

QUEENSLAND COMPETITION AUTHORITY ACT 1997

SECTION 23

MINISTER'S REFERRAL NOTICE

Referral

Pursuant to section 23(1) of the *Queensland Competition Authority Act 1997* (the Act), I refer the monopoly business activity of bulk water supply by the Queensland Bulk Water Supply Authority (Seqwater) in the local government areas listed below to the Queensland Competition Authority (the Authority) for an investigation about the pricing practices relating to that activity with the objective of recommending the State bulk water prices (Prices) for Seqwater in the following local government areas for the period of 1 July 2022 to 30 June 2026 (the Regulatory Period).

Brisbane	Logan	Scenic Rim
Gold Coast	Moreton Bay	Somerset
Ipswich	Noosa	Sunshine Coast
Lockyer Valley	Redland	

(A) Pursuant to section 24 of the Act, I direct the Authority to consider and make recommendations about the following matters as part of its investigation:

- 1) Recommend Prices for the Regulatory Period that allow Seqwater sufficient revenue to recover the prudent and efficient costs of providing bulk water supply services (defined as per (C)(4)) and repay Price Path Debt (as per (C)(11) and (C)(14)) by 2027-28 under normal operating conditions as per (C)(2).
- 2) Prices are to be consistent with the following:
 - (a) bulk water costs include, but are not limited to:
 - i. prudent and efficient capital expenditure and operating expenditure as per (C)(5);
 - ii. a return on assets (including working capital) using a rate of return as per (C)(10);
 - iii. an allowance for tax (where applicable);
 - iv. interest on Price Path Debt as per (C)(13);
 - v. depreciation calculated as per (C)(8);
 - vi. any costs detailed in Seqwater's bulk water supply agreements; and
 - vii. additional prudent and efficient operating and capital costs arising from Review Events (defined as per (C)(14))
 - (b) the regulated asset base (RAB) is to be established as per (C)(6) and subject to the opening RAB dictated by (C)(7);
 - (c) repayment of Price Path Debt by 2027-28;
 - (d) prices as per (C)(1);
 - (e) forecast demand as per (C)(2)-(C)(3); and
 - (f) the inflation forecasting methodology as per (C)(9).
- 3) Price Path Debt is to be calculated as per (C)(11)-(C)(13);
- 4) A Drought Allowance is to be calculated as per (C)(15)-(C)(17); and
- 5) The other matters as per (C)(18)-(C)(19).

(B) Timing

- 1) Pursuant to section 24 of the Act, I direct the Authority to provide to the Minister for Water and me:
 - (a) a Draft Report by 30 November 2021, following on a submission being made by Seqwater by 30 June 2021; and
 - (b) a Final Report by 31 March 2022.

A handwritten signature in blue ink, appearing to read "Cameron Dick". The signature is fluid and cursive, with a prominent initial "C" and a long horizontal stroke at the end.

HON. CAMERON DICK MP

Treasurer and Minister for Investment

(C) Definitions

Price structure

- 1) The Authority is to recommend Prices that:
 - (a) are volumetric only with a single common price to apply for all SEQ council areas;
 - (b) are consistent with smoothing price changes over the Regulatory Period; and
 - (c) remain constant in real terms beyond the Regulatory Period until 2027-28.

Normal operating conditions and Forecast demand

- 2) For the purpose of recommending Prices, forecast demand is to be as provided by Seqwater for normal operating conditions and must be within the range (low-high) published in the SEQ Water Security Program.
- 3) The Authority can make adjustments to the normal operating conditions forecast demand to ensure it is appropriate for regulatory pricing purposes as long as any Authority adjusted forecast remains within the range (low-high) published in the SEQ Water Security Program.

Capital and Operating Expenditure

- 4) Capital and operating expenditure includes activities related to the provision of bulk water supply services (including catchment management) as well as activities related to recreation management and flood mitigation costs.
- 5) To assess capital and operating expenditure from 1 July 2022 to 30 June 2028, the Authority must:
 - (a) form a view on the prudence and efficiency of capital and operating expenditure, with the focus on cost areas which are material rather than matters which are likely to have a minor and inconsequential impact in total;
 - (b) to the extent that it is not practicable to form a view on the prudence and/or efficiency of aspects of capital expenditure (for example, because a project is not expected to be commissioned until later in the price path period), adopt an appropriate assessment approach; and
 - (c) have regard to the strategic and operational plans approved by the responsible Ministers under the South East Queensland Water (Restructuring) Act 2007.

RAB

- 6) The opening RAB as at 1 July 2017 is not to be optimised and the Authority is to accept the remaining lives as used by the Authority in the 2018-21 review.
- 7) To establish the opening RAB as at 1 July 2022, the Authority is to:
 - (a) assess actual capital expenditure from 1 July 2017 to 30 June 2022 (to the extent actual capital expenditure information is available) for prudence and efficiency. The review should focus on items that would have a material impact rather than matters which are likely to have a minor and inconsequential impact in total. Any findings of the Authority against the prudence and efficiency of projects sampled should not be extrapolated to un-sampled projects.

- (b) roll forward the RAB from 1 July 2017 to 30 June 2022, using actual capital expenditure, and forecast capital expenditure where actual expenditure is not available, adjusted for any findings as per (C)(7)(a); and
- (c) adjust for depreciation and actual inflation over the period.

8) Depreciation is to be calculated using the straight-line method, reflecting the remaining useful life of the assets.

Forecast inflation

9) The forecast rate of inflation must be determined by the Authority using the 40-day average of the forward inflation rate for that year implied by traded zero-coupon Australian inflation swaps.

Rate of Return

10) In regard to the rate of return the Authority uses to recommend Prices, the following is to apply:

- (a) for assets (including working capital), a benchmark weighted average cost of capital (WACC) return, using a cost of equity as determined by the Authority for the equity component, and Seqwater's cost of debt as advised by Queensland Treasury Corporation (QTC) for the debt component; and
- (b) if the cost of equity calculation determined by the Authority is lower than Seqwater's cost of debt, the rate of return applying to assets should be Seqwater's cost of debt as advised by QTC.

Price Path Debt

11) Price Path Debt is the accumulated under-recovery arising from the bulk water price path.

12) To establish the opening Price Path Debt as at 1 July 2022, the Authority is to make an end of period adjustment to the Price Path Debt as at 1 July 2017 based on:

- (a) an updated assessment of Maximum Allowable Revenue from 1 July 2017 to 30 June 2022 adjusting for the updated capital costs based on rolling forward the RAB as per item (C)(7);
- (b) updating the rate of return and interest costs for the relevant actual cost of debt as advised by QTC;
- (c) any prudent and efficient costs arising from Review Events as per (C)(14);
- (d) any foregone revenue as a result of pricing amendments or decisions;
- (e) Seqwater's actual revenue from 1 July 2017 to 30 June 2021 and forecast revenue for 1 July 2021 to 30 June 2022; and
- (f) actual demand-related variable costs from 1 July 2017 to 30 June 2021 and forecast demand-related variable costs for 1 July 2021 to 30 June 2022.

13) Interest on Price Path Debt from 1 July 2022 is to be calculated by applying Seqwater's cost of debt as advised by QTC.

Review Events

- 14) Review Events are defined in accordance with the Authority's recommendations from the previous price review, as set out in its March 2018 report; with the Authority also to consider and make a recommendation on the appropriateness of future review events.

Drought Allowance

- 15) The Authority is to recommend a Drought Allowance that could be applied during the Regulatory Period, that is in addition to Prices under normal operating conditions as per (C)(1), and expected to provide Seqwater with total revenue sufficient to recover prudent and efficient costs associated with Drought operating conditions.
- 16) Drought operating conditions refers to a situation where Seqwater is operating at or below the 'Drought Response' trigger per the published SEQ Water Security Program for the length of the Regulatory Period.
- 17) The Drought Allowance is to:
 - (a) include the incremental costs expected to be incurred during drought operating conditions including, but not limited to, costs associated with water conservation measures, and mobilisation of the Gold Coast Desalination Plant and the Western Corridor Recycled Water Scheme, with a focus on cost areas which are material rather than cost areas which are likely to have a minor and inconsequential impact in total;
 - (b) account for reduced forecast demand during drought operating conditions, noting that the Authority can make adjustments to the drought operating conditions forecast demand to ensure it is appropriate for regulatory pricing purposes as long as any Authority adjusted forecast remains at or above target demand consistent with medium level water restrictions as published in the Water Security Program (not including demand from power stations and Toowoomba Regional Council); and
 - (c) remain constant in real terms for the duration of the Regulatory Period.

Other Matters

- 18) Bulk water costs are to be offset by the below revenue streams, as advised from Seqwater:
 - (a) revenue from the sale of water to power stations;
 - (b) revenue from other water sales;
 - (c) revenue from any other source, except revenue related to the hydroelectric power stations; and
 - (d) revenue as a result of pricing amendments or decisions.
- 19) Costs and revenues associated with Seqwater's declared irrigation services are to be excluded. The costs related to irrigation services are to be calculated consistent with the cost allocation approach adopted by the Authority in its review of Seqwater's irrigation price paths for 2020-24.