considered a priority area for consideration in future performance monitoring. |

Stakeholder submissions

Redland Water contended it is ready to transition to the annual performance monitoring framework.

Final assessment

The QCA's final assessment takes account of changes in the recommended framework since the position paper, namely in regard to updated financial information and service quality indicators.

Compared to the draft assessment, Redland Water reports against seven of the QCA's revised service quality indicators. Fact sheets at the time of the 2014-15 price announcements still contained dated pricing information.

To date, Redland Water has not provided a satisfactory submission on its proposed revised modelling approach in response to the QCA's draft assessment.

Redland Water meets the criteria for transition to annual performance monitoring on all criteria except that we are unable to conclude that Redland Water are not exercising market power due to the evident shortcomings of its price modelling (and potentially the pricing principles being applied - these are yet to be reviewed for all retailers). That is, it is not the prudence and efficiency of Redland Water's costs that is the issue and therefore another cost of service review is not useful or warranted.

It is recommended that Redland Water be required to provide the revised pricing model by 30 November 2014 for review by the QCA and that:

- (a) if the QCA can then confirm that there is no exercise of market power, the QCA recommend to the Minister that Redland move to annual performance monitoring
- (b) if the QCA considers there is an exercise of market power, or if Redland Water do not submit their pricing model to the QCA by 30 November 2014, the QCA publicly release a statement to that effect and advise the Minister accordingly. In this instance, Redland Water should address the QCA's concerns about the potential exercise of market power, and submit its pricing model at the time of the first review under the annual performance monitoring framework. At that juncture, upon consideration of all information including that relevant to annual performance monitoring, if still not satisfied, it would be open to the QCA to recommend to the Minister that price determination is warranted.

Recommendation

H.1. Redland Water provide the revised pricing model by 30 November 2014 for review by the QCA and:

- (a) if the QCA can confirm there is no exercise of market power, the QCA recommend to the Minister that Redland Water move to annual performance monitoring**
- (b) if the QCA considers there is an exercise of market power, or if Redland Water do not submit their pricing model to the QCA by 30 November 2014:**
 - (i) the QCA publicly release a statement to that effect and advise the Minister accordingly**
 - (ii) Redland Water address the QCA's concerns about the potential exercise of market power, and submit its pricing model at the time of the first review under the annual performance monitoring framework.**

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