



**Submission to the Queensland Competition Authority
(QCA)**

**Gladstone Area Water Board 2020 Price Monitoring
Investigation**

29 November 2019

1. Introduction

The Queensland Competition Authority (QCA) is currently investigating bulk water prices the Gladstone Area Water Board (GAWB) intend to charge for the 2020-25 regulatory period. GAWB lodged its Bulk Water Price Review submission on 30 September 2019, a key element of which is a proposal to recover accumulated under-recovered revenues of \$124.7 million from existing customers. On 4 November 2019, GAWB released a revised Part B submission which included redacted information on the under-recovery and proposed annuity payments by customer.

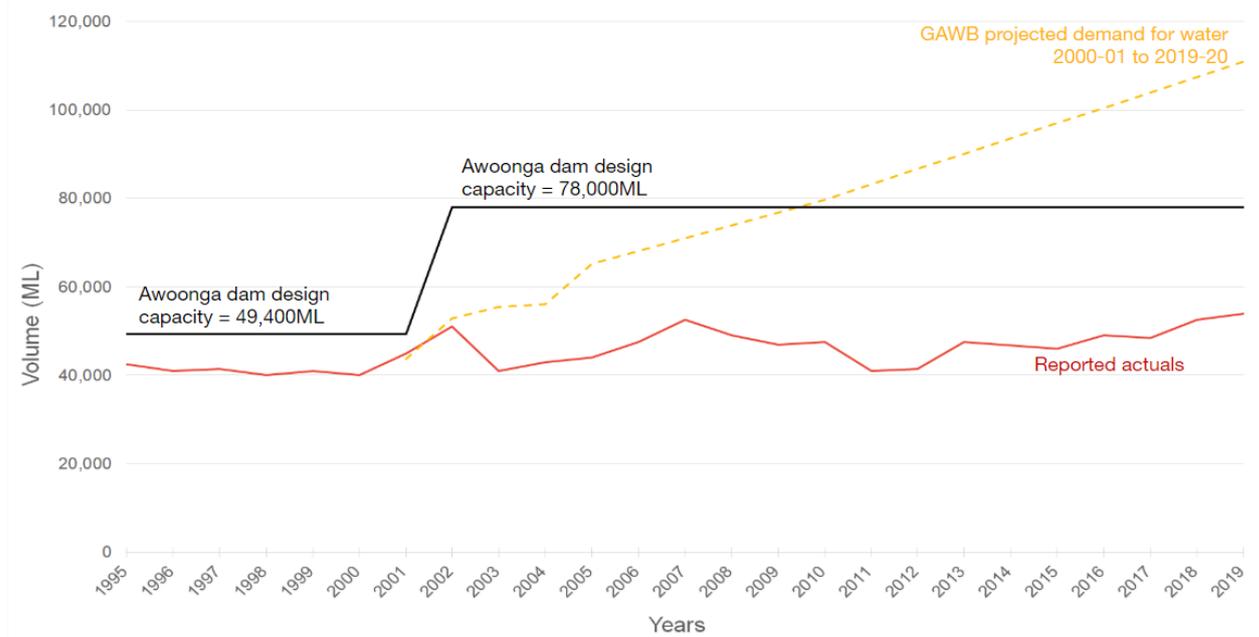
Callide Power Management Pty Ltd (CPM) is the manager of Callide C Power Station in Biloela, Queensland, and contracts its water supply from GAWB on behalf of the owners (Callide Energy Pty Ltd and IG Power (Callide) Limited). Following initial stakeholder responses to the 2020-25 Price Monitoring Investigation, CPM has been invited to further respond to the additional information made available (Part B Confidential).

2. Background

CPM understands that, in 2000, a works program was initiated to raise the storage level of Awoonga dam by 10 metres, increasing the available supply from 49,400ML to 87,900ML (later restricted to 78,000ML under the Water Resource (Boyne River Basin) Plan 2000). The augmentation was part of a long-term plan to meet expected future growth in demand. At the time of expansion, demand forecasts anticipated rapid growth in raw water demand over the period to 2019-20 (see Figure 1). This was primarily driven by anticipated growth in demand from a small number of large industry customers, including CPM, Suncor Energy (Stuart Shale Oil), Astral Calcining and Comalco Alumina Project, who together accounted for 87% of total growth in demand to 2009-10. Based on these forecasts, all new capacity provided by the augmentation was expected to be utilised by 2009.¹

¹ QCA (2001) Gladstone Area Water Board: Projected demand for water 2000/01 to 2019/20

Figure 1: Projected demand forecasts as at March 2001



Source: Actual demand data sourced from Bulk Water Price Review, GAWB Submission 2021-25 period Part A, P. 45 Figure 5.1. Projected demand sourced from Queensland Competition Authority (March 2001) Gladstone Area Water Board: Projected Demand for Water 2000/01 to 2019/20, Table 4.

Notes: This chart is illustrative. Demand was projected for 2000/01 - 2004/05; 2009/10 and 2019/20. To prepare this graph, data has been interpolated for years where projections were not provided. This graph is designed to show the trajectory for projections. Actual demand data was estimated from available graphs and should be considered indicative only.

3. Pricing framework & recovery of augmentation costs

Consistent with other regulated businesses, the QCA’s approach has been to recommend bulk water prices for GAWB based on recovery of ‘building block’ costs against forecast demand.

Acknowledging the significant increase in GAWB’s capital costs relating to the Awoonga raising, and recognising this augmentation was developed on the expectation of catering for significant future growth in bulk water demand, the QCA recommended a 20-year planning period with prices set to recover costs over this period (with a five year regulatory period to reset prices based on updated demand forecasts and other parameters). This methodology was adopted to avoid a significant step change in bulk water charges, and to ensure current customers did not carry the full burden of excess capacity provided through augmentation which was intended to service future demand. Implicit in this approach was a sharing of risk whereby GAWB was responsible for the costs of any excess capacity not considered optimal.²

To accommodate any impact the price smoothing mechanism had on investment incentives, GAWB was permitted to roll forward any under- or over-recovery as an adjustment amount for

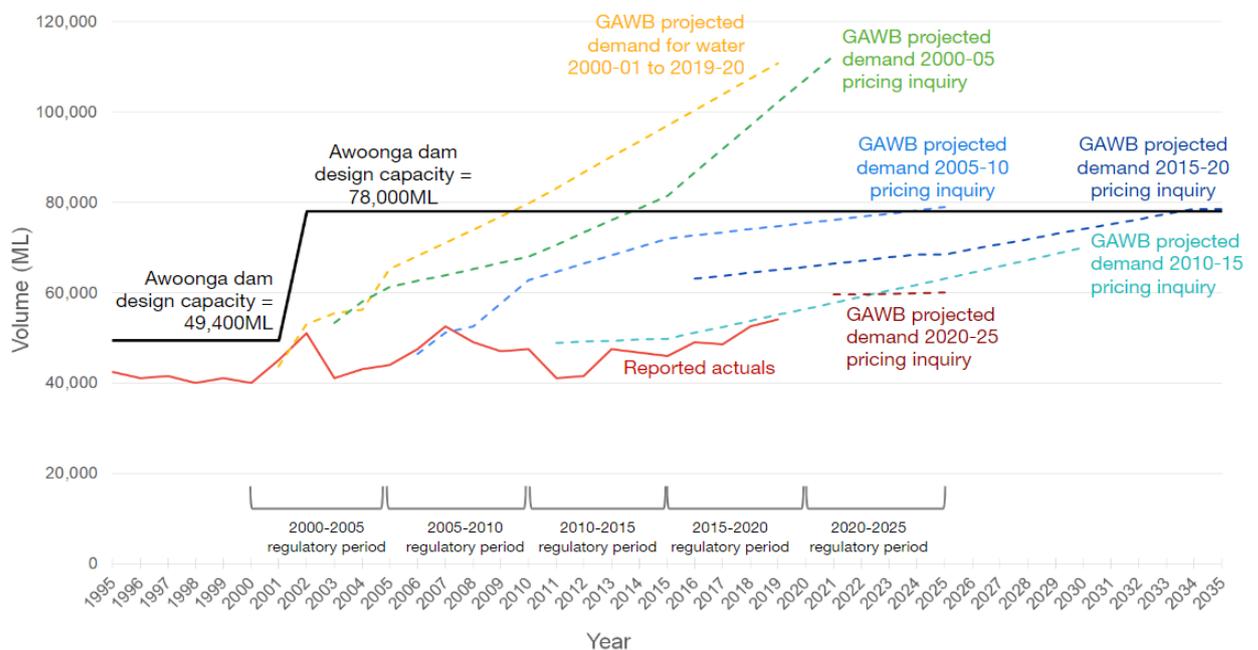
² QCA (September 2002) Gladstone Area Water Board: Investigation of Pricing Practices, Final Report (p.23)

the next regulatory period. This allowed any under- or over-recovery to be capitalised into future bulk water prices. Under this approach, it was anticipated that GAWB would under-recover in the early years against its Annual Revenue Requirement (ARR). However, this would be followed by a period of over-recovery, subject to demand projections being achieved.

Importantly, whilst this methodology is based on GAWB recovering, over time, its efficient costs, it did not provide for a guarantee of full cost recovery in any year, nor cost recovery within a specific time period, given the rolling nature of the 20-year planning period.

Despite GAWB's initial projections, demand forecasts have been progressively revised downwards at each subsequent pricing review. As a result, Awoonga Dam, which was initially expected to reach capacity in 2009, is now not anticipated to reach capacity until beyond 2035.³

Figure 2: Projected demand provided under each regulatory period



Source: Actual demand data sourced from Bulk Water Price Review, GAWB Submission 2021-25 period Part A, P. 45 Figure 5.1. Projected demand 2000-01 to 2019-20 sourced from Queensland Competition Authority (March 2001) Gladstone Area Water Board: Projected Demand for Water 2000/01 to 2019/20, Table 4. All other demand projections sourced from QCA Investigation into pricing practices (multiple years) and GAWB's submission to the bulk water price review (multiple years).

Notes: This chart is illustrative. Demand was projected for 2000/01 - 2004/05; 2009/10 and 2019/20. To build this graph, data has been interpolated for years where a projection was not provided. This is designed to show the trajectory for projections. Actuals data and demand projections for 2015-20 and 2020-25 were taken from a figure and should be considered indicative.

³ QCA (March 2005) Gladstone Area Water Board: Investigation of Pricing Practices Final Report (p.86)

Projected demand was revised significantly in the 2005-2010 regulatory period. This followed a period of drought, which resulted in severe water restrictions and the permanent transition of some customers towards more water efficient measures. In addition, a number of expected infrastructure projects did not proceed, and this lowered GAWB's future demand expectations. In 2010 GAWB first reported an under-recovery estimated at \$35m, which GAWB contended was a result of historical overestimates of demand which had negatively impacted on its ability to recover costs.

In the following regulatory period (2010-15), GAWB refined its methodology to move away from projections prepared for infrastructure planning purposes (which historically tended to overestimate demand) to a method which produced a demand scenario that was less than the customer's possible water usage, but greater than the water usage that was likely to occur. This was accompanied by the allocation of a specified amount of capacity (300ML annually in 2013-14 increasing to 3,600ML annually in 2024-25) which was allocated for undetermined projects. In the 2015 investigation on pricing practices, a carryover amount of \$95.01m was accepted by the QCA as reflecting accumulated under-recovery of revenue from prior periods.

4. GAWBs proposal

GAWB's current submission indicates that the accumulated revenue under-recovery has now increased to \$124.7m. GAWB further contends that the current framework for cost recovery is overly reliant on future users to fully recover the costs of servicing current users.

As a result, GAWB is seeking the QCA to approve:

- a change to the price smoothing period from 20 years to 5 years
- repayment of the accumulated under-recovery by existing customers, commencing in 2022-23 over a default repayment term of 20 years

Adopting GAWB's proposed approach would significantly accelerate the timeframe for recovering any accumulated under-recovery of revenue, prevent the current under-recovery from growing and, it is claimed, ensure that the prices paid by current users are cost-reflective.

5. Callide Power Management Pty Ltd's response to additional information

CPM has reviewed the additional information provided regarding GAWB's proposal to recover accumulated under-recovered revenues from customers by way of an annuity amount (Part B Confidential).

CPM is concerned that GAWB's proposal effectively changes the cost recovery methodology established to support the augmentation of Awoonga Dam, and results in a significant change in demand risk allocation, effectively transferring demand risk from GAWB to current users.

The information presented by GAWB in Part B of their submission with respect to the repayment of accumulated under-recovery, even the recently released confidential version, does not provide sufficient information for CPM to properly assess GAWB's proposal, or the likely implications. The scope and nature of the annuity payment is unclear, as is the method for calculating it.

Accordingly, before providing a detailed response to GAWB's proposal, CPM requires further and detailed information to be provided. On the basis that both the calculation of the claimed under-recovery, and the attribution of some fraction of that to each individual customer, likely is based on calculations which use information confidential to each customer, CPM's view is that this more detailed analysis is properly undertaken by the QCA (see section 6, below). Further information could then be provided to each customer, to allow them to provide a more considered response to GAWB's proposal.

6. Considerations for the QCA

To validate the analysis undertaken by GAWB and to quantify the factors which have contributed to the claimed revenue under-recovery, CPM submits that the QCA needs to request from GAWB:

- **A clear explanation of the basis on which the revenue under-recovery has been calculated and apportioned.** GAWB has provided a conceptual description of the circumstances which have given rise to the accumulated revenue under-recovery, and (confidentially) details on the amount proposed to be attributed to CPM.

However, the basis for these calculations is not clear to CPM and needs further exposition. For instance, CPM is presuming that GAWB has applied some form of volume/demand-weighted apportionment of the \$124.7m amount, but it is not clear whether this is based on past demand (over what period), future demand (over what period), or some alternative method.

In doing so, the QCA should seek to consider and quantify the impact (if any) of:

- **Variances in bulk water consumption / contracted amounts attributable to existing users.** This should include variances actual/planned demand over the period to 2019, and over the period 2019 onwards for all bulk water customers in operation at the time the Awoonga Dam augmentation was developed.

As shown in Figure 2, GAWB's demand projections have been revised downwards at each subsequent pricing reset. However, it is not clear the extent to which those revisions were attributable to existing users specifically. CPM believes it is necessary to identify the extent to which the accumulated revenue shortfall as determined by GAWB reflects the demand of existing customers falling short of what was originally anticipated.

- **Variance in bulk water consumption / contract attributable to new users.** This should include variances over the period to 2019, and over the period 2019 onwards.

Similarly, CPM needs to understand the extent to which the accumulated under-recovery is attributable to bulk water prices being set lower in the period since the Awoonga augmentation, on account of an expectation of significant future demand growth. This information is necessary for CPM to understand the extent to which GAWB is effectively seeking to shift demand risk relating to that future growth, back to existing customers.

- **Whether the revenue under-recovery captures revenue shortfalls incurred in previous periods.** Revenue shortfalls which are a consequence of unrealised demand are the responsibility of GAWB. Under-recoveries are able to be rolled forward, with interest, to be collected from new customers through future pricing.

GAWB has submitted that the \$124.7m revenue under-recovery does not include any component relating to within pricing period demand variance, however from the information provided it is not possible for CPM to validate that.

- **Mechanism for application within existing water supply agreements.** A carry-over adjustment, such as that which makes up the accumulated under-recovery, is not contemplated by CPM's current Water Supply Agreement with GAWB. CPM will need to understand how any adjustment mechanism is intended to operate, within the framework of its existing agreement, and expects similar concerns to be held by other large industry customers.

Please contact the below should you need to discuss this submission further.

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