

Our ref:A2515497

Mr John Hindmarsh
Chief Executive Officer
Queensland Competition Authority
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9 October 2014

Dear John

Unitywater input to QCA review of Seqwater Bulk Water Prices

Thank you for the opportunity for Unitywater to provide input into the QCA's response to the Ministers' Direction Notice (the Direction) requiring the QCA conduct an investigation into Seqwater bulk water prices for the three years ending 30 June 2018.

Unitywater notes that the Direction severely limits the scope of the QCA's exercise. In particular, the QCA is required to recommend a tariff path that moves all Seqwater supplied customers to a common price that will remain constant in real terms thereafter and to recommend tariffs that are purely volumetric.

Unitywater is concerned that these limitations on the scope of the QCA's review:

- limit the usefulness of the exercise;
- risk locking in flawed pricing structures; and
- potentially encourage inefficient competition and bypass of the existing water grid.

Inefficient competition and bypass of the water grid can occur where the pricing structure diverges from the underlying economic costs of providing the service. This may incentivise customers to invest in alternative supply technology (whether demand management or alternative supply options) on the basis that the avoided cost (given the flawed pricing structure) makes the alternative financially attractive. However, from a whole of water grid perspective, this may be inefficient and result in total costs being higher than they would otherwise be.

In the current context, this possibility is due to the magnitude of the forecast bulk water price which DEWS currently estimate will be in the order of \$3/kl in current dollar terms by 2017-18. Given the capacity of Seqwater's in situ assets, there is unlikely to be any need for significant investment in increased capacity over the foreseeable future.

Further, the majority of Seqwater's costs are related to existing sunk investments rather than covering operating costs such as labour, energy and materials. As such, in economic terms, the pricing structure that has the least distortionary impact on water consumption and that most accurately reflects the forward looking efficient costs of supply would be use of a two part tariff

with the majority of costs recovered via a fixed charge element rather than the mandated purely variable charge required under the Direction.

Unitywater is concerned that reliance on a fully variable charge to recover Seqwater's costs will actively encourage the potential development of inefficient recycled water schemes or other alternative supply options that are inefficient in that they are only viable because of the customer's ability to avoid the very high variable water charge. If in future this pricing approach changes yet again it may well strand any such schemes and create issues for distribution businesses who must act as providers of last resort and whose performance will be assessed against prudence and efficiency standards.

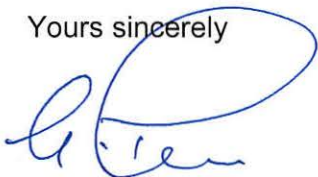
Unitywater recognises that the QCA can only respond to the Direction as drafted. Nevertheless, Unitywater hopes that the QCA is able to identify the potential for unintended consequences associated with a distorted purely volumetric pricing structure for bulk water within its response to the Direction.

While the QCA is precluded from suggesting a move away from variable pricing, it would appear open for the QCA to recommend increased transparency in terms of the build-up of costs leading to the bulk water variable charge. Specifically, Unitywater sees significant value in bulk water charges being split into major cost components. Such a split might reflect cost categories such as:

- secure water supply (possibly split between headworks and transfer costs as done by Melbourne Water);
- flood mitigation; and
- catchment and recreational management.

The increased transparency delivered by splitting up bulk water costs would go some way to educating customers on the costs of the complex tasks involved in providing a secure, high quality water supply and therefore would assist distributor/retailers such as Unitywater in communicating the reasons for water bill increases.

Yours sincerely



George Theo
Chief Executive Officer