2020 PRICE Monitoring Investigation

Response to the QCA Draft Report

Part A: Overview

March 2020

Gladstone Area Water Board

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Executive Summary

The Queensland Competition Authority (QCA) has been asked by the Queensland Treasurer to undertake a Price Monitoring Investigation, pursuant to sections 23A and 24 of the *Queensland Competition Authority Act 1997* (Qld) (the QCA Act). As noted by the QCA, its role is to simply report on the findings of its investigation. As such, the QCA's findings have an informative rather than deterministic function and do not bind the Gladstone Area Water Board (GAWB).

Notwithstanding this, the process of periodic price reviews provides government and GAWB's customers with an invaluable update on the appropriateness of GAWB's proposed prices.

GAWB welcomes the QCA's findings that:

- there is no evidence to suggest systemic flaws or significant deficiencies in GAWB's policies, procedures and frameworks relevant to the operating and capital expenditure forecasts;
- GAWB's policies, procedures, frameworks and capital governance measures are sound;
- GAWB's historical capital expenditure, i.e. expenditure undertaken during the 2015-20 pricing period, was prudent and efficient;[1]
- the weighted average cost of capital (WACC) put forward by GAWB is appropriate;
- GAWB's demand forecast is reasonable for the purposes of setting prices for the 2021-25 period; and
- GAWB's proposed pricing practices for the 2021-25 period are appropriate (i.e. zonal pricing, pricing structure, over-run charges and contract length-premium).

Based on the QCA's findings, GAWB has:

- updated its cost escalation factors to be more reflective of current market factors;
- considered the matters raised in relation to the material operating expenditure cost categories (i.e. operating costs that would give rise to a material price change) and has made adjustments;
- updated its expenditure forecasts for electricity and insurance to reflect recent market trends and regulatory decisions (in the case of electricity);
- accepted the QCA's proposal for a more challenging efficiency target to apply to operating expenditure; and
- provided additional information on two of the projects included in the capital expenditure forecast.

[1] The issues raised by the QCA with regard to the purchase of 136 Goondoon Street are timing considerations. That is, they will be resolved over the next regulatory period.

Based on the findings set out in the QCA's Draft Report, the resultant allowable revenue over the regulatory period is 2.49% per cent lower than GAWB's regulatory proposal (September 2019). Based on GAWB's comments, as set out in this response, the updated allowable revenue over the regulatory period is 0.64% per cent lower than the revenue forecast set out in GAWB's initial regulatory submission (September 2019).

GAWB views its response to the Draft Report as a key step in ensuring there is a continuous level of transparency for our customers and key stakeholders on what elements we will adopt when setting prices for the next five-year regulatory period. To aid transparency, we have summarised the QCA findings we accept and the key issues for further consideration – see Table 1.2 below. This is to allow stakeholders 'at a glance' to develop a clear view on our positions.

Throughout the review process, GAWB sought to meet all the information requests issued by the QCA and its consultants, irrespective of whether it believed the data requests were reasonable or not, given the nature of the QCA's price review. GAWB will continue to work with the QCA and its consultants to ensure they have the information they need to complete the price monitoring investigation.

1. Introduction

The Gladstone Area Water Board (GAWB) welcomes the opportunity provided by the Queensland Competition Authority (QCA) to comment on both parts of its Draft Report, including Part A which covers GAWB's proposed prices for the next five-year regulatory period (1 July 2020 to 30 June 2025), and Part B which covers the accumulated revenue under-recovery.

This response focuses on the areas where the QCA has disagreed with a position set out in Part A of GAWB's regulatory submission or where further information has been sought. A separate response has been prepared to address the QCA's comments on Part B of GAWB's regulatory submission.

While GAWB accepts many of the QCA's findings, we have concerns with certain aspects, in particular:

- the scope of a price monitoring investigation; and
- the limited role of materiality in determining the scope of the assessment of operating expenditure forecasts.

A summary of GAWB's responses to the QCA's findings is provided below to provide stakeholders with a concise summary of our positions. A more detailed discussion of our positions is set out in sections 2 to 7 (inclusive).

Table 1.1 sets out the icons used in Table 1.2. Table 1.2 sets out a summary of GAWB's responses and where applicable a reference to the section in this response where the matter is discussed.

Table 1.1: Explanation of Icons

Icon	Draft Report
✓	GAWB accepts the QCA's finding and it will be used to develop prices for the regulatory period. Alternatively, this matter will be used to inform future engagement and/or activities aimed at improving operational performance.
?	New information or an alternative approach has been put forward for the QCA to consider.
✗	GAWB does not support the QCA's finding and further information will be provided to support GAWB's position.

Table 1.2: Response to QCA Draft Findings

Finding	Draft Report		GAWB Response
3.1	GAWB has robust procurement practices and is moving towards best practice asset management. The QCA has not seen evidence to suggest systemic flaws or significant deficiencies in GAWB's policies and procedures and frameworks relating to opex. The QCA encourages GAWB to consider the potential areas for improvement identified by KPMG.	✓	GAWB welcomes the QCA's findings on the improvements we have made since the last price review in the areas of procurement and asset management. GAWB will have regard to the areas identified by KPMG for potential improvement. However, any measures implemented need to be appropriate given the size and scope of GAWB's operations.
3.2	GAWB's proposed cost escalators are reasonable to adopt for the purposes of this draft report, after making our adjustments to weightings and updates for more recent information. The QCA's draft findings on cost escalators for opex reflect these adjustments and updates. The QCA intends to further review the appropriateness of these escalators, including the underlying data sources, for its final report.	?	GAWB has engaged Deloitte Access Economics to update its cost escalation factors so that they are more reflective of current market expectations. Refer to section 3.5.
3.3	The QCA finds an appropriate total forecast for GAWB's operations costs during 2020-25 is $11.14 million.	✗	GAWB has concerns with the scope of KPMG's review i.e. the limited level of regard given to materiality as prescribed in the Referral Notice. GAWB does not support the QCA's findings for this non-material cost (i.e. as it would not give rise to a material change in prices). Refer to section 3.1.
3.4	The QCA finds an appropriate total forecast for GAWB's maintenance costs during 2020-25 is $16.88 million.	?	GAWB does not support the QCA's findings as due consideration by the QCA is yet to be given to the information provided by GAWB via the RFI process. GAWB believes the forecast for maintenance expenditure is prudent and efficient. Refer to section 3.2.1.

Finding	Draft Report		GAWB Response
3.5	The QCA finds an appropriate total forecast for GAWB's electricity costs during 2020-25 is $12.08 million.	?	Deloitte Access Economics has calculated an updated cost escalation factor for electricity costs. Further analysis has also been conducted by GAWB in support of an updated forecast. Refer to section 3.3.
3.6	The QCA finds an appropriate total forecast for GAWB's employment costs during 2020-25 is $68.9 million.	✓	GAWB accepts the QCA's finding that forecast employment costs are prudent and efficient.
3.7	The QCA finds an appropriate total forecast for GAWB's professional services costs during 2020-25 is $15.93 million.	?	Based on the QCA's findings, an alternative approach has been put forward for consideration regarding professional services. Refer to section 3.2.2.
3.8	The QCA finds an appropriate total forecast for GAWB's information systems costs during 2020-25 is $15.16 million.	✓	GAWB accepts the QCA's finding that forecast information services costs are prudent and efficient. Refer to section 3.2.3.
3.9	The QCA finds an appropriate total forecast for GAWB's insurance costs during 2020-25 is $7.63 million.	?	In light of recent events, GAWB has provided an updated methodology to estimate the insurance forecast. This methodology is based on KPMG's preferred approach, that is, the use of actual costs. Refer to section 3.4
3.10	The QCA finds an appropriate total forecast for GAWB's administration costs during 2020-25 is $8.08 million.	✗	GAWB has concerns with the scope of KPMG's review i.e. the limited level of regard given to materiality as prescribed in the Referral Notice. GAWB does not support the QCA's findings for this non-material cost (i.e. as it would not give rise to a material change in prices). Refer to section 3.1.

Finding	Draft Report		GAWB Response
3.11	The QCA finds an appropriate total forecast for GAWB's chemical costs during 2020-25 is $3.63 million.	✗	GAWB has concerns with the scope of KPMG's review i.e. the limited level of regard given to materiality as prescribed in the Referral Notice. GAWB does not support the QCA's findings for this non-material cost (i.e. as it would not give rise to a material change in prices). Refer to section 3.1.
3.12	The QCA finds an appropriate total forecast for GAWB's council charges (rates) during 2020-25 is $2.67 million.	✓	GAWB has concerns with the scope of KPMG's review i.e. the limited level of regard given to materiality as prescribed in the Referral Notice. GAWB supports the QCA's finding that the rate cost forecasts are prudent and efficient. Refer to section 3.1.
3.13	The QCA finds a prudent and efficient opex forecast for GAWB for the 2020-25 period is $158.5 million. The QCA considers GAWB should more transparently document divergences in expenditures from forecast, including identifying drivers of those changes. Overspending is a key concern that GAWB's customers have raised, and the QCA encourages GAWB to ensure its actual expenditure is explained clearly to customers. GAWB provided some additional information late in the review process in support of its opex forecasts, which the QCA and KPMG were not able to consider for this draft report. This information will be considered in developing the final report.	✓ ✗	*Efficiency Factor* GAWB accepts the QCA's finding that an efficiency target of 1 per cent should be applied annually on a compounded basis. *Controllable vs Uncontrollable Costs* GAWB does not support the QCA's finding that an expanded definition of controllable operating expenditure be applied. GAWB has proposed an alternative approach based on KPMG's analysis. GAWB provided some additional information on 6 January 2020. This information included copies of GAWB's governance frameworks and additional information in support of the capital and operating expenditure forecasts. Refer to section 3.6.

Finding	Draft Report		GAWB Response
4.14	The QCA finds GAWB's capital planning and governance frameworks are robust. The QCA has not seen evidence to suggest systemic flaws or significant deficiencies that would introduce bias to GAWB's forecasting. The QCA encourages GAWB to consider the potential areas for improvement that KPMG identified in its report.		GAWB welcomes the QCA's findings on the improvements we have made since the last price review in terms of the project management governance framework. GAWB will have regard to the areas identified by KPMG for potential improvement. However, any measures implemented need to be appropriate given the size and scope of GAWB's operations.
4.15	The QCA considers that an amount of $122 million of capex, expected to be incurred between 1 July 2015 and 30 June 2020, should be included in GAWB's opening RAB at 1 July 2020. We encourage GAWB to consider ways to more transparently document divergences from forecasts, including identifying drivers of those changes, and to ensure that customers are informed of reasons for expenditures.		GAWB accepts the QCA's finding that its expenditure on capital projects during 2016-20 was prudent and efficient. GAWB has identified a preferred approach to recognise the proceeds of sale from 147 Goondoon Street. GAWB will have regard to the areas identified by KPMG for potential improvement. Refer to section 4.1.1.
4.16	The QCA finds GAWB's proposed expenditure of $60.7 million for the Awoonga Dam spillway upgrade to be prudent and efficient. Given the magnitude of project costs, the QCA anticipates to conduct an ex post review of this expenditure in 2025.		GAWB accepts the QCA's finding that the project is prudent and efficient. GAWB agrees with KPMG's comment that the forecast budget is conservative. GAWB believes this is appropriate given the stage of development of this project.
4.17	The QCA finds GAWB's proposed capex of $6.63 million for the expansion of Boat Creek pump station efficient, but not prudent. The QCA will review further information and present a formed view in its final report.		GAWB does not support the QCA's finding and additional information has been provided to demonstrate prudency of the project. Refer to section 4.1.2.

Finding	Draft Report		GAWB Response
4.18	The QCA finds GAWB's proposed capex of $4.31 million for the Calliope River bridge replacement neither prudent nor efficient. The QCA welcomes further supporting information from GAWB.	?	GAWB does not support the QCA's finding and additional information has been provided to demonstrate prudency and efficiency of the project. Refer to section 4.1.3.
4.19	The QCA finds GAWB's proposed capex of $3.70 million for UV disinfection not prudent or efficient. The QCA welcomes further supporting information from GAWB on this project.	✓	GAWB accepts the QCA's finding that the project is not prudent or efficient. This project and the associated electricity expenditure will be removed from the capital and operating expenditure forecasts.
4.20	The QCA finds the proposed contingency allowance of $0.944 million for the recreational strategy should be excluded from GAWB's forecast capex allowance for 2020-25. The QCA seeks stakeholders' views on GAWB's proposal.	✗	GAWB does not support the QCA's finding and additional information has been provided to demonstrate the proposed contingency is appropriate. Refer to section 4.1.4.
4.21	The QCA finds GAWB's proposed $7.12 million expenditure for the hatchery relocation is prudent and likely efficient. The QCA requests further information from GAWB to demonstrate progress and updated cost estimates.	✓	GAWB accepts the QCA's finding that the project is prudent and likely efficient. Additional information has been provided to demonstrate progress and anticipated costs. Refer to section 4.1.5.
4.22	The QCA finds the appropriate cost escalation factor to be applied to GAWB's capex allowance for 2020-25 is the updated CPI inflation forecast.	✗	GAWB does not support the use of CPI as it does not account for the large labour component of the capital expenditure forecast. Refer to section 4.2.
4.23	The QCA finds GAWB's proposed interest during construction methodology is appropriate.	✓	GAWB accepts the QCA's finding.

Finding	Draft Report		GAWB Response
4.24	The QCA considers that a forecast of $156.7 million represents a reasonable estimate of prudent and efficient capex for GAWB during the 2020-25 pricing period. We consider GAWB should more transparently document divergences in expenditure from forecast, including identifying drivers of those changes. Overspending is a key concern that GAWB's customers have raised, and we encourage GAWB to ensure its actual expenditure is explained clearly to customers.	✓ ✗	GAWB accepts the QCA's finding that the following projects are prudent and efficient: • Awoonga Dam Spillway Capacity Upgrade – Stage 2 & 3; • South Gladstone Reservoir Replacement; • Connection to Gladstone Regional Council/Kirkwood Reservoir; and • Gladstone Water Treatment Plant to South Gladstone Reservoir Stage 3. Refer to the findings identified above where GAWB does not support the QCA's finding (4.17, 4.18, 4.20 and 4.22).
5.25	The QCA finds GAWB's updated RAB of $470.61 million as at 1 July 2015 appropriate.	✓	GAWB accepts the QCA's finding.
5.26	The QCA finds GAWB's proposed opening RAB of $567.05 million as at 1 July 2020 appropriate.	✓	GAWB accepts the QCA's finding.
5.27	The QCA finds that a forecast RAB of $703 million as at 30 June 2025 is appropriate, rather than GAWB's forecast RAB of $732 million.	?	GAWB does not support the QCA's findings as per GAWB's comments set out above for findings 4.17, 4.18, 4.20 and 4.22.
6.28	The QCA finds GAWB's proposed values of 0.45 for the asset beta and 0.73 for the equity beta are appropriate.	✓	GAWB accepts the QCA's finding.
6.29	The QCA finds GAWB's proposed value of 7.0 per cent for the market risk premium is not appropriate. Rather, a value of 6.5 per cent is appropriate.	✗	GAWB does not support the QCA's findings and still believes the methodology set out in the regulatory submission is the most appropriate methodology. Refer to section 5.1.

Finding	Draft Report		GAWB Response
6.30	The QCA finds GAWB's proposed approach to calculating the risk-free rate is appropriate. The QCA calculates a value of 0.94 per cent for the risk-free rate over the placeholder period for this draft report. The QCA will provide an updated estimate for its final report. It would be appropriate for GAWB to nominate an averaging period to apply to its final prices for 2020-25, through a submission.	✓	GAWB accepts the QCA's finding. Refer to section 5.2.
6.31	The QCA finds GAWB's proposed 50 per cent gearing rate is appropriate.	✓	GAWB accepts the QCA's finding.
6.32	The QCA finds GAWB's proposed BBB credit rating is appropriate.	✓	GAWB accepts the QCA's finding.
6.33	The QCA finds GAWB's proposed approach to calculating the debt risk premium is appropriate. The QCA calculates a placeholder value of 2.169 per cent for the debt risk premium for this draft report, comprising a raw debt risk premium of 2.06 per cent and debt-raising cost allowance of 0.108 per cent. The QCA will provide an updated estimate for the final report (using the averaging period for the risk-free rate that GAWB nominates, or the 20-day period ending 31 March 2020).	✓	GAWB accepts the QCA's finding.
6.34	The QCA finds GAWB's proposed value of 0.484 for gamma is appropriate.	✓	GAWB accepts the QCA's finding.

Finding	Draft Report		GAWB Response
6.35	The QCA finds a 4.57 per cent WACC is appropriate for GAWB for the 2020-25 period, based on the placeholder averaging period ending 30 August 2019. This value will be updated for the final report, using an average period closer to the commencement of the regulatory period.	✓	GAWB accepts the QCA's finding.
7.36	For the 2020-25 pricing period, the QCA finds it appropriate to apply a revenue cap with a 10 per cent deadband form of regulation, which: • covers all revenue, including storage, administration, delivery, over-run charges and contract length premium revenue; • fixes prices (with the exception of CPI increases) for the term of the regulatory period; • carries forward annual revenue variances in excess of 10 per cent of total revenue to the next regulatory period (indexed at the WACC).	?	GAWB accepts the QCA's finding, except for the proposed treatment of over-run and contract length premium revenue. Refer to section 6.1.
7.37	The QCA finds the inclusion of adjustments to demand as an eligible review event is not appropriate.	✗	GAWB does not support the QCA's finding as this trigger has been part of GAWB's regulatory frameworks since 2002. Refer to section 6.1.
7.38	The QCA considers that GAWB should clarify procedures regarding a review trigger and make public specific actions that it will take in response to a trigger event, specifically the: • methodology to determine a demand trigger event; • effect of the event on its annual revenue requirement and aggregate revenue; • interaction with the form of regulation; • timing of these actions.	?	GAWB will consider the need for further clarification in the next update of the Pricing Principles that form part of its contractual arrangements with its customers. Refer to section 6.2.

Finding	Draft Report		GAWB Response
7.39	The QCA finds that the addition of force majeure to review triggers is appropriate.	✓	GAWB accepts the QCA's finding.
7.40	The QCA finds that the addition of drought response measures to review triggers is appropriate.	✓	GAWB accepts the QCA's finding.
7.41	The QCA finds GAWB's proposal of reducing the materiality threshold from 15 to 10 per cent is not appropriate. The QCA's preferred option for the materiality threshold is for GAWB to eliminate the numerical threshold and instead implement a qualitative process to determine if sufficient material impacts on GAWB's operations have occurred, and for GAWB to be eligible for a mid-period review.	✓ ✗	GAWB accepts the QCA's finding and will keep the materiality threshold at 15 per cent. GAWB does not support the QCA's finding. A quantitative approach is preferred by GAWB. Refer to section 6.4.
7.42	The QCA encourages existing and potential stakeholders to present their views on the proposed amendments to the capital contributions framework.		GAWB supports stakeholder engagement on this matter.
7.43	The QCA finds it is not appropriate for GAWB's standard water supply terms and conditions to include a provision for the QCA to resolve pricing disputes. GAWB should amend its standard water supply terms and conditions to remove QCA resolution and instead provide effective pricing dispute provisions that balance the interests of customers with GAWB's interests.	✗	GAWB does not support the QCA's finding as the potential involvement of the QCA is just one step in a staged dispute resolution process involving four stages/steps. Refer to section 6.5.
7.44	The QCA finds that GAWB should publish its standard water supply terms and conditions on its website.	✗	GAWB does not support the QCA's finding as its standard water supply terms and conditions, which govern the supply of water to some of its customers, are confidential. Refer to section 6.6.

Finding	Draft Report		GAWB Response
8.45	The QCA finds GAWB's proposed demand forecasts for the 2020-25 period are reasonable, as they are based on the latest available information, historical outcomes or trends and advice from customers. We understand GAWB will provide updated demand forecasts, which we will consider in preparing our final report.	✓	GAWB accepts the QCA's finding. At the time of drafting this response, GAWB has not received any additional information that would warrant a change to the demand forecast. Refer to section 7.
9.46	The QCA finds GAWB's pricing zones are appropriate, as they reflect the operational and physical structure of GAWB's delivery network. Zonal prices are also more cost-reflective than average-cost pricing and therefore should promote more efficient consumption decisions by GAWB's customers.	✓	GAWB accepts the QCA's finding.
9.47	The QCA finds GAWB's proposed pricing structures for storage, delivery and administration charges appropriate.	✓	GAWB accepts the QCA's finding.
9.48	The QCA finds GAWB's proposed approach of storage and administration over-run charges for industrial customers appropriate. The QCA seeks stakeholder feedback on GAWB's proposed increase of storage and administration over-run charges for the Gladstone Regional Council.	✓ ?	GAWB accepts the QCA's finding. The Pricing Principles currently include this charge. The reference to 25 per cent is a typographical error. This will be corrected when the Pricing Principles are updated following the current price review. These over-run charges have not been levied to date, so there has been no adverse impact associated with this typographical oversight.
9.49	The QCA finds GAWB's proposed approach for levying delivery over-run charges on a monthly basis appropriate under the specified terms.	✓	GAWB accepts the QCA's finding.

Finding	Draft Report		GAWB Response
9.50	The QCA finds the contract length premiums proposed by GAWB appropriate, as they allow GAWB to more effectively manage its network and the take-up of spare capacity over the long term by incentivising customers to sign up for long-term contracts.	✓	GAWB accepts the QCA's finding.

2. Price Monitoring and Materiality

GAWB has some concerns with the extent of the QCA's review and its reporting in this investigation, and how this has influenced some of the draft findings. In particular, GAWB is concerned that some aspects of the QCA's approach goes beyond the scope of a price monitoring investigation as provided for in Part 3 of the QCA Act; and/or the Ministerial directions given to the QCA in relation to the conduct of this particular price monitoring investigation. GAWB would also like to raise some concerns regarding the level of misunderstanding that has arisen (or was permitted to occur) due to the lack of adherence to regulatory practice as it applies to Queensland water businesses and/or guidelines.

2.1 Price Monitoring

2.1.1 The Intended Lighter Handed Nature of Price Monitoring

A price monitoring investigation under Part 3 of the QCA Act is a materially lighter handed form of regulation than the forms of regulation which apply to other regulated infrastructure services under Part 5 of the QCA Act (such as Aurizon Network's and Queensland Rail's rail access services, and Dalrymple Bay Coal Terminal's coal handling service).

There is a clear hierarchy of increasing regulatory intervention which the QCA Act provides for (see Figure 2.1).

Figure 2.1: Hierarchy of Regulatory Intervention

The government has determined that GAWB's water supply service should be subjected to the least interventionist of those presented in Figure 2.1.

The QCA's role in a price monitoring investigation is simply to monitor GAWB's pricing practices and report on them.[2] As recognised in the Draft Report, the QCA's findings 'have an informative rather than deterministic purpose and do not directly bind the Minister or the monopoly business'[3]. In other words, the intention is to provide transparency to assist GAWB and its customers with their commercial arrangements.

As the explanatory notes for the Bill, which introduced the price monitoring regime, explain:[4]

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2 *Queensland Competition Authority Act 1997*. (Qld). s. 22.

3 Queensland Competition Authority. 2020. *Gladstone Area Water Board Price Monitoring 2020-25, Part A: Overview – Draft Report*. February. p 5

4 Explanatory notes, Queensland Competition Authority Amendment Bill 2008 (Qld).

> Price monitoring will provide a light-handed transparent regulatory regime for monopoly business activities that provides maximum flexibility for a monopoly business to operate in the market with minimal interference from the regulator.

That intended minimal interference is fundamentally different to the role the QCA has under Part 5 of the QCA Act in relation to considering a draft access undertaking, where the QCA is required to determine whether a proposal is appropriate,[5] and if not, to determine the amendments which would be required in order for the undertaking to be appropriate.[6]

GAWB submits that this context is important, particularly in guiding the level of granularity to which a price monitoring investigation is intended to descend.

GAWB supports the valuable role the QCA performs in ensuring expenditure is appropriate. However, in the context of this price review, GAWB is concerned the QCA has assumed a more detailed, and heavy-handed role, relative to the role intended for a prices oversight review. In particular, approaches like the QCA's consultant not being required to form a view on materiality in its report, and materiality not being defined (as discussed further below) has resulted in:

- extensive information requests, including requests into costs and projects that are not material;
- GAWB being unfairly criticised for providing information late and:
  - in most cases the additional information was provided on 6 January 2020 or before; and
  - the information provided on 6 January 2020 related to GAWB's capital projects, governance frameworks and operating expenditure. Whilst the additional information provided on the capital projects and governance frameworks was captured in the consultant's draft report, this was not the case for the operating expenditure items; and
- adjustments being made under the guise of prudency and efficiency to operating costs that are immaterial to pricing.

While GAWB appreciates that much of the QCA's investigation has now been completed, it submits that it is important for this review to confine its findings to truly material costs and for the approach to future reviews to reflect the legislative intention in relation to price monitoring.

2.1.2 Aspects Beyond Pricing Practices

The current investigation by the QCA is a price monitoring investigation under section 23A of the QCA Act.

The QCA Act expressly defines a price monitoring investigation as:[7]

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5 *Queensland Competition Authority Act 1997*. (Qld). s 138(2).
6 *Queensland Competition Authority Act 1997*. (Qld). ss 140(2) and 142(3).
7 *Queensland Competition Authority Act 1997*. (Qld). s 22.

> an ongoing investigation in which the authority –
>
> (a) monitors pricing practices relating to the activity; and
>
> (b) reports periodically to the Minister about the results of the investigation.

What is clear from that definition is that this investigation is intended to be limited to pricing practices. The limited scope for the review is supported by the numerous references to pricing practices (and not other matters) in:

- the relevant paragraph concerning the QCA's statutory functions;[8]
- the heading of Part 3;
- the statutory description of what Part 3 is about;[9] and
- the required contents of the QCA's report on a price monitoring investigation.[10]

Pricing practices is then defined as meaning:[11]

> (a) the level and structure of prices for the activity; or
>
> (b) anything that affects the level and structure of prices for the activity, including, for example, the service quality, costs of production and levels of performance relating to the activity.

GAWB's concern is that aspects of the QCA's investigation appear to go beyond matters relating to pricing practices. For example, GAWB's approach in relation to the publication of terms and conditions of water supply are not pricing practices.[12]

2.2 Materiality

The QCA is obliged to comply with Ministerial directions given to it under section 24 of the QCA Act.[13] In the Ministerial Referral and Direction Notice (Referral Notice), the QCA was relevantly directed as follows:

> 1.1 Pursuant to section 24 of the Act, I direct the Authority to consider the following matters for the period 1 July 2020 to 30 June 2025 when conducting the investigation:
>
> …
>
> (e) for capital expenditure to be included in the RAB, form a view on prudency and efficiency of capital expenditure using an appropriate sample size and focusing on

8 *Queensland Competition Authority Act 1997*. (Qld). s 10(b).
9 *Queensland Competition Authority Act 1997*. (Qld). s 13A(1)(b)
10 *Queensland Competition Authority Act 1997*. (Qld). s 33(1)(d)
11 *Queensland Competition Authority Act 1997*. (Qld). Schedule 2.
12 Queensland Competition Authority. 2020. *Gladstone Area Water Board Price Monitoring 2020-25, Part A: Overview – Draft Report*. February. p 96-97.
13 *Queensland Competition Authority Act 1997*. (Qld). s 24(2).

> areas which would give rise to material price changes rather than matters which are likely to be have a minor or inconsequential impact; and
>
> (f) for operating expenditure to be included in the forecast revenue, form a view on prudency and efficiency in any function by using an appropriate sample size and focusing on areas which would give rise to material price changes rather than matters which are likely to have a minor or inconsequential impact.
>
> 1.2 For the avoidance of doubt, the Authority may consider a matter not indicated in B(1.1) if it is likely to have a material impact on the price to a customer.

While the QCA's Draft Report acknowledges the requirement to consider the materiality of impacts on prices, GAWB is concerned that that requirement was applied in a manner which did not, effectively, apply any materiality threshold. In particular, the QCA noted:[14]

> For this review, we do not consider that materiality of any specific cost needs to be strictly defined. In this instance, we consider it is preferable to apply judgement, having regard to a range of factors, in deciding whether GAWB's forecasts are reasonable estimates of prudent and efficient costs. This approach acknowledges that while some identified inefficiencies may not be material in isolation, they can be significant when considered in aggregate.

This approach effectively assumes GAWB has not achieved any individual efficiencies which might counterbalance such individual inefficiencies. It also appears that the QCA did not actually determine the magnitude of the impacts of each adjustment that it has proposed.[15]

GAWB acknowledges that the Ministerial direction required the QCA to determine what constituted a material impact. However, the interpretation utilised in the Draft Report results in there effectively being no materiality threshold, because immaterial costs were deemed to be material on the basis that 'they can be significant when considered in aggregate'.

This stands in stark contrast to the QCA's Final Report in the 2015-2020 review which defined a material change as 'a change in the Annual Revenue Requirement (ARR), in aggregate or for a particular price zone or customer, of more than 1%'.[16] That approach was also reflected in the lesser number of projects sampled, and a focus principally on impacts on pricing zones rather than individual customers.

GAWB considers that the QCA's approach to the current price monitoring investigation is not compliant with the materiality requirements of the directions, and submits that the Final Report should not adjust indicative prices for individual differences which do not of themselves give rise to material price changes.

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[14] Queensland Competition Authority. 2020. *Gladstone Area Water Board Price Monitoring 2020-25, Part A: Overview – Draft Report*. February. p15

[15] Queensland Competition Authority. 2020. *Gladstone Area Water Board Price Monitoring 2020-25, Part A: Overview – Draft Report*. February. p123

[16] Queensland Competition Authority. 2015. *Final Report Gladstone Area Water Board Price Monitoring 2015-2020*. May 2015. p 27.

2.3 Guidelines

At various points during the price review process, namely during interactions with the QCA's consultant (KPMG), the lack of regulatory guidelines has caused misunderstandings around the way in which information should be presented and the methodologies to be applied to develop expenditure forecasts. This level of misunderstanding has had a material impact on the way KPMG has reviewed GAWB's operational forecasts.

The lack of guidance materials has also resulted in the consultant setting out their expectations for future reviews. For example, the use of reporting templates as it would improve the review process. The consultant has also set out their expectations on how a regulated water business should engage with their customers. Whilst several of the consultant's recommendations reflect current trends in economic regulation, they do not reflect regulatory practice and/or water policy as it currently applies to Queensland water businesses.

The imposition/assumption of these expectations sets an unfair basis for the assessment of a Queensland water business's expenditure forecasts. For example, a water business is not able to ensure it presents its expenditure forecasts in the most practicable and convincing way if it is only after the consultant delivers its draft report that it becomes aware of the framework that has been applied to assess prudency and efficiency.

3. Operating Expenditure

Consistent with a s23A price review and clause 1.1(f) of the Referral Notice, GAWB's regulatory submission focused on areas that give rise to material price changes.

To support transparency and consistency in the regulatory framework, GAWB applied a materiality threshold consistent with what was used for the 2015 price review. That is, a change in a cost category that would give rise to a 1% annual increase in the ARR. For the purposes of the 2021-25 price review *a material cost* is one where there is a sustained annual increase of approximately $700,000 or more over the pricing period, compared to the 2018-19 base year.

GAWB's operating expenditure forecast has been identified in terms of functional categories, such as staffing costs, chemicals, electricity, professional services and administration. However, not all functional cost categories are material, as defined above. As noted in GAWB's regulatory submission, only the following areas will have a material impact on bulk water prices in the order of a 1 per cent annual increase in the ARR:

- maintenance costs;
- employment costs;
- professional services; and
- information services.

It was appropriate for the QCA and its consultant KPMG to review the appropriateness of the above material functional cost categories. However, to extend the review to all other functional cost categories was not, in the absence of 'materiality' being demonstrated. It is regretful that the QCA permitted the consultant to not make an assessment of materiality in line with the Referral Notice and to consider matters outside the scope of the price review.

3.1 Non-material Cost Categories

QCA's Approach

For several of the cost categories identified in Table 3.1, the QCA based its findings on recommendations from its consultant KPMG and has adjusted GAWB's forecast. These amendments have been justified on the basis that GAWB was unable to fully demonstrate prudency and/or efficiency.

GAWB's Approach

GAWB does not accept the QCA's findings on the non-material cost categories. That is, cost categories that do not give rise to material price changes. GAWB will be adopting the operating expenditure forecasts for each of these cost categories as they were submitted in the regulatory submission. These costs are set out in Table 3.1.

Table 3.1: Non-material Costs ($2018-19 million)

Cost Function	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Operations	2.04	2.08	2.09	2.12	2.12	**10.45**
Information Systems	3.14	2.67	2.74	2.84	2.70	**14.09**
Administration	1.65	2.04	1.62	1.67	1.67	**8.66**
Chemicals	0.67	0.67	0.69	0.69	0.69	**3.43**
Council Charges	0.48	0.48	0.48	0.48	0.48	**2.42**

(1) The values presented in the table are exclusive of any efficiency factor.
(2) The values may not sum due to rounding.

3.2 Material Cost Categories

Each of the material cost categories, apart from employment costs, is discussed below with reference to the QCA and/or KPMG's analysis.

3.2.1 Maintenance Costs

QCA's Approach

The QCA has based its findings on KPMG's recommendations that GAWB's forecast maintenance costs were prudent, but were yet to be demonstrated to be efficient. In light of this, GAWB's budgeted maintenance spend in 2019-20 was adopted as the baseline, plus a 10% buffer to allow for any legitimate need to increase maintenance spend over the forward period. The maintenance forecast was also excluded from the application of the agreed efficiency factor.

GAWB's Approach

Through the implementation of the Life Cycle Management Plans (LCMPs) GAWB has developed a more detailed understanding of the asset base, especially in terms of ongoing maintenance and the timing for asset replacements.

The development and adoption of LCMPs to inform asset planning and expenditure forecasts have been acknowledged by KPMG as: [17]

> a significant improvement in how GAWB manage their asset base and the implementation of a leading practice asset management approach'.

However, KPMG's analysis fails to fully acknowledge that maintenance expenditure forecasts, if based on the supporting LCMPs, should by their very nature, be lumpy rather than linear in profile. This is due to the underlying costs being reflective of the actions required, based on

[17] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report)*. February. p41.

condition, age, and warranty requirements, rather than historical assumptions around the business' capacity to spend.

Approximately two months before the release of the Draft Report, GAWB provided KPMG with spreadsheets demonstrating for each individual asset the scheduled maintenance program, manual mandated inspections, and condition assessments, etc. These spreadsheets related to the business units that undertake the majority of GAWB's maintenance expenditure.

GAWB believes the information presented in the spreadsheets demonstrates the efficiency of the forecast as well as substantiated the basis upon which GAWB's maintenance forecasts were developed. Furthermore, GAWB believes the forecast is efficient as it was externally reviewed prior to lodging the regulatory submission (i.e. reviewed by Assetivity). This review verified the appropriateness of the costs contained in the forecast and areas where improvements could be made. All of Assetivity's recommendations were actioned and are reflected in the forecast contained in the regulatory submission.

GAWB acknowledges the level of forecast expenditure is significantly higher than the current regulatory period. KPMG also raised concerns around local industries' capacity to deliver a program of this size. Through the improvements made in this regulatory period to GAWB's procurement processes, GAWB believes it can deliver the services related to the expenditure forecast.

GAWB does not agree with the QCA's draft findings that a lower forecast should be used to develop prices, as this finding is based on an incomplete assessment of the information provided. The original maintenance forecast is considered prudent and efficient, as the activities and associated scopes of work can be referenced back to warranty, compliance or a reliability of service obligation and the associated costs have been externally reviewed.

The forecast set out in the regulatory submission will be reflected in prices for the next regulatory period (see Table 3.2).

Table 3.2: Maintenance Costs ($2018-19 million)

2020-21	2021-22	2022-23	2023-24	2024-25	Total
3.78	3.95	3.37	3.63	3.47	**18.21**

(1) The values presented in the table are exclusive of any efficiency factor.
(2) The values may not sum due to rounding.

3.2.2 Professional Services

QCA's Approach

KPMG raised concerns with GAWB's forecast including the lumpiness of the expenditure profile. To address these concerns, it recommended adopting GAWB's average spend during 2015-20 as the baseline for 2020-25, including budgeted spend in 2019-20. This represented an average annual spend of $2.5 million per year compared with GAWB's average proposed spend of $2.8 million per year, in 2018-19 dollar terms.

GAWB's Approach

The professional services forecast set out in the regulatory submission includes $622,167 ($2018-19) for activities related to the Lake Awoonga Recreational Strategy (Recreational Strategy). The Recreational Strategy is an initiative that has been developed in consultation with the Gladstone community and GAWB's customers. As this is a discrete initiative and not part of GAWB's standard operational costs, all professional services related to the Recreational Strategy should be excluded from any adjustment to the professional services forecast due to the prudency and efficiency review.

GAWB accepts KPMG's recommendation to use the average spend in the current period as the baseline for the forward period. However, the historic spend profile recommended by KPMG does not include any monies associated with the recreational strategy. Therefore, the average historic spend is not relevant to the succinct package of work associated with the recreational strategy. The amended professional services forecast set is set out in the table below and will be used to determine prices for the next regulatory period (see Table 3.3).

The values shown below may be adjusted further to reflect any updated estimates of the QCA's regulatory fees for the 2021-25 period. GAWB will be seeking confirmation from the QCA on its anticipated regulatory fees prior to setting prices for the next regulatory period.

Table 3.3: Professional Services Costs ($2018-19 million)

2020-21	2021-22	2022-23	2023-24	2024-25	Total
3.61	2.47	2.47	2.77	3.97	**15.31**

(1) The values presented in the table are exclusive of any efficiency factor.
(2) The values may not sum due to rounding.

3.2.3 Information Services

QCA's Approach

KPMG recommended that no reductions be applied to GAWB's proposed forecast at this stage. It was noted that increases in information systems expenditure would be required over the next regulatory period, but it was not able to identify an alternative forecast that could be credibly justified.

GAWB's Approach

GAWB accepts the QCA's findings that no reduction should be applied to GAWB's proposed forecast for information services. The forecast set out in the regulatory submission will be reflected in prices for the next regulatory period (see Table 3.4). GAWB's response to matters raised by the QCA on cost escalation factors is addressed in Section 3.5.

Table 3.4: Information Services Costs ($2018-19 million)

2020-21	2021-22	2022-23	2023-24	2024-25	Total
3.14	2.67	2.74	2.84	2.70	**14.09**

(1) The values presented in the table are exclusive of any efficiency factor.

The QCA has requested further information to justify its forecast information systems expenditure program. Between October 2019 and early January 2020 GAWB provided documentation on its governance processes, strategic plans, past investments and procurement processes in support of its expenditure forecast.

GAWB trusts that the information provided to date, along with the following information adequately addresses any questions that may remain on the prudency or efficiency of the expenditure forecast.

Medium to long term planning for information services is challenging due to the rapid rate of change in technology and available market solutions. Due to these challenges GAWB has placed a significant level of emphasis on developing an appropriate governance and planning framework to oversee all future investment in information services. The model that has been adopted is a Management Committee comprised of GAWB staff (executive team members and technical experts). External subject matter specialist/s may be engaged to assist the Committee in performing its oversight role.[18]

As noted in the regulatory submission, benefits were identified and assumed at the time of the last price review. However, these were not realised as planned. The financial impacts associated with the inability to capture the assumed efficiency improvements have been borne by GAWB, not our customers as there are no pricing mechanisms in place to capture cost over-runs. Based on an internal assessment of prior information technology investments, GAWB has adopted a suite of additional measures to address any impediments to attaining future efficiency improvements. These measures have been largely in the areas of governance and the involvement of external technical experts to inform project and strategic planning processes (e.g. to provide advice on costs, timeframes etc).

In 2019 GAWB's Board approved the ICT Strategic Plan.[19] The ICT projects set out in the strategy will deliver enhancements and additional capabilities, such as mobility and streamlined digital processes. As noted in the regulatory submission most of the initiatives set out in the IT Strategic Plan are required to achieve the regulatory obligations mandated by the Queensland Chief Information Office (QCIO). As such these initiatives will not deliver financial savings via improvements in operational process or the removal of redundant systems.

The ICT Strategic Plan includes a summary and works schedule for all of the activities to be undertaken, including the associated costs (recurrent and non-recurrent), timeframes and interdependencies. The timeframes and costs are based on professional estimates which have been developed in consultation with external subject matter experts including the Information and Communications Technology (ICT) Strategy Governance Committee (ISGC) technical matter expert (who is a KPMG Partner).

GAWB's ICT management committee meets on a regular basis to consider matters relating to potential information solutions including monitoring, evaluating, reporting and overseeing information services projects. The committee also identifies opportunities for, and challenges that may impact, GAWB's operations. This governance approach is considered appropriate

[18] Refer to RFI 0121, lodged 6 January 2020.
[19] Refer to RFI 0060, lodged 22 October 2020.

for the size of GAWB and the complexity of the initiatives planned (across ICT and operational technologies (OT)), as all significant information technology activities receive an appropriate level of oversight. This will ensure the initiatives deliver the outcomes sought, adjustments can be made in a timely manner and expenditure is monitored.

The procurement of future 'software as a service' activities will be done in accordance with GAWB's procurement framework, which has been identified by KPMG to be of a 'high standard and provides a strong foundation to the efficiency of the forecasts'.[20] Market testing will be conducted prior to commencing the procurement process. This will assist with ensuring the scope of work reflects current market offerings as well as GAWB's strategic and technical requirements at that point in time.

KPMG's report notes that it was difficult to assess the forecast expenditure due to the absence of business cases for the initiatives contained in the ICT Strategic Plan. As noted above the values contained in the ICT Strategic Plan are based on professional assessments taking regard of current technical solutions and infrastructure. Business cases are yet to be developed for the underlying activities as they are not due for implementation until the latter years of the regulatory period.

GAWB appreciates why KPMG is seeking this documentation, but it is accepted industry practice to complete a business case during the year of implementation (or slightly longer for more complex projects). This timeframe is appropriate as it ensures the business case includes prices that best reflect market conditions at that point in time. To complete a business case at an earlier point in time increases the likelihood of the estimates and/or the services in question materially changing due to innovation and market fluctuations.

It is therefore not appropriate to develop business cases for initiatives several years before the proposed date for implementation/completion. The strategy provides justification for the proposed timeframes. The justification of the proposed timeframes has been reviewed and adjusted based on feedback from an external technical expert.

3.3 Electricity

QCA's Approach

Based on the recommendations from KPMG, GAWB's base cost forecast for electricity was viewed as not justified and should be reduced by 15 per cent. KPMG considered this was a conservative reduction and should provide a sufficient allowance for any specific cost drivers affecting GAWB.

GAWB's Approach

Whilst GAWB's forecast expenditure on electricity does not represent a material cost, it is a significant cost for GAWB. This is also the case for most of our customers.

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[20] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report).* February. p 46.

It was always GAWB's intention to review the appropriateness of its electricity forecast prior to setting prices, to ensure it reflected the outcomes of the current Price Monitoring Review (i.e. the QCA's views on GAWB's capital program) and recent regulatory decisions for the Queensland distribution networks (e.g. Ergon Energy). A similar approach was applied prior to setting prices for the current regulatory period (1 July 2015 to 30 June 2020).

KPMG notes in its report that it is unclear what level of energy efficiency initiatives or operational changes are forecast to occur over the regulatory period. GAWB's pumping regime is risk based therefore there is limited, if any, scope to improve operational practices around energy usage. As infrastructure is replaced, as per the capital forecast, improved levels of energy efficiency may result. As these are generally small incremental investments GAWB has not assumed energy efficiencies will result over the regulatory period.

KPMG also queried whether GAWB's forecast reflected general market expectations of decreasing electricity costs. A decline in electricity costs was accounted for in GAWB's forecast. As noted by Deloitte Access Economics:

> Electricity prices are forecast to moderate in coming years, largely led by a fall in wholesale prices. Beyond the short-term, electricity prices are forecast to rise in line with inflation.[21]

Since submitting the regulatory submission, GAWB has investigated further the extent to which the base year costs (2018-19) reflected current electricity prices. In doing so consideration has been given to the nature of GAWB's connections (i.e. non-contestable and contestable) and current market trends.

Notified tariffs are currently set by the QCA. Over the last five years, the cumulative trend has been a negligible decrease in the tariffs applicable to GAWB's connections. This decline has only come about as a result of recent reductions (i.e. 2019-20 tariffs) in the applicable tariffs. This reduction has been offset by an increase in the number of GAWB's connections, such as the new Offline Storage Facility. As a result, GAWB is not proposing to adjust the electricity forecast for the non-contestable connections that was assumed in the regulatory submission.

KPMG's analysis is based on electricity pricing trends for residential connections in South East Queensland, which is not an appropriate basis to assess the pricing trends applicable to GAWB's connections. Whilst some sites can benefit from moving to a contestable environment, different network charges apply to regional sites (i.e. Ergon Energy's network tariffs apply to GAWB's connections, not Energex's who provides network services to connections in South East Queensland). Consumption profiles and the location of individual connections can also play a part in the willingness and/or competitiveness of wholesale market offers.

Over the current regulatory period, a decline in wholesale and network costs has occurred, while over the same period there has been an increase in retail, renewable and metering charges. GAWB re-engaged Deloitte Access Economics (DAE) in early 2020 to update its cost escalators for electricity services to reflect current market factors and recent regulatory

[21] Deloitte Access Economics. 2019. *Cost Escalation Factors (2020-21 to 2024-25) – Prepared for Gladstone Area Water Board*. August. p 18.

decisions. The updated forecast also includes a negative escalation factor for the 2019-20 period, reflecting the market adjustments outlined above (see Attachment A – DAE's Updated Escalated Report (March 2020)).

Based on the above analysis, GAWB will adjust its electricity forecast for the regulatory period to take account of market trends during the current regulatory period.

As noted in Table 1.2, GAWB accepts the QCA's finding on the UV disinfection project. The electricity forecast has been adjusted to take account of this change in the capital program.

Subject to any further material market movements or regulatory outcomes, the forecast set out below will be reflected in prices for the next regulatory period (see Table 3.5).

Table 3.5: Electricity Costs ($2018-19 million)

2020-21	2021-22	2022-23	2023-24	2024-25	Total
2.91	2.91	2.91	2.91	2.91	**14.57**

(1) The values presented in the table are exclusive of any efficiency factor.
(2) The values may not sum due to rounding.

GAWB's response to matters raised by the QCA on cost escalation factors is addressed in Section 3.5.

3.4 Insurance

QCA's Approach

The QCA accepted KPMG's recommendation that GAWB's budgeted insurance spend in 2019-20 plus the forecast costs associated with the asset valuation form the expenditure forecast. The QCA also noted the recent challenges faced by GAWB and other water businesses in securing insurance for industrial special risks, particularly coverage for dams.

GAWB's Approach

Base Insurance Costs

As noted by the QCA, the process of securing insurance for industrial special risks, particularly the coverage for dams, has become challenging for water businesses. GAWB has and continues to work closely with its insurance broker to conduct a competitive process to select insurers.

GAWB accepts KPMG's recommendation to use the actual costs and to then escalate these costs based on the applicable cost escalation factors. In light of recent events, such as the fire and storm events on the east coast of Australia and the COVID-19 virus pandemic, GAWB proposes to use:

- actual industrial special risk costs for the 2020-21 year, escalated by the updated DAE escalator for the remaining years of the regulatory period (2021-22 to 2024-25); and
- actual combined general liability costs for the 2019-20 year, escalated by the updated DAE escalator for the regulatory period (2020-21 to 2024-25).

Prices to apply from 1 July 2020 will be updated with these revised inputs when the data becomes available.

GAWB believes this approach best reflects the QCA's findings and will ensure the impacts of the recent unprecedented events are appropriately reflected in the expenditure allowance.

Asset valuation

GAWB accepts KPMG's recommendation to use the forecast costs associated with the asset valuation in 2020-21 and 2023-24.

Cyber-security Insurance

Queensland Government agencies are required to take proactive measures to ensure data is securely stored. Despite best efforts, cyber-security incidents can occur. Most Queensland Government agencies are automatically covered by the Queensland Government Insurance Fund (QGIF) in the event of a cyber-security incident. QGIF's policy includes cover for cyber-related events which cause loss or damage to the agency's ICT systems. It also covers amounts an agency may be liable to pay to third parties because of a cyber event or data breach. As a statutory authority, this type of insurance is not currently available to GAWB.

To ensure GAWB has a level of coverage comparable to all other Queensland Government agencies it must source cyber-security insurance via the private market. To ensure the cost of this cover is efficient, it is procured via the same process as the rest of GAWB's insurance portfolio i.e. via a broker. KPMG found this approach to be appropriate for delivering efficient costs.[22]

As this is a compliance obligation GAWB believes the cost of cyber-security insurance is prudent. To ensure the associated cost is efficient GAWB will include the actual insurance cost for the 2019-20 year, escalated by the updated DAE escalator for the remaining years of the regulatory period (2021-22 to 2024-25).

The values set out in Table 3.6 are provided to give an indicative forecast and are based on KPMG's forecast for 2019-20. The actual cost for insurance will be used, where applicable, to determine the applicable forecast that will be used to determine prices for the 2021-25 regulatory period.

[22] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report).* February. p 151.

Table 3.6: Insurance Costs ($2018-19 million)

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Insurance coverage – industrial special risk[2] & combined general liability costs	1.21	1.21	1.21	1.21	1.21	6.04
Asset revaluation	0.10	-	-	0.075	-	0.175
Cyber-security Insurance[2]	0.015	0.015	0.0175	0.0175	0.020	0.085
Total cost	**1.32**	**1.22**	**1.23**	**1.30**	**1.23**	**6.30**

(1) The values presented in the table are exclusive of any efficiency factor.
(2) The premium associated with this coverage will be updated to reflect the actual costs for the 2020-21 financial year.
(3) The values presented may not add due to rounding.

GAWB's response to matters raised by the QCA on cost escalation factors is addressed in Section 3.5.

3.5 Cost Escalation Factors

KPMG raised the following key issues with DAE's escalators and GAWB's application of the escalators:

- more suitable escalators are available for a number of cost categories;
- updated forecasts for CPI and WPI figures are available and should be used to develop forecast expenditure; and
- annual cost escalators were not used to escalate costs from $2018-19 to nominal values.

The QCA has accepted KPMG's recommendations.

Each of these issues is discussed in detail below.

3.5.1 Appropriateness of DAE's Escalators

GAWB appreciates the reasons for the QCA's preference towards CPI inflation forecasts that are reasonably transparent, based on publicly available data and can be replicated by stakeholders (i.e. Reserve Bank of Australia forecasts). However, it should be noted that the CPI inflation forecast is used to calculate various inputs and outputs of the regulatory process. For example, the CPI inflation forecast is used to calculate:

- the operating expenditure forecast (input);
- the opening value of the regulated asset base (RAB) and inflation across the regulatory period (input); and
- smoothed prices for the regulatory period (output).

A consistent approach does not need to be applied to each of the above values. This has been recognised most recently by the QCA in its irrigation review, as it uses three different calculations of inflation.

Operating Expenditure Forecasts

GAWB believes the requirement for a 'reasonably transparent' process has been afforded to stakeholders through the review performed by KPMG. For example, KPMG's terms of reference required it to assess:[23]

> (f) the reasonableness of proposed trends applied to the base year including, but not limited to, cost escalation methodologies; and
>
> (g) the reasonableness of proposed escalation rates applied to forecast capex outlays.

Furthermore, KPMG did not raise any concerns with the methodology applied by DAE to determine the CPI or WPI forecasts.

As these values are used to convert base year costs to nominal forecast values rather than mid-year calculations and DAE's methodology was made available to stakeholders at the time of lodging the regulatory submission, GAWB believes that full transparency of the process, via KPMG and QCA's review, has been achieved and GAWB will continue to use DAE's escalation factors for the purpose of calculating nominal expenditure forecasts.

Modelling Inputs

GAWB supports the use of a constant CPI across the regulatory period for the purposes of determining the forecast opening value of the RAB (i.e. calculation of inflation used in the roll forward of the RAB) and to calculate smoothed prices for the regulatory period.

GAWB will apply the applicable compound annual growth rates (CAGR) for escalation across the 2021-25 regulatory period and the annual escalation amounts for 2019-20.

Whilst the QCA has raised concerns with the use of inflationary forecasts developed via proprietary models, GAWB believes the forecast is robust and was made available to stakeholders at the time of lodging the regulatory submission. The outputs have also been reviewed by KPMG.

3.5.2 Updated Business Outlook Figures

The escalators used to develop the regulatory submission expenditure forecasts were based on Deloitte's *Business Outlook - March 2019* (Business Outlook). KPMG noted in its report that updated forecasts were available.

[23] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report).* February. p 26.

GAWB acknowledges that since lodging its regulatory submission, more current data is available and that this should be used to calculate the cost escalation factors. In light of this, GAWB engaged DAE to update its analysis to reflect the most current market forecasts. These updated forecasts are based on the macroeconomic factors that underpin the Business Outlook - December 2019 publication which incorporates the September 2019 quarter Australian Bureau of Statistics (ABS) National Accounts released.

The updated nominal cost escalation factors are presented in the table below.

Table 3.7: Nominal Cost Escalation Factors: 2020-21 to 2024-25

Estimate	2020-21	2021-22	2022-23	2023-24	2024-25	CAGR 2020 to 2025
CPI (Brisbane, all groups)	1.75%	1.99%	2.24%	2.38%	2.26%	2.13%
Employee costs	2.64%	3.09%	3.51%	3.28%	3.06%	3.12%
Contract Labour costs	2.15%	2.73%	3.26%	3.16%	3.06%	2.87%
Contractors (service delivery)	2.15%	2.73%	3.26%	3.16%	3.06%	2.87%
Electricity	-11.02%	-2.95%	2.24%	2.38%	2.26%	-1.56%
Chemicals	-7.13%	6.97%	4.31%	2.58%	2.29%	1.69%
Other materials and services	2.05%	2.55%	3.01%	2.97%	2.86%	2.69%
Professional services (engineering)	2.15%	2.73%	3.26%	3.16%	3.06%	2.87%
Rates	2.15%	2.56%	2.95%	2.91%	2.76%	2.67%
Insurance	5.17%	5.41%	5.66%	5.79%	5.68%	5.54%
Maintenance	2.03%	2.51%	2.96%	2.93%	2.82%	2.65%

Source: Deloitte Access Economics
(1) The cost escalation factors apply to all pricing zones.

The nominal cost escalation factors presented in Table 3.7 will be used to develop an updated operating expenditure forecast for the regulatory period.

3.5.3 Annual Cost Escalators

The base year for GAWB's operating expenditure forecast is $2018-19. These values were escalated to calculate nominal values.

KPMG recommended applying the relevant annual escalator for the 2019-20 period as it would likely result in a more accurate forecast. GAWB agrees with the recommendation to apply an annual escalator to this period.

In light of this, GAWB engaged DAE to calculate the annual cost escalation factor for each of the cost categories. The 2019-20 nominal cost escalation factors are presented in the table below.

Table 3.8: Nominal Cost Escalation Factors: 2019-20

Estimate	2019-20
CPI (Brisbane, all groups)	1.94%
Employee costs	2.73%
Contract Labour costs	2.12%
Contractors (service delivery)	2.12%
Electricity	-5.69%
Chemicals	6.99%
Other materials and services	2.08%
Professional services (engineering)	2.12%
Rates	2.24%
Insurance	5.36%
Maintenance	2.07%

Source: Deloitte Access Economics

The nominal cost escalation factors presented in the above tables will be used to develop an updated operating expenditure forecast for the regulatory period.

3.5.4 Alternative Escalators

QCA's Approach

KPMG's review of the proposed cost escalation factors identified a number of alternative methodologies. These adjustments have been adopted by the QCA for the purposes of the Draft Report. Each of these adjustments is discussed below.

GAWB's Approach

Operations

GAWB accepts the QCA's finding that the Gladstone Regional Council (GRC) rate escalator should be applied to trade waste costs.

KPMG also suggested (and was accepted by the QCA) to incorporate the 2018-19 council cost proportions for each cost category, which have been released since the original cost escalation factors were provided to GAWB. GAWB accepts KPMG's suggestion.

GRC cost proportions for 2018-19 (and 2017-18) are described below in Table 3.9. The marginal change in GRC cost proportions has a negligible impact on the GRC rates cost escalation factor (on average -0.002% a year between 2020-21 and 2024-25). The escalators have also been updated for updates to the outlook for Brisbane CPI and Queensland WPI which are used to project forward council costs for materials, employee costs, depreciation and amortisation and finance. Combined, these changes reduce the cost escalation factor marginally between 2020-21 and 2024-25. The effect of updating the GRC cost proportion and updating CPI and WPI escalation factors is described below in Table 3.10.

Table 3.9: Gladstone Regional Council Cost Proportions, 2017-18 and 2018-19

	2017-18	2018-19	Difference (percentage points)
Materials	41%	43%	2
Employee costs	31%	31%	0
Depreciation & Amortisation	24%	23%	-1
Finance costs	4%	3%	-1
Total	**100%**	**100%**	

Source: Gladstone Regional Council. 2019. *Annual Report 2018-19*. https://www.gladstone.qld.gov.au/plans-reports.

(1) Values may not sum due to rounding.

Table 3.10: Cost Escalation Factors for GRC Rates (Previous and Updated Nominal Cost Escalators)

Estimate	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Previous	2.33%	2.66%	2.89%	2.97%	2.78%	2.63%
Updated	2.24%	2.15%	2.56%	2.95%	2.91%	2.76%
Difference (percentage points)	-0.09%	-0.51%	-0.33%	-0.01%	0.12%	0.13%

(1) Values may not sum due to rounding.
(2) The 'previous' values relate to the cost escalation factors applied in the regulatory submission. The 'updated' values reflect values contained in Deloitte Access Economics updated report (March 2020).

Maintenance

In escalating maintenance operating expenditure, GAWB specified a portion of maintenance spend as services (70%) and the remainder at materials (30%). GAWB applied DAE's contractors (services delivery) cost escalation factor to the services portion and 'other materials and services' cost escalator to the materials portion.

KPMG notes that 'other materials and services' is a composite cost escalator reflecting a split of labour and materials. As such, it would be more appropriate to apply an escalator that is 70% WPI based (for services) and 30% Brisbane CPI based (for materials). GAWB agrees with KPMG's recommendation and the applicable cost escalation factor is provided below based on a 70-30 weighting of Queensland WPI and Brisbane CPI.

Table 3.11: Maintenance Costs, Nominal Cost Escalators

Estimate	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Previous	N/A	N/A	N/A	N/A	N/A	N/A
Updated	2.07%	2.03%	2.51%	2.96%	2.93%	2.82%

Chemicals

The chemicals forecast included in the regulatory submission applies DAE's cost escalator for chemicals, which is based on the forecast for the price of crude oil. KPMG has raised concerns with this approach and recommends escalating chemicals costs by CPI.

GAWB does not agree with KPMG's concerns. DAE's approach uses lagged forecasts of tapis crude prices which reflect variability that is characteristic of chemical prices. The use of CPI as a cost escalator does not capture the year to year variation that (lagged) tapis crude enables. The superiority of DAE's approach compared to KPMG's suggestion is addressed in Attachment A – DAE's Updated Escalated Report (March 2020).

Table 3.12: Chemical Cost Escalators (Previous and Updated Nominal Cost Escalators)

Estimate	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Previous	5.09%	-3.23%	6.14%	2.44%	1.87%	1.74%
Updated	6.99%	-7.13%	6.97%	4.31%	2.58%	2.29%
Difference (percentage points)	1.90%	-3.91%	0.84%	1.87%	0.71%	0.55%

(1) Values may not sum due to rounding.
(2) The 'previous' values relate to the cost escalation factors applied in the regulatory submission. The 'updated' values reflect values contained in Deloitte Access Economics updated report (March 2020).

3.6 Efficiency Factor

QCA's Approach

As noted by KPMG, GAWB's operational performance on an operating expenditure per ML is lower than most large utilities for the period 2015-16 to 2018-19.[24] Despite GAWB's operating costs being lower than its peers on an opex/ML basis, GAWB acknowledges the need to deliver its services more efficiently and ultimately at a lower price.

[24] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report).* February. p 121.

GAWB's Approach

Compound vs Static Adjustments

GAWB accepts the QCA's finding that an efficiency target of 1 per cent should be applied on an annually compounded basis.

Controllable vs Non-Controllable Costs

The regulatory submission included an efficiency factor that was applied to the controllable portion of the total operating expenditure forecast, where a 'controllable cost' is a cost that GAWB has direct influence over and an 'uncontrollable cost' is a cost that GAWB does not have a direct influence over, such as:

- regulatory and compliance obligations; and
- costs imposed by a third party where there is limited or no scope to exert competitive pressure (i.e. a price taker).

For a number of cost items, KPMG has noted that GAWB has 'applied a too tight interpretation on what costs are within the control of the business'. According to KPMG[25]:

> uncontrollable costs are defined strictly as costs that the business has no control over and include such items as licence fees and environmental levies set by government.

GAWB has reconsidered the cost items identified by KPMG as controllable costs (see Table 3.13). As noted in the table below, GAWB accepts KPMG's suggestions on the treatment of environmental and chemical costs. The costs items will be included in the *efficiency adjustment* calculation along with maintenance and variable electricity.

[25] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report).* February. p 129.

Table 3.13: Costs Identified by KPMG as Controllable

Cost item	KPMG's reasons[1]	GAWB's comments
Environmental compliance costs Handling of trade waste Water quality testing and management	These costs are to a significant degree affected by the processes, tools and resources GAWB chooses to utilise in meeting its obligations.	**Accept**
Land lease payments	GAWB has a non-trivial degree of control over its total land lease payments (in particular before building an asset) through for example: • its capital planning and design processes; • its ability to negotiate and manage contracts; and • its decisions on whether to rent or own land.	**Reject** Land lease payments are typically a government charge. In most instances GAWB does not have a choice in the location of a connection, as this is generally determined by the location of the customer, the existing infrastructure or the engineering solution that delivers the most prudent and efficient outcome.

Cost item	KPMG's reasons[1]	GAWB's comments
Electricity fixed charges	While in the short-run GAWB may have limited control over the fixed electricity charges it incurs, over time GAWB has considerable influence over where and how it connects to the energy grid. For example, it can invest in both energy savings measures and local generation (e.g. solar power, hydro-power, co-generation, waste-to-energy).	**Reject** GAWB has limited influence over where and how it connects to the energy grid. This is due to the following factors: • the location of essential infrastructure (e.g. transmission and distribution assets); • not all connections are eligible to go to market (i.e. they are non-contestable and electricity charges are regulated); • only a limited number of the alternative energy solutions identified by KPMG are applicable to GAWB. This is due to GAWB being a bulk water supplier. Therefore, GAWB does not have direct access to feedstock for waste-to-energy solutions or to be in the business of electricity generation; and • in most instances GAWB does not have a choice in the location of a connection, as this is generally determined by the location of the customer or the engineering solution that delivers the most prudent and efficient outcome.
Chemicals	GAWB has significant control over the manner in which it utilises these inputs through its technological choices and service supply solutions and therefore has control over the quantity and manner in which these inputs are utilised.	**Accept**

Cost item	KPMG's reasons[1]	GAWB's comments
Water treatment plant operators (employment costs)	GAWB has control over employment costs associated with water treatment plant operators through its recruitment processes and wage negotiations, the potential use of contractors or third-party operators, the implementation of various automation technologies, etc.	**Reject** Whilst the reasons outlined by KPMG are plausible, they do not reflect current market and operational factors. For example: • it is widely acknowledged within the water industry that there is an ageing workforce and a shortage of specific skills; • the recruitment challenges associated with being in a regional area; and • in the short to medium term there is limited scope to fully leverage the operational benefits of automation technologies. GAWB has and will continue to invest over the next regulatory period in automation technologies so that it can deliver more efficient water services within a more flexible operating environment.
Insurance	GAWB has direct control over the timing and manner in which it goes to market and the manner in which it chooses to manage the risk profile associated with its assets.	**Reject** Whilst GAWB has control over the timing and manner in which it goes to market, it is a price taker. Furthermore, due to the location of our assets GAWB is limited in the number of service providers. These challenges were noted by the QCA[2] in the context of the ability to secure insurance for industrial special risks.

(1) KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report).* February. p 130
(2) QCA. 2020. *Gladstone Area Water Board Price Monitoring 2020-25 Part A: Overview.* February. p 30.

4. Capital Expenditure

Each of the projects specifically considered by the QCA in the Draft Report are discussed below.

4.1 Material Projects

4.1.1 Accommodation Project

While KPMG considered that GAWB's preferred option of purchasing a new premises at 136 Goondoon Street was prudent and efficient, it recommended the expected sales proceeds from GAWB's existing premises (147 Goondoon Street) be deducted from the project costs that would otherwise enter the RAB, along with transaction costs and estimated capital gains tax.[26] This approach is inconsistent with regulatory precedent, noting that KPMG did not seek to identify or assess GAWB's historical treatment of asset disposals.

In its Draft Report the QCA agreed 'in principle' with KPMG's findings, recommending that GAWB either make an appropriate adjustment for the sale of the existing premises to the capitalised project costs or via an asset disposal.[27] At this stage the QCA has not made an adjustment because: (1) the impact on revenue and prices is not considered material; and (2) the adjustment would indirectly reveal GAWB's confidential information, being the reserve price for 147 Goondoon Street that was previously set by the Board in 2017.

While in the context of GAWB's total asset base and revenues this is not a significant value, this highlights the lack of certainty and predictability in some areas of GAWB's regulatory framework. Whilst not supported by a regulatory guideline, asset disposals have been subject to a consistent approach over regulatory periods, where GAWB only recovers its prudent and efficient costs net of any proceeds of sale.[28] The QCA has not raised any concerns or objections with this approach in the past. If the QCA was to accept KPMG's recommendations, this would represent a significant change in regulatory precedent.

While GAWB agrees that the impact on revenue and prices is not material, it is still important to treat asset disposals on a consistent basis, having regard to historical treatment as well as sound regulatory practice. Noting that GAWB is only subject to a price monitoring framework, the treatment of asset disposals should be relatively uncontroversial (as has generally been the case across regimes) provided the outcome for customers is same (i.e. NPV neutrality is achieved). Within this context, GAWB emphasises the importance of regulatory certainty. Confidence in the future regulatory treatment is important to GAWB for planning, decision-making and the management of internal processes.

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[26] KPMG (2020). Gladstone Area Water Board Expenditure Review, Prudency and Efficiency Assessment, Draft Report Prepared for Queensland Competition Authority, p.69.

[27] Queensland Competition Authority (2020). Draft Report, Gladstone Area Water Board Price Monitoring 2020-25, Part A – Overview, p.46.

[28] This is determined by ensuring an NPV neutral outcome.

Proposed treatment

Overall, GAWB agrees with the QCA that the 147 Goondoon Street premises should be removed from the RAB. However, the methodology used to achieve this outcome should be consistent with regulatory practice, i.e. the approach previously applied to GAWB's asset disposals and accepted by the QCA in past reviews. Under current practice:

- once the disposal has occurred, the asset is removed from the RAB based on the written down value of that asset in the RAB (i.e. the residual RAB value);
- to ensure that GAWB is able to fully recover the efficient costs of investment in that asset, the residual RAB value is recovered via accelerated depreciation; and
- any sales proceeds GAWB receives from disposing of that asset is then returned to customers by deducting that amount from the accelerated depreciation amount, net of any taxes and transaction costs that GAWB will necessarily incur as part of the sale.

GAWB considers that this approach remains the most appropriate as apart from being consistent with historical practice, it is consistent with the regulatory principle of enabling it to fully recover its efficient costs while ensuring that it does not recover more than those costs.

Issues with KPMG's approach

Apart from being inconsistent with the past treatment of asset disposals, GAWB has a number of issues with KPMG's recommendations (noting that they have not necessarily been accepted in full by the QCA). These issues are as follows.

Adjustment to capitalised project costs

KPMG has proposed that the value of the 147 Goondoon Street premises be deducted from the capitalised project costs of the new building. The disposal of the existing building was a necessary part of GAWB's commercial business case for the project, even though KPMG acknowledges that if the sales proceeds from 147 Goondoon Street were excluded from the options analysis, the preferred option would be unchanged.[29]

However, how that disposal is actually treated for pricing purposes should reflect accepted regulatory practice.

The standard regulatory approach that has been applied by the QCA and other Australian regulators in such circumstances is to remove the existing asset from the RAB as an asset disposal. In the situation where an existing asset is replaced by a new asset, this clearly separates the regulatory treatment of each asset, with:

- the existing asset removed from the RAB based on its residual RAB value; and
- the replacement asset entering the RAB based on its current value, which in this case, is an arms-length commercial market value (along with other relevant capitalised project costs).

[29] KPMG. 2020. *Gladstone Area Water Board Expenditure Review: Prudency and Efficiency Assessment (Draft Report)*. February. p.65.

GAWB notes that the QCA has indicated that the existing asset is removed either as an adjustment to the capitalised project costs, or a separate asset disposal.

The asset's disposal value

Sales proceeds v RAB value

KPMG has proposed that the disposal value is based on the assumed sales proceeds. GAWB considers that the most appropriate treatment – which is administratively simple and the most transparent approach – is to remove the value of the asset at its residual RAB value at the time of the disposal.

Full recovery of GAWB's efficient costs is then enabled by the application of accelerated depreciation (equivalent to that residual RAB value), with any amount that GAWB then receives on the sale of that asset returned to customers as a revenue offset, net of any associated taxes and transaction costs, preventing it from recovering anything above its efficient costs.

Removing the value of the asset from the RAB based on the sales proceeds will always be problematic as it is likely that those sales proceeds will differ from the RAB value, to the extent that if:

- the sales proceeds exceed the RAB value, the asset will have a 'negative' value in the RAB; or
- the sales proceeds are below the RAB value (as is often the case), a residual amount for that asset will remain in the RAB.

As noted above, removing disposed assets at the RAB value is consistent with the regulatory treatment applied to GAWB in the past. The QCA has not previously raised any concerns with that approach. If the value of the disposed assets is based on the sales proceeds, as proposed by KPMG, this exposes GAWB to the risk of it not being able to fully recover its efficient costs to the extent that the disposal value is less than the RAB value (which is quite likely).

As the proceeds of sale will be remitted to GAWB's customers in full, rather than retained by GAWB, this will mean that they are effectively receiving a partial rebate for their contribution to the cost of this asset. As GAWB is proposing that the adjustment is based on the net proceeds, it is therefore only proposing to retain that portion of the sales proceeds that will recover any taxes and transaction costs. In GAWB's pricing model, this adjustment will be applied by netting off the (net) sales proceeds against the accelerated depreciation amount. Again, this is consistent with the approach that has been applied historically.

Assumed sales proceeds

As KPMG is proposing removal of the asset prior to its actual disposal, it has had to assume a value for the sales proceeds. It has based this assumed value on GAWB's internal analysis which was collated at the time of purchasing 136 Goondoon Street. Since then the market for commercial buildings in Gladstone has remained very flat. Despite the current mood of the property market GAWB is committed to progressing the sale of 147 Goondoon Street.

Ultimately, the sales price will be determined by market conditions. As the proceeds from sale will be returned to customers (by way of an offset to the accelerated depreciation adjustment), it is in customers' best interests for GAWB to dispose of the property at the highest achievable price.

Apart from the fact that GAWB does not consider that the disposal value should be based on the sales proceeds, the figure relied upon by KPMG is not appropriate as it is no longer a relevant constraint. In the current market it is extremely difficult to forecast the likely timing of the sale, or what sales proceeds GAWB can expect to realise.

The issue of the assumed timing of the disposal is addressed below.

Timing of the disposal

The other key issue that GAWB has with KPMG's analysis is that it proposes that the 147 Goondoon Street asset is removed from the RAB immediately, that is prior to its actual disposal. To do so it requires an assumption to be made on future sales proceeds, as discussed above.

In terms of timing, the standard treatment of asset disposals for GAWB (and would appear to be standard regulatory practice elsewhere) is to remove the asset from the RAB in the year of disposal. If a forecast of asset disposals is made at the start of the regulatory period as part of the projected roll-forward of the RAB, this then requires:

- an assumption as to the timing and value of the disposal (a set of assumptions that are difficult to predict with any certainty); and
- a subsequent adjustment for any differences between forecast and actuals at the end of the regulatory period to ensure that only the prudent and efficient costs of the asset are recovered. This increases complexity and creates uncertainty for GAWB and its customers.

Forecasting disposals might be appropriate if the asset to be disposed is of material value in the context of the RAB or there is certainty around when an asset will be disposed of, which may then justify the additional costs and complexity associated with a forecast. That is not the case here, and even if it was material, GAWB considers it important to have a clear and consistent set of guidelines in place to provide regulatory certainty and reduce the risk of error.

The QCA has commented that 'customers should not bear the cost of holding the unsold 147 Goondoon Street property'.[30] Customers are not bearing any 'holding costs'. In practice, customers will be no worse off because they will only ever compensate GAWB for the efficient costs of that asset and will effectively pay less because the accelerated depreciation adjustment will be reduced by the net sales proceeds. That is, either:

- the asset is removed from the RAB immediately at the current residual RAB value, requiring an offsetting acceleration of depreciation to ensure GAWB recovers the cost of that asset in full; or

[30] Queensland Competition Authority. 2020. *Gladstone Area Water Board Price Monitoring 2020-25, Part A: Overview – Draft Report*. February. p.46.

- the asset remains in the RAB until sold, meaning that GAWB continues to recover a return on and of capital. Once sold, it will be removed from the RAB at the lower residual value, with a (lower) offsetting accelerated depreciation adjustment based on that (lower) residual RAB value.

Ultimately, these outcomes are equivalent. In both cases, GAWB only recovers its prudent and efficient costs (no more and no less); the main difference is timing.

As noted by the QCA, the impact on revenue and prices is not material. If it were, the potential benefits to customers of setting 2021-25 prices based on forecast assumptions could justify the added complexity of such an approach. Given this is not the case, GAWB is not proposing to include a forecast of the disposal of 147 Goondoon Street in 2021-25 prices.

Summary

GAWB is proposing the following treatment for the accommodation project:

1. The existing 147 Goondoon Street asset is treated separately as an asset disposal, in accordance with standard practice for GAWB.

2. The assumed value will not be deducted from the capitalised project costs of the new premises.

3. A forecast of any disposal value will not be captured in 2021-25 prices.

4. At the end of the 2021-25 period, an adjustment will be made as part of the RAB roll-forward and revenue adjustments.

In the year in which the asset is sold, this will involve:

1. removing the asset from the RAB at the (then) residual RAB value;

2. an offsetting accelerated depreciation adjustment to ensure GAWB fully recovers its efficient costs, which will be based on:

    a. the (then) residual RAB value; less

    b. the sales proceeds realised by GAWB, net of relevant taxes and transaction costs.

This proposed approach aligns with how GAWB's previous asset disposals have been modelled historically. It is not aware of any concerns having been expressed by the QCA with this approach.

GAWB highlights the importance of regulatory certainty and ensuring that there is sufficiently clear and detailed guidance to aid future decision-making.

4.1.2 Expansion of the Boat Creek Pump Station

QCA's Approach

The QCA found the proposed capex of $6.63 million for the expansion to be efficient, but not prudent. The QCA's capital forecast for the 2021-25 period excluded the proposed capital expenditure in the Draft Report.

GAWB's Approach

GAWB's 2015 regulatory submission included the Boat Creek Expansion Project. This project sought to provide 24 hours' worth of emergency storage in the northern industrial area. That is to ensure supply to customers in the event of the Mt Miller Raw Water Pipeline being isolated as a result of a planned or unplanned event.

The project was to expand storage in the northern industrial area from 29 ML to 38.5 ML. The project, as scoped at the time, was to be undertaken in two stages:

- Stage 1: involved increasing capacity by creating a new reservoir immediately to the north of the existing reservoir and emptying and cleaning out the material from the existing Boat Creek Reservoir; and
- Stage 2: involved the expansion of the existing reservoir to the south.

Stage 1 was forecast to be undertaken during the 2015-2020 regulatory period and only Stage 1 of the project was reviewed by the QCA in 2015. The QCA found the project to be prudent but only partially efficient. The QCA's consultant (Jacobs) considered the project to be necessary to GAWB meeting its network design standard[31] as the provision of 24 hours storage capacity is reasonable for a surface reservoir supplying a local water distribution system and recommended that costs be allowed for new storage of 10 ML.[32] The cost of Jacobs' recommended option was $2.90 million.

GAWB accepted that the project was partially efficient and included the $2.90 million for the purpose of calculating prices.[33]

During the current regulatory period it was discovered that the capacity of the Boat Creek pump station was limited and that the expansion as per Stage 1 would not deliver the project objective. This was due to the pump station not being able to deliver water at the required contracted demand flow rate.

As a result, the scope of the project was expanded to include both an increase in storage and an increase in pumping capacity. The revised scope continues to propose to augment the storage to provide and maintain a minimum of 24 hours supply in all parts of the delivery network volume based on contracted demand. The updated augmentation is slightly smaller than the Stage 1 expansion originally proposed by GAWB in 2015. However, it is larger than the augmentation recommended by Jacobs. Due to changes in short to medium term demand

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[31] Refer to RFI 0079.
[32] QCA. 2015.*Gladstone Area Water Board Price Monitoring 2015-20 – Final Report*. May. p 35.
[33] QCA. 2015.*Gladstone Area Water Board Price Monitoring 2015-20 – Final Report*. May. p 35.

outlook, the Stage 2 expansion as described in 2015 is no longer required. The revised scope now includes a pump station upgrade which is required to facilitate delivery of the water in storage to the customers at the contracted demand flow rate.

GAWB's regulatory proposal included the updated project as a material capital activity for the 2021-25 regulatory period. The QCA found GAWB's proposed capex of $6.63 million for the expansion to be efficient, but not prudent.

GAWB does not accept the QCA's finding that this project is not prudent, on the basis that:

- the project was previously considered prudent by the QCA in the 2015 price review;
- the change in scope is necessary to achieve GAWB's network design standard of 24 hours of available risk storage - a standard previously accepted by the QCA;
  - GAWB's network design standard was outlined in GAWB's regulatory submission for the 2015 price review period;[34]
  - the Boat Creek Expansion Project was one of three material projects included in the capital forecast that were necessary to meet the design standard. The other two projects were the 'low lift and high lift pump station switchboard and variable speed drives' and 'offline storage and repump station'. Both projects have been completed.
- recent condition reports for the Mt Miller Raw Water pipeline support the need for this project and the need for works to be completed by 2023. This is so that scheduled works on the Mt Miller Raw Water pipeline can be undertaken within the recommended timeframes.

Additional information has been provided to the QCA to support the inclusion of the estimated project cost.

GAWB will be adopting the capital expenditure forecast for this project as submitted in the regulatory submission. In light of a recent condition assessment for the Mt Miller Raw Water pipeline the project will be completed by 2023.

Table 4.1: Expansion of Boat Creek Pump Station (Updated Forecast)

Proposed capex ($m)	Capitalisation year	Asset Class	Driver	Pricing Zone
$6.107	2023	Potable	Regulatory	Boat Creek to East End

(1) Includes update of escalation factor and IDC calculation based on revised commissioning expectation, resulting in a change in proposed capitalised value.

[34] QCA. 2015.*Gladstone Area Water Board Price Monitoring 2015-20 – Final Report*. May. p 26.

4.1.3 Calliope River Bridge Pipeline Replacement

QCA's Approach

The QCA found the proposed capex of $4.31 million for the Calliope River Bridge pipeline replacement neither prudent nor efficient. The QCA's capital forecast for the 2021-25 period excluded the proposed capital expenditure in the Draft Report.

GAWB's Approach

GAWB supplies treated water to the Yarwun Water Treatment Plant (YWTP) for further downstream distribution to the industrial areas to the north of Gladstone via a DN375 Asbestos Cement (AC) pipeline which crosses the Calliope River via the Anabranch and Calliope River Bridges.

In mid-2018, failures of a mechanical connector (Gibault) were experienced at various times on the Anabranch Bridge. The failures resulted in a leak that was temporarily repaired and supported by pumping restrictions placed on the pipeline.

In late 2019, the entire section of the AC pipe on the Anabranch Bridge was replaced and a similar technical solution for the AC pipe on the Calliope River Bridge was included in the regulatory submission, with a forecast completion date of 2021-22. Both the Calliope and Anabranch pipelines were constructed around the same time in 1981. At the time of lodging the regulatory submission, this project was at P1 of GAWB's Project Management Framework - Project Initiation.

GAWB has continued its investigations to identify the most prudent and efficient solution. In January 2020 Asbestos Surveys Central Queensland (ASCQ) were engaged to visually assess the external surface of the AC pipe. Based on ASCQ's assessment the scope of works has been adjusted to include:

- the replacement of all cracked and dislodged timber pipe support chocks;
- the replacement of any missing nuts and washers on all structural components;
- the re-torqueing all the holding down bolts, pipe support straps, mechanical pipe connectors (Gibault) and bridge abutment support brackets;
- the realignment of the pipeline; and
- the completion of a detailed assessment of the AC pipe by a corrosion engineer to determine the remaining life of the AC pipe and the steel support brackets.

The updated project cost and completion date is summarised below.

Additional information has been provided to the QCA to support the inclusion of the estimated project cost.

Table 4.2: Calliope River Bridge Pipeline Replacement (Updated Forecast)

Proposed capex ($m)	Capitalisation year	Asset Class	Driver	Pricing Zone
$0.308	2021	Potable	Replacement	Calliope

4.1.4 Recreational Strategy

QCA's Approach

The QCA considered that prudency was reasonably demonstrated by general community (and customer) acceptance of the proposed program and associated costs through GAWB's customer engagement activities. The contingency allowance of $0.944 million for potential future upgrades to ablutions and to progress new ideas identified in further community consultation was not considered efficient and was excluded from the capital forecast for the regulatory period.

GAWB's Approach

GAWB currently provides or facilitates a range of recreational areas and facilities, both water and land based, at Lake Awoonga. These facilities generally relate to family recreation, recreational fishing, self-drive and caravan-based tourism, regional water sports and ecotourism.

In 2018 the Gladstone Community through various engagement channels, such as GAWB's Community Consultative Forum (CCF) (and their engagement channels) and social media, identified ways GAWB could enhance liveability in the Gladstone region through the operation of its assets or future investments. The recreational strategy represents these ideas, which are related to current GAWB activities or new investments of varying size, cost and/or complexity. In some instances, these activities may be incremental to what GAWB currently does; this just reflects the community's feedback on what additional measures they believe would have a positive influence on liveability in the region.

The QCA has found prudency to be reasonably demonstrated through community (and customer) acceptance of the proposed program and associated costs through GAWB's customer engagement activities. However, it has sought further information from stakeholders to validate GAWB's customer engagement outcomes.

As noted in the information provided to the QCA via the RFI process, GAWB has taken steps to ensure all parties have been informed and provided (dependent on their level of involvement) an opportunity to directly influence the scope of the recreational strategy. The information provided included:

- a report from JTA Australia, the consultant engaged by GAWB to assist with the design of the consultative process and to facilitate all CCF meetings. Regarding the recreational strategy, JTA noted that the CCF:

  …members could easily see their ideas and how they have been acknowledged in GAWB's forward work plans. This was welcomed by the CCF members. When the potential pricing impacts of the draft Strategy were discussed, the members were comfortable with what was being proposed. This response reflects the collaborative

process adopted by GAWB and that the projects have been identified on the basis they will provide amenity value to the community and enhance liveability. [35]

- the slide pack was used for customer engagement during June and July 2019. One of the issues discussed with customers during this round of consultation was the recreational strategy; [36] and
- a copy of the minutes from the Customer Representative Panel (CRP) meeting where the recreational strategy was presented in draft form and comments/feedback were sought.[37]

GAWB discussed the recreation strategy with the CRP in December 2018. A copy of the minutes from this meeting have been provided in support of the RFI. The recreational strategy was discussed with all customers in Round 2 of the customer engagement 1:1 meetings.

The reference to contingency, in the associated materials on the recreational strategy, does not have the same meaning as it would in a true project context. In the context of the recreational strategy these funds represent an allowance for the identified additional activities or opportunities. The project budget, the additional allowance and the purpose of these additional funds was explicitly discussed with CCF and CRP members.[38]

GAWB does not agree with the QCA's finding that the proposed allowance for this component of the recreational strategy should be excluded from GAWB's forecast capital allowance for the regulatory period. This is on the basis that the scope of projects, anticipated costs and allowance was discussed with stakeholders as the strategy was accepted and finalised.

4.1.5 Hatchery Relocation

QCA's Approach

The QCA found the proposed project expenditure for the hatchery relocation to be prudent and efficient. The QCA requested further information be provided by GAWB to demonstrate progress and updated cost estimates.

GAWB's Approach

Since lodging the regulatory submission, GAWB has commenced the open tendering process to identify a contractor to undertake the design and construction of the new facility. Based on an assessment of the relevant markets and current market conditions, GAWB has decided to modify its procurement strategy by decoupling the design and construction components of the project. These changes seek to ensure the most efficient outcome is achieved.

Based on the modified procurement strategy, the project is still estimated to be delivered for $7.12 million (including interest during construction) with completion by 2020-21.

Additional information has been provided to the QCA to support the inclusion of the estimated project cost.

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35 RFI 0116.
36 RFI 0079.
37 RFI 0079.
38 RFI 0116.

4.2 Cost Escalation – Capital Expenditure

QCA's Approach

KPMG raised the following issues with the forecast rate of capital expenditure escalation and recommended using forecast CPI as the basis for escalating capital expenditure:

- it is not clear why GAWB is using ABS data to split the labour and capital components of its capital expenditure, as opposed to using GAWB's own recent historical data; and
- it is not clear why GAWB has used the construction data to determine the labour and capital split, but then not applied a forecast of the WPI for the construction industry.

GAWB's Approach

GAWB does not accept the suggestion of using only CPI as it would not account for the large labour component of capital expenditure. DAE's approach is considered appropriate. The updated annual cost escalators are provided in the table below.

Table 4.3: Capital Expenditure Escalation Factors (Previous and Updated Nominal Cost Escalators)

Estimate	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Previous	2.19%	2.55%	2.83%	2.94%	2.80%	2.69%
Updated	2.07%	2.03%	2.51%	2.96%	2.93%	2.82%
Difference (percentage points)	-0.12%	-0.52%	-0.32%	0.02%	0.12%	0.14%

(1) Values may not sum due to rounding.

5. Rate of Return

5.1 Market Risk Premium

QCA's Approach

The QCA acknowledged that due to the Market Risk Premium (MRP) being unobservable, it is difficult to identify a determinative value. Whilst the QCA has previously considered the merits of adjusting the weighting placed on the Wright method, it did not believe there was convincing evidence at this time to justify a further increase.

GAWB's Response

GAWB applied a MRP of 7.0% in its regulatory submission. This estimate was informed by a weighting scheme that retained the same weightings as the QCA for the Ibbotson, Siegel and survey/independent expert report methodologies. However, Synergies proposed a slight adjustment to the weightings for the Cornell DGM and Wright methodologies. Specifically, Synergies decreased the weighting on Cornell DGM by 10 percentage points (from 25% to 15%), on the basis that recent estimates generated by the QCA appear to have been abnormally low when compared to other Australian regulatory decisions (a trend which has continued in the GAWB draft report and Queensland Rail final decision). On the other hand, the weighting on the Wright MRP was increased by 10 percentage points (from 15% to 25%), reflecting the low interest rate environment.

Taken together, these adjustments result in a weighted mean MRP of 7.11% (as at 28 February 2020), compared to an MRP of 6.53% under the QCA's preferred weighting scheme. If the weightings for the Cornell DGM and Wright methodologies are decreased and increased by only 5 percentage points each respectively (rather than 10 percentage points), the resulting MRP is 6.82% (which rounds to 7.0% if the QCA's convention of rounding to the nearest 0.5% is adopted). What this shows is that the overall MRP outcome is extremely sensitive to the choice of weights applied to each MRP methodology, which is itself a subjective process given the MRP is not observable and different MRP methodologies can provide widely different estimates. Recognising the lack of precision inherent when assigning weights to different MRP methodologies, it is clear that the range of techniques relied upon by the QCA can readily substantiate an MRP of 7.0% under various weighting schemes that depart only incrementally from the QCA's own preferred weights.

In light of these considerations, GAWB maintains its view that an MRP estimate that is based on a lower weighting of the Cornell DGM and higher weighting of the Wright MRP compared to the QCA's approach is appropriate (all other MRP weightings that Synergies have used align with the QCA's approach) and will facilitate GAWB's ongoing incentive to invest to meet its customers' future water needs. Further, as noted by the QCA in its Draft Report, GAWB's proposed WACC is below the WACCs of comparable Australian water entities and is only slightly higher than the QCA's own bottom-up WACC estimate.

5.2 Risk Free Rate - Averaging Period

The QCA noted in the Draft Report that GAWB should nominate an averaging period, ideally being a period in the first half of 2020.

To support the calculation of prices by 30 June 2020, the 20 day averaging period should commence in May 2020. It is GAWB's intention to commence the averaging period on 4 May 2020.

6. Risk Management

6.1 Revenue Cap Adjustments

QCA's Approach

The QCA found it appropriate to apply a revenue cap with a 10 per cent dead-band form of regulation, which:

- covers all revenue, including storage, administration, delivery, over-run charges and contract length premium revenue;
- fixes prices (with the exception of CPI increases) for the term of the regulatory period; and
- carries forward annual revenue variances in excess of 10 per cent of total revenue to the next regulatory period (indexed at the WACC).

GAWB's Response

GAWB supports the finding that it is appropriate to apply a revenue cap with a 10 per cent dead-band form of regulation. However, the proposed scope of the revenue cap is too broad, as noted below.

Revenue from Over-run Charges and Short-duration Surcharges

In the context of the revenue cap adjustments, the QCA noted in 2015 in relation to over-run charges:[39]

> … these should also be included as a deduction in the inter–period carry forward—except where the customer over–run has caused a material increase in GAWB's costs. In this case, the revenue cap may be increased by the additional cost.

GAWB has therefore assumed the QCA's previous reference to the inclusion of over-run charges in the revenue cap is only to the extent that the over-run has resulted in an increase in costs. Otherwise, over-run charges should be excluded from the revenue cap as this revenue has already been returned to customers.

Similarly, further clarification was sought by GAWB previously regarding the treatment of short-duration surcharges. In 2015, the QCA advised that:[40]

> Revenue from surcharges (net of GAWB's costs) should be refunded to customers in the next regulatory period. Refunded surcharges should be offset against the administration charge.

[39] Queensland Competition Authority. 2015. *Gladstone Area Water Board: Price Monitoring 2015-20 – Final Report.* May. p.62.
[40] Queensland Competition Authority. 2015. Gladstone Area Water Board: Price Monitoring 2015-20 – Final Report. May. p.71.

It also determined the additional revenue from surcharges "should be used to offset charges for contracts of 20 years or more".[41]

This approach will not result in GAWB making any windfall gains as any additional revenue GAWB recovers from over-run charges or short-duration surcharges will continue to be rebated to customers in the subsequent regulatory period.

In its response to the QCA's 2015 Draft Report, GAWB noted the revenue cap adjustments are only triggered when the deadband is exceeded. However, regardless of whether or not this occurs, it must return any revenue from over-run charges and short-duration surcharges collected net of any additional costs.

In effect, this means that any revenue received from over-run charges or short-duration surcharges should be excluded from the revenue cap adjustment at the end of the period.

GAWB continues to hold this view. That is, in order for this mechanism to work correctly:

- any amounts received from over-run charges and short-duration surcharges should be excluded from the revenue cap calculations; and
- GAWB must refund the full amount of any revenue received from customers from these charges, net of the amount of any additional costs. This should be a separate adjustment to the revenue cap mechanism, as a revenue cap adjustment is only made where the deadband is exceeded.

6.2 Adjustments to Demand

GAWB's regulatory framework provides for review triggers. That is a mechanism to recover costs that are uncertain and not provided for in capital or operating expenditure forecasts.

QCA's Approach

Despite demand-based review triggers being in place since GAWB became subject to economic regulation, the QCA has concluded that such triggers are no longer appropriate. This change in approach is based on the QCA's view that demand-based review triggers have the same effect as a revenue cap.

GAWB's Response

The assumption that demand-based review triggers have the same effect as a revenue cap is not correct. This difference and the need to treat them separately, has been previously noted by the QCA. For example, during the 2010-15 price review, the QCA stated:[42]

[41] Queensland Competition Authority. 2015. Gladstone Area Water Board: Price Monitoring 2015-20 – Final Report. May. p.70.

[42] Queensland Competition Authority. 2010. *Gladstone Area Water Board: Investigation of Pricing Practices, Final report.* June. p 181.

> The Authority's current 15% trigger is designed to cover major threats to GAWB's existence not a de-facto revenue cap arrangement which the arrangements in the other States resemble.

The form of regulation mechanism looks at differences between revenue received versus revenue allowed. In the case of GAWB, which operates under a hybrid revenue cap, the assessment related to *revenue allowed* is measured against the applicable dead-bands that are calculated with reference to GAWB's ARR. The assessment of differences is an annual calculation that is undertaken at the end of each regulatory year once actual revenues are known. The aggregate impact, being the sum of values associated with revenue being outside the dead-bands (i.e. the net figure), is either recovered from or returned to customers in the next 5 year regulatory period.

Prices are calculated based on forecast demand, but actual revenue received is based on actual demand. There is a risk that revenue recovery will deviate from the ARR simply because actual demand will not match the forecast demand used to set prices. The form of regulation mechanism (i.e. hybrid revenue cap) recognises this and has been put in place to share this risk between GAWB and its customers i.e. GAWB bears the first 10% of this risk. This variation in revenue is inherent within a regime that sets prices over a forecast horizon, based on a set of forecast inputs.

The form of regulation does not cater for variations to forecast opex or forecast capex under normal operating circumstances, as these levels have been assessed in terms of efficiency and prudency and GAWB bears 100% of the risk of varying from these forecasts over the regulatory period. This risk sharing mechanism is relevant to normal and anticipated operating circumstances. It does not contemplate a change in ARR.

The purpose of a review trigger mechanism is to update the revenue assessment mid-period to take account of unanticipated events, i.e. events that could not have been foreseen or anticipated at the time of the price review. Due to the unanticipated nature of such events, GAWB and its customers have no ability to pre-emptively manage these risks or include any risk sharing mechanisms to balance these risks.

For example, one such event could be the emergence of a new customer connection with a very high demand. The entry of an unanticipated high demand connection has the potential to also impact operating and capital expenditure. In these instances, an adjustment to the ARR may be necessary.

Accordingly, if a material increase in demand occurs, it would also likely be in the customer's interests to have this type of event trigger a review. As a material increase in demand is likely to result in a reduction in the price of water in the applicable pricing zones.

GAWB maintains the position set out in the regulatory submission for a demand based review trigger.

6.3 Procedures Regarding a Review Trigger

QCA's Approach

The QCA has sought clarification from GAWB on the procedures it would follow in the event of a demand based review trigger occurring and to make public the actions it would take, specifically the:

- methodology to determine a demand trigger event;
- effect of the event on its annual revenue requirement and aggregate revenue;
- interaction with the form of regulation; and
- timing of these actions.

According to the QCA, this would clarify the purpose of having two mechanisms, a demand-based review trigger as well as a hybrid revenue cap with a dead-band. It would also provide transparency to customers and offer structured protocols if such an event was to occur.

GAWB's Response

As noted above, the assumption that demand-based review triggers have the same effect as a revenue cap is not correct.

Irrespective of the nature of the review trigger, i.e. demand based or relating to a force majeure event, GAWB will adopt a process which is transparent and reflects accepted regulatory practice. In principle, the following steps would be followed by GAWB and associated outcomes set out in supporting correspondence with customers:

1. Identify event.
2. Collate information to determine whether the trigger event has met the threshold.
3. Develop the case for a review trigger and discuss with the GAWB Executive and Board.
4. Consider the timing of the event and the terms of the current Referral Notice.
5. Confer with customers.

The outcome of items 3 -5 will guide what occurs after this point and how any adjustments may be made.

If a review trigger was ever to be determined as appropriate, any resulting adjustments would be made in line with the regulatory framework in place at the time.

GAWB will consider further clarification as part of the next update of the Pricing Principles that form part of its contractual arrangements with its customers.

6.4 Materiality Threshold

QCA's Approach

The QCA has stated a preference for numerical materiality thresholds to be eliminated and for a qualitative process to be used to determine if sufficiently material impacts have occurred to GAWB's operations. Should this criterion be satisfied, GAWB should be eligible for a mid-period review.

GAWB's Response

GAWB does not support the QCA finding, as the use of numerical materiality thresholds compared to qualitative process are more transparent, easily reflected in GAWB's contractual arrangements with customers (including its Pricing Principles) and consistent with current regulatory practice.

6.5 Resolution of Pricing Disputes

QCA's Approach

The QCA notes that GAWB's water supply contracts include provisions for the parties to request the QCA intervene to resolve pricing disputes. However, the QCA is of the view that it would have to decline any request to intervene in a pricing dispute on the part of GAWB and/or a customer. This is due to the QCA not having the requisite statutory power to intervene in pricing disputes of this type.

Under Parts 6A and 7 of the QCA Act, the QCA's mediation and arbitration powers are primarily limited to disputes arising in relation to access and access agreements under Part 5 of the QCA Act and do not extend to monopoly business activities declared under Part 3 of the QCA Act.

The QCA believes this situation may leave customers facing a greater level of risk than they have initially envisaged at the time of entering into a contract with GAWB. That is, the customer may be expecting pricing disputes could be resolved by an independent regulator.

GAWB's Response

The terms of GAWB's contractual arrangements with its customers are confidential. Without discussing the terms of specific customer contracts, which may differ from GAWB's standard terms and conditions of water supply, GAWB would like to address the matters raised by the QCA.

As the QCA notes, GAWB's standard terms and conditions of supply provide that in the event of a pricing dispute, the parties may request the QCA intervene to resolve the dispute. However, it is somewhat disappointing that the QCA has failed to point out that this is part of a staged dispute resolution process, which involves four stages/steps. The first stage of that process involves executive negotiations. If they fail to resolve the dispute, the parties will request the QCA intervene to resolve the pricing dispute. If the QCA declines to intervene, or fails to respond within a specified time, then the pricing dispute is referred to mediation and then arbitration (if not resolved at mediation). A separate process applies for disputes related to matters other than pricing, which does not involve QCA intervention.

The QCA has flagged that it does not have statutory power to intervene in a pricing dispute between GAWB and its customers, and that its mediation and arbitration powers are primarily limited to disputes in relation to access matters. The QCA is concerned that customers may have an expectation that the QCA will intervene in all cases, and that customers may be exposed to greater risk as a result.

GAWB's customers are primarily sophisticated commercial and government entities, who are able to form their own views on, and seek legal advice regarding, the terms of their contractual arrangements with GAWB. Those arrangements are generally long term agreements, where regulatory oversight may change over time. Since GAWB's pricing practices were first referred to the QCA, the QCA's statutory powers have evolved, and GAWB expects this will continue to occur. Statutory bodies such as the QCA also generally have broad powers to act pursuant to directives from their responsible Ministers.

If a pricing dispute arises between GAWB and one or more of its customers, then in light of the QCA's regulatory oversight role, which informs the amount GAWB may charge, there is a significant likelihood that the dispute will relate to matters on which the QCA has expressed a finding or recommendation. For example, a dispute may relate to the proper interpretation of one of the QCA's findings as part of a price monitoring investigation. The QCA is not obliged to intervene in any such dispute, but GAWB considers it prudent that its contractual arrangements contemplate that, depending on the relevant circumstances and the QCA's statutory powers at the time, the dispute could be referred to the QCA for consideration.

In these circumstances, GAWB does not consider it necessary or appropriate to remove this 'step' in its pricing dispute resolution process under which the QCA may elect to intervene, if it has the necessary authority or power to do so.

6.6 Publishing the Standard Water Supply Terms and Conditions

QCA's Approach

The QCA noted that unlike some other water supply entities, GAWB does not publish its standard water supply terms and conditions on its website. The QCA suggests GAWB publish its standard water supply terms and conditions on its website.

GAWB's Response

GAWB's current practice is not to publish its standard terms and conditions of water supply.

GAWB has a small existing customer base and publicises its water supply operations and engages with the local and regional community to promote its services. It then engages with potential customers about their specific water supply requirements and business context, before determining whether its standard terms and conditions of water supply are suitable for the relevant customer.

Based on the outcomes of this engagement, GAWB then provides either its standard terms and conditions, or appropriately tailored ones, to new potential customers and negotiates with those customers on their terms of supply. This process enables GAWB to make prudent risk based decisions relating to its terms of supply, consistent with its statutory obligations and its responsibilities to its existing customers.

The terms of GAWB's contractual arrangements with its customers are confidential. Given the supply of water to some of GAWB's customers is governed by its standard terms and conditions of supply, the consent of those customers (and customers supplied on materially similar terms) may be required if GAWB was to publish its standard terms and conditions.

GAWB does not consider that publishing its standard terms and conditions of supply will provide the benefits set out in section 7.7 of the QCA Draft Report. In particular, the QCA has been able to, over a number of pricing reviews, successfully refer to relevant terms of GAWB's contractual arrangements with its customers in a limited way so as to respect confidential/commercial in confidence matters.

The other potential benefits identified by the QCA are addressed in the matters set out above.

7. Demand

The QCA has found GAWB's proposed demand forecast for the 2020-25 period to be reasonable, given they are based on the latest information, historical outcomes or trend and advice from customers.

Since submitting the regulatory proposal, GAWB has continued to work with each of its customers to discuss their future demand requirements, having regard to their reservations and operational plans.

At the time of drafting this response, GAWB has not received any information from its customers to warrant an adjustment to the demand forecast set out in the regulatory submission. The QCA has found the same forecast to be reasonable.

Subject to the terms of customers' contractual arrangements, there may be scope for the customers to adjust their current reservations prior to the finalisation of prices to apply from 1 July 2020. GAWB has recently written to customers, encouraging them to review their water requirements, given the material impact the demand forecast can have on bulk water prices.

GAWB will use the information provided through this consultative process to determine the bulk water prices that will apply for the 1 July 2020 to 30 June 2025 regulatory period.