

9 June 2023

Mr Leigh Spencer
Project Manager
Queensland Competition Authority
Brisbane, Queensland

Dear Leigh,

Re: DBIM comments on the QCA draft position paper on climate change expenditure

Dalrymple Bay Infrastructure Management Pty Ltd (**DBIM**) appreciates the opportunity to comment on the QCA's draft position paper on climate change expenditure issued in April 2023.

DBIM considers that the QCA's draft position paper has struck a pragmatic balance between managing the inherent uncertainties which define climate change-related expenditure and maintaining appropriate incentives for prudent and efficient expenditure.

It is clear that the economic and financial risks of climate change are material to our business, customers, and community. DBIM considers that the QCA's existing assessment frameworks are broadly appropriate to manage these risks. However, given the unique drivers of climate change-related expenditure, DBIM considers there is merit in the QCA developing a climate change-related expenditure guideline. This will promote regulatory certainty and facilitate prudent and efficient outcomes.

Although it is not directly within the scope of this review, DBIM notes that the factors related to climate change that influence expenditure will also impact the cost of capital for regulated businesses. We recognise the draft position of the QCA that these factors can be adequately considered within the QCA's established rate of return framework, on a case-by-case basis.

Further to these comments, please find attached a paper by Frontier Economics: *Climate change related expenditure – review of the QCA's draft positions*, which reflects DBIM's views on the related matters.

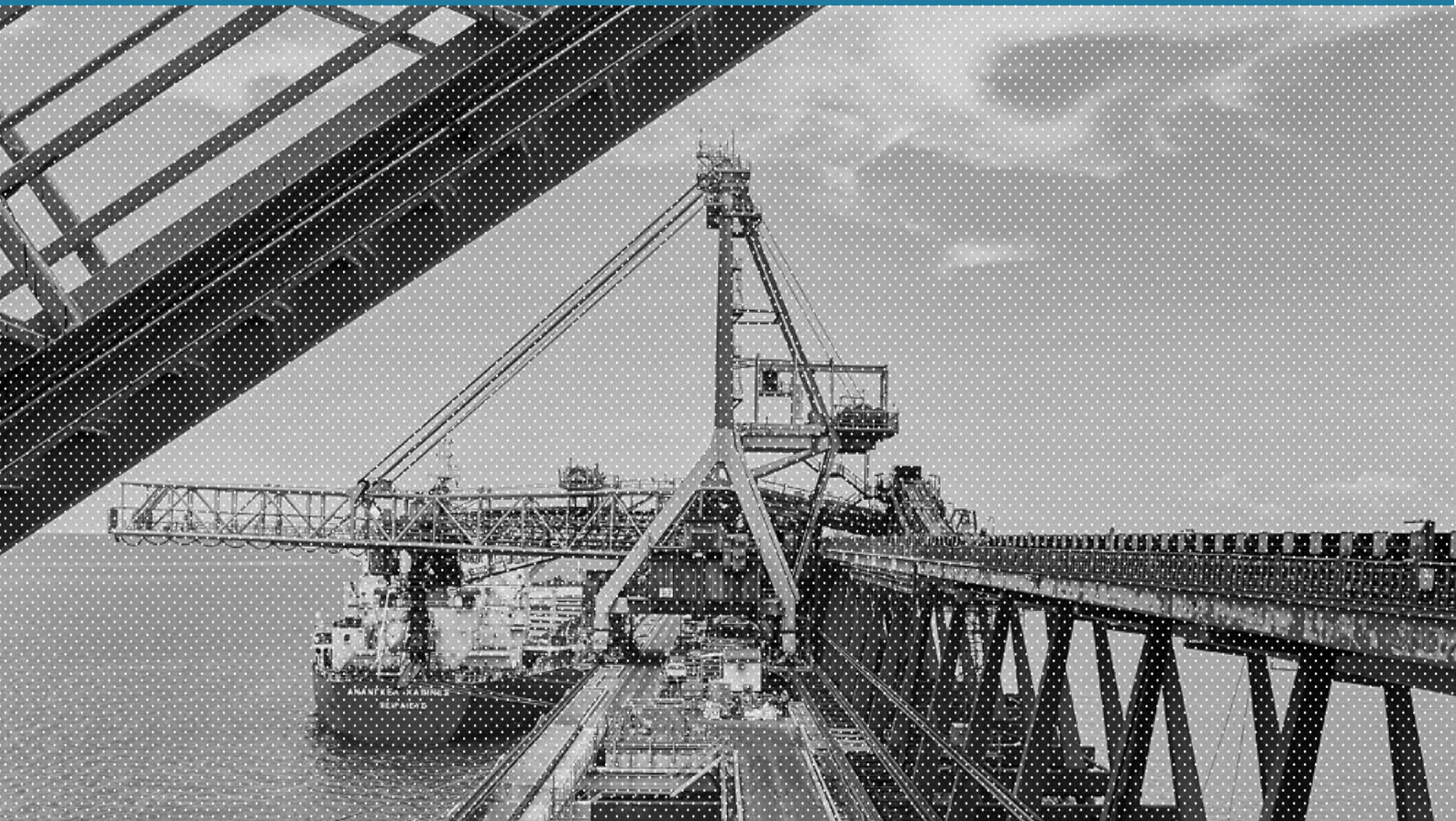
If you need any further information, please do not hesitate to contact me directly.

Yours sincerely,



Jonathan Blakey
Chief Commercial & Sustainability Officer

Dalrymple Bay Infrastructure



Climate change related expenditure – review of the QCA's draft positions



A report for Dalrymple Bay Infrastructure Limited | 8 June 2023



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1 Introduction

1.1 Background

The Queensland Competition Authority (QCA) is examining whether its current regulatory frameworks are adequately equipped to facilitate prudent and efficient expenditure related to climate change. In April 2023, the QCA released its draft position paper *Approach to climate change related expenditure* for stakeholder comment.

Broadly, the QCA has adopted a preliminary view that adaptation and mitigation expenditure in response to climate change is in the interests of regulated entities, their customers and the wider community. The QCA states that:¹

Businesses in unregulated markets are modifying their capital and operating expenditure profiles in response to climate change, consistent with community expectations. We are therefore open to considering prudent and efficient climate change related expenditure proposals from regulated businesses, and we provide clarity in this paper [the draft position paper] on how the provisions in the QCA Act and our existing approval frameworks can accommodate consideration of both adaptation and mitigation expenditure. It is not evident that our existing processes for considering expenditure need to materially change in order to consider this type of expenditure—although we recognise that the nature and drivers of such expenditure may differ from those we have considered in the past.

To support its main preliminary stance, the QCA has developed a range of specific draft positions. The ultimate goal in finalising these positions is to provide regulated entities, their customers, and the wider community with a clear understanding of how the QCA intends to accommodate climate change-related expenditure in a way that is consistent with its regulatory objectives.

¹ Queensland Competition Authority 2023, *Draft position paper approach to climate change related expenditure*, April, p. i.



1.2 Our instructions and key findings

DBI has asked Frontier Economics to review the QCA's draft position paper *Approach to climate change related expenditure* and offer our perspective on the QCA's draft positions and to identify any potential points for further comment. In summary, after reviewing the QCA's draft position paper:

- We support the QCA's draft position that its current processes for assessing the prudence and efficiency of expenditure does not need to materially change to incorporate climate change-related expenditure;
- The QCA has developed a set of well-reasoned and pragmatic draft positions which can act as a basis for appropriately incorporating climate change adaptation and mitigation expenditures more formally into its regulatory decisions; and
- The QCA should produce a guideline that indicates how it will consider climate change-related expenditure. A well-developed guideline will promote regulatory certainty for business and their stakeholders.

Economic regulation must give due consideration to expenditure related to climate change and the environment. To this end, economic regulators both domestically in Australia and abroad are contending with the difficult balancing act presented by the risks and opportunities of climate change. In our view, the QCA's proactive and transparent approach in managing these regulatory challenges stands as a model for other jurisdictions to emulate.



2 Our review of key draft positions

We support the QCA's draft positions that:

- It is open to considering prudent and efficient climate change-related expenditure; and
- Its existing processes for considering expenditure do not need to materially change to incorporate climate change-related expenditure.

The QCA has also acknowledged that the nature and drivers of climate change-related expenditure may differ from other areas of expenditure. In this regard, we discuss the benefits of the QCA developing a climate change-related expenditure guideline in Section 3.

In this section we review and provide comment on the QCA's key draft positions.

2.1 The QCA's draft positions are pragmatic and will promote regulatory certainty

The QCA's regulatory framework does not need to be overhauled to incorporate climate change-related expenditure. In its draft position paper, the QCA has formed a range of draft positions which collectively strike a pragmatic balance between the regulatory need to facilitate decision making under uncertainty while also maintaining incentives for prudent and efficient expenditure.

In **Table 1** we highlight what we consider to be the QCA's key draft positions and provide accompanying review comments.

Table 1: The QCA's draft positions and Frontier Economics comment

Theme and QCA draft position	Frontier Economics comment
<p>Existing assessment frameworks are broadly appropriate.</p> <p>The QCA considers that the existing regulatory framework, including the scope/standard/cost approach to assessing prudence and efficiency, is sufficiently flexible to incorporate climate change-related adaptation and mitigation expenditures.²</p>	<p>We agree – the QCA's existing assessment framework is well understood and has proven flexible over time.³</p> <p>The drivers of climate change-related expenditure will likely differ to those considered by the QCA in the past, providing the case for an expenditure guideline.</p>

² Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 38.

³ This is discussed at greater length in Frontier Economics' report: Frontier Economics 2022, *Climate-related risks and regulated infrastructure*, 9 December.



Prudence and efficiency of climate change-related projects should be considered on a whole-of-life basis and encompass private and social costs.

The QCA emphasises efficiency should be considered from a whole-of-life perspective and incorporate social costs (including externalities).

The QCA's position references the factors listed in s. 138(2) of the Act, such as the public interest, that may be more clearly linked to environmental outcomes than the object clause.⁴

We agree, the efficiency and prudence of expenditure should be considered on a whole-of-life basis.

Climate-resilience should be a necessary condition to project prudence and efficiency. Investing in infrastructure that is vulnerable, by design, to an accepted range of climate-related risks is likely to be lower cost in the short term but higher cost in total over the life of the asset.⁵

The weights given by the QCA to factors listed in s. 138(2) of the Act are largely for it to determine. An expenditure guideline may help regulated entities align their expenditure submissions with the QCA's expectations.

Ex ante approval of climate change-related expenditure should reference a credible strategy and business case.

The QCA outlines a set of steps it could use to assess a spending proposal. The steps are based on a regulated entity's coherent, credible strategy and robust business proposal covering need, consultation, options, and efficiency.⁶

We agree – the QCA's openness to accepting a regulated entity's corporate sustainability strategy alongside a business case to support climate change-related expenditure is reasonable.

Most corporate sustainability frameworks explicitly place a business's stakeholders at the centre of the identification of material sustainability issues, including climate change risks and opportunities.⁷ This is a potentially rich source of information to inform the QCA's assessment of climate-change related expenditure.

The social licence to operate is a potential driver of mitigation expenditures.

The QCA acknowledges that mitigation may be necessary for the facility to retain its social licence to operate.⁸

We agree with the QCA's suggestion of a proportionate approach to the scrutiny applied to mitigation expenditure proposals based on materiality and linkages to customer approval or legal requirements. This approach is sensible and aligned to the QCA's existing practices.

⁴ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, pp. 18–21

⁵ This is discussed at greater length in Frontier Economics' report: Frontier Economics 2022, *Climate-related risks and regulated infrastructure*, 9 December.

⁶ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 42.

⁷ For example, in preparing its 2022 Sustainability Report, DBI engaged with its internal and external stakeholders across a series of interviews and online surveys to understand their perspectives on sustainability-related risks. Refer: Dalrymple Bay Infrastructure 2022, Sustainability Report 2022, https://dbinfrastucture.com.au/wp-content/uploads/2022/11/DBC0007-SR22-PFOa_web_spreads.pdf

⁸ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 60.



The QCA also introduces a *Mitigation expenditure pathway approach* that involves applying greater scrutiny in evaluating the prudence and efficiency of such expenditure as customer approval or legal requirements become less present or direct.

Further, the greater the proposed mitigation expenditure the greater the scrutiny the QCA is likely to apply⁹

Ex-post reviews should explicitly avoid hindsight bias.

The QCA stated that climate related expenditure lends itself to ex ante assessment, conditional on a well-supported business case.¹⁰

In the situation that an ex post review does occur, the QCA clarified the test for information known at the time centres around what an entity ‘could have known at the time’ as distinct to what it did appear to know at the time.¹¹

Social license to operate may align to several of the factors listed in s 138(2) of the Act.

We agree that a well-supported business case supports the case for ex ante assessment of climate change related expenditure.

In our view, a greater reliance on ex ante frameworks will limit the degree of regulatory uncertainty imposed on the regulated entity.

The QCA’s positioning that the use of ex post reviews will be designed to support ex ante assessment and will not penalise for hindsight will incentivise prudent and efficient investment and is consistent with good regulatory practice.

Explanation of how the QCA intends to operationalise this practice will be an important element of any guideline.

The potential for a climate change-related expenditure guideline

The QCA acknowledges that a climate change-related expenditure guideline that specifically signals how it may consider such expenditure could be useful to stakeholders. It proposes a range of topics that such a guideline could cover.¹²

We support the development of a climate change-related expenditure guideline. Matters raised in the Guideline should align to the practices undertaken by well-managed, efficient businesses operating in a competitive environment.

We consider a climate change-related expenditure guideline more fully in Section 3.

⁹ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 56.

¹⁰ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 46.

¹¹ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 47.

¹² Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 65–66.



3 Climate change-related expenditure guideline

The QCA stated in its draft position paper that it is considering publishing a draft climate change related expenditure guideline (Guideline) with the final position paper, potentially including indicative submission templates.

In this section, we discuss:

- the function of the Guideline, and the potential benefits for regulated entities, their customers, and wider communities; and
- specific matters for inclusion in the Guideline.

3.1 A Guideline will provide benefits

We consider that a QCA Guideline would be of significant benefit to regulated entities and their stakeholders. We note that the QCA's forthcoming final position paper will contain a significant amount of material that regulated entities might consider when preparing their climate change-related expenditure submissions. A Guideline should both reflect this material and complement it with the provision of practical guidance as to the potential actions, practices, or standards the QCA may have regard to when it assesses the prudence and efficiency of climate change-related expenditure.

The QCA's position paper and the related Guideline may be reviewed in the future based on evolving market practices, standards, and government policies relevant to the prudence and efficiency of climate change-related expenditure.

We agree with the QCA's observation that climate change-related expenditure differs to other types of expenditure. This difference in part reflects a combination of:

- a greater level of inherent uncertainty related to the scale and timing of expenditure required to adequately manage the physical impacts of climate change;
- the material and growing role of government policies in driving expenditure requirements; and
- the tendency for the beneficiaries of expenditure to extend beyond the regulated entity or its customers.

With this in mind, a Guideline will aid regulatory certainty, assist with compliance and accountability and set the groundwork for future and ongoing improvement:

- **Regulatory certainty:** The Guideline should assist in decision making by providing frameworks, criteria or principles regulated entities may consider when preparing an expenditure proposal – thereby reducing investment uncertainty and minimising ambiguity in regulatory expectations. Regulatory certainty helps to foster an environment conducive to investment, innovation, and long-term planning as it enables stakeholders to make informed decisions. Stakeholder comments on the QCA's draft position paper suggest that perceived



uncertainty as to the use and nature of ex post reviews may disincentivise prudent and efficient investment.¹³

- **Compliance and accountability:** Following the processes and considerations contained in the Guideline should provide a degree of assurance to stakeholders that a regulated entity's proposed expenditures, especially in uncertain situations, are in line with practices followed by well-managed and efficient businesses operating in a competitive environment. The Guideline will be particularly useful in providing a reference point for how regulated entities may consider the role of positive externalities related to an expenditure proposal.
- **Continuous improvement:** The Guideline will likely evolve over time to reflect resolved uncertainties, changing policy and market circumstances, and new emerging trends (for example, closely related to the threats raised by climate change risk is an increasing recognition of nature-related risks).¹⁴ The Guideline will provide a focal point for future reviews.

Notwithstanding these benefits, the Guideline should avoid acting to constrain regulated entities' decision making or, as a result, indirectly hamper innovation in climate change-related expenditure. In our view, the QCA is also correct in its assessment of what a Guideline should not do:¹⁵

Any guideline [The QCA] may prepare is not intended to be a compliance hurdle for submitters seeking approval for climate-related expenditure. Nor is it intended to constrain how any business prepares its submission. As such, a guideline would not seek to be prescriptive or exclusively identify the matters that a business ought to have regard to when making a submission seeking approval of climate-related expenditure. Ultimately, the nature and content of any submission are matters for the submitter in making a sound case for its expenditure proposal.

The next section outlines the matters that the QCA may consider including in the Guideline.

¹³ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 37–41.

¹⁴ For example, see: Australian Government 2023, *Financing Solutions for Nature*, accessed 29 May 2023, <https://www.dcceew.gov.au/climate-change/policy/nature-based-solutions-for-climate/financing-solutions>

¹⁵ Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 66.



3.2 Potential matters for inclusion in the Guideline

Given a decision to produce a Guideline, the QCA asks in its draft position paper what matters it should contain and provides a range of examples (see **Box 1**). We support the matters raised by the QCA in its draft position paper for inclusion in the Guideline – in particular:

- the provision of further detail on the treatment of voluntary mitigation activities; and
- how the QCA intends to employ ex post reviews for climate change-related expenditure.

The QCA may consider the additional matters presented in **Table 2**.

Box 1: Scope of QCA climate related expenditure guideline

The QCA considers that a Guideline could include a series of matters that a regulated business may wish to have regard to, as outlined in this draft position paper, across aspects of the QCA Act, including Part 3 and Part 5. It mentions that a guideline could provide further detail on:

- how a business can demonstrate the alignment of its expenditure proposal with the specific aspects of its long-term strategy, such as any asset master plans or climate strategy plans
- the requirements for a properly supported submission and business case and a step-by-step explanation of how such material can be compiled
- the nature of our role ex ante (with the focus on the business case and the consistency of the expenditure with a long-term strategy) and ex post (with the focus on the cost outcome or the process by which the cost outcome was realised, such as the nature of the tendering process)
- how we may consider a proposal where it has differing degrees of support among customers or has potential impacts beyond the business and its customers/potential customers
- how we will view mandatory mitigation requirements compared to voluntary mitigation activities
- our expectations regarding stakeholder consultations, including the timing of consultations and the nature of the information provided as part of any consultations
- how we view government-endorsed offsets, compared to other offsets.

Source: Queensland Competition Authority 2023, Draft position paper approach to climate change related expenditure, April, p. 65–66.



Table 2: Additional matters for potential inclusion in the Guideline

Matter	Frontier Economics' comment
<p>Case studies: Inclusion of case studies and concrete examples</p>	<p>The Guideline could include examples, or case studies, of climate change-related projects in order to reinforce the principles and trade-offs that may need to be considered by a regulated entity when preparing a submission.</p> <p>These examples would be most useful in instances where the drivers of expenditure differ to those the QCA has tended to see in the past. For example, voluntary mitigation expenditure, expenditure related to the maintenance of social licence, and adaptation investment to manage specific climate change-related hazards.</p> <p>Further, such case studies might provide guidance on how the QCA will consider the appropriate weight of factors when considering an application to approve climate related-expenditure pursuant to s. 138(2) of the Act.</p>
<p>Measurement of non-market values: How and when to measure social and environmental costs and benefits related to climate change-related expenditure, including externalities.</p>	<p>The Guideline could provide principles supporting the robust quantitative valuation of the social and environmental costs and benefits related to climate change-related projects.</p> <p>This advice could consider a range of different approaches employed in practice (such as willingness to pay studies or benefit transfer) as well as outline when qualitative evidence would be suitable to support a business case (such as when quantification is not practically feasible).</p>
<p>Demonstration of public interest: How to demonstrate a proposed expenditure aligns to the public interest or maintenance of social licence to operate.</p>	<p>The Guideline could provide practical guidance on how a regulated entity can align a proposed project with the public interest, community expectations, or maintenance of social licence.</p> <p>This may involve demonstrating a project's alignment with the regulated entity's Corporate Social Responsibility strategy, adherence to international standards (e.g., the UN Sustainable Development Goals), or obtaining third party verification (e.g., B Corp certification).</p>



Incorporating uncertainty: How to practically assess and incorporate long term climate uncertainty into decision making.

The Guideline could outline concepts and approaches to manage long term uncertainty related to climate change. This could include the use of real options and scenario analysis, developed in collaboration with regulated entities' stakeholders.

While not being determinative, a business's climate strategy should rest on a credible and consistent fact base.

Submission templates: The QCA has signalled that its draft Guidance may include indicative submission templates.

We support the QCA's idea of testing the role that submission templates could play in supporting regulated businesses' climate-related expenditure proposals.

It is encouraging that the QCA is exploring the provision of practical guidance. This stands in contrast to the expenditure guidelines produced in some other jurisdictions which have proven to be vague and oftentimes unhelpful over time.

Effective submission templates should strike a balance between provide clear and useful guidance, on the one hand, and limiting a regulatory process to a formulaic 'box ticking' exercise on the other.

In this context, a submission template should also encourage businesses to innovate in their climate change-related projects in the interests of their customers and communities.

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