

2 August 2013

Dr Malcolm Roberts  
Chairman  
Queensland Competition Authority  
Level 27, 145 Ann Street  
Brisbane QLD 4000

Dear Dr Roberts

**Initial Submission to Long-Term Regulatory Framework and Pricing Principles Review**

Thank-you for providing the opportunity to submit an initial submission in response to the Ministers' Direction Notice (the Direction Notice) released on 28 June 2013.

Queensland Urban Utilities is aware of the importance of establishing a clear long-term framework that is specifically designed for the water businesses of South-East Queensland. The current interim regulatory period expires at the end of 2014/15; therefore it is important that the framework to apply from 1 July 2015 onwards is appropriately established prior to the commencement of that regulatory period.

The Direction Notice provides a very broad scope for the Queensland Competition Authority (QCA) to develop the long-term regulatory framework. This provides the QCA with an opportunity to reconsider the standard approach to regulation and consider a framework that best suits the SEQ water industry and its customers. The Direction Notice highlights a number of issues for the QCA to consider throughout the review. This submission provides an overview of some of the important issues that should be considered throughout the review:

- Promoting regulatory certainty and stability
- Development of pricing principles
- Implement appropriate timeframes
- Level of regulatory oversight to be applied
- Consideration of whole-of-sector approach
- Incorporating customer engagement

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More specific details and our position on these issues (based on consultation with key stakeholders) will be put forward throughout the review process.

#### *Promotion of regulatory certainty and stability*

Queensland Urban Utilities considers it important that any regulatory framework provides certainty to the industry and its stakeholders. The previous and current Interim Regulatory Frameworks have not provided certainty with issues such as revenue under-recovery and changing frameworks.

A stable regulatory framework with certainty in its application will ensure that the costs and burden in applying regulation will be minimised. Examples of this include the costs associated with preparing for new regulatory review periods and the time required to ensure financial information is consistent with regulatory requirements. In addition to this, a stable framework will allow the businesses to make long-term strategic decisions without concerns there may be a change to the regulatory framework that alters the outcome of the investment decision.

In developing a stable regulatory framework, consideration should also be given to the consistent treatment of different businesses (i.e. distribution-retailers, council water businesses and bulk water providers). It is important that the design of the regulatory framework should be based on getting a consistent positive outcome across the industry regardless of the business.

#### *Development of pricing principles*

Queensland Urban Utilities welcomes the requirement within the Direction Notice to establish pricing principles to apply from 1 July 2015 onwards. The establishment of clear pricing principles to apply to the whole SEQ water industry (including distribution-retail and bulk providers) will provide guidance to the businesses with any pricing related decision-making.

One of the most common issues in relation to setting pricing principles is the issue of conflicting objectives (i.e. cost reflective v. administrative simplicity). In determining the pricing principles to apply to the industry, the review should also consider how these conflicting objectives should be dealt with.

There should be sufficient consultation from all interested parties in determining the most important principles to apply to the industry. This will ensure that stakeholders, such as customer groups, shareholders and businesses, are able to put forward the most important principle from their own perspective.

#### *Appropriate timeframes*

The timeframes for the current regulatory framework result in the regulatory review being completed within the regulatory period. This means that recommendations and findings of the review are received by the business to

action or implement within the period to which they apply. In addition to this, the current review is undertaken at the same time the business must finalise

end of financial year statutory accounting requirements. This impacts on the resources available for the review.

In considering the most appropriate timeframes for the long-term framework to apply, the review should consider the benefits of conducting periodic regulatory reviews at different times (i.e. completely before or completely after the regulatory period). In other jurisdictions, these reviews are completed prior to the commencement of the regulatory period to ensure that the recommendations are incorporated into prices for that regulatory period.

The length of the regulatory period should also be determined with the view to ensuring the most appropriate length of time between reviews is implemented. The previous interim framework with annual reviews did not provide the businesses with opportunity to implement any of the findings from the review. These very regular reviews also add extra cost to the businesses. Long-term regulatory periods however, can create forecasting risks for both customers and the businesses. An appropriate balance is sought through this process.

#### *Level of regulatory oversight to be applied*

The current price monitoring framework was developed with a view to transitioning businesses to price deterministic regulation at the end of the initial 3-year period. Given that this did not eventuate, it is prudent to re-consider the level of regulatory oversight to be applied to the businesses.

The Direction Notice specifies:

- the form of prices oversight should be proportionate with the risk of misuse of market power by the businesses to ensure that the costs of implementing the framework do not exceed the benefits
- the form of oversight applied should seek to minimise the administrative burden on the businesses, and
- the long-term framework should facilitate the businesses moving to more light-handed oversight over time.

The content of the Direction Notice indicates that the businesses will continue to be reviewed through an assessment of their maximum allowable revenue (MAR). This represents a quasi-form of revenue cap regulation, with the businesses to remain responsible for the setting of their own tariffs and tariff structures. The setting of these tariffs would then need to comply with the pricing principles agreed through this review process.

It would be expected that where the risk of the misuse of monopoly power were low, the oversight would be minimal. This is especially the case where businesses are under-recovering in relation to the QCA-determined MAR, or through continued findings from the QCA of not exercising monopoly power.

There are a number of factors to consider in the level of oversight to be applied:

- Strength of regulatory penalties and incentives (such as in the form of specific incentive mechanisms or the length of the regulatory period)
- Any possible transitioning to a lighter-handed regime (potential for businesses to reduce the regulatory burden through meeting regulatory hurdles)
- Complexity of data reporting requirements (level of detail in Information Requirement templates)

The requirement for the framework to facilitate the businesses moving to more light-handed oversight over time could happen through a number of options – the regulatory reviews could focus on processes rather than outputs, while regulatory 'hurdles' could be put in place to transition the businesses to more conventional price monitoring that focuses on reasonableness rather than prudence and efficiency. The concept of this transition will need to be clearly outlined through this review process to ensure there is certainty for the industry as to how this process may occur.

As outlined in the Direction Notice, the treatment of any under or over-recoveries in relation to water and sewerage services should be considered throughout the review process. Mechanisms that deal with under and over-recoveries are designed to ensure businesses recover their regulated revenue over the long-term while being mindful of equity concerns to customers of any tariff structural adjustments. Any clarification of the regulatory treatment of these under or over-recoveries for the businesses will assist in providing certainty for the industry.

The regulatory framework must also be cognisant of the fact that the water businesses receive a material portion of revenue from developers through infrastructure charges. At present, the businesses do not control the setting of these charges as they are capped by the State Government. Given the number of factors that can influence development it is difficult to forecast the level of revenue to be received from infrastructure charges. It should be noted however that the revenue received from these charges impact on the level of revenue to be recovered through ongoing utility charges, therefore it is important that the framework takes account of these two sources of revenue.

#### *Consideration of whole-of-sector approach*

The requirement to ensure that the framework encourages a whole-of-sector approach to solutions for the industry is important. This consideration could potentially lead to reductions in the level of expenditure required by the businesses to provide water and sewerage services through increased co-ordination between businesses within the supply chain. This could potentially reduce the need for significant long-term capital investment for the industry. Queensland Urban Utilities is welcoming of any such considerations that could possibly reduce the cost impact on customers.

### *Incorporating customer engagement*

Queensland Urban Utilities welcomes the reference in the Direction Notice to consider the appropriate levels of customer engagement for the framework. Throughout this review process, Queensland Urban Utilities will consult with its shareholders and customers (through customer groups such as QCOSS and our Customer and Community Reference Group) to ensure the positions put forward throughout the review are supported by Queensland Urban Utilities' key stakeholders.

QUU notes that the QCA is currently undertaking an industry-wide review of the cost of capital and it is expected that the outcomes of that review will inform this review of the framework to apply beyond 1 July 2015.

Queensland Urban Utilities looks forward to engaging with the QCA throughout the review process. If you have any queries in relation to this submission or would like to discuss Queensland Urban Utilities' involvement throughout the review, please contact Tim Ryan on (07) 3855 6161.

Yours sincerely



**LOUISE DUDLEY**  
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**Queensland Urban Utilities**