QUEENSLAND Urban Utilities

SUBMISSION:

SEQ LONG-TERM REGULATORY FRAMEWORK REVIEW

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Queensland Urban Utilities ("QUU") is making this submission in response to the Queensland Competition Authority's ("QCA") two position papers for the Long Term Regulatory Framework Review for SEQ Water Entities – "Framework Position Paper" and "Pricing Principles Position Paper".

Framework Position Paper

Overall, QUU supports the move towards a regulatory framework that is light-handed in nature, with appropriate mechanisms in place to ensure that customers are protected against the potential misuse of monopoly power, and to encourage SEQ distributor-retailers ("DRs") to operate prudently and efficiently.

Having reviewed the QCA's Framework Position Paper, QUU considers that there are three broad issues that need to be addressed. These are:

- issues with the framework that need further clarity
- issues with the framework that need to change
- characteristics of good regulatory practice that are missing from the QCA's proposed framework

These issues are outlined in the diagram below.

Issues with the Framework that need clarity

- Application of CPI-X;
- Regulatory discretion;
- WACC;
- Determining the X-factor (will it change over time?);
- Level of justification required? (propose template?);
- Details on determination/cost of service review requirements;
- RAB Roll-Forward;
- Growth
- Setting of initial year for efficient costs;
- Under-recovery

Issues with the Framework that need to change

- Netserv Plan trigger;
- Prescribing asset management standard;
- Consideration for practicality of implementation;
- Minister setting price;
- Decline in service standards as trigger
(define materiality/threshold);

Aspects missing from Framework Paper

- Transparency – require a 'Framework Rules' document
- Adaptability/Flexibility – Periodic review of framework to see if Directions Notice objectives are being met
- *Accountability* – independent review of regulator's decision
- *Efficiency/Cost effectiveness* – of framework

QUU's detailed responses regarding each of the issues above, and other issues stemming from the Framework Position Paper are contained within the body of this submission.

Issues of particular significance to QUU are highlighted below:

Performance Monitoring Determination:

QUU suggests that the final recommendations from the review should be transferred to ("reside in") a determination made by the QCA. This determination (such as a "Performance Monitoring Determination") should contain the rules of the framework and the obligations of each party. Where further, more detailed, guidance to the DRs is needed in relation to specific obligations under the framework, such as the development of long run marginal cost estimates, the QCA should release guidance papers.

Including the Performance Monitoring Determination as part of the governance structure will assist the QCA in effectively administering the framework and provide a degree of certainty and predictability to the framework. This document would also set out how the QCA would use its regulatory discretion within the framework – i.e. what criteria will guide the QCA in using its discretion.

Independent review of regulatory decisions:

QUU proposes that an independent review process be introduced to the proposed framework. The QCA's decisions regarding the outcomes of cost of service reviews which may ultimately result in the application of heavy handed deterministic price regulation should be subject to a review by an appropriately qualified, independent body/group against the QCA's obligations as outlined in the Performance Monitoring Determination. This ensures that the regulator is held accountable for its decisions, and that it undertakes its administrative duties in a prudent manner. This process would need to be streamlined to minimise costs, however the costs should not be so minimal that it would lead to frivolous attempts by DRs to review regulatory decisions.

Periodic review of the framework/Performance Monitoring Determination:

QUU suggests that independent, periodic reviews of the framework be undertaken to assess the effectiveness, and the ongoing relevancy of the framework to the initial objectives as set out in the Direction Notice. Regulatory regimes need to be flexible and adaptable to take account of changes in customer behaviour, technological improvements, Government policy, operational improvements (or deterioration) and changes in environmental regulations. This review could focus on the Performance Monitoring Determination, with recommendations made for revisions to this document to ensure that the framework's objectives will continue to be met.

QUU suggests that this review be undertaken every 4-5 years, and could be undertaken by the Office of Best Practice Regulation (OBPR).

Cost Effectiveness of Framework:

The QCA will need to be cognisant of the intent of the Direction Notice and the proposed light handed framework, which is to minimise the regulatory burden and associated costs on DRs, while protecting consumers from the exercise of market power. When the CPI-X threshold is breached, the QCA will need to ensure that the level of information required to justify the breach is not disproportionate to the level of the breach.

At present, the QCA has not demonstrated how it will ensure that the costs of ongoing operation of the framework will not exceed the benefits of the proposed framework. A consideration of the cost effectiveness of the framework within the QCA's regulatory discretion (outlined in the Performance Monitoring Determination) will assist with ensuring the cost effective objective is met by the framework.

Netserv Plan:

QUU does not agree with the QCA's proposal that a full cost of service review is initiated when an entity's Netserv Plan is materially changed, as there is no link between the Netserv Plan and whether a business is exercising monopoly power. Also, the QCA's statement that undertaking a review is a 'stocktake of the effectiveness of annual performance monitoring'[1] is not clear, as there is no link between the Netserv Plan and the proposed framework itself. Therefore, QUU is proposing that the intention to undertake a cost of service review as a consequence of updating the Netserv plan be removed.

In its place, QUU suggests that there should be periodic independent reviews of the framework itself to consider whether the framework is meeting its initial objectives and what improvements or adjustments can be made. As discussed above, QUU suggests that such a review could be undertaken by the OBPR.

Overlap between different regulatory regimes applied to SEQ DRs

QUU has some concerns about the potential for the DRs to face conflicting or inconsistent regulatory objectives stemming from the interaction between elements of the QCA's proposed long term framework and developments in the Queensland Government's water policy more broadly. This includes in relation to infrastructure charging, the development of new water and sewerage service quality standards and a new water strategy for the State. QUU would like to see closer dialogue between the QCA and other regulators and Government policy departments in the water and sewerage sector to prevent DRs being placed in potentially adverse regulatory compliance situations beyond their control.

[1] Page 22, Position Paper – Long Term Regulatory Framework for SEQ Water Entities, February 2014

Pricing Principles Position Paper

QUU recognises that pricing principles can play an important role under both direct (deterministic) and indirect (light-handed) forms of economic regulation.

An acknowledgement is needed of the engagement that DRs may have already had with customers and key stakeholders in relation to pricing. This engagement forms a key part of the DRs consideration of pricing for their customer base. QUU has a set of internal pricing principles, developed in conjunction with our Customer and Community Reference Group and shareholders, to broadly guide the business for pricing-related decisions.

In light of this background and given the intended light-handed nature of the proposed framework, QUU considers that any pricing principles developed by the QCA should be for guidance purposes only. However, in QUU's view, the draft recommendations are generally quite prescriptive in nature, belying the intended light-handed nature of the framework.

QUU also considers that the QCA needs to clarify whether it expects the DRs to implement rather than have general regard to its draft recommendations, a number of which represent substantial tariff reform. In QUU's view, careful consideration would need to be given to the customer impacts of any major changes to existing water and sewerage pricing structures as required by the QCA. Previous pricing principles guidance from the QCA refers to the balance between efficiency and 'fairness' in price setting, with the status quo generally the benchmark against which consumers assess fairness. In light of this, careful consideration would need to be given to the customer impacts of any major changes to pricing structures on efficiency grounds.

In terms of the pricing objectives identified by the QCA, QUU suggests that these form the general pricing principles for the framework – thereby replacing those outlined in the Pricing Principles Position Paper. However the reference to 'taking account of public interest' objective needs to be reviewed as this is quite broad and encapsulates elements normally outside the operation of a water and sewerage business.

In addition to this, the Pricing Principles Position Paper considers aspects that QUU considers either outside the scope of a pricing principles paper (i.e. demand forecasting), have little relevance to the DRs (i.e. the introduction of scarcity charging and tradeable urban water entitlements) or are covered through other mechanisms (i.e. metering and billing arrangements and hardship). QUU considers that the inclusion of these aspects detracts from the overall purpose of the Pricing Principles Position Paper, which is to provide guidance to the DRs on appropriate tariff structures for water and sewerage services.

1. INTRODUCTION

Queensland Urban Utilities (QUU) is pleased to be making this submission to the Queensland Competition Authority's (QCA) review of the long term regulatory framework for the SEQ water entities. QUU considers it important to ensure that the governance and application of a regulatory framework is effective.

The Ministerial Direction requires that the overarching regulatory objective of the long term framework is:

> *'To protect the long term interests of users of water and sewerage services by ensuring the prices of these services reflect prudent and efficient costs, while promoting efficient investment in and use of those services having regard to service reliability, safety and security over the long term'.*

QUU agrees with this overarching objective and given this, we envisage a long term, light handed regulatory framework without the burdensome requirements of the interim price monitoring regime, which saw extensive, annual reviews of costs.

QUU looks forward to providing input during this review, and participating in the discussions to shape the long term regulatory framework.

1.1 Who we are

QUU is a statutory body established in July 2010. QUU is the largest water and sewerage DR in South East Queensland. We are jointly owned by the Brisbane and Ipswich City Councils, and the Lockyer Valley, Scenic Rim and Somerset regional councils.

Governed by an independent Board, our primary role is to deliver drinking water, recycled water, and sewerage services to the urban cities and rural townships across our five service territories. We are also one of the largest water and sewerage DRs in Australia, with our service territory size being 14,384 square kms, and the population of our service territory being over 1.3 million

As at 1 January 2014, we had:

- Over 515,000 residential water customers and just under 37,000 non-residential water customers. $4.9 billion worth of infrastructure which included:
    - 125 water reservoirs
    - 41 water pump stations
    - 107 water boosters
    - 336 sewage pump stations
    - 27 sewage treatment plants
    - 8,967km of water mains
    - 9,152km of sewerage mains.

During the 2012/13 financial year, we delivered 133,000 mega litres of potable water, and collected and treated 128,000 mega litres of sewage.

1.2 Our commercial environment

The service that we provide is an essential infrastructure service that supports economic advancement in our region, as well as enhancing the wellbeing of our communities.

Since its establishment, QUU has understood the need to provide a service that brings value to our customers. Delivering value means providing a service that is safe and reliable, at the lowest cost possible. It also means, understanding our customers and delivering the services that they need.

The drive to operate at the lowest cost possible has seen QUU undertake a number of initiatives to achieve operational efficiencies and achieve savings for our customers. The most recent initiatives have been:

- The Enterprise Excellence Program - a QUU, whole of business, improvement program, focussing on key areas of our business to improve operational efficiency and deliver better customer service,
- A review of strengthening a number of our governance frameworks relating to capital planning and delivery, asset management and risk management.
- An organisational restructure to allow for the streamlining of and alignment of business functions and activities.

1.3 Structure of this Submission

This submission has been structured as follows:

- Section 2 - discusses issues relating to the governance of the regulatory framework.
- Section 3 – responds to the QCA's Long Term Framework position paper, with various sub-sections relating to specific issues raised by the QCA.
- Section 4 responds to the QCA's pricing principles paper.

We note that a Technical Paper has subsequently been released by the QCA in June, however this was not able to be incorporated within this submission. A separate submission will be provided to the QCA in relation to that paper.

1.4 Consistency of Terminology

Throughout the Long Term Framework Position Paper, the QCA has used various terminologies to define processes, parameters and issues. QUU suggests that the QCA should adopt a consistent terminology throughout the document to assist readers understand their position.

As an example, the QCA uses the following terminology in the document, *"performance monitoring investigation", "regulatory review", "detailed review", "price review" and "cost of service review"*.

The use of this terminology causes confusion as to which review the QCA is referring to, given that under the proposed long term framework there is likely to be the potential for multiple reviews.

2. ECONOMIC REGULATION FRAMEWORK

2.1 Importance of Effective Regulation.

Queensland Urban Utilities understands the need for effective economic regulation to be applied in relation to the SEQ water distributor and retail sector. We understand that in an industry where there is limited scope for competition, regulatory oversight of some form is likely to be necessary to protect the interests of customers against the potential risk of market power being exercised.

For regulated entities, effective economic regulation has a number of benefits. Where regulation and price setting is independent of Government, prices are likely to be based on economic efficiency principles and take into consideration the long-term financial viability of the entity. Furthermore, when regulatory regimes are established with the appropriate incentives and penalties in place, it encourages firms to innovate, become more efficient and increase productivity. All of which benefit customers.

However, it is a widely accepted view that regulation is a second best outcome when compared to the outcomes observed in competitive markets. Therefore, it is important that where economic regulation is applied, its form is commensurate with the available evidence regarding the exercise of market power. Hence, if the available evidence indicates that market power exists, but it has not been exercised, a more light handed form of economic regulation is likely to be appropriate. This recognises that the imposition of economic regulation imposes both direct (administrative) and indirect costs, including the risks associated with regulatory error. Some potential risks from flawed regulatory regimes can include:

- prices being set without regard for the efficient cost of service delivery, thereby risking the long term financial viability of regulated entities. This places customers at risk of receiving poor or declining service standards, and potentially receiving significant price hikes in the future.
- discouraging innovation and the drive to seek operational efficiencies
- lack of an independent appeals or review process to hold regulators accountable for their decisions
- the cost of economic regulation becomes burdensome and exceeding its potential benefits

From this perspective, it is important to get the regulatory framework right.

In a soon to be released study undertaken by Frontier Economics for the Water Services Association of Australia (WSAA) on the economic regulation of the urban water industry in Australia, Frontier Economics outlined key features and principles of best practice regulatory regimes. These are outlined below in Table 1.

Table1: High-level principles/characteristics of effective regulation[2]

Principle	Implication for regulatory framework
Clarity of objectives/focus	Economic regulators should have clearly specified and prioritised objectives concentrated on protecting the long-term interests of end users of infrastructure services. The role of economic regulators should be focussed on outcomes rather than specified inputs or tools by ensuring the operation of well-functioning and contestable markets where appropriate or by designing a system of incentives and penalties that replicate as far as possible the outcomes of competitive markets
Efficiency/cost-effectiveness	Regulatory interventions should be proportionate and cost-effective to ensure that the benefits from regulation outweigh the costs Compliance costs should be minimised through avoiding delays and excessive information requirements and undertaking regulatory reviews in a timely manner Unnecessary duplication between regulators should be eliminated
Consistency/predictability	The framework for economic regulation should provide a stable and objective environment (e.g. well-defined decision making criteria and clear timetables) enabling all those affected to anticipate the context for future decisions and to make long term investment decisions with confidence The framework of economic regulation should not unreasonably unravel past decisions, and should allow efficient and necessary investments to receive a reasonable return, subject to the normal risks inherent in markets Ensure consistency of treatment of participants across service sectors, over time and across jurisdictions
Accountability	Roles and responsibilities between Government and economic regulators should be allocated in such a way as to ensure that regulatory decisions are taken by the body that has the legitimacy, expertise and capability to arbitrate between the required trade-offs Regulatory decisions should be subject to appropriate scrutiny and challenge including effective appeal mechanisms
Transparency	Decision-making powers of regulators should be exercised transparently (e.g. reasons for decisions clearly articulated and publicly available) and with procedural fairness Explain rules about the treatment of confidential information
Adaptability/flexibility	The framework of economic regulation needs capacity to evolve to respond to changing circumstances and continue to be relevant and effective over time Where possible use a goals-based approach, giving businesses flexibility to decide how best to achieve clear targets
Independence	The regulator should ideally be free of conflicting objectives and independent of both the policy processes of government and stakeholders and the operational activities of businesses . Ensure regulatory decisions are free from undue influences that could compromise regulatory outcomes

[2] P.17-18, Improving economic regulation of urban water – Frontier Economics, expected release of August 2014

Capability	Ensure regulators have appropriate expertise and resources to effectively undertake their functions
Coherence	Regulatory frameworks should form a logical part of the Government's broader policy context, consistent with established priorities Regulatory frameworks should enable cross-sector delivery of policy goals where appropriate

In the table below, QUU has undertaken a high level assessment of QCA's proposed long term framework, against the principles outlined in the table above.

Table 2: QUU High Level Assessment of QCA's Proposed Framework against best practice principles identified by Frontier Economics.

Principle	QUU's Views
Clarity of objectives/focus	QUU understands the QCA's objective of protecting customers from the potential misuse of market power by DRs . Other objectives are also that prices should be efficient and services should be delivered at appropriate service standards. It is also important that the long term financial viability of DRs is maintained. However, these objectives becomes unclear when the QCA is proposing that the framework allows the Minister to set prices where there is an imperative to manage short term cost pressures. Where prices are to be set by Ministerial powers, it is less likely that efficient costs will be considered. Therefore prices set in this manner result in prices that provide misleading price signals to customers and providers of water and sewerage services, it will likely encourage inefficient consumption of resources, lead to underinvestment and a decline in service standards. Also, the incentives and penalties that the QCA is proposing to introduce to influence SEQ Water entities to operate efficiently need greater clarity. e.g. Pricing Principle priorities, guidance needed on efficiency vs. equity e.g. Guidance needed on Service Standards. Are some indicators more equal than others?
Efficiency/cost-effectiveness	QUU understands and supports the move towards a more light handed approach. This should potentially reduce the regulatory cost on DRs. The cost effectiveness of this regulatory regime also depends on how the QCA uses its discretion when DRs exceed the proposed CPI-X threshold and whether a cost of service review is triggered. QUU is of the view that the cost effectiveness of this proposed light handed regime will depend on the QCA's use of regulatory discretion in monitoring the performance of DRs.
Consistency/predictability	Greater detail of rules and how QCA will apply those rules is required. Binding Rulings will assist in providing predictability, where DRs receive decisions on proposed expenditure that may contribute to increasing aggregate costs (maximum allowable revenue) above CPI-X.
Accountability	The proposed long term QCA framework does not propose a mechanism for the challenge of its decisions or outcomes through an independent appeals panel.
Transparency	At this current stage, the decision-making process, the timings of that process and the criteria for decision-making, is light on detail. QUU suggests that further details be revealed and outlined in a stand-alone Performance Monitoring Determination. Details of the proposed Performance Monitoring Determination are explained further in section 2.3 of this submission.

Adaptability/flexibility	QUU agrees that the proposed long term framework attempts to be flexible and adaptable. QUU suggests that to assess the currency and relevance of the framework over time, it should be subject to periodic independent review e.g. every 4-5 years. This is discussed in detail in section 2.3 of this submission.
Independence	The QCA's proposal to introduce Ministerial powers to set prices contradicts the independency of the framework.
Capability	QUU is of the view that the QCA is appropriately staffed and has the relevant expertise.
Coherence	QUU is satisfied that this review is a part of the Government's broader policy framework to protect the long term interests of customers of SEQ water and sewerage services.

2.2 The level of regulation

QUU agrees with the underlying intent of the proposed long term framework. That is, it should be light handed in nature, with appropriate arrangements in place to allow the QCA to monitor DRs' performance, and if the available evidence indicates the exercise of substantial market power, seek to apply a heavier handed form of regulation.

The move away from the interim price monitoring regime is welcomed by QUU for a number of reasons including:

- shortcomings of previous regime
- no evidence of the exercise of market power
- internal and external drivers of business performance

These are discussed below.

<u>Short-coming of previous regime</u>

The interim price monitoring regime which applied from 1 July 2010 had two significant short comings.

Firstly, it required an annual review process which involved the preparation and submission of detailed annual returns to the QCA. These annual returns and the QCA's subsequent reviews of these annual returns required QUU to devote significant time and resources to the process to demonstrate that it was operating in a prudent and efficient manner. This did not make sense, given that a framework which was light handed in name ("price monitoring") was actually heavy handed in its application. Given that these reviews occurred on an annual basis, it meant that it was more heavy handed than the price deterministic regimes seen in other Australian jurisdictions.

Secondly, the regulatory framework was neither an ex-ante nor ex-post regime. Regulatory reviews for a particular financial year concluded and recommendations made on the 30th of March. This meant that it was impractical for QUU to implement any of the QCA's recommendation prior to the financial year ending in June.

No Evidence of Exercise of Market Power

In the period from July 2010 to June 2013, the QCA found no evidence of abuse of market power by QUU. In its review of QUU's projected costs and revenues from July 2013/14 – 2014/15 the QCA also arrived at the same conclusion, that no market power is being exercised. From 1 July 2010 to June 2013, QCA assessed that QUU under recovered allowable revenue by over $74 million. For the regulatory period from 1 July 2013 to June 2015, the QCA has determined that QUU is expected to under recover by $177 million.

Therefore, the proposed light handed approach is appropriate for QUU and other DRs in SEQ given that most utilities have been observed to be under-recovering significantly.

Internal and External Drivers of Business Performance

There are also significant internal and external drivers for QUU to keep prices down and maintain service standards. Two important external drivers are the public scrutiny we are subject to, and the oversight of our shareholding councils over our operations and decisions.

As a provider of an essential community service, QUU's prices and service standards are subject to scrutiny by our communities, local businesses, media organisations, and State and Local Government. This level of public accountability ensures that QUU does not behave in a monopolistic manner within the light handed framework. It can be seen from the recent experience with Allconnex that public scrutiny can be a strong factor for DRs.

Furthermore, our governance structure of QUU acts to prevent any exercise of market power. Our shareholding councils are strong advocates for our customer base and play an important role in ensuring that sufficient tension is placed on our operations to ensure the provision of water and sewerage services to the required service standards at a reasonable price. The competing tensions also hold QUU to account, with the business having to ensure financial viability through maintaining an investment grade credit rating such that we can continue to raise the funding necessary to undertake appropriate network investment. It is important that, as a business, QUU delivers balanced outcomes for both our customers and our shareholders.

With regard to internal drivers for operational efficiencies, QUU understands that it provides an essential service. Therefore since our establishment on 1 July 2010, we have undertaken various initiatives to reduce costs and ensure that our customers pay the lowest price possible and receive these services at appropriate standards of service.

A number of these initiatives have been highlighted in section 1.2 of this submission.

Threshold Regulation

Given the presence of internal and external drivers for operational efficiency, and the fact that QUU and other DRs are under recovering significantly, QUU does not understand the need for a CPI-X threshold as proposed by the QCA.

The QCA's proposed light handed framework is effectively a threshold based form of regulation, whereby any increases in the weighted average price and/or economic costs (in the form of maximum allowable revenue) above a CPI-X threshold will trigger further detailed information provision and justification by the DRs.

In light of this, QUU raises the following issues that it would like clarified.

Firstly, at what level does the threshold need to be set? If a threshold is needed, does that threshold need to be stricter than CPI-linked annual increases in relation to both prices and maximum allowable revenues?

Secondly, what level of justification is required for any breach of the threshold?

2.3 Governance of the long term regulatory regime

QUU is of the view that good governance of the long term regulatory framework is needed to provide DRs with guidance and confidence to operate prudently and efficiently.

As the proposed framework currently stands, there are some governance issues that need to be strengthened. This was alluded to in Table 2 above. A number of these relate to the lack of detail surrounding procedural fairness, accountability, consistency in decision making and independence. These are discussed in greater detail below.

"Framework Rules"

In price deterministic and price monitoring regimes seen in other Australian jurisdictions, regulatory policies and frameworks are enshrined in legislation and further supported by both legislative and regulatory instruments (e.g. Orders, Codes, and Guidelines) which provide further clarity on various components of the regulatory framework.

Matters such as regulatory processes, the timing of these processes, the basis for detailed reviews of revenues and costs, the justifications and mechanisms for price adjustments, carry forward of over or under recoveries, how or why regulatory frameworks or parameters can be adjusted or reviewed, the investigative powers of the regulator and the penalties that apply are all clearly laid out.

Rules set out in this manner ensure that the regulatory regime is clear and unambiguous, and that the regulated entities understand what their obligations are. In addition, it also holds the regulator to account for its decisions.

QUU suggests that the framework for the performance monitoring regime be appropriately established with the rules of the framework clearly documented. QUU suggests that this should be a separate document from the Final Report.

This would mean that the Final Report from the QCA review would most likely have the justification of the findings for the framework resulting from feedback on the Position Papers, with QUU suggesting that a Performance Monitoring Determination be developed as a separate document that is concise, sets out the rules of the framework and is unambiguous in terms of the requirements and obligations under the framework.

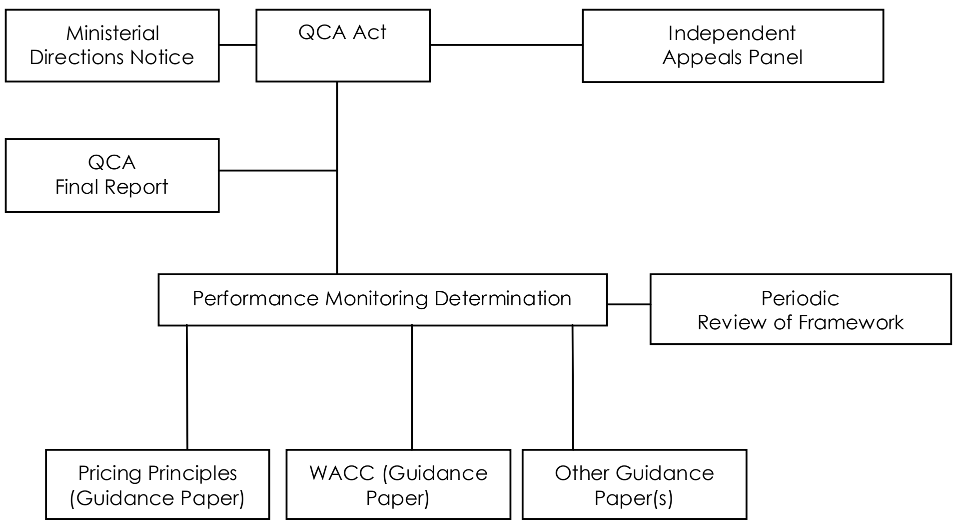
QUU suggests this could be in a form similar to the Price Monitoring Determination that is established by the Essential Services Commission of Victoria for the regulation of ports in Victoria. This document would set out:

- the obligations on all parties in relation to the framework,
- how decisions would be made by the QCA,
- what processes (and their timing) are to be followed and,
- when a review of the framework should occur

  Where rules established within the Performance Monitoring Determination require further clarity, guidance papers can be issued.

This governance structure is shown in figure 1 below.

Figure1: Potential Governance Structure for Light Handed Framework



Ultimately, QUU needs assurance that the light-handed framework is as intended by the Directions Notice and it is essential that all parties understand their obligations under the framework and how it will operate prior to it being implemented.

<u>Periodic Review of Light-handed framework</u>

QUU suggests that the long term framework should be subject to periodic independent review. This review would consider whether the framework is meeting its initial objectives and what improvements or adjustments can be made to improve its effectiveness. The basis for such a review could be the Performance Monitoring Determination (suggested above) with the review suggesting changes to this document that provides the rules for the framework.

The potential cost of this review would need to be considered in determining how it would be undertaken and how often.

QUU suggests that such a review could be undertaken by the Office of Best Practice Regulation (OBPR), to provide some level of separation and appropriate governance.

Accountability for Regulatory Discretion

QUU appreciates the requirement to have a credible threat of heavy-handed regulation under a light-handed framework. We also understand that a certain degree of regulatory discretion is required within a regulatory framework to ensure there is sufficient flexibility over time to account for unknowns events at the time of developing the framework.

However, the flipside of regulatory discretion is that it has the potential to create inconsistencies in regulatory decision-making and can lead to regulatory uncertainty for the regulated businesses.

Therefore QUU suggests that further information and detail should be incorporated (ideally within the proposed Performance Monitoring Determination discussed above, which prescribes the rules of the framework) that sets out how regulatory discretion will be applied (i.e. what will be given consideration – such as cost of alternatives, etc.)

It is important to ensure that it is clear within the framework how the regulatory discretion will be applied, due to the fact that while the long term regulatory regime is proposed to be a light handed regime, the presence of deterministic elements within the overarching framework, such as a cost of service review and price determination gives rise to significant concern. Very little is known about the details of the framework.

To be clear, QUU understands that there needs to be mechanisms within the regulatory framework which incentivises DRs to maintain cost discipline, operate prudently, and continue to seek further efficiencies in the long run. The threat of price determination serves this purpose within the framework. However, QUU's concerns are that the detailed rules that should accompany this proposal remain ambiguous at this point in time. It is hoped that as the overarching review progresses, these details will become clear.

Independent Review Mechanism

In some deterministic regimes, the presence of an independent review process further strengthens the regulatory framework and process by ensuring that the regulator is held accountable for its decisions. The regulator's decision can be challenged without the need to resorting to potentially costly and extensive judicial review.

However, in Queensland, no such formalised independent review process exists (other than judicial) and none have been proposed in the light handed framework. This is a cause for concern, especially where the proposed framework, while light handed in nature, will still have deterministic elements that require the QCA to exercise discretionary judgement. If the QCA deems that a business has operated inappropriately and decides to undertake a cost of service/deterministic review to set prices for the businesses, there is no way of the businesses having an independent review of this decision if they disagree with the QCA's decision.

The QCA will be making decisions on whether cost of service or detailed reviews is required, and eventually the QCA will be determining the prices that will apply, how long they will apply for and the transition arrangements back to a light handed framework. All of this will happen without the QCA's decisions being subject to independent scrutiny.

QUU is of the view that an independent review process will only seek to strengthen the framework, as it will ensure that the QCA will only undertake cost of service review and pricing determination reviews if it has a strong case that an entity is abusing monopoly power.

Therefore QUU suggests that the QCA introduce a formalised independent review mechanism. Such a process would clearly need to be cost effective and also need to ensure frivolous challenges/appeals do not occur.

This review mechanism would hold the use of regulatory discretion to account and ensure that the intent of the framework is maintained.

Characteristics of an effective appeals mechanism are:

- Independent process –the process should be independent from the economic regulator.
- Appeals Body – the appeal should be heard by a panel of experts with relevant experience. The appeals body will need to be empowered to review the economic regulator's decision.
- Timely – the process should be, as far as practically possible, expedient. This means having deadlines for making initial submissions to the appeals body, responding to the appeals panel with any new information or counter submissions and the final decision from the appeals panel.

QUU considers this an important aspect of the overall framework.

<u>Greater Interaction between Regulators</u>

The economic regulatory framework administered by the QCA is just one of many regulatory regimes that QUU is required to comply with. For example, QUU is obliged to comply with water quality (i.e. safety) and environmental regulations.

Where overlap exists between different regulatory regimes, it would be far more effective for regulators to co-operate and co-ordinate their activities. From a regulation standpoint, co-operation between regulators could potentially cut costs as they chase common objectives.

On another note, decision and policy making undertaken without consulting other regulators could potentially lead to the scenario where DRs are pursuing conflicting and inconsistent goals. This is an inefficient outcome. A potential scenario for this is the impact of changes to infrastructure charges on ongoing utility charges. A reduction in infrastructure charges through changes in Government policy will result in an increase in ongoing utility charges, and could potentially result in QUU breaching the QCA's threshold.

For the reasons outlined above, QUU would like to see greater dialogue between the QCA and other regulators in the water and sewerage sector.

Cost effectiveness of Framework

An objective of the light handed regulatory framework is to decrease the regulatory burden and cost on DRs. Therefore in administering the framework, the QCA will need to be cognisant of this light handed intent, especially where there are breaches of the CPI-X threshold and the QCA is requesting further information from DRs to justify the breaches. These information requests should not place unnecessary burden on the DRs.

3. REGULATORY FRAMEWORK POSITION PAPER

3.1 The Long-term regulatory framework

On the whole, QUU supports the Queensland Government's objective for a light handed, regulatory framework to be applied to the SEQ DRs, as envisaged in the Directions Notice. QUU agrees that the long term framework should be based on the provision of key information to the QCA relating to prices, costs, revenues and service quality, combined with the threat of heavier handed regulation should it be determined that an entity is operating in a manner that is consistent with exercising monopoly power.

However, while QUU supports the broad direction of the long term framework position paper, QUU has concerns about the lack of detail and clarity with regard to the application of various elements of the framework. Examples of areas where we are seeking clarification are:

- Cost of service reviews and the detailed reviews – details on the timelines and processes
- Cost of capital – how will this be determined?
- The application of, and calculation of, the X-factor
- Nature of Information Template
- Service standards – how will the QCA define significant deterioration of service standards?

QUU's concerns regarding the above issues are discussed further below. The structure of this section of our submission follows the QCA "Framework Position Paper"[3].

3.1.1 Approaches to economic regulation

Issue: "Limited" reviews

In Section 3.2, the QCA comments that: [4]

> *"no evidence of an exercise of market power has been found in the (limited) reviews of Unitywater and QUU over the 2010-13 period".*

QUU disagrees with the use of the word 'limited' to describe the reviews undertaken from 2010-13. The annual reviews were in fact detailed and extensive, and required QUU to devote significant amounts of resources to the QCA to demonstrate that it was operating prudently and efficiently.

During the reviews, QUU made available to the QCA and its consultants, members of its executive leadership team, senior managers, project managers, key planning engineers and management accountants. The QCA also engaged engineering consultants to review and provide reports on QUU's capital and operating expenditure programs.

[3] "*Position Paper - Long Term Regulatory Framework for SEQ Water Entities*", QCA, 2014

[4] page 11, paragraph 3, Ibid

Later in the report, the QCA comments that: [5]

> *"there is significant time, effort and cost dedicated to annual detailed regulatory reviews of expenditure"*.

This contradicts its statement about "limited' reviews. QUU suggests that the word 'limited' be removed from the paragraph mentioned above, and replaced with the word "detailed".

Draft Recommendation 3.1

QUU agrees with draft recommendation 3.1 that an indirect (light handed) approach to regulation be adopted for the longer term and notes that this is clearly the intent of the Directions Notice. However, having said that, QUU is of the view that while the long term regulatory framework should be light handed in nature, this should not be synonymous with having a framework that is light on detail with regard to how it will function, and how the QCA will apply various elements of that framework under different scenarios.

As outlined earlier in this submission in section 2.3, a clear governance structure and associated obligations on the relevant entities need to be established and documented, this being incorporated in a Performance Monitoring Determination.

Draft Recommendation 3.2

QUU agrees partially with the draft recommendation 3.2, that where a DR's performance is deemed to be unacceptable, the QCA should set prices directly. The threat of heavier handed regulation will continue to incentivise DRs to operate in a fiscally disciplined and prudent manner under the new framework. However, the QCA needs to provide further details on how it will define unacceptable performance. This means that the QCA should establish (ex-ante):

- clear processes and rules for the cost of service review, and
- the price determination process, to provide DRs with certainty as to how the review process will take place.

With regard to the remaining parts of the recommendation, the QCA does not define who the cost pressures relate to. Do the cost pressures relate to the costs incurred by DRs in supplying water and sewerage services? Or do they relate to the cost pressures faced by QUU's customers and the wider community in terms of paying for water and sewerage services?

Moreover, QUU does not understand the need for a provision for the Minister to set prices to form any part of the long term regulatory framework, as these powers already exist within the broader policy framework. This is evidenced by the State Parliament enacting the *Fairer Water Prices for SEQ Amendment Act 2011*, which capped price increases at CPI for 2011/12 and 2012/13.

Given that Parliament already has broad powers to set prices outside of the proposed long term regulatory framework , QUU does not understand what purpose an instrument such as this will serve within the framework.

[5] page 21, paragraph 3, Ibid

QUU suggests that references to the Minister setting prices be removed.

Draft Recommendation 3.3

QUU has no issue with the draft recommendation that transition arrangements may apply. QUU also notes that it has met the proposed transition arrangements through the QCA's draft assessment.

3.1.2 Form of regulation and the appropriate form of regulation for SEQ entities

Issue: "Definition of Certain Costs"

The QCA comments in section 3.4, that: [6]

> *"…annual monitoring and reporting be undertaken by the (independent) QCA of the entities' performance against a range of measures including prices, revenues, certain costs (including efficiency targets)….."*

It is unclear what the QCA is referring to with the use of the words "certain costs". If a threshold is required on costs, then QUU's position is that economic costs (Maximum Allowable Revenue (MAR)) would be monitored to ensure that small swings and roundabouts in disaggregated cost items do not influence the outcome.

Also, QUU does not understand what is intended by the term 'efficiency targets'. The CPI-X mechanism proposed by the QCA is an information threshold, whereby the DRs will need to provide justification to the QCA if any annual increase in their weighted average prices exceeds the increase in the CPI-X.

Given that CPI-X is an information threshold and the overall purpose (as stated by the QCA on p.38) of the framework is to track the businesses' performance, QUU does not understand why the term 'efficiency target' is being used in this context.

Issue: "Netserv Plan Update"

The QCA comments that: [7]

> *A cost of service review is otherwise recommended to be scheduled when an entity's Water Netserv Plan is updated, which, under legislation, is required at least every 5 years (see Chapter 6). This is in effect, a stocktake of the effectiveness of annual performance monitoring over the preceding period- the QCA will not proceed with the scheduled review if the changes to the Water Netserv Plan (endorsed by the Minister and councils) are not material and do not warrant a full cost of service review.*

QUU disagrees with this trigger being included in the long term framework as it has no relationship to whether any of the businesses are operating in a monopolistic manner.

[6] paragraph 2, page 22, Ibid
[7] last paragraph, page 22, Ibid

The QCA's statement that this is a *"stocktake of the effectiveness of annual performance monitoring"*[8] does not make sense, as there is no link between the Netserv Plan and the proposed framework itself.

As discussed in section 2.3 of this submission, QUU suggests that this trigger be removed from the framework and be replaced with a review of the framework itself.

Issue: Regulatory Certainty

In section 3.4, the QCA comments that it: [9]

> *"…agrees that regulatory certainty is an important objective and the commitment to a long-term performance monitoring framework is consistent with such a requirement. The recommended approach recognises the low risk of misuse of market power and the costs of more intensive regulation".*

QUU agrees that regulatory certainty is an important objective; however, QUU does not consider the commitment to a long-term performance monitoring framework of itself provides regulatory certainty. Regulatory certainty also requires certainty in terms of how a framework is administered, including certainty of regulatory decision making processes and the associated outcomes.

Even where the rules of the performance monitoring regime are clearly outlined, the QCA may still have significant scope for regulatory discretion. It is the application of this discretion within the framework that will either bring regulatory certainty or introduce uncertainty into the regulatory framework.

For example, under the proposed framework, the QCA will need to make a judgement on the materiality of a breach of CPI-X to decide whether further information is needed to demonstrate the reasonableness of the breach. It is in such a scenario that the businesses require an understanding of the criteria that the QCA will use in determining materiality. QUU suggests that a consideration of the costs and benefits of undertaking a cost of service review for the specific breach is incorporated in these criteria.

Issue: Scrutiny of Innovation

In section 3.4, page 23, bullet point (g) does not make sense. Could the QCA provide further discussion and explanation on this point including how it will impact on the details of the long term framework, if any?

Draft Recommendation 3.4

QUU agrees that in the longer term, a lighter-handed form of regulation should apply; however, QUU reiterates the comments in section 2.3 of our submission about the need to have a clear, transparent, detailed framework that minimises ambiguity and ensures that its ongoing application continues to be light handed.

[8] Last paragraph, page 22, Ibid
[9] bullet point (a), page 23, Ibid

Draft Recommendation 3.5

QUU agrees with the concept that a light handed framework be complemented by the prospect of heavy handed regulation being applied in the event of a substantial degree of market power being exercised. However, the grounds upon which any such decision about the exercise of market power will be made by the QCA needs to be clearly understood by the DRs prior to the implementation of the long term framework

Draft Recommendation 3.6

QUU acknowledges the need for these amendments.

3.1.3 Key elements of the long-term framework

Issue: Timing for detailed review and pricing determination

The QCA statein section 3.5.1 that: [10]

> *As a detailed review and price determination will require a greater level of information and analysis compared to performance monitoring, such a review will typically take up to 12 months. Any such review should be announced at the time of the Final Report in any year (that is 31 March). It is recommended that during the investigation, the retail and distribution component of prices be frozen (real terms).*

QUU seeks further explanation from the QCA as to how this will actually be applied in practice. In particular, is the QCA proposing that the retail and distribution component of prices would be frozen at the level applying at 31 March of the relevant financial year and could not be increased on 1 July in the subsequent financial year when the QCA's review is undertaken?

In addition, the QCA refers to seeking "a greater level of information" in the event that a detailed review is undertaken. QUU suggests that the QCA outlines the information requirements for such a review as part of the long term framework (this could be done through a document such as a Performance Monitoring Determination, raised earlier in the submission).

Draft Recommendation 3.7

QUU agrees with draft recommendation 3.7, that light handed monitoring be undertaken on an ex-post annual basis.

Draft Recommendation 3.8

QUU agrees with draft recommendation 3.8. However, as noted earlier in our submission, greater detail is needed regarding the timing and processes of cost of service reviews, and detailed price determination reviews. Furthermore, this timing should not preclude the QCA from releasing its Final Report for a DR earlier than 31 March.

Draft Recommendation 3.9

QUU agrees with the proposed timing of the first submission being 30 October 2015.

---

[10] *1st Paragraph, page 28, Ibid*

Draft Recommendation 3.10

QUU agrees with the proposed timing of the release of QCA annual performance reports. However, it is unclear as to how this timeframe will work following any decision to undertake a cost of service review.

QUU interprets this draft recommendation as follows; the QCA's Final Report in March 31 would signal the need for a cost of service review to commence. This review would commence sometime after 31 March in the relevant year, with a real price freeze for the duration of the cost of service review, and the detailed determination process that may follow the cost of service review. QUU requests further information how this timing would work.

As stated above, given the intended light-handed nature of the long term framework and the possibility of limited review by the QCA, QUU suggests that it should be stated that the QCA can release the reports earlier if analysis is completed early.

Draft Recommendation 3.11

QUU has no issue with this draft recommendation, except for the fact that the QCA should specify what types of circumstances would justify a shorter period.

Also, there is an inconsistency between draft recommendation 3.11 and the discussion preceding it in the Framework Position Paper [11]. QUU suggests that the discussion before the draft recommendation should be adjusted to reflect 'a shorter period' as opposed to 'unless specific circumstances justify otherwise', because this wording could imply a period greater than 5 years.

Draft Recommendation 3.12

While QUU does not have an issue with this draft recommendation, the QCA needs to clarify how this will actually work in relation to timing and processes – i.e. when would a decision be made, what year of pricing would it apply to, and what measure of CPI would be used to keep prices fixed in real terms?

Draft Recommendation 3.13

QUU agrees with the draft recommendation allowing a DR to seek a binding ruling from the QCA. However, further information is needed to understand its operation. In particular, what are the initiatives for the binding rulings that the QCA are referring too?

These details need to be incorporated in the long term framework documentation so that entities can seek binding rulings from the QCA with clarity.

Furthermore, QUU seeks clarification on whether the request for a binding ruling is intended to form part of the annual reporting. Should this be the case, QUU is of the view that this would be restrictive and impractical, as the request for a binding ruling should be able to be made at any time. While entities should be able to seek binding rulings at any time, QUU recognises

[11] Last paragraph, page 27, Ibid

that DRs will need to be cognisant of the time and resources needed by the QCA to assess the information and make a ruling with respect to the future time period being considered.

Draft Recommendation 3.14

QUU agrees that the QCA should be bound by its binding ruling provided that there are no significant deficiencies of fact later found to exist at the time of a submission.

Issues: Achieving CPI-X

In relation to establishing the CPI-X threshold, the QCA states in section 3.5.2 that:[12]

> *The appropriate X factor/s will be reviewed in a separate report by 30 May 2014, in consultation with the entities.*
>
> *If achieved over a regulatory period there would not appear any evident reason to review an entity's performance – subject to there being no major changes in the market for water services or technology.*

The QCA is implying that even if CPI-X is not breached, the QCA may still trigger a review if it considers that there were major changes in the market or technology. QUU suggests that such an open-ended review trigger is not appropriate, and seeks further explanation on this matter from the QCA.

Issue: Summary of Risk and Recommended Allocation and Mechanism

QUU does not understand the purpose of Table 6 on page 33. The QCA discusses revenue and price caps in a manner that is befitting of deterministic regimes.

Regarding the 1st recommendation within Table 6, the QCA discusses price caps with triggers for material changes in volumetric and fixed charges. QUU considers that this is not appropriate for the light handed framework being developed. Triggers should only be associated with the increases of weighted average prices above the CPI-X threshold. Notwithstanding this, QUU does not understand why the QCA is discussing price caps within the proposed framework. If the QCA is considering setting prices with a CPI-X mechanism, then the framework becomes a quasi-deterministic regime.

In Table 6, under Market Cost Risks, the QCA state that breaches of CPI-X are likely to trigger a cost of service review. QUU was under the impression that if increases in price or MAR breached CPI-X, DRs would need to justify the breaches through the provision of further information. As the wording currently stands, a breach would automatically trigger a cost of service review.

Issue: Future Prices

The QCA comments in section 3.5.2 that: [13]

> *Any changes to future prices above CPI-X would be a significant factor in deciding whether to trigger a more*

---

[12] paragraph 7, page 29, Ibid
[13] last paragraph, p33, Ibid

> *detailed cost of service review (except insofar as they incorporate an underspend from a previous period or for which the reasons could be substantiated by the QCA).*

Given that this is an ex-post regulatory regime, the QCA will be receiving information on actual prices in October (after the end of the financial year). Therefore, QUU does not understand how the QCA will be able to assess annual changes to future prices above CPI-X, as these future prices will not be available (unless a DR is seeking a binding ruling).

Unders and Overs – accounts

The QCA states that: [14]

> *Where under-recovery occurs in the future and it is not the result of an express decision to accept lower than prudent and efficient costs, it would seem that prior under-recoveries could be offset against future over-recovery. It is therefore proposed that under-recoveries incurred in 2013-14 and 2014-15 as part of a price path can be carried forward and capitalised in the MAR. For previous years, under-recovery may only be recognised where it relates to flood impacts (QCA 2014a).*

QUU agrees that past under-recoveries from 2013-14 to 2014-15 should be carried forward and capitalised in the MAR. However, QUU does not understand the QCA's reference to a price path in the statement above. The statement seems to infer that under-recoveries will only be permitted to be capitalised if they were associated with a price path.

QUU understands that the QCA will be issuing a separate report to discuss in more detail how an unders and overs mechanism will work under the long term framework. QUU will make more detailed comments when this separate report is released.

Draft Recommendation 3.15

QUU agrees with the draft recommendation of monitoring prices on an ex-post basis. However, the monitoring should be in relation to weighted averages prices, not individual prices. The QCA needs to clearly outline how the monitoring will apply to prices.

Draft Recommendation 3.16

QUU suggests that price changes should be based on weighted average price changes. This ensures that DRs have the ability to undertake price reform within the framework without breaching the threshold.

Draft Recommendation 3.17

The word "increase" and references to weighted average price is absent from draft recommendation 3.17. QUU suggests that the draft recommendation should state:

[14] 7th paragraph, p35, Ibid

> *"where the weighted average price increase exceeds CPI-X, entities will be required to justify the differences".*

Draft Recommendation 3.18

QUU agrees with this draft recommendation in relation to cost pass-throughs; however, there is a slight error in the way the QCA has worded it. Under/Over recoveries are based on the difference between allowable revenue based on prudent and efficient costs and actual revenue, and not (as the draft recommendation currently states) the difference between actual costs and efficient costs.

QUU also suggests that the QCA outline how growth in volumes sold will be incorporated into the assessment.

QUU also suggests that recommendation 3.18 (c) be reworded as:

> "where they have been substantiated by an entity prior to the reporting period through a binding ruling".

In addition to this, QUU suggests that the QCA specify that changes in Government policies, which are uncontrollable events for the DRs, which subsequently result in a breach of the threshold should not be seen as effectively as pass-throughs for the purposes of the proposed regulatory framework. An example of this is a policy that reduces developer charges revenue that leads to the DRs increasing ongoing utility charges higher than the threshold to ensure revenue adequacy.

Draft Recommendation 3.19

As outlined earlier, QUU considers it is essential that the QCA provide greater detail on how the triggers will be applied under the long term framework.

Issue: Implicit Triggers

In section 3.5.2 the QCA states that: [15]

> *On balance, an implicit trigger allowing the regulator to exercise judgement is superior. However, while the QCA proposes not to define the thresholds which would trigger a cost of service review and price determination, it has defined the measures which must be reported annually. These measures will be the inputs into the QCA's decision on whether to initiate a cost of service review and price determination and therefore provide some certainty to entities.*

QUU accepts that implicit triggers are needed to some extent to provide some level of regulatory discretion and allow for flexibility; however, for regulatory certainty to exist within the long term framework, the DRs need to understand how that discretion will be applied. This is particularly important in relation to the triggers because of the potentially significant consequences of their activation. The necessary certainty in this regard is currently absent.

[15] paragraphs 2 and 3, page 37, Ibid

Issue: Cost and Benefit of Undertaking a Review

The QCA comments[16] in section 3.5.2 that it will weigh up the potential costs and benefits of undertaking a full cost of service review.

QUU agrees with this statement; however QUU does not consider this intent to be prominent enough throughout the document in terms of how the QCA will use its discretion. In addition, QUU suggests that it should form part of the review trigger criteria to incorporate a degree of certainty as to how the QCA will apply its discretion.

Issue: Fees for Cost of Service Review

The QCA needs to clarify if the DRs would be charged individually for a cost of service review. Also, will this fee be set in advance so that the businesses know the potential costs or will it be after the fact?

The QCA discusses this issue in the executive summary of its position paper but does not discuss it further within the main body.

Issue: Service standards set by technical regulators

The QCA makes comments about service standard performance in section 3.5.2: [17]

> *"Where service quality changes occur, breaches of standards set by technical regulators (for example for drinking water quality standards) will be referred also to the relevant regulator. Where service quality standards are significantly higher than the minimum set by a regulator or changed, evidence that the difference is supported by customers will be required when considering whether to trigger a more complete review."*

QUU has a number of issues regarding this statement. Firstly, QUU would like to know which technical regulator the QCA is referring to, as all breaches of standards are referred to the appropriate regulator as stipulated under relevant legislation.

Secondly QCA implies that a high achievement for a service standard may trigger a cost of service review. QUU is of the view that this is not outlined anywhere previously in the position paper, where most of the discussion has centred on deteriorating service standards.

Furthermore, it also implies that a single service standard could be used as a review trigger, notwithstanding the proposed 39 service quality indicators proposed by the QCA. For QUU, it raises the broader issue of how service quality indicators can be a trigger event given the uncertainty around definitions and how the 39 indicators will be combined into a meaningful index (or not).

---

[16] 2nd last paragraph, page 37, Ibid

[17] paragraph 1 and 2, page 38, Ibid

Issue: Transition to long term framework – financial information

The QCA states[18] in section 3.5.3, bullet point (a) that an entities performance will be assessed against CPI-X and certain financial information.

QUU suggests that the QCA specify exactly what "certain" financial information it is referring to.

Issue: Regulatory Review

The QCA comments that: [19]

> *"Where a regulatory review has been triggered for an entity, the same criteria would apply for that entity to return to light-handed monitoring"*

QUU queries if the QCA is referring to a cost of service review or the detailed price determination review?

QUU suggests that the terminology throughout the document be clarified to ensure consistency.

Issue: Opening Cost Base

The QCA briefly discusses[20] how it will determine the opening cost base for QUU in section 3.5.3. However the QCA does not provide significant detail on the process for determining the opening cost base, and whether actual costs will be considered.

QUU is of the view that appropriate consideration of actual expenditure is incorporated in the process.

QUU also seeks further information on how the QCA will determine the opening cost base.

Issue: X-factor during transition arrangements

In section 3.5.3, the QCA mentions[21] establishing an x-factor. Can the QCA clarify if this is an x-factor to be used for smoothing a price path, or an x-factor that is similar to the CPI-X mechanism proposed for the performance monitoring framework i.e. as an efficiency factor in the CPI-X threshold?

The QCA's paragraph does not make sense, as it implies that the QCA is developing an x-factor to manage potential price shocks, including in relation to changes in pricing policies. This is different to the x-factor being used as a component of the CPI-X threshold. It also raises the issue of the QCA's expectations regarding the pricing policies of the DRs.

In addition to this, QUU is also seeking clarity as to how long the x-factor will be applied or will it be reviewed at any point.

Draft Recommendation 3.20

QUU considers that as draft recommendation 3.20 currently stands, it is quite definitive. That is, it implies that if any of the scenarios in Table 9 occur, a cost

---

[18] page 38, Ibid
[19] paragraph 3, page 40, Ibid
[20] page 40, Ibid
[21] 1st paragraph, page 41, Ibid

of service review will be automatically triggered. This conflicts with the discussion leading up to Table 9, where the QCA states that these are indicative scenarios that (along with other performance factors such as customer engagement, long term strategic investment practices and the application of pricing principles) will assist the QCA in making a decision whether to undertake a cost of service review.

Furthermore, under the proposed long term framework, material breaches above CPI-X need not automatically trigger a cost of service review, but rather will trigger a request by the QCA for more information from the DR in order for the latter to justify the increases above CPI-X. Where justification is provided and accepted by the QCA, a cost of service review is not necessary.

QUU recommends that the wording be changed to:

> *"The scenarios outlined in Table 9 will provide guidance to the QCA in its consideration of whether to seek further information and explanation from the distributor-retailers".*

QUU also considers that much greater clarity is required regarding the scenarios in Table 9 before it can be recommended that a request for information and a subsequent cost of service review can be triggered in line with the scenarios in the table.

At this point in time, QUU considers it is difficult to understand how the QCA will determine a 'significant deterioration' in service standards across the proposed 39 indicators. Therefore, QUU suggests that such changes in service standards should not be separately identified as a limb of the review trigger scenarios, but rather should be considered more generally along with other factors such as customer engagement.

Also, QUU considers that any attempt to measure service standards over time needs to outline how the long term framework will allow for force majeure and acts of God events (e.g. flood, drought, turbidity issues affecting bulk water supply).

Issue: Consideration of Financeability

QUU considers that an important consideration of whether a cost of service review needs to be triggered is the long-term financial viability of a DR.

In the long term, QUU needs to ensure that it maintains its financial health at a level where it will attract finance to continue to undertake investments in its water and sewerage infrastructure. As the QCA is aware, its decisions can have very real impacts on the financial viability, and long term credit ratings of DRs.

Regulatory decisions without regard for the financial health of DRscan have long term financial impacts on the organisation to the detriment of its customers.

This could mean that a specific test of the financeability of the business be incorporated into the decision by the QCA as to whether a cost of service review should be triggered. A financeability test would involve assessing the impact of a regulatory decision on a DR's notional credit rating and relevant credit metrics.

Draft Recommendation 3.21

QUU seeks clarification from the QCA on whether this public report mentioned in draft recommendation 3.21 is part of the QCA's annual reporting to be released on 30 March. Furthermore, is the 'price review' mentioned in draft recommendation 3.21 a cost of service review? If a cost of service review is triggered then it will have to be in accordance with the scenarios defined in draft recommendation 3.20, and as QUU has stated above, material breaches above CPI-X should not automatically trigger a cost of service review, but will trigger a request for more information to justify the increases above CPI-X.

Draft Recommendation 3.22

As informed by the QCA, QUU will be transitioning to the new framework. With regard to how the QCA will determine the opening cost base, and the RAB, QUU has outlined its views in other parts of this submission.

Draft Recommendation 3.23

QUU has no issues with this draft recommendation.

Draft Recommendation 3.24

QUU has no issues with this draft recommendation.

Draft Recommendation 3.25

QUU has no issues with this draft recommendation.

3.2 Regulatory parameters

QUU recommends that the QCA discuss at the beginning of section 4 on "Regulatory Parameters" that the purpose (for a large proportion of this section) is to outline how the QCA would assess the regulatory parameters in the event that a cost of service review is triggered. It is therefore seen as guidance for how DRs should treat the various regulatory parameters.

As it currently stands, this message is not prominent enough throughout this section. The DRs will be using this section as a guide on an ongoing basis in case a cost of service review is triggered, and therefore, this should be highlighted at the beginning of this section and be more prominent throughout the section.

3.2.1 Ministerial Direction

Issue: CPI-X is not a Price Cap

In section 4.1 the QCA comments that:[22]

> *"The following details are relevant to both the establishment of the initial asset base and potentially for any variation to the CPI-X price cap".*

[22] 3rd paragraph, page 42, Ibid

There is no CPI-X price cap in the regulatory regime being proposed, so why is the QCA mentioning it in the paragraph above?

QUU suggests that this wording be amended. QUU considers that the QCA's proposed treatment of regulatory parameters is relevant both to how a DR is expected to calculate its MAR each year (including the RAB roll forward) and in the context of a possible cost of service review.

3.2.2 Regulatory Asset Base (RAB)

Issue: RAB Value

The QCA states in section 4.3.1that: [23]

> *Consistent with the Direction, the QCA will accept the RAB established in the 2013-15 price monitoring review carried forward to 1 July 2015.*

The above statement is incorrect, the Ministerial Direction states that:

> *"..a revaluation of the initial RAB (established for the purpose of the 2010-13 price monitoring period) is not to be considered";*

Hence there is no mention in the Ministerial Direction of the 2013-15 RAB.

QUU suggests that the wording be adjusted to reflect the Ministerial Direction whereby the initial RAB is not to be reviewed and the rolling-forward of the RAB be consistent with QUU's suggestion below in relation to draft recommendation 4.1

Draft Recommendation 4.1

In addition to the comment made immediately above, the QCA states in draft recommendation 4.1 that:

> *"The QCA accept the QCA forecast RAB at 1 July 2015 as established in the 2013-15 price monitoring review".*

QUU does not understand why the QCA is proposing to use a forecast value of RAB, and treat this differently to other roll-forwards of the RAB where actual information has been used.

QUU suggests that draft recommendation 4.1 should be changed such that the QCA accept the RAB at 1 July 2015 where actual information from 2013/14 and 2014/15 is used to roll the RAB forward.

In addition, the draft recommendations are not very clear in that if a cost of service review is triggered, then the prudency and efficiency assessment of capital expenditure will only apply to the six largest projects. QUU suggests that this should be made clearer in draft recommendation 4.1.

Draft Recommendation 4.2

QUU agrees that prudency be assessed against these drivers, however we suggest the following wording to make it clear that the prudency and efficiency reviews are related to cost of service reviews.

---

[23] last paragraph, page 43, Ibid

> *"Where the QCA determines that a cost of service review is necessary, prudency be assessed against key drivers: compliance, growth, renewals, service and business efficiency. Efficiency is tested against the scope and standard of works."*

Furthermore, QCA needs to make it clear that where a cost of service review is triggered, the top 6 'as-commissioned' capital projects are to be reviewed.

Draft Recommendation 4.3

QUU agrees that it is the DRs responsibility to ensure that investments are consistent with prudency and efficiency guidance.

Draft Recommendation 4.4

QUU agrees with the proposed approach to roll-forward the RAB.

Draft Recommendation 4.5

In the supporting discussion, the QCA mentions using CPI, or another indicator such as the mid-point of the RBA's inflation target band, to roll-forward the RAB. However, in draft recommendation 4.5, the QCA only mentions CPI as the relevant index and does not mention the RBA's inflation target.

QUU suggests that this inconsistency be amended by adjusting the draft recommendation to reflect the discussion preceding it.

Draft Recommendation 4.6

QUU agrees that revenues from capital contributions should be taken into account in determining the revenue requirement.

Draft Recommendation 4.7

QUU agrees that easements be valued at market rates where available, or at historic cost indexed by CPI.

Draft Recommendation 4.8

QUU agrees that work in progress spanning more than a year be capitalised until commissioning at the appropriate WACC.

Draft Recommendation 4.9

QUU agrees that a working capital allowance should account for the timing difference between receivables and payables, plus inventory costs where it can be justified.

Draft Recommendation 4.10

QUU suggests that the draft recommendations 4.10 and 4.11 be merged such that it reads as follows:

> *Return of capital be based on straight-line depreciation with details of alternative depreciation profiles for long life assets be justified to the QCA.*

Draft Recommendation 4.11

Refer to our response to draft recommendation 4.10.

3.2.3 Operating Costs

Issue: Forecast Costs

The QCA state in section 4.5 that: [24]

> *Under the light handed performance monitoring framework, prudent and efficient base year operating costs may be used as a reference point to assess forecast costs.*

As QUU understands, under the proposed light-handed performance monitoring framework, the DRs will not be providing forecast costs to the QCA.

It is also unclear whether the QCA would even be assessing forecast costs under a cost of service review.

QUU suggests that the QCA amend this section, or provide further clarity of what is meant by assessing forecast costs.

Draft Recommendation 4.12

QUU agrees with this draft recommendation. However, the manner in which this draft recommendation is currently expressed seems more of a statement, than a methodology for determining prudent costs. Also, it should be clear that prudency and efficiency reviews will only be undertaken during cost of service reviews.

Therefore, QUU suggest the following words;

"In the event that a cost of service review is initiated, operating costs will be considered prudent if they can be justified in terms of service, growth, or compliance drivers".

Draft Recommendation 4.13

Reiterating our comments made above regarding draft recommendation 4.12, QUU suggests that the wording be changed to the following:

"In the event that a cost of service review is initiated, operating costs are efficient where they represent the least cost over the life of the assets".

Draft Recommendation 4.14

QUU agrees that the Maximum Allowable Revenue (MAR) should include a tax allowance based on a benchmark calculation.

3.2.4 Cost Allocation

Draft Recommendation 4.15

QUU suggests that the wording in relation to cost allocation contained in the Pricing Principles Position Paper (discussed later in chapter 4) should be reflected in this draft recommendation

[24] last paragraph, page 54, Ibid

3.2.5 Information Requirements for monitoring prices and costs

Issue: Figure 4 - MAR vs. Revenue

While QUU understands that Figure 4[25] is stylised, it is not entirely correct. QUU suggests that the figure be adjusted to reflect revenue received for fixed water charges and variable sewerage charges.

Issue: Forecast Revenues

The QCA comments in section 4.8, that: [26]

> *For performance monitoring and any cost of service review, the QCA will compare an entity's forecast revenues and MAR to establish whether there is any explicit intention to exceed MAR*

The QCA will not have forecast information available to them for ongoing performance monitoring purposes. .

Moreover, QUU suggests that the QCA should not attempt to assess 'intent' to exercise market power under the performance monitoring framework. Rather, its analysis should focus on actual outcomes compared to the thresholds set by the QCA which are intended to prevent the exercise of market power.

Issue: CPI-X target or threshold

QCA states in section 4.8: [27]

> *"For this purpose, the QCA will require an assessment of prices against CPI-X targets"*

QUU does not understand why QCA is using the word "target". As far as QUU is aware, CPI-X is understood to be an information threshold. Where the weighted average price increases above CPI-X in a financial year, DRs will be required to provide further information to explain or justify the increases.

QUU suggests that the QCA clarify that the CPI-X is an information threshold and should be referred to as such

Issue: Initial Submission

QCA states in section 4.8 that: [28]

> *If not available in the initial submission, the QCA would require further information from an entity.*

The QCA should be clear with terminology, what is the initial submission?

[25] page 60, Ibid
[26] last paragraph, page 60, Ibid
[27] paragraph 2, page 62, Ibid
[28] paragraph 4, page 62, Ibid

Issue: Growth Factor for Revenues

QCA states in section 4.8:[29]

> *"Where prices or revenues have increased by more than CPI-X and cannot be justified on the basis of cost pass-throughs (see above), the QCA will require entities to provide broad data to estimate the MAR…"*

The QCA needs to clarify how it will be assessing the CPI-X threshold and how growth is factored into the assessment. QUU suggests that growth is explicitly factored into the calculation of the threshold.

Issue: Binding Rulings

QUU suggests that the QCA provide greater clarity around the processes and timeframes for binding rulings. This means answering the following questions:

- What will binding rulings apply to?
- What information should be provided as part of the application for a binding ruling?
- What are the time frames for seeking a binding ruling?

Reiterating its earlier comments, QUU would like to be able to make applications for binding rulings at any time, however with the understanding that the QCA needs sufficient time to assess applications and make a ruling.

Issue: Outperformance

In section 4.8, QCA states that:[30]

> *"Where entities demonstrate that price increases are in line with CPI-X but costs increased by less than CPI-X due to efficiency initiatives, these gains may be retained by the entities for up to three years before being passed through to customers. The retention of such gains would not be truncated in the event of a triggered or scheduled cost of service review. Relevant information should be submitted to the QCA."*

QUU does not understand how this will work in practice and regards it as a feature of deterministic price regulation not light handed price monitoring.

It also appears to be another form of review trigger for the QCA in relation to a DR's cost of service.

QUU suggests that this review trigger should be removed from the proposed framework.

[29] paragraph 5, page 62, Ibid
[30] page 63,Ibid

Draft Recommendation 4.16

QUU agrees with this draft recommendation. During its annual reporting to the QCA, on 30 October, QUU will provide details of its prices and components of its prices to the QCA.

However, QUU considers that any assessment of price increases against the CPI-X threshold should be undertaken using weighted average not individual prices. Furthermore, under a light handed regulatory framework, the components of tariff structures should not be considered in any assessment.

Draft Recommendation 4.17

QUU suggests that the QCA should clarify the process regarding the CPI-X threshold and how it will be applied.

As previously noted, QUU considers that any assessment should be made in relation to weighted average prices rather than individual prices or components of those prices.

A consideration of the components of prices against CPI-X is unnecessary and unreasonably intrusive if weighted average prices do not breach the threshold and the business has not implemented changes that are in breach of the QCA's pricing principles guidance.

Draft Recommendation 4.17

QUU suggests that the QCA should clarify the process regarding the CPI-X threshold and how it will be applied.

As previously noted, QUU considers that any assessment should be made in relation to weighted average prices rather than individual prices or components of those prices.

A consideration of the components of prices against CPI-X is unnecessary and unreasonably intrusive if weighted average prices do not breach the threshold and the business has not implemented changes that are in breach of the QCA's pricing principles guidance.

Draft Recommendation 4.18

Given that this draft recommendation relates to draft recommendation 4.17, it should begin with the words *"as for draft recommendation 4.17"*. As such it would read as follows:

> *"As for draft recommendation 4.17, the QCA should seek additional information on any matter that it considers is necessary to assess whether the change in prices can be justified"*

As it is currently worded, this draft recommendation implies that the QCA should seek additional information to assess whether any change in prices can be justified.

QUU is also seeking further clarity on the type of additional information that the QCA may be seeking and the level of justification that may be required to satisfy the QCA. This should be set out in the Performance Monitoring Determination we have proposed in section 2.3 of this submission.

Draft Recommendation 4.19

QUU agrees with this draft recommendation where information is being sought to determine whether a cost of service review should be triggered. Where the QCA is seeking further information for clarity in relation to a minor issue, this should not be stated on its website.

Draft Recommendation 4.20

As outlined earlier in the submission, QUU suggests that the QCA should provide greater clarity regarding the processes and timeframes for binding rulings. Furthermore, QUU considers it appropriate that DRs can seek a binding ruling at any time.

Draft Recommendation 4.21

As discussed above, QUU suggests that this recommendation should be removed from the proposed long term framework.

3.3 Customer engagement

QUU understands the important role that our services play in our communities, and given this, we have endeavoured to foster a closer relationship with our customers to better understand their needs and deliver the services they require.

QUU is of the view that actively engaging its customers is not only good business practice, but it is also the norm. In addition, we believe that effective customer engagement is not a one way street, but one where customers receive specific and meaningful information from us, and are able to provide feedback and influence the behaviour of QUU. This approach is reflective of those that are observed in competitive markets were firms need to be continually vigilant to changing customer needs and trends.

To reinforce this customer centric focus at QUU, we established it as one of our four strategic pillars to support and guide the delivery of our vision.

This customer centric strategic pillar is outlined below:

"We understand our customers and deliver a quality service that meets their evolving needs"

Under this strategic pillar, QUU has identified a number of key focus areas, these being:

- Developing customer insight and understanding
  - This will involve developing the capabilities within QUU to capture and synthesise our customers' needs, wants and attitudes, by monitoring broader consumer customer service trends – locally, nationally and globally
- Delivering QUU customer experience consistently
  - QUU intends to achieve this through a continued examination of all facets of customer experience. This will involve monitoring our customers' experience of our services through various channels such as online, face to face interviews and the call centre. QUU

intends to do this for all our customer segments (residential, industrial and developers).

- Educating our customers
    - QUU intends to engage with our customers to educate them on our value proposition, and the balance between value drivers such as quality, service and price.

Initiatives that QUU has implemented to engage with our customers on a regular basis and to understand their needs are as follows:

- Customer experience surveys – QUU has three regular and ongoing customer surveys to measure the health of its corporate brand and the satisfaction of customers with our surveys. These are outlined below.
    - Brand Index – the purpose of this index is to measure the perception of QUU's brand. QUU uses the Brand Index score to measure its Brand Health and customer perception of its overall performance. The Brand Index score is based on performance against core brand drivers identified through customer research as things that QUU needs to do very well to ensure our brand is regarded highly.

      Research conducted firstly in May 2011 and re-visited annually confirms four key brand drivers for QUU, which are;

        - Value
        - Customer Focus
        - Transparency
        - Reliability

      The research also defined the relative weighting of each of these four drivers to determine the overall perception of the QUU brand (i.e. does value contribute more to brand health than transparency etc.) as follows: value 39%, transparency 11%, customer focus 29%, reliability 21%.
    - Customer Experience Satisfaction Survey – this is conducted every 6 months, and its intention is to measure customer experience satisfaction following a recent customer interaction with QUU. The research seeks to understand how customers currently interact with QUU, what their service needs are, how customers feel about the service they receive from QUU and how it could be improved. Findings from the research are used to drive service improvements across key business units. Previously, this research has focused on residential customers but has recently been expanded to develop a greater understanding of the service delivered to commercial customers.
    - Corporate Reputation - QUU uses a global Corporate Reputation Index. The measure considers customer perceptions

of how the organisation is viewed by the community, customer emotional associations with it, including favourability and trust and the organisations social, economic and service competence. As a globally recognised approach to measuring reputation the index enables QUU to benchmark itself against other utilities across Australia and the rest of the developed world.

- Website redesign – We recently redesigned our website to make it easier for our customers to find information and provide feedback to us. The redesign also increases the ease of navigability across a number of platforms (PC, Tablet and mobile).
- Social media – QUU has established a presence on social media to engage with our customers. We have a social media presence on YouTube, Facebook, Twitter, LinkedIn and Instagram to interact with our customers and partners.
- Public Report of Service Standard Performance – we publish our service standard performance within our Annual Report. Our Annual Report is publicly available on our website.
- Customer and Community Reference Group (CCRG) – the CCRG was established in 2010 as part of QUU's intention to focus more closely on our customers and better understand their needs. The CCRG is composed of a diverse group of stakeholders, from different socio economic sectors and representing both urban and regional areas of QUU's service areas. They include low-income consumer advocacy, urban development, local government, environment and sustainability, regional development, pensioners and retirees, community service, and residential and commercial customers. The CCRG meets quarterly to provide feedback on a range of issues from the delivery of services to pricing.

Issue: Customer engagement minimum requirements

QUU agrees with the minimum customer engagement elements that should be incorporated into a DR's customer engagement strategy, as outlined by the QCA on p.77 (second last paragraph). At a very minimum, entities should have,

- Transparent and timely provision of information to customers through relevant media
- A Customer Consultation Committee, and
- Provide regular updates of Customer Charter and Customer Service Standards

Draft Recommendation 5.1

For draft recommendation 5.1, the QCA states that:

> *Each SEQ entity, in consultation within its customers, develop a strategy for customer engagement based on best practice principles.*

QUU agrees that SEQ Entities should have in places strategies to effectively engage with customers based on best practice principles, however at this stage, these strategies may not specifically reside in a single customer engagement strategy document.

If QUU is able to demonstrate that it is already engaging customers in a manner that is consistent with best practice principles, does it need to develop this strategy document as a requirement under the long term framework?

Draft Recommendation 5.2

QUU agrees with this draft recommendation.

Draft Recommendation 5.3

QUU agrees with this draft recommendation that the customer engagement strategy should include a customer consultation committee. However, this can take a number of different forms, with the primary objective being that SEQ Water DRs are able to gather feedback from a wide range of customers.

Draft Recommendation 5.4

QUU agrees with this recommendation.

Please also refer to comments made further above with regard to Draft Recommendation 5.1

Draft Recommendation 5.5

QUU has no issue with this draft recommendation.

However, QUU also refers to comments made further above with regard to Draft Recommendation 5.1

3.4 Strategic approach to long-term investment

3.4.1 Legislative Framework

Draft Recommendation 6.1

QUU is unclear whether the QCA is able to determine which legislation the council water businesses are to be subject to.

3.4.2 Strategic Planning

Draft Recommendation 6.2

QUU agrees with the approach of providing evidence of approval and endorsement of the Water Netserv Plan.

3.4.3 Co-ordination with other Planning Requirements

Draft Recommendation 6.3

QUU can provide its annual capital works plan in its annual submissions, however the QCA needs to state which year it is requiring. It should also be noted that these plans will be based on ‘as incurred’ expenditure rather than ‘as commissioned’ which is what is included for the roll-forward of the RAB.

The QCA also needs to be aware that the detail contained within these annual capital works plans are at a high level and only projects that exceed $15 million, or are of interest to the Board, are separately identified.

Draft Recommendation 6.4

The most up to date Netserv Plan will be always be available on QUU's web page. QUU considers it unnecessary to inform the QCA of all updates to the Netserv Plan and suggests that the only changes within the updates that the QCA needs to be made aware of are minor and major changes (in accordance with the definitions within the South-East Queensland Water (Distribution and Retail Restructuring Act 2009)).

3.4.4 Asset management

Draft Recommendation 6.5

QUU agrees with the concept of draft recommendation 6.5, however, however QUU would like further clarity on the reporting framework that will facilitate the reporting of performance against asset management standards and the use of the term 'compliance'.

QUU suggests that the use of the term compliance in this draft recommendation relates to the DRs compliance with their own asset management standards rather than a formalised asset management standard. The QCA should be aware that there are significant cost implications with regard to achieving compliance with a specific standard, as opposed to having systems in place that are consistent with a particular standard. QUU suggests that this point be made more strongly by stating that these are not formalised standards, rather they are the asset management standards adopted by the individual business.

Draft Recommendation 6.6

QUU disagrees with the QCA draft recommendation 6.6 that, should a cost of service review be triggered, the QCA will assess entities' asset management practices against PAS-55

This is a prescriptive approach and essentially means that the businesses would need to implement the PAS-55 asset management standard under the lighter-handed form of regulation to ensure that there are no negative asset management outcomes from the cost of service review.

The regulator should not be prescribing its preferred asset management standard, but rather the businesses need to ensure that their asset management standards are consistent with a standard asset management system.

3.4.5 Evaluating Efficiency of Long-Term Investment Alternatives

Issue: Project Evaluation Guidelines

The QCA states that "Queensland Government agencies are already required to comply with the Project Evaluation Guidelines issued by the

Queensland Treasury"[31]. This statement implies that this applies to the SEQ DRs, however this is incorrect.

QUU suggests that this statement either be removed, or state that the Project Evaluation Guidelines can be used by the businesses as a guide rather than stating that we must comply with them.

Draft Recommendation 6.7

QUU agrees with the draft recommendation to provide information on the project evaluation practices for significant capital projects, however the statement is unclear as to when the information is to be provided.

QUU suggests that the project evaluation practices are provided to the QCA in the initial submission for the proposed framework, and any changes to the process be provided in subsequent annual submissions.

Draft Recommendation 6.8

QUU agrees with the draft recommendation that it provide details of analysis for up to the 6 largest capital projects where required as part of a request for further information.

QUU considers it important that these requests remain conscious of the overarching intent of the proposed framework – to operate under a light-handed regulatory framework.

3.5 Service quality performance reporting

Delivering water and sewerage services at an appropriate standard has always been, and will continue to be a key focus for QUU. We recognise that our delivery of water services need to be maintained at a high level to ensure that public health and safety is safeguarded at all times, and that waste is treated and safely discharged to our environment.

Therefore, overall QUU is supportive of the concept of reporting its performance of service quality against agreed, comparable measures, with the opportunity for the QCA to seek further information as required.

QUU's strive for excellence in delivering safe and reliable water and sewerage services is evidenced by:

- Its compliance with Drinking Water Management Guidelines
- in 2012, QUU brought the call centre in-house so that it could have greater control and monitor the delivery of the services it provided through the call centre
- we recently opened a new depots to be able to better respond to incidents.
- our review of our current asset management systems and focus on having an asset management system that is consistent with the ISO 55000 standard.

In response to the QCA's Framework Position Paper, QUU makes the following comments.

[31] page 98, Ibid

Issue: SAMP Legislation

In Appendix B QCA refers to SAMP legislation driving performance measures currently being in place, however this legislation is obsolete for DRs (and withdrawn Councils) who have and the industry has moved to customer-impact driven legislation (e.g. Customer Code). QUU suggests that the QCA should update all references to SAMP-driven indicators for SEQ WSPs in its Final Report for this.

Draft Recommendation 7.1

QUU agrees with this draft recommendation 7.1 that the service quality performance reporting framework incorporates indicators that are:

(a) relevant and meaningful to stakeholders
(b) linked to controllable costs
(c) suitable for relative performance assessment within, and across, entities over time
(d) cost effective - the costs of collecting and reporting indicators should be
justifiable relative to benefits
(e) measurable - clearly defined, quantifiable, reliable, and verifiable

Draft Recommendation 7.2

QUU agrees with the use of pre-agreed NPR indicators. However, QUU does not agree with the use of non-NPR indicators, as the information QUU provides regarding its service standard performance against NPR indicators is extensive and should provide the QCA with adequate information on how QUU is performing.

As a fall-back position, QUU considers that any non-NPR indicators developed by the QCA should be consistent with the indicators proposed by DEWS.

Also, any additional indicators from the current work by DEWS would need to have a clearly defined benefit as to why it is being captured; or else this places an unnecessary burden on QUU.

Draft Recommendation 7.3

QUU agrees that DRs be required to publish annually on their websites their performance against the service quality indicators agreed to between the DRs and the QCA. QUU is of the view that the service quality indicators should only be of NPR indicators.

Draft Recommendation 7.4

QUU agrees with this draft recommendation, however, the QCA needs to be cognisant of the intent of light handed framework, which is to minimise the regulatory burden and cost on DRs. The QCA should not request information unnecessarily, unless there is a material deterioration in service standards as highlighted in draft recommendation 7.7(c).

Draft Recommendation 7.5

QUU's would like further clarity from the QCA on how the information on service standard performance will be used.

QUU is of the view that service standard performance should only be assessed by tracking an individual DRs performance over time. The QCA should not be attempting to compare service standards between DRs as the service standard performance results would not be comparable across DRs, and would be easily misinterpreted by the public.

Draft Recommendation 7.6

QUU agrees with this recommendation, however, this should solely based on the NPR indicators as agreed to between the QCA and the DRs.

Draft Recommendation 7.7

QUU agrees with draft recommendations 7.7(a) and 7.7(b) that, service quality performance be:

> (a) be addressed in public annual performance reports by the QCA (including attendant media statements), and
>
> (b) be subject to specific advices by the QCA to the Minister

However, QUU requests further consultation on the proposed content of QCA's proposed public annual performance reports.

Again this is subject to QUU's view that service standard indicators should solely based on the NPR indicators as agreed to between the QCA and the DRs.

With regard to QCA's draft recommendation 7.7(c) that:

> "material deterioration in performance trigger a full cost of service review".

QUU is of the view that the QCA needs to inform the DRs how it will define the materiality of deterioration in service standard performance. Will the QCA determine a deterioration or performance by observing a general decline in performance over time (i.e. establish a downward trend)? Or will the QCA determine this in a different manner?

Therefore, the DRs need further clarity on this matter.

QUU does not agree that a significant decline in service standards should automatically lead to a cost of service review. QUU is of the view that it should trigger a request for further information to explain why performance has decline, and what actions the DRs have undertaken to address these issues, as the benefits of asset management strategies and service standard initiatives can take time to be realised after they are implemented. For example, QUU is working on shifting more focus on planned maintenance than reactive maintenance to reduce operating costs, however the benefits of this shift will not be seen in the immediate years.

Draft Recommendation 7.8

Regulation of DRs in Queensland is in a state of confusion with DRs covered primarily by the DR Act, withdrawn councils by the DR Act, water supply Act and local government act, and non-SEQ water service providers by the water supply Act and local government act. Until a common regulatory environment across Queensland can be reached, GSLs should not be considered in Queensland.

Furthermore, QUU understands that there are significant costs involved in establishing GSL schemes, therefore from this perspective, QUU will need to assess the costs and benefits of implementing a scheme prior to it approaching its customers.

4. PRICING PRINCIPLES POSITION PAPER

4.1 Introduction

QUU acknowledges the work undertaken by the QCA to provide guidance to the DRs on how pricing principles will apply to tariff structures for various water and sewerage services under the long term regulatory framework.

The purpose of this section of our submission is to:

- First, provide QUU's views on what we see to be the appropriate role of pricing principles under the long term regulatory framework; and
- Second, provide our responses to each of the QCA's draft recommendations in the Position Paper.

4.1.1 QUU's views on role of pricing principles

QUU recognises that pricing principles can play an important role under both direct (deterministic) and indirect (light handed) forms of economic regulation. In this regard, QUU notes that pricing principles have been developed and applied across the Australian water industry over a long period of time, including the QCA's regulatory water pricing principles released in 2000.[32]

Following the establishment of QUU, the Participating Councils, QUU Board and the Customer and Community Reference Group agreed to the following pricing principles:

QUU Pricing Principle	Description
Simplicity of design	Tariffs should be practical to implement, simple to administer and readily understood by customers
Price shock minimisation	Price shocks to customers should be minimised through the use of smoothed price paths and transitional arrangements where appropriate
Equity	Tariffs should be equitable, which is defined by the level at which cost reflectivity is applied
Revenue adequacy	Tariff structures and prices should be set to recover the efficient cost of delivering water and sewerage services
Customer control	Tariffs should provide customers with some ability to influence the total charges faced through managing their water consumption
Sustainability	Tariffs should promote the sustainable use of scarce resources and reflect the cost of consumption decisions

These pricing principles were developed with the previously legislated Price Mitigation Path in mind; however, they have subsequently been adopted by QUU more broadly to guide the business with any pricing-related decisions.

[32] QCA (2000), Statement of Regulatory Pricing Principles for the Water Sector, December

In addition to this guidance, QUU regularly consults and meets quarterly with our Customer and Community Reference Group and key stakeholders, including on water and sewerage pricing and related topics, such as QUU's Hardship Policy and Concealed Leak Policy.

In light of this background and given the intended light-handed nature of the long term regulatory framework, QUU considers that any pricing principles developed by the Authority should be for guidance purposes only. However, in QUU's view, the draft recommendations are generally quite prescriptive in nature, belying the intended light-handed nature of the framework. Alternative approaches that could be adopted to guide DRs' price setting, such as customer engagement, are given little weight.

Moreover, the Position Paper, as currently drafted, can be interpreted such that the DRs must comply with each of the Authority's recommendations in order to not trigger an intrusive annual review by the QCA.

QUU is also concerned that implementation of many of the draft recommendations would represent fundamental retail water tariff reform in SEQ, with associated large customer impacts. It is not clear to QUU from reading the Position Paper whether this is the QCA's intention or not.

In this regard, QUU notes that the Authority has previously provided pricing principles guidance that refers to the balance between efficiency and 'fairness' in price setting, with the status quo generally the benchmark against which consumers assess fairness.33 In practice, this suggests that very careful consideration would need to be given to the customer impacts of any major changes to retail water and sewerage tariffs on efficiency grounds (such as the rigid application of long run marginal cost (LRMC) pricing), with the possibility of transition being required to mitigate any potential customer impacts. QUU notes that such transitioning is a requirement of the Directions Notice. However, QUU's strong preference is that the QCA clarify exactly what its expectations are regarding the DRs' water and sewerage tariff structures under the long term framework.

Finally, QUU considers that there are a number of aspects of the Position Paper that are not required to be addressed by the QCA, either because there are legislative provisions that deal with them, or they are not practically implementable by the DRs, specifically:

- More frequent metering and billing arrangements
- Introduction of water scarcity charges
- Introduction of tradeable urban water entitlements

QUU is particularly concerned that by flagging the potential implementation of matters such as water scarcity charges and tradeable urban water entitlements in the Position Paper, the QCA could create unnecessary uncertainty and concern amongst our customers when QUU has no intention of, nor considers that there is any realistic possibility of, acting on these matters. QUU provides further comments on these potentially sensitive matters in the relevant sections below.

[33] QCA (2013), Statement of Regulatory Pricing Principles, August, p v

4.2 General pricing principles

4.2.1 General pricing objectives

QUU, in general, agrees with the QCA's identification and discussion of the following pricing 'objectives':

- promoting economic efficiency;
- ensuring revenue adequacy;
- taking account of the public interest; and
- being transparent, predictable, simple and cost effective to apply.

However, QUU is concerned that 'taking account of public interest' is too broad a pricing objective for the DRs as commercial water businesses. This is because the public interest can be interpreted to potentially encompass matters beyond the control of the DRs and that are more appropriately addressed by Government. For example, the provision of community service obligations, promotion of competition in markets and promotion of regional development.

In addition, QUU considers that the QCA's proposed pricing 'objectives' should be recast as the overarching pricing principles that apply under the long term regulatory framework.

The more detailed consideration of different tariff structures discussed in the later chapters of the Position Paper should be made with reference to these overarching principles. This happens in some cases but not consistently throughout the Position Paper.

<u>Draft Recommendation 1.1</u>

QUU agrees with the pricing objectives proposed by the QCA, with the exception of the public interest objective. QUU considers that public interest is too broad and that it be replaced with a principle/objective that is more reflective of the DRs.

QUU considers that the pricing objectives should also be recast as the overarching pricing principles that apply under the long term regulatory framework.

4.2.2 General pricing principles

QUU considers that this section of the Position Paper is unclear given the specific principles subsequently developed in relation to different types of water and sewerage services. If it was removed from the Position Paper, there would be no impact on the long term framework because much of the analysis and draft recommendations appear to be repeated in subsequent sections of the Position Paper.

<u>Draft Recommendation 1.2</u>

QUU does not consider this to be a principle rather it is a direction requiring compliance by the DRs, including a requirement to advise the QCA of any departures from the pricing principles, the reasons for the departures and provide relevant supporting analysis.

QUU is unsure how the DRs can establish that the detailed pricing principles proposed by the Authority for different water and sewerage service classifications are being applied without undertaking a significantly burdensome administrative exercise. This is especially the case in relation to the application of marginal cost pricing. In QUU's view, this potentially onerous process is contrary to the intent of light handed regulation as provided for in the Directions Notice.

Draft Recommendation 1.3

QUU suggests that what appears to be a default requirement for marginal cost pricing to be applied in relation to water services be removed as a pricing principle. Such a requirement is unlikely to be practical to apply in many cases and where applied could potentially have large customer price impacts. QUU also considers that such a requirement is inappropriate under a light handed price monitoring framework.

The issue of marginal cost pricing arises on a number of occasions throughout the QCA's Position Paper and is addressed further by QUU where it arises.

Draft Recommendation 1.4

QUU suggests that this be removed as a pricing principle. If the QCA would like it specifically addressed as a principle, QUU proposes that it could expand the economic efficiency objective to reflect that it applies in relation to the efficient pricing band.

Draft Recommendation 1.5

QUU considers that this recommendation is too specific and likely to result in significant price shocks if the DRs were to actually implement it.

QUU considers that its LRMC estimates for the water network using the Average Incremental Cost (AIC) method is likely to be low at present (and likely to remain this way for a period of time). By setting the volumetric charge to the LRMC estimate, this would result in a significant increase in the fixed charge in order to ensure revenue adequacy.

If the QCA wishes to retain a reference to LRMC as a pricing principle, QUU suggests that it should be adjusted to state that "prices have regard to the LRMC …". This less prescriptive approach is less likely to result in significant price shocks.

Rather, it recognises there are likely to be practical limitations to implementing LRMC-based pricing, including metering and the need to undertake consumer education. Internal system capability/capacity, particularly in terms of billing capability, can also restrict the range of LRMC pricing options available at a point in time.

Finally, QUU considers that this draft recommendation is captured under the first objective of economic efficiency and draft recommendation 2.4 (which provides guidance on DRs' volumetric pricing for urban water services).

Draft Recommendation 1.6

QUU considers that this recommendation is purely theoretical in nature and fails to consider the realities of the SEQ water industry. There is currently no differential pricing for different bulk water supplies and therefore pricing cannot incorporate these differential source costs.

Moreover, it is not clear to QUU that the Authority has considered this recommendation against its objective of transparent, predictable, simple and cost effective pricing.

As the QCA notes, SRMC pricing is a form of scarcity charging and there are many practical constraints on its implementation in the SEQ water industry. Scarcity charging is discussed later in our submission.

4.3 Urban water

This section of the Position Paper (and the following sections) set out the QCA's guidance regarding how it sees different tariff structures complying with the pricing principles.

QUU considers that the wording should reflect the fact that it is guidance rather than a requirement for the DRs to adopt these tariff structures.

In addition, QUU suggests that a consistent approach should be taken to the guidance provided for the pricing of each classified water service, such that the service-specific pricing guidance relates back to the general pricing principles (that are currently identified by the QCA as pricing objectives) to ensure consistency in approach.

4.3.1 Urban water demand forecasting

It is not clear to QUU why demand forecasting is contained within a document setting out the pricing principles for the long term regulatory framework.

If the QCA is including this section on the basis of it being a key input into calculating the LRMC, then it should be contained within a separate document that provides guidance to the businesses on calculating the LRMC rather than within the pricing principles document. Including demand forecasting in a pricing principles document creates confusion as to the purpose of the document.

QUU suggests that this section be removed from the pricing principles document and be incorporated with guidance to the DRs on estimating the LRMC. QUU's responses to the QCA's draft recommendations regarding demand forecasting are made in this context.

Draft Recommendation 2.1

QUU agrees that long-term forecasts used for capital planning be based on SEQ Water Strategy forecasts

Draft Recommendation 2.2

QUU agrees with the QCA's proposed approach to short-term demand forecasting.

Draft Recommendation 2.3

Similarly, QUU agrees that industry-wide improvements to demand forecasting can be made.

4.3.2 Urban water volumetric charges

Draft Recommendation 2.4

As noted above, the current estimates of LRMC for QUU's network are likely to be quite low, therefore complying with this principle will likely result in considerable price shocks to customers, reflecting a lower volumetric charge and higher fixed charges to meet QUU's revenue requirement.

In its later discussion regarding self-selecting tariff options, the QCA states that "Efficiency may not be greatly curtailed if all the volumetric charge options on offer are greater than LRMC and demand elasticity is low"[34]. QUU considers that this point is relevant in the context of the strength of guidance provided by the QCA in relation to the use of LRMC estimates to set volumetric charges.

In light of this, QUU suggests that the Authority's wording should be changed to state that "prices have regard to the LRMC …". Consistent with the Directions Notice, this would be a more light-handed and practical pricing guide for the DRs, rather than imposing a prescriptive approach to pricing.

Draft Recommendation 2.5

QUU considers that the wording for this draft recommendation and the discussion preceding it needs to more clearly state what is meant in relation to an over-recovery of revenue.

QUU does not disagree with the conceptual approach expressed in the draft recommendation. However, we suggest that the wording of the discussion and the draft recommendation be adjusted to specify more simply that it relates to over-recoveries where the volumetric charges based on LRMC result in an over-recovery of MAR.

4.3.3 Urban water fixed charges

Draft Recommendation 2.6

QUU agrees that the fixed charges should be set to recover the maximum allowable revenue not recovered by the volumetric charges.

Draft Recommendation 2.7

QUU agrees with the draft recommendation that charges should not encourage customers to bypass or disconnect from the network.

4.3.4 Inclining and declining block tariffs

QUU acknowledges the issues associated with inclining block tariffs (IBTs). However, these tariffs were introduced prior to the formation of QUU in light of the drought conditions prevailing in SEQ at the time. The IBT was introduced as a way of signalling the importance of water conservation to consumers.

[34] page 41, SEQ Long Term Regulatory Framework – Pricing Principles, March QCA (2014)

Draft Recommendation 2.8

QUU acknowledges the QCA's draft recommendation for DRs to phase out inclining block tariffs over time to be replaced with a single volumetric charge.

QUU will consider this recommendation and our own pricing principles in reviewing the need for reforms to our pricing structures over time.

4.3.5 Location-based or nodal pricing

QUU considers that the QCA must acknowledge the current reality that the DRs face in regards to bulk water prices.

While there are currently differentiated bulk water prices for different regions within SEQ, the Bulk Water Price Path is designed as a postage stamp price for bulk water that applies throughout all of SEQ. This approach for bulk water pricing (and the size of the bulk water component of the average bill) severely diminishes any location-based pricing signal that DRs could reasonably be expected to impose on their customers.

Moreover, given the institutional history of the SEQ water industry, it would be very difficult to implement any location-based or nodal pricing that was not aligned with existing, or previous, council boundaries. If QUU were to apply cost-reflective tariffs on a location basis, this would have significant customer impacts across some of our regions.

Draft Recommendation 2.9

QUU notes the draft recommendation that location-based charges be applied where there are material cost differences. However, there are likely to be significant practical constraints and customer impacts that would need careful consideration prior to any implementation of locational pricing.

4.3.6 Peak period and seasonal pricing

The QCA's discussion prior to the draft recommendation states that peak period and seasonal pricing practices are practical and cost effective. In QUU's view, this is not true.

For a DR to implement such an approach, considerable investment would be needed in:

- Metering technology
- Billing systems
- Marketing/Communication

QUU notes that the size of this new investment is unlikely to be compatible with the tight CPI-X price constraint that the QCA proposes to apply under the long term framework.

QUU also considers that adopting such an approach to pricing would be unlikely to be consistent with the QCA's general pricing objectives (principles). This is especially in relation to ensuring revenue adequacy and being transparent, predictable, simple and cost effective to apply.

Draft Recommendation 2.10

QUU is not opposed to the consideration of peak period and seasonal pricing. However, QUU considers it is unlikely that there will be a point in the foreseeable future where there are identified material economic efficiency benefits from implementing such pricing or that it would be practical and cost effective to do so.

4.3.7 Self-selecting tariffs

QUU notes that self-selecting tariffs have been introduced by other utility retailers whereby customers have a degree of choice about the type of tariff they are subject to.

While there are potentially benefits for customers in providing self-selecting tariff options, it raises other issues in terms of customer education and the potential for ill-informed decisions resulting in negative outcomes for customers.

Draft Recommendation 2.11

QUU agrees with the QCA that self-selecting tariffs should only be considered where there is sufficient information for customers to make informed decisions, if self-selection does not result in cross-subsidies or does not introduce unmanageable revenue risk for the DR.

4.3.8 Service quality differentials and interruptible tariffs

The QCA's analysis appears to envisage differentiated pricing for customers based on different costs of service.

QUU notes that given the nature of the water and sewerage networks, it is unusual for a section of our network to solely serve one connection. This means there is a considerable amount of sharing of the network between customers.

Given this sharing of the network, it is difficult to 'offer' differentiated services for customers on the same section of the network. Moreover, having an option for a differentiated service offering is different to charging differently due to the provision of an inferior or better service. Currently QUU applies a lower charge in some areas for a lower level of service. This is not an option that the customers have chosen, but rather a reflection of the service that they are getting from the QUU network in their region.

Draft Recommendation 2.12

QUU considers that the draft recommendation is not clear. In particular, the reference to "price/service quality tariff options be adopted" needs to be clarified.

For example, is the QCA referring to QUU's current situation where a lower price for a lower level of service is charged in some areas of the network or, alternatively, is it referring to the development of more refined price service 'offerings' across different customers in the same customer class? If it is the latter, then QUU is not supportive of the draft recommendation because of the reality that a differentiated service for customers using the shared network will not generally be possible.

Furthermore, a reference to 'where practical ….' needs to be incorporated into the draft recommendation because the existence of material cost differentials is a necessary but not sufficient condition regarding the implementation of service-based differential pricing.

4.3.9 Metering and billing arrangements

A significant portion of this section of the Position Paper raises issues which are addressed either through legislation or Government policy. QUU is not sure that the QCA needs to provide recommendations for matters that are not strictly related to pricing and are already covered through legislation and associated Codes (such as hardship).

Draft Recommendation 2.13

QUU considers the requirement to individually meter flats and units depends on the tenure arrangements associated with the premises, complex or building.

Since 2008, it is a requirement for sub-meters to be installed in new body corporate community title scheme complexes.

QUU does not intend to retrospectively fit sub-meters to flats and units which are not unless specifically requested by the customer or part of a body corporate complex. QUU's considers that there is no legal obligation for QUU to take on the responsibility or ownership of sub- meters where the property/premises are not separately titled.

Practically, retrofitting sub-meters may not be technically feasible in existing property/premises.

Draft Recommendation 2.14

QUU would have difficulty billing tenants directly for the fixed and variable charges for water and sewerage under our current legislation. Our recovery powers for overdue water and sewerage accounts are directed at our customers which are also "owners" of the property/premises. There are no recovery powers directed at tenants.

The *Residential Tenancies and Rooming Accommodation Act 2008* prevents a landowner from passing through fixed access charges to a tenant. It would appear unreasonable for QUU to apply such charges to a tenant directly (particularly as the *Water Supply (Safety and Reliability) Act 2008* allows QUU to recover these fixed charges from a landowner).

Furthermore, the costs associated with adopting such a recommendation would be quite significant.

With recent amendments to the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009 and the Water Supply (Safety and Reliability) Act 2008*, QUU is no longer obliged to provide occupier water advices to tenants.

Draft Recommendation 2.15

QUU agrees that unmetered connections be charged a deemed amount for usage.

Draft Recommendation 2.16

QUU agrees that customers with unmetered connections should be given the option of paying for meter installations.

Draft Recommendation 2.17

QUU considers that this draft recommendation should be changed to state that vacant land and non-connected properties have charges applied where services are available for connection.

This change is consistent with the wording of the section of text that precedes the QCA's draft recommendation.

Draft Recommendation 2.18

QUU considers that it is difficult for the DRs to ensure that concessions and rebates reflect a generally consistent approach as the decision to adopt concessions and rebates is usually undertaken by third parties (i.e. State or Local Governments).

It is also difficult for the DRs to decide on how the concessions or rebates are applied (i.e. on fixed or gross invoiced amount) when the concession or rebate is being provided by a third party (again, the DRs will be acting based on directions from the third party). Similarly, the business will not be able to put a cap on the concession or rebate when it is 'owned' by the third party (i.e. State or Local Government).

QUU agrees with the QCA that the DRs should be transparent and acknowledge the source of the concessions or rebates and the purpose of them.

QUU suggests that the QCA adjust the wording of the draft recommendations to reflect the fact that some of these aspects of concessions and rebates will be outside the control of the DRs.

Draft Recommendation 2.19

QUU agrees that concessions associated with excess water use caused by leaks should be determined by the DRs in consultation with customers. QUU currently has a concealed leaks policy that addresses such situations.

Draft Recommendation 2.20

QUU agrees that hardship arrangements should be consistent with legislative and operating requirements and avoid cross-subsidies where practical. However, it is not clear that this needs to be prescribed in a QCA pricing principles document.

Draft Recommendation 2.21

QUU agrees that billing should be undertaken at least quarterly. However, in some cases it may not be possible to undertake meter-reading more frequently than this. QUU notes that more frequent meter reading will be more costly to undertake and it is not clear that customers are prepared to pay extra for this service.

QUU suggests that this recommendation be changed to incorporate the fact that meter-reading should be undertaken at least quarterly 'where administratively feasible and cost effective'.

4.3.10 Scarcity charges

It is unclear to QUU how this section of the Position Paper relates to the DRs as the Queensland Government and bulk water service provider (SEQ Water) are most closely associated with addressing water scarcity. In light of this, QUU suggests that this section of the paper should be removed.

Moreover, QUU notes that there is no draft recommendation associated with this section. However, the QCA appears to support increasing the price of water during times of water scarcity. QUU is concerned that this ambiguity creates uncertainty for the DRs and their customers.

As with the QCA's comments on SRMC, given that the DRs do not provide bulk water and are required to pass-through bulk water charges without adjustment, it is unclear how this section relates to the DRs.

4.3.11 Tradeable urban water entitlements

QUU considers that it is difficult for the DRs (and our customers) to engage in trading of urban water entitlements when there are no entitlements to trade. QUU suggests that this section of the Position Paper be removed

The QCA states that: [35]

> *"The QCA recognises the efficiency benefits that could be achieved through tradeable water entitlements in the urban water sector. Such gains are more likely to offset the additional administration and transactions costs if applied to large industrial water users"*

The QCA has not presented any evidence to support this statement, which would represent a fundamental reform to water pricing in the SEQ water industry.

QUU recognises that trading of water entitlements has clear benefits in an informed market – such as rural water customers – where usage is well known and understood. However, the QCA has not addressed whether such a market is likely to exist in SEQ.

As with earlier statements, QUU considers the QCA's analysis should be compared against the general pricing principles in a consistent and structured manner. Similar to its discussion of scarcity charging, the QCA's discussion of this issue and the open ended nature of the draft recommendation creates clear uncertainty for stakeholders.

Draft Recommendation 2.22

QUU is unsure how this draft recommendation complies with the QCA's proposed transparent, predictable, simple and cost effective to apply pricing objective. QUU suggests that the QCA should either remove this

[35] page 58, Ibid

recommendation or clarify and explain what action it expects the DRs to take in relation to the recommendation.

4.4 Sewerage

As with the urban water section of the Position Paper, QUU considers that this section should be drafted in a way that provides guidance to the DRs rather than imposing requirements on them.

As with the earlier sections of the Position Paper, QUU considers that guidance in terms of how to comply with the pricing principles should be subject to the consideration of customers' priorities.

4.4.1 Sewerage service demand forecasting

As previously noted, it is not clear to QUU why demand forecasting is contained within a document setting out the pricing principles for the long term regulatory framework

QUU suggests that this section be removed from the pricing principles document and be incorporated with guidance on estimating the LRMC. QUU's response to the QCA's draft recommendation regarding sewerage service demand forecasting is made in this context.

Draft Recommendation 3.1

QUU agrees with the QCA's statement that the demand for sewerage services should be based on forecast growth in connections, linked to population growth.

4.4.2 Efficient pricing of sewerage services

Given the difficulties in measuring the impact that customers have on the sewerage network, QUU considers that the pricing structure for sewerage services should give consideration to feedback from customers as to their pricing preferences.

One of the reasons the QCA identifies that creates difficulties in applying LRMC-based pricing principles to sewerage services is: [36]

> *"In addition, where there is no capacity cost, LRMC is likely to be relatively low, limited to some pumping and treatment costs. Hence, any prices based on LRMC are likely to be predominantly fixed charges, since customers have limited scope to reduce their costs by reducing sewage"*

QUU suggests that this statement is further reason why the QCA should soften its stance in relation to requiring the DRs to use LRMC as the basis for the volumetric water charge because the same 'problem' of low LRMC estimates is likely to arise.

It appears in the discussion that the QCA considers that it is appropriate for unconnected properties to be charged the fixed charge where they are able to connect. However, this is not incorporated as a draft recommendation and QUU considers that it should be.

[36] page 61, Ibid

Draft Recommendation 3.2

QUU has no issue with the draft recommendation that residential customers be charged a single fixed charge per customer or connection. However, this should be subject to the general pricing principles and consideration of customer preferences regarding their DRs' pricing structures.

QUU also has no issue with the application of volumetric charges for sewerage services being applied where the LRMC is significant. However this should also be subject to the general pricing principles and the consideration of customer preferences.

Draft Recommendation 3.3

In the QCA analysis preceding the draft recommendations, there is no consideration given to a single flat charge for non-residential properties for sewerage services.

The QCA states that in many jurisdictions, fixed charges are often linked to an indicator of usage of the sewerage infrastructure; however this is not the case, with a number of businesses in other jurisdictions using a single flat charge.

QUU considers it appropriate that where a volumetric charge is applied for sewerage, it should have relevant discharge factors for different non-residential customer types to reflect the different usage-based costs they impose on the network.

Draft Recommendation 3.4

As outlined in QUU's response in the urban water section, given the institutional history of the SEQ water industry, it would be very difficult to implement any location-based or nodal pricing that was not aligned with existing, or previous, council boundaries.

QUU considers that the QCA's draft recommendation that nodal services be applied where cost effective establishes a default position for the businesses to comply with, that is too strong and ignores the complex political and customer equity issues that will arise if it were to be implemented.

4.5 Trade waste

4.5.1 Forecasting demand for trade waste services

As previously noted, it is not clear to QUU why demand forecasting is contained within a document setting out the pricing principles for the long term regulatory framework.

QUU suggests that this section be removed from the pricing principles document and be incorporated with separate guidance on estimating the LRMC. QUU's responses to the QCA's draft recommendations are provided in this context. QUU's responses to the QCA's draft recommendations regarding sewerage service demand forecasting are made in this context.

Draft Recommendation 4.1

QUU agrees that trends in growth be used to forecast trade waste services.

Draft Recommendation 4.2

QUU agrees that large customers be consulted to monitor any changes in demand for trade waste services.

4.5.2 Efficient pricing of trade waste services

Draft Recommendation 4.3

QUU agrees that trade waste prices should be based on the impactor pays principle

Draft Recommendation 4.4

QUU suggests that the QCA consider this recommendation in light of a volumetric sewerage charge for non-residential customers. If a volumetric charge is applied with a discharge factor for sewerage services, DRs will need to consider how the volumes are charged when non-residential customers are also trade waste customers.

Draft Recommendation 4.5

QUU agrees that charges for inspection and monitoring be applied on a cost reflective basis.

Draft Recommendation 4.6

QUU agrees with the draft recommendation to have differential charging for trade waste services reflecting the heterogeneity of customers using these services.

4.5.3 Compliance

Draft Recommendation 4.7

QUU agrees that businesses apply penalty charges for non-compliance and breaches of conditions.

4.6 Recycled water

4.6.1 Efficient pricing of recycled water

Draft Recommendation 5.1

The QCA's draft recommendation implies that recycled water will require its own revenue requirement calculation that could potentially be required to be submitted to the QCA under the price monitoring framework. It is not clear to QUU why this needs to be the case given the materiality of recycled water as a source of revenue for the DRs.

Draft Recommendation 5.2

QUU considers that further clarity is required in terms of what the QCA envisages when it states that direct and avoidable costs be allocated between relevant parties on a beneficiary pays basis.

Draft Recommendation 5.3

QUU considers that when the LRMC for recycled water is greater than the potable water volumetric charge, consideration of the cost of the direct substitute (i.e. potable water) is likely to be more important than demand sensitivities. The price of potable water will effectively set a cap for the price of the recycled water.

Draft Recommendation 5.4

QUU agrees with the QCA's draft recommendation to consider a fixed charge to cover the shortfall from recycled water systems. However, QUU is unlikely to undertake a detailed customer willingness-to-pay study to inform us of the level of the fixed charge as the cost to undertake such a study will most likely make it prohibitive.

Draft Recommendation 5.5

QUU queries whether the QCA envisages that the allocation should be on avoidable (forward-looking) rather than avoided (actual) costs.

Draft Recommendation 5.6

QUU suggests that the wording for this draft recommendation be adjusted to state that "Approaches to recycled water pricing be periodically reviewed, as customer acceptance increases".

4.6.2 Sewer mining

Draft Recommendation 5.7

QUU agrees with the draft recommendation that charges for sewer mining be set on a case-by-case basis to reflect relevant direct costs, a share of sewerage system common costs, service costs for any returns, less avoided/avoidable costs.

4.7 Stormwater reuse and drainage

QUU has no comment to make on this aspect of the paper as we do not provide stormwater reuse or drainage services.

Moreover, QUU notes that stormwater drainage was not incorporated within the Directions Notice and is not charged for separately by Councils. As a result, it is unclear why the QCA has incorporated this service into its analysis.

4.8 Industry-wide pricing issues

4.8.1 Pricing for externalities

Draft Recommendation 7.1

QUU acknowledges that consideration of the full economic cost of projects (through the consideration of externalities) is important to understand the complete picture of the impact of certain large projects with potentially large environmental impacts.

However, the costing of these externalities is a difficult process and is usually open to large variations and high sensitivity of the resulting estimates to the choice of assumptions.

Therefore, setting prices for customers that include cost values for externalities would be highly problematic and potentially create confusion within the customer base, contrary to the QCA's proposed pricing objective (principle) that prices should be transparent, predictable, simple and cost effective to apply.

Draft Recommendation 7.2

QUU agrees that if prices were to incorporate estimates of externalities, then a DR must avoid duplication with other mechanisms and be transparent.

Draft Recommendation 7.3

While QUU agrees that licences and market mechanisms can assist with the costing of externalities, the inclusion of this draft recommendation creates confusion as to the purpose of the pricing principles document. In particular, are the recommendations directed only to the DRs or are they also relevant for the industry/Government more generally? If it is more broadly, are the draft recommendations also relevant for Seqwater?

4.8.2 Pricing for third party access

QUU notes that the issue of third party access to DRs' water and sewerage networks raises complex broader issues than the appropriate pricing of access rights, including the need for an overarching regulatory framework. This will be particularly important for cases where the third party access seeker is proposing a partial bypass of the network. For example, it is seeking to connect to the sewerage network but not the water network. QUU envisages that, among other things, regulatory 'provider of last resort' arrangements will need to be developed to ensure continuity of supply and provide appropriate protection to water and sewerage customers over time.

In relation to possible third party access seeker applications, QUU considers that the analysis undertaken by the QCA needs to refer to the QCA Act and the obligations imposed on the Authority in considering access regimes.

In relation to access pricing, the QCA states that: [37]

> *"Under the retail-minus methodology, the access price is determined by taking the established regulated retail price for a bundled service and applying a discount (representing net avoided or avoidable costs) to account for services the access seeker does not require of the infrastructure provider."*

QUU considers that this description should be adjusted to reflect the fact that avoidable costs relate to the future costs, if any, that the access seeker helps the access provider avoid by providing the service.

The QCA states that:

> *"The retail-minus approach may incorporate any monopoly rents (profits) or inefficiencies that are already incorporated into the retail price"*[38]

It is not clear whether the QCA is referring to the DRs specifically in this statement or infrastructure service providers more broadly, including those not subject to economic regulation.

[37] page 116, Ibid
[38] page 61, Ibid

If the statement is in relation to regulated entities it implies that the regulatory process is not achieving one of its key objectives.

Draft Recommendations 7.4 and 7.5

QUU considers that there are likely to be two different ways of setting the access price that, in theory, should be the same but in practice may not be. However, both approaches will give a defensible outcome, including because the rest of the customer base do not have to pay more due to the provision of access to the access seeker.

However, QUU considers that the most important guiding principle for third party access is that existing customers should not be made any worse off in financial terms as a result of the access seeker connecting to the network.

4.8.3 Cost allocation

QUU considers that there is an overlap with this section and the cost allocation section in the Framework Position Paper. QUU considers that the most appropriate place for this discussion is in the consideration of the long term regulatory framework itself rather than pricing principles.

Draft Recommendation 7.6

While QUU disagrees with the location of this section, QUU supports the statement that common costs should be allocated on a causal basis if reasonably possible.

Draft Recommendation 7.7

QUU agrees that a reasonable cost allocator needs to be established if a causal relationship cannot be established. QUU recommends that this draft recommendation should be incorporated into the long term regulatory framework.

4.8.4 Price paths

Draft Recommendation 7.8

QUU agrees that price paths should be applied to mitigate price shocks, having regard to customers' ability to pay and ensuring revenue adequacy for the DR.

Draft Recommendation 7.9

QUU agrees that price paths should be set on a revenue neutral basis.