

Date: 10<sup>th</sup> April 2015  
Contact: Andre Kersting  
Location: Gold Coast Water  
Telephone: 07 5582 9006  
Your reference:  
Our reference: 48924272

Mr Malcolm Roberts  
Chairman  
Queensland Competition Authority  
GPO Box 2257  
Brisbane QLD 4001

Dear Malcolm,

**Re: Submission SEQ Retail Water Annual Performance Monitoring Guidance Paper**

The Council of the City of Gold Coast (Council) appreciates the opportunity to respond to matters relevant to the rules of the *SEQ Retail Water Long-Term Regulatory Framework* (the Framework) as outlined in the Queensland Competition Authority's *SEQ Retail Water Annual Performance Monitoring - Guidance Paper* (Guidance Paper).

Council supports the continuation of economic regulation post 30 June 2015 and sees merit in expanding the framework to include service quality performance reporting and stakeholder engagement.

The attached submission provides Council's response to a number of issues raised within the Guidance Paper, including:

- *Regulatory Uncertainty Surrounding the Framework*
- *Regulatory Period*
- *Information Requirements*
- *Application of Pricing Principles and*
- *Consumer Price Index (CPI).*

Should you wish to discuss the issues outlined in the attached submission, please contact Mr Andre Kersting, Coordinator Pricing and Regulation on (07) 5582 9006.

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Yours Faithfully

Paul Heaton  
**Director Gold Coast Water**  
*For the Chief Executive Officer*  
Council of the City of Gold Coast

Enc. Attachment: Submission - SEQ Retail Water Annual Performance Monitoring - Guidance Paper

## **Submission - SEQ Retail Water Annual Performance Monitoring Guidance Paper**

This submission seeks to address a number of issues raised within the 'SEQ Retail Water Annual Performance Monitoring - Guidance Paper' (Guidance Paper). These issues include:

- *Regulatory Uncertainty Surrounding the Framework*
- *Regulatory Period*
- *Information Requirements*
- *Application of Pricing Principles and*
- *Consumer Price Index (CPI).*

### **Regulatory Uncertainty Surrounding the Framework**

As outlined in the Queensland Competition Authority's (QCA's) final report on the *SEQ Retail Water Long-Term Regulatory Framework* (the Framework), retailers have the option to adopt alternative Weighted Average Cost of Capital (WACC) methodologies, with any variations to the QCA method to be justified. Despite this, the QCA has acknowledged it will determine the benchmark (WACC) for the purposes of establishing the Reference Maximum Allowable Revenue (Reference MAR) using an 'on-the-day' rate.

The annual approach to WACC creates regulatory uncertainty and inconsistency for the retailers, which has the potential to discourage investment. Over time, it may be unsustainable to have a situation where prices are not reflective of the actual cost to deliver services.

Although the under and over recovery mechanism would assist in managing such situations, it has the potential to influence material changes to annual prices. For example, a 0.5 per cent change in WACC translates to around a plus or minus \$12.5m change to Council's annual revenue requirement.

Readjusting prices annually to account for changes to WACC can result in material price variations for customers. Such price variations has the potential to confuse customers and may consequently result in community backlash as it is a difficult concept to explain (ie: price rises associated to an under-recovery in revenue from previous years) to customers.

Council recommends a longer term outlook on WACC to mitigate the risks of regulatory uncertainty. This outlook could be aligned to the five year review of the 0.25 per cent efficiency (X) factor (currently proposed by QCA).

### **Regulatory Period**

While it is noted that distributor-retailers (i.e. entities) are required to provide an annual submission to the regulator under the Framework, Council does not believe the regulatory period should be set to one year.

The QCA has in the past been directed to adopt 'a five-year regulatory period for its oversight of the Gladstone Area Water Board (an initial review covered three years)', 'a three-year regulatory period (with annual reporting) for 2010-13 price monitoring in SEQ', and a 'two-year price monitoring review for the South East Queensland (SEQ) distributor-retailers (i.e. entities) for 2013-15'<sup>1</sup>.

Application of a longer regulatory period (i.e. three to five years) that has clear alignment to asset management planning and service contracts would assist in ensuring maximum operational

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<sup>1</sup> SEQ Retail Water Long-Term Regulatory Framework - Overview - Part A

efficiency and effective regulatory outcomes. This framework can readily accommodate a longer regulatory period with annual performance monitoring and reporting.

### **Information Requirements**

Council does not share the QCA's view that a range of information requirement levels promote light-handed regulation. Future submissions from Council are likely to be reflective of its 2013-15 submission, to ensure regulatory compliance with Level 3 as outlined in the Guidance Paper. It is important to note that this does not include additional regulatory requirements proposed by the QCA, for example supporting information demonstrating the application of the QCA's pricing principles and service standards.

Under a level 3 assessment, QCA proposes to monitor the impact of cost changes against a Reference MAR that will be calculated and updated annually for each retailer using principles consistent with the CPI - X framework. The Reference MAR will be based upon that carried forward from the 2013-15 price monitoring investigation. To avoid confusion in future regulatory years, Council suggest 2013-15 information submissions are updated with actual's rather than forecast data prior to carrying forward the Reference MAR.

In addition to the categorisation of information requirements Council recommends the Guidance Paper consider including elements of the QCA's information requirements paper for the 2013-15 regulatory period. This should include definitions and interpretation. Adopting a more prescriptive approach to the Guidance Paper would ensure consistency and avoid confusion (relating to cost information) if the QCA were to undertake a cost of service investigation.

### **Application of Pricing Principles**

The QCA's Guidance Paper states that *'Retailers would be required to provide a statement of their pricing practices. This statement should address the general pricing objectives and principles.'*<sup>2</sup>

This statement suggests that the applications of all pricing principles as outlined in the Guidance Paper are a mandatory regulatory requirement. Council does not consider that all principles are in line with the intention of the light handed nature of the proposed Framework. For example, pricing principle 2.22 (as outlined in Appendix B of the Guidance Paper) suggest tradeable urban water entitlements should be considered where the efficiency gains are sufficient to justify the administration and transactions costs. SEQ entities do not have water entitlements and therefore the principle serves no purpose and imposes unnecessary administrative burden.

Council acknowledges QCA's marginal cost pricing framework and recommends the framework to be expanded to offer further guidance on long run marginal cost (LRMC) to include the following 'three distinct steps'<sup>3</sup>:

- *identifying the relevant dimensions of each service, before considering the application of LRMC*
- *determining whether it is practicable to measure how much of each service is 'consumed' and whether customers are able to make independent decisions as to how much of a particular service dimension is 'consumed' and*
- *assessing the likelihood and magnitude of customer response to price signals derived from the application of LRMC.*

Expanding the framework to incorporate these steps would ensure the application of LRMC pricing principles in pricing decisions and provide a consistent approach for all entities.

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<sup>2</sup> Queensland Competition Authority (March 2012), SEQ Retail Water Annual Performance Monitoring – Guidance Paper, p. 15.

<sup>3</sup> Smart Water Fund, NERA Economic Consulting (2012), An Economic Framework for Estimating Long Run Marginal Costs in the Victorian Water Industry – Final Report, p. 11.

As Council does not apply variable sewage charges to residential customers, it is not considered practical to apply LRM for residential customer's sewerage services.

### **Consumer Price Index**

The QCA proposes the use of the CPI be based on the Reserve Bank of Australia forecast national CPI index (or the mid-point of the forecast range where a forecast is not available), to be applied at the time of SEQ entities' pricing decisions.

Council currently uses the Australian Bureau of Statistics, March to March CPI data (released in mid-April each year) to make its final pricing decisions. This practice is undertaken as it aligns with Council's contractual arrangements and provides greater certainty and reduces cost risks. Additionally, it minimises the exposure to fluctuations associated with the indexation calculation when revising the regulatory asset base (RAB) roll forward with actual CPI data.

It is proposed that any under or over recovery of revenue associated with variations in definition of CPI be addressed in future periods using QCAs proposed under and over recovery mechanism.