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MANAGEMENT PTY LTD

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12th October 2009

Mr John Hall
Chief Executive
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

Dear Mr Hall,

Submission to the Queensland Competition Authority (QCA) in response to Gladstone Area Water Boards Commercial Framework and Pricing Principles (for the 2010 review)

Callide Power Management (CPM) wishes to make the following submission to the QCA in response to the Gladstone Area Water Boards (GAWB) Commercial Framework and Pricing Principles submission prepared for the QCA as part of the 2010 price review.

1. Form of Regulation

CPM understands the logic of implementing a revenue cap as opposed to price cap methodology largely as a means of reducing GAWB's exposure to demand risk.

The QCA should request that GAWB quantify the benefits gained by mitigating demand risk upon moving to a revenue cap form of regulation, and ensure that this benefit is able to be passed through to the customer base in some way. CPM notes that there is some argument that a transition to a revenue cap approach should be accompanied by a reduction in the allowed regulatory return, on account of the service provider's reduced exposure to market/demand risk.

Should a revenue cap form of regulation be employed, CPM is concerned that the side constraint on annual tariff reviews of CPI plus 5% could result in annual increases that are excessive and above market.

2. Planning Period

CPM does not support GAWB's proposal to shorten the planning period from 20 years to 5 years from 1 July 2015. This change would result in:

- Current customers paying for excess capacity installed by GAWB to meet longer-term demand;
- Significant potential price shocks, depending on the level of excess capacity held at 2015; and
- New customers paying lower charges in the future on account of existing users 'funding' capacity on their behalf.

Although this change is flagged to occur during the next regulatory period review, it is CPM's view that a 5 year planning period has the potential to lead to significantly higher pricing by 'front loading' the cost of capacity for demand that is required in later periods. It also limits the opportunity to smooth impact over a longer period. This is a further concern given GAWB's position on Price Transition, whereby the allowable period for price transitions in confined to a single regulatory period.

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GAWB cites a number of regulated businesses where the planning period is shorter than 20 years. Generally, these businesses operate with capital programs focused on near-term (3-5 year) demand, so prices can legitimately be determined on a consistent planning horizon. The nature of GAWB's customer base and its previous and planned future capacity augmentations is substantially different, justifying a longer planning and cost-recovery horizon.

3. Demand Management Measures & Methodology

CPM supports the Demand Management Measures suggested by GAWB and is pleased that customers will have the opportunity to contribute to demand reduction opportunities. CPM has no major issue with GAWB's proposal to analyse demand management measures against the suggested framework.

4. Price Transition

CPM does not support price transition arrangement limited to a single 5 year regulatory period – especially if a planning period is reduced from 20 years to 5 years. CPM is of the view that a price transition period consistent with the customer's current or remaining contract term should be adopted.

While a price transition period of 5 years could be reasonable where the change in price is not substantial, it could have a significantly harmful impact on a commercial customer's operations where it is.

5. Zonal Pricing

CPM is generally comfortable with the proposal to retain geographical differential pricing for its customers, provided that the 'source zone' does not change.

CPM continues to be of the view that it is not appropriate for GAWB to recover preparatory costs related to the Contingent Supply Strategy (CSS) until such time that the physical infrastructure associated with the CSS is commissioned. This is consistent with CPM's submission to the QCA in respect to GAWB's recent Gladstone to Fitzroy Pipeline "Part (C)" submission.

6. WACC Parameters

CPM notes that GAWB has proposed changing a number of WACC parameters, with the collective effect of significantly increasing the allowable regulatory return. CPM would expect that the QCA would review in detail these changes, and have regard both to consistency with the Authority's established approach to estimating WACC and to the advantages of stability in regulatory financial arrangements over time (which was considered in some detail by the Australian Energy Regulator in its recent WACC determinations).

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7. Price Differentiation

In order to facilitate its ability to plan and finance the water supply system, as well as meet its objective of longer-term revenue security, GAWB is proposing price surcharges to customer contracts in the form of favourable treatment of longer-term agreements over shorter-term contracts.

CPM wishes to clarify the statement that "a short term contract is one which has an original term from less than 2 years to 20 years". CPM interprets this statement as meaning that current contracts which initially had a term of 20 years or more, but where the remaining contract term is less than 20 years, would not be considered a short term contract. Many of GAWB's customers initially would have executed such long-term agreements, and the benefit to GAWB of this should be recognised. It would be unrealistic to expect customers to maintain 'evergreen' 20 year agreements to avoid any price surcharge.

8. Instantaneous Flow Rate (IFR) Pricing

CPM is seeking clarification that the proposed IFR principles would not apply to Raw Water access contracts ex Awoonga Dam. CPM would expect that IFR principles would be relevant only to customer water delivery contracts using GAWB's water distribution network.

Yours Sincerely,

[redacted]

Jamie Maione
Commercial Manager
Callide Power Management