



Treasurer  
Minister for Trade and Investment

Our Ref: 01339-2017

25 MAY 2017

Professor Roy Green  
Chair  
Queensland Competition Authority  
Level 27, 145 Ann Street  
BRISBANE QLD 4001

QLD COMPETITION AUTHORITY

31 MAY 2017

DATE RECEIVED

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Dear Professor ~~Green~~ Roy

**Referral Notice for the Review of South East Queensland Bulk Water Prices**

Please find enclosed a referral notice under section 23 of the *Queensland Competition Authority Act 1997* requiring the Queensland Competition Authority (the Authority) to conduct an investigation into the bulk water prices for the Queensland Bulk Water Supply Authority (Seqwater) for the period 1 July 2018 to 30 June 2021.

Following the devastating impacts of the millennium drought, and the significant subsequent investment in the South East Queensland (SEQ) water grid and implementation of the bulk water price path, this is the second time the Authority has been tasked with recommending bulk water prices for SEQ. This demonstrates that the price path has been, and will continue to be an effective and important policy instrument for transitioning to a cost reflective common price, and ultimately, repaying the investment in the water grid over a sustainable period of time. It is pleasing to have the Authority's continued involvement in this process, and the progress that has been made in ensuring the bulk water price path has effective regulatory oversight.

I am advised that officers from my department have consulted with the Authority in the preparation of this referral notice. Seqwater has also been advised of this investigation and have been encouraged to work closely with the Authority to ensure the reporting timeframes for the review are met.

Should you have any queries regarding this matter, please contact Mr Gregory Tonks, Assistant Under Treasurer, Shareholder and Structural Division on [REDACTED].

**HON. CURTIS PITT MP**  
Treasurer  
Minister for Trade and Investment

Encl: *Minister's Referral Notice under s.23 of the Queensland Competition Authority Act 1997*

Cc.: The Honourable Mark Bailey MP, Minister for Main Roads, Road Safety and Ports, and Minister for Energy, Biofuels and Water Supply.

**QUEENSLAND COMPETITION AUTHORITY ACT 1997**  
**SECTION 23**  
**MINISTER'S REFERRAL NOTICE**

**Referral**

Pursuant to section 23(1) of the *Queensland Competition Authority Act 1997* (the Act), I refer the monopoly business activity of bulk water supply by the Queensland Bulk Water Supply Authority (Seqwater) in the local government areas listed below to the Queensland Competition Authority (the Authority) for an investigation about the pricing practices relating to that activity with the objective of recommending bulk water prices (Prices) for Seqwater in those local government areas for the period of 1 July 2018 to 30 June 2021 (the Regulatory Period).

Brisbane	Logan	Scenic Rim
Gold Coast	Moreton Bay	Somerset
Ipswich	Noosa	Sunshine Coast
Lockyer Valley	Redland	

**(A) Pursuant to section 24 of the Act, I direct the Authority to consider and make recommendations about the following matters as part of its investigation:**

- (1) Recommend Prices for the Regulatory Period which allow Seqwater sufficient revenue to recover prudent and efficient costs incurred from providing bulk water supply services and to repay Price Path Debt (defined as per (C)(3)) by 2027-28 on the basis that the Government's position is as follows:
- (2) Prices are to be consistent with the following:
  - (a) bulk water costs include, but are not limited to:
    - i. prudent and efficient capital expenditure and operating expenditure as per (C)(1)-(C)(2) below;
    - ii. a return on assets (including working capital);
    - iii. an allowance for tax (where applicable);
    - iv. interest on Price Path Debt;
    - v. depreciation calculated as per (C)(8);
    - vi. any costs detailed in Seqwater's bulk water supply agreements; and
    - vii. additional prudent and efficient operating and capital costs arising from Review Events (defined as per (C)(18)).
  - (b) the regulated asset base (RAB) is to be established as per (C)(7) below and subject to the opening RAB dictated by (A)(4);
  - (c) repayment of Price Path Debt by 2027-28;
  - (d) a price path as per (C)(10)-(C)(14) below; and
  - (e) Seqwater's demand forecasts as per (C)(17).

- (3) Price Path Debt is to be calculated as per (C)(4)-(C)(5) below;
- (4) The opening RAB is to be established as per (C)(6) and (C)(7) below;
- (5) The rate of return to be used for calculating Prices is as per (C)(9) below; and
- (6) The other matters as per (C)(15)-(C)(16) below.

**(B) Consultation and Timing**

- (1) Pursuant to section 24 of the Act, I direct the Authority to provide:
  - a) a Draft Report to me and the Minister for Energy, Biofuels and Water Supply, by 30 November 2017, following on a submission being made by Seqwater by 31 July 2017; and
  - b) a Final Report to me and the Minister for Energy, Biofuels and Water Supply by 31 March 2018.



**HON. CURTIS PITT MP**

Treasurer

Minister for Trade and Investment

## **(C) Definitions**

### Operational & Capital Expenditure

- (1) Capital and operating expenditure includes activities related to the provision of bulk water supply services (including catchment management) as well as activities related to recreation management and flood mitigation costs.
- (2) To assess operating expenditure and capital expenditure from 1 July 2018 to 30 June 2028, the Authority must adopt the following approach:
  - (a) form a view on the prudence and efficiency of capital expenditure and operational expenditure, with the focus on cost areas which are material to price changes rather than matters which are likely to have a minor and inconsequential impact;
  - (b) have regard to the strategic and operational plans approved by the responsible Ministers under the *South East Queensland Water (Restructuring) Act 2007*;
  - (c) capital expenditure must be reviewed giving consideration to demand forecasts as per (C)(17) below; and
  - (d) accept the prudence of any augmentations expected to be required under the Water Security Program, including augmentations to increase LOS yield or augmentations required to address system peak demand requirements.

### Price Path Debt

- (3) Price Path Debt is the accumulated under-recovery arising from the bulk water price path.
- (4) To establish the opening Price Path Debt as at 1 July 2018, the QCA is to roll forward the Price Path Debt as at 1 July 2014 as used by the QCA in the 2015-18 review based on:
  - (a) an updated assessment of Maximum Allowable Revenue from 1 July 2014 to 30 June 2018 adjusting for the updated capital costs based on rolling forward the RAB as per item (C)(7) below and applying asset indexation and inflationary gain consistent with the approach used by the QCA in the 2015-18 review;
  - (b) updating interest costs for actual cost of debt as advised by QTC;
  - (c) any prudent and efficient costs arising from Review Events; and
  - (d) Seqwater's actual revenue from 1 July 2014 to 30 June 2017 and forecast revenue for 1 July 2017 to 30 June 2018.
- (5) Interest on Price Path Debt from 1 July 2018 is to be calculated using Seqwater's cost of debt as advised by QTC.

### RAB

- (6) The opening RAB as at 1 July 2014 is not to be optimised and the QCA is to accept the remaining lives as used by the QCA in the 2015-18 review;
- (7) To establish the opening RAB as at 1 July 2018, the Authority is to:
  - (a) review historical capital expenditure as follows:

- i. in the event actual capital expenditure in 2014-15 and 2015-16 and, to the extent actual capital expenditure is available for 2016-17 and 2017-18 is at or below that previously allowed over the period then do not conduct an ex-post review;
  - ii. in the event actual capital expenditure in 2014-15 and 2015-16 and, to the extent actual capital expenditure is available for 2016-17 and 2017-18 is above that previously allowed over the period then conduct an ex-post review of those expenditures only;
  - iii. if required, any review of capital expenditure should focus on items that would have a material impact on the price path.
- (b) roll forward the RAB from 1 July 2014 to 30 June 2018, using actual capital expenditure (to the extent capital expenditure is available), adjusted for any findings as per (C)(7)(a) above; and
- (c) roll forward depreciation and asset appreciation based on actual inflation over the period.
- (8) Depreciation is to be calculated using the straight-line method, reflecting the remaining useful life of the assets.

#### Rate of Return

- (9) In regard to the rate of return to be used to calculate Prices, the following is to apply:
- (a) for assets (including working capital), a benchmark weighted average cost of capital (WACC) return, using a cost of equity as determined by the QCA for the equity component, and Seqwater's cost of debt as estimated by QTC for the debt component;
  - (b) if the cost of equity calculation determined by the QCA is lower than Seqwater's cost of debt, the rate of return applying to assets should be Seqwater's cost of debt as advised by QTC; and
  - (c) Subject to a decision of the Government at the time, it is intended that the next price review (for prices to apply post 30 June 2021) will provide for an end-of-period adjustment for the difference between the estimated and actual cost of debt over the Regulatory Period.

#### Price Path Structure

- (10) The prices for Redland, Sunshine Coast and Noosa are to be transitioned to the Common Price in 2019-20 unless this would result in a transitional price that is above the Common Price 2018-19, in which case prices should be set to the Common Price from 1 July 2018.
- (11) The Price for Noosa is to be the same as the price for Sunshine Coast for consistency following the de-amalgamation;
- (12) The Common Price for other council areas is to be reset from 1 July 2018, and prices are to remain constant in real terms once the Common Price has been reached until 2027-28.
- (13) The QCA is to present one alternative option which smooths price increases (if any) for all council areas including Redland, Sunshine Coast and Noosa, over the three-year regulatory period. The smoothed prices are:

- (a) to be net present value (NPV) neutral, with the under-recovery recovered through the price path over the period to 2027-28, consistent with the historic arrangements for the bulk water price path; and
- (b) to result in a new Common Price that remains constant in real terms beyond the three-year regulatory period until 2027-28.

(14) Prices are to be volumetric only.

Other Matters

- (15) Bulk water costs are to be offset by revenue from the sale of water to power stations, Toowoomba Regional Council and revenue from other water sales or any other source, as advised from Seqwater.
- (16) Costs and revenues associated with Seqwater's declared irrigation services are to be excluded. The costs related to irrigation services are to be calculated consistent with the cost allocation approach adopted by the Authority in its prior review of Seqwater's irrigation price paths;
- (17) Forecast demand is to be provided by Seqwater and is to include demand from power stations and Toowoomba Regional Council. QCA oversight is to ensure forecasts are within with the range (low-high) published in the SEQ Water Security Program.

Review Events

- (18) Review Events are to be:
  - (a) defined in accordance with the Authority's recommendations from the previous price review, as set out in its March 2015 report.
  - (b) for the period 1 July 2015 to 30 June 2018 the QCA is to review any additional costs for drought response for efficiency where these occur in accordance with the Water Security Program and the costs are material.