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3 August 2011

The Chief Executive Officer
Queensland Competition Authority
G.P.O. 2257
Brisbane Qld.4001

Dear Sir/Madam,

Please consider public comment regarding the Authority's prices monitoring role for water and sewerage services provided by declared Government Monopoly Business Activities (GMBAs) providing natural monopoly services throughout South East Queensland (SEQ). Such entities are subject to the provisions of the National Water Initiative (NWI) agreements between the Federal and Queensland Governments.

I submit charges incorporated in the Unitywater 2011/12 Budget will result in actual revenues exceeding maximum allowable revenues (MAR) permitted under NWI Pricing Principles. This is because no effective prices oversight can be performed prior to adoption of that Budget due to improper restrictions incorporated in Terms of Reference (TOR) issued by the Ministers QCA. Should comprehensive prices oversight be permitted it will be discovered that improper manipulation of non-current distribution assets of Unitywater and the Queensland Bulk Water Supply Authority have been accepted by the Minister of Water Utilities in the determination of July 2008 legacy regulatory assets. It should also be noted that the Queensland Bulk Water Supply Authority has not been declared a GMBA under Part 3 of the Queensland Competition Authority Act although clearly being such an entity.

Correspondence from the Treasurer (Ref: QTO-09535) dated 26 July 2010 and from the Queensland Water Commission (QWC) dated 22 July 2011 (Ref: ME/11/0396) state that a discounted cash-flow methodology was used to determine non-current asset valuations for bulk water assets purchased from SEQ councils as at 30 June 2008. Sole reliance on this methodology is at variance with Principle 3 (17) of the NWI's Principles for the Recovery of Capital Expenditures that mandates use of the Optimised Deprival Value approach described on page 33 of QCA's "Statement of Regulatory Pricing Principles for the Water Sector". It has resulted in inflated valuations of all bulk water non-current assets throughout SEQ. Consequently capital recovery charges developed by the Queensland Water Commission, now mandated by the Ministers QCA are inflated and at variance with the methodologies required by NWI agreements. Consequently the TOR for 2011/12 prices monitoring is a breach of NWI's Principles for the Recovery of Capital Expenditures Principle 3 (17), and Principle 6 (23). TOR for the 2009/10, and 2010/11 SEQ Price Monitoring evaluations by former Ministers QCA were also in breach of NWI's Principles for the Recovery of Capital Expenditures Principle 3 (17).

Such TOR issued by the current Ministers QCA again prevent QCA from performing an investigation of prior year regulatory asset determinations that established the foundation upon which 2011/12 service price increases are based. The QCA is being prevented from performance of its duty to households throughout SEQ to have regard to *the protection of consumers from abuses of monopoly power* ("Statement of Regulatory Pricing Principles for the Water Sector Section 4.1 page 17).

Yours sincerely,

R.J.Koerner

Enc: Letter Qld. Treasurer (Ref: QTO-09535) dated 26 July 2010
Letter Queensland Water Commission (Ref: ME/11/0396) dated 22 July 2011

Cc: Productivity Commission's Urban Water Sector Inquiry



Queensland
Government

Office of the
**Treasurer and Minister for Employment
and Economic Development**

QTO-09535

26 JUL 2010

Dr Richard Koerner
Strategic Management / Econometric Market Analysis
31 Fauna Terrace
COOLUM BEACH QLD 4573

Dear Dr Koerner

I refer to your letter of 10 June 2010 to the Honourable Andrew Fraser MP, Treasurer and Minister for Employment and Economic Development, regarding water pricing in South East Queensland (SEQ), and have been asked to respond on his behalf.

The Government has undertaken a range of structural, institutional and regulatory reforms to enhance regional water security and improve the way water services are provided. Key elements of this program have been the separation in ownership of regional water assets, and the reduction in the number of entities involved in managing SEQ's water supply. In particular, you will be aware that Unitywater, created from the amalgamation of the water business of the Moreton Bay and Sunshine Coast Regional Councils, commenced operations on 1 July 2010.

The Government considers that economic regulation of the SEQ water sector will make an important contribution to the success of these reforms. To this end, the Queensland Competition Authority (QCA), as the state's independent regulator, will have a central role in regulating prices charged by the new distributor-retailers and the Government-owned bulk water entities, Linkwater, WaterSecure and Seqwater.

In 2007, the Government retained KPMG to carry out the financial due diligence for the purchase of SEQ councils' bulk water assets. KPMG applied a discounted cash-flow methodology, based on generally-accepted economic regulatory principles, to establish a 'line-in-the-sand' valuation for each council water business as at 30 June 2008. These valuations were broken down into separate bulk and distribution components.

In March 2010, the Honourable Stephen Robertson MP, Minister for Natural Resources, Mines and Energy and Minister for Trade determined that the distribution valuations would form the regulatory asset bases for the distributor-retailers and be used for regulatory pricing purposes. This means that, from 1 July 2010, the written-down value of assets will no longer be used as the basis for setting or measuring returns for water and wastewater prices.

As an interim measure for the next three years, the QCA will monitor water and wastewater prices charged by Unitywater, Queensland Urban Utilities and Allconnex Water on the basis of a framework which it has recently proposed to Government. This will ensure that water and wastewater prices in SEQ are appropriate and reflective of costs. As part of its price monitoring assessment, the QCA will undertake prudency and efficiency reviews of proposed new capital expenditure.

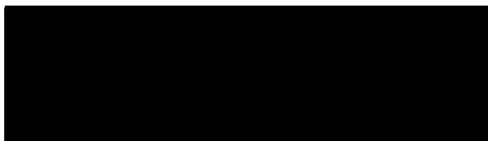
It is intended that the interim framework will subsequently transition to a deterministic regime from 1 July 2013, at which time the QCA will become responsible for setting retail water and wastewater prices. The regulated asset base set on 30 June 2008 will continue to be applied and 'rolled forward' consistent with standard regulatory practice. The Government will shortly direct the QCA to recommend a regulatory framework and key regulatory pricing principles for this purpose. As part of its review, the QCA will undertake an open consultation process, providing all interested stakeholders with an opportunity to express their views.

Currently, prices paid by the Water Grid Manager to the bulk water entities (grid service charges) are recommended to Government by the Queensland Water Commission (QWC), based on pricing principles contained in the Water Market Rules established under the *Water Act 2000*. These principles require full recovery of costs and reflect a number of key Government policies, including the limiting of returns on those assets constructed under the *Water Amendment Regulation (No 6) 2006* to their cost of debt.

The Government also intends for the QCA to assume responsibility for setting grid service charges under the *Queensland Competition Authority Act (1997)* from no later than 2013-14. In the near future, the QCA will conduct a public review to propose a framework for the deterministic regulatory regime, taking account of the Government's existing policies in relation to the bulk entities.

As a transitional measure, from 2011-12, the QCA will assume the QWC's existing role in recommending grid service charges to Government on the basis of the Market Rules.

Yours sincerely



Sharon Humphreys
Principal Advisor

Our ref: ME/11/0396

22 JUL 2011

Mr Richard Koerner
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Dear Mr Koerner

Thank you for your email of 3 July 2011 regarding Seqwater's revaluation of its dams and weirs as disclosed in its 2009/10 Annual Report.

As you correctly point out, under sections 1.12(a) and 2.2 of the South East Queensland (SEQ) Market Rules, the Queensland Water Commission (QWC), in the role of Rules Administrator, is responsible for the administration and enforcement of the SEQ Water Market Rules (the Market Rules).

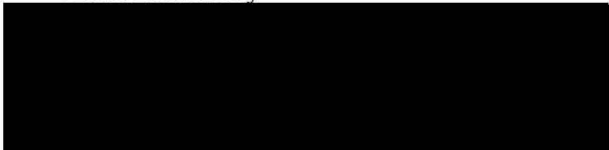
As you are no doubt aware, the Price Regulator under *Chapter 8 – Pricing* of the Market Rules is the Minister for Energy and Water Utilities. The QWC has an advisory role to the Price Regulator. The Queensland Competition Authority has been directed to investigate and recommend bulk water Grid Service Charges for the 2011-12 period.

The revaluation of Seqwater's assets in 2009/10 does not affect Seqwater's Regulated Asset Base (RAB) which is used for regulatory pricing purposes. The RAB used to calculate Seqwater's Grid Service Charges is the Initial Regulated Asset Base established at 1 July 2008 which is then updated (or rolled forward) each year to reflect prudent capital additions, disposals and depreciation. This is consistent with the National Water Initiative (NWI) Pricing Principles.

The revaluation of the Seqwater assets in 2009/10 is a matter for Seqwater and consequently the QWC does not have any information on the methodology used for the revaluation. If you require further information on the revaluation I recommend you contact Seqwater directly on 07 3035 5500.

If you require any further information, please feel free to contact Ms Tracie-Lee Waldock, Director, Water Reform, Queensland Water Commission on 3405 3550.

Yours sincerely



Ms Karen Waldman
Chief Executive Officer