Submission to the Queensland Competition Authority (QCA)

Gladstone Area Water Board 2020 Price Monitoring Investigation

1. Introduction

Callide Power Management Pty Ltd (CPM) is the Manager of the Callide C Power Station in Biloela, Queensland, and contracts for the supply of water from the Gladstone Area Water Board (GAWB) on behalf of the owners (Callide Energy Pty Ltd and IG Power (Callide) Limited).

CPM has been invited to respond to the 2020 Price Monitoring Investigation submitted by GAWB to the Queensland Competition Authority (QCA), which is intended by GAWB to form the basis of the 2020 price reset process.

2. Executive Summary

CPM has reviewed GAWB's 2020 Price Monitoring Investigation submission to the QCA. CPM understands that its indicative 1 July 2020 price, as calculated by GAWB, is expected to be 6% (in real terms) lower than the current price. Whilst at face value, a real price decrease is a 'good' result for industry, CPM is seeking to ensure the QCA scrutinise and validate the key changes in approach and methodology proposed in GAWB's submission.

CPM wishes to impress upon the QCA the need to ensure that it fully understands – and makes transparent to users – the underlying impact of the movements in each pricing parameter/assumption. CPM believes this is necessary because if the QCA accepts each of these changes, a precedent will be set for future pricing reviews. CPM's key concerns regarding GAWB's submission and the QCA process include:

- **Capital Expenditure and Forecast** for the 2021 – 2025 period. The projects that GAWB advised that are of significance to CPM include:
    - Hatchery Relocation, $6.213M, 2021
    - Muster Point – Emergency Shelter, $1.666M, 2021
    - AWD Pipeline Remediation, $3.630M, 2023
    - AWD Spillway Capacity Upgrade – Stage 2 and 3, $55.534M, 2025
    - GFP Agreement Option – SGIC $1.128M, 2025
    - GFP Agreement Option – GDSA $1.134M, 2025

Whilst CPM understands that many of these capital projects are a regulatory requirement, most (approximately 80%) are regarded as asset replacement.

- Limited flexibility on the **Customer Water Demand obligation (CWD)**. The current five-year period beginning 1 July 2015 – 30 June 2020 is forecast to be ~47,500ML vs CWD of 54,000ML.
- Revenue Under-Recovery and the methodology being proposed.

3. Capital Expenditure and Forecast

All capital expenditure should yield benefits, either direct productivity, reduced risk (safety etc) or reduced contingent liabilities. If it is GAWB's intention to include increased capital expenditures in the cost base then the corresponding benefits should be included in any price adjustment and/or through improved (and contractually defined) levels of service or reduced risk profiles to customers.

GAWB has included a significant forecast capital expenditure program for the 2021-2025 regulatory period. Over the five-year period 2021 - 2025, GAWB is proposing to spend $178.5 m to either replace ageing assets or to address regulatory or compliance obligations, while $60.7 m will be spent on dam safety upgrades.

Of these projects, CPM notes that the *Up Lift Lower Spillway* and the *Cavitation and damage of lower spillway* is required by 2025. However, the *Structural Instability of Gravity Concrete Spillway* isn't required until 2035. GAWB have advised that all three projects will be done in the 2021 – 2025 pricing period due to cost efficiencies achieved by executing the above works concurrently. CPM argues that the *Structural Instability of Gravity Concrete Spillway* should be completed in two tranches (in line with regulatory requirements) with the first being 2025 and the second in 2035. GAWB is proposing to complete both tranches by 2025. While CPM agrees there is potential for cost savings in undertaking the two tranches simultaneously, the required completion dates are separated by a significant amount of time which could give rise to a number of uncertainties (cost being one of them).

The remainder of this forecast capital expenditure relates to GAWB's downstream networks and does not directly affect charges for dam-only customers, like CPM. However, CPM submits that the QCA should critically review the forecast capital expenditure to ensure that charges recover only expenditure that is absolutely necessary to meet demand and service requirements, and represents the most prudent and efficient response to these requirements.

CPM also notes that security and reliability of supply should be appropriately balanced with the level of required capital expenditure and the customer's ability and desire to separately manage these risks.

4. Customer Water Demand Obligation

CPM has previously raised concerns with GAWB with regards to its current CWD. For the period 1 July 2010 – 30 June 2015, CPM's demand was ~38,000ML vs CWD of 63,000ML. Due to the large decrease in water consumption from 2010 - 2015, CPM revised its demand down to reflect future generation requirements. For the current 5-year period of 1 July 2015 – 30 June 2020, CPM's demand is forecast to be ~47,500 vs CWD of 54,000ML. Over the combined 10-year period, CPM's demand forecast will be 85,500ML vs CWD of 117,000ML representing a variance of 31,500ML. The maximum annual demand that CPM has had across the 10-year period is expected to be FY19, and will be approximately ~10,300ML which is still below its CWD.

The above highlights the disparity between the CWD arrangement and Callide C Power Station demand. At present, CPM must ensure that the annual CWD is adequate to meet a one in 5-year cycle in which both generating units are not undergoing a major or minor overhaul. Meaning all other years within the cycle will likely require at least 7% less than the annual CWD. CPM estimates that over the past 10 years it has paid ~$14 m for water that was never delivered.

The Water Supply Agreement (WSA) between CPM and GAWB was entered June 2002 and has an initial term of 28 years. The agreement outlines that the parties will give effect to the pricing principles as determined by the QCA from time to time. The terms of the agreement will then be amended to reflect the QCA decision. It is important to note that no amendment has been made to the WSA since it was executed despite the various changes in pricing principles that have been adopted. Since the QCA decision of 2010, GAWB has been charging CPM a take or pay amount which varies from the WSA. The assumed reason for this is in fact due to the QCA decision. The actual wording in the agreement outlines a minimum take or pay obligation of 75%, however CPM has been invoiced at 100% of its CWD despite never taking the full amount (as noted above).

CPM would like to draw the attention of the QCA to the contractual arrangements GAWB has in place with its customers and consider the unintended consequences of its recommendations.

5. Revenue Under-Recovery

GAWB is requesting the QCA consider an alternative approach to "price smoothing" due to the accumulation of under recovered revenue over the past 20 years. GAWB is seeking to change from a 20-year price smoothing period to 5-years with a separate payment to be made by customers to make up any under-recovery in revenue. CPM has the following concerns with this approach:

- It does not drive efficiencies when managing costs.
- It sends a signal that GAWB does not have a good understanding of its operating costs if it is constantly under recovering its revenue.
- In its submission GAWB refers to the uncertainty around its future customer profile. However, many of its customers will be managed through long term supply contracts therefore giving it certainty around future demand.
- GAWB has not disclosed its annual surplus / deficit so it is difficult to assess the impact the revenue under-recovery has on its ability to service its assets.
- CPM notes a difference between contracted volume and metered volume and would like to question whether GAWB is marketing excess water accordingly in order to reduce the revenue under-recovery

Currently, a "carry over adjustment" is not considered under the current WSA CPM has in place with GAWB. CPM would like the QCA to consider this, as well as those concerns listed above as part of its review.

6. Other Considerations

CPM would like the QCA to consider the differing pricing structures with customers who take water from the same node. CPM has been advised that it will receive an overall reduction of 6% and would expect that all customers who take bulk water from the 'Awoonga Node' would all be receiving the same 6% reduction.

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

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