

26 August 2010

The Chief Executive Officer
Queensland Competition Authority
G.P.O. 2257
Brisbane Qld.4001
Attn Ms. Cath Barker

Dear Ms. Barker,

The Queensland Competition Authority (QCA) has invited public comment regarding its prices monitoring role for water and sewerage services provided by government owned business entities providing natural monopoly services throughout South East Queensland (SEQ).

I believe charges incorporated into the Unitywater 2010/11 Budget will cause over-recovery of revenues and exceed statutory ceiling levels. This is because the Board of Unitywater performed no effective prices oversight prior to adoption of that Budget. Had thorough prices oversight been performed, the Board would have discovered improper manipulation of the written down replacement value of non-current distribution assets of Maroochy Water Services (MWS). This manipulation is recorded in the financial reporting just prior to MWS amalgamation into Sunshine Coast Water. That audits of the Maroochy Council's Financial Statements for 2007/March08 did not detect such irregularities raises most serious questions regarding the integrity of Local Government governance practices and also audit processes in Queensland.

Correspondence from the Treasurer (Ref: QTO-09535) dated 26 July 2010 has been provided to me to assist in this submission (see Attachment 1). It states (page 1, last paragraph) that KPMG applied a discounted cash-flow (DCF) methodology to determine non-current asset valuations for SEQ bulk water assets purchased from SEQ Councils as at 30 June 2008. Use of this methodology is at variance with Principle 3 (17) of the National Water Initiative's (NWI's) Principles for the Recovery of Capital Expenditures, which mandates use of the Optimised Deprival Value approach. This principle is also described on page 33 of QCA's "Statement of Regulatory Pricing Principles for the Water Sector". The use of DCF methodology has resulted in inflated valuations of bulk water non-current assets throughout SEQ. Consequently, capital recovery charges developed by the Queensland Water Commission (QWC), also endorsed by the Minister for Natural Resources, are inflated and not in compliance with the methodology mandated in NWI agreements.

This correspondence from the Treasurer (Attachment 1) also states that the Minister for Natural Resources has determined that distribution asset valuations, also based on the cash-flow methodology used by KPMG, would

form the regulatory asset base (RAB) for pricing purposes throughout SEQ. Such a RAB determination for Unitywater is in breach of NWI's Principles for the Recovery of Capital Expenditures Principle 3 (17), and Principle 6 (23). Its use will likely result in over-recovery of capital related charges for bulk water, retail water distribution, and sewerage treatment services for 2010/11 and exceed the Maximum Allowable Revenue requirement under full cost pricing principles.

QCA's terms of reference require provision of transparent information to customers about the costs and other factors underlying annual increases in water and wastewater prices for 2010/11, 2011/12 and 2012/13. However, the QCA is not authorised by the Minister to perform independent investigation of 2009/10 and prior year determinations, including the 2007/March'08 determination that established the foundation upon which these increases are based.

Given the examples of non-compliance cited above, households can have no confidence that provisions contained in the Water Market Rules set out in the Queensland Water Act (2000), and used by QWC for bulk water charge determination, comply with requirements set out in the NWI Regulatory Pricing Agreement or the QCA's current "Statement of Regulatory Pricing Principles for the Water Sector".

I request that the QCA's terms of reference be extended to include, as a minimum, investigation of asset value determination just prior to Maroochy Water Services being incorporated into Sunshine Coast Water.

Yours sincerely,

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Brian K. Raison

Attachment 1: Letter from Queensland Treasurer to R.Koerner (Ref: QTO-09535) dated 26 July 2010

**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.

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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 prudence and efficiency reviews of proposed new capital expenditure.

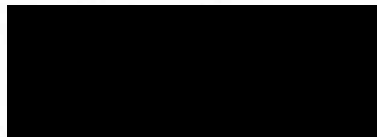
It is intended that the interim framework will subsequently transition to a deterministic regime from 1 July 2013, at which time the QCA will become responsible for setting retail water and wastewater prices. The regulated asset base set on 30 June 2008 will continue to be applied and 'rolled forward' 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

A black rectangular redaction box covering the signature of Sharon Humphreys.

Sharon Humphreys
Principal Advisor