QLD COMPETITION AUTHORITY

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QUEENSLAND UrbanUtilities

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28 February 2014

Dr Malcolm Roberts
Chairperson
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

Emailed to: water@qca.org.au.

Dear Dr Roberts,

Submission to the Queensland Competition Authority - Draft SEQ Interim Price Monitoring Report 2013-15

Queensland Urban Utilities welcomes the opportunity to respond to the Queensland Competition Authority's (QCA's) Draft SEQ Interim Price Monitoring Report Parts A and B.

This is the fourth year of operations since Queensland Urban Utilities ("QUU") was created to provide potable water, recycled water and sewerage services to over 1.3 million people in South East Queensland.

In the three price monitoring reviews completed to date, the QCA has concluded that there is no evidence of QUU exercising monopoly power, and based on this draft report, the QCA will again be arriving at the same conclusions for 2013/14 and 2014/15.

QUU takes its role as a provider of essential services within the community seriously, and we are acutely aware of customer sentiments with regard to delivering services at least cost. Recently, we were able to demonstrate our commitment to our customers by limiting the increase in the distribution-retail component of our 2013/14 water and sewerage prices to 3.9% (less than a dollar a week). QUU was able to manage this despite rising costs and including the need for significant investment in infrastructure projects.

To meet the challenges of operating and maintaining the current network and investing for future growth, QUU has undertaken internal reviews of a number of its management systems and has adopted a number of initiatives with the intention of

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putting in place systems that are consistent with industry best practice and to operate in a more efficient manner.

This has seen QUU:

- undertake an Enterprise Excellence Review to find further efficiencies within the business. The review has translated into an Enterprise Excellence Program which now sees QUU working on achieving the identified efficiencies. Some of these initiatives include:
  - identifying unaccounted for water throughout our network;
  - establishing an internal transactional services division; and

- enhancing the delivery of the capital program through improving frameworks and procurement processes.

- review and update its capital planning and delivery framework to ensure that only prudent and efficient capital works are undertaken

- review our asset management systems to develop plans and systems that are consistent with established asset management standards

- develop and implement an enterprise risk framework, to identify and better manage the risks the company is exposed to

QUU is of the view that as it continues to mature as a business, and its new management systems and initiatives begin to take effect, it will begin to see improvements in productivity and efficiency.

While we are proud of the work we have undertaken to date, and of our achievements, going forward, we intend to seek opportunities where we can improve, and to continue to provide services that will enrich the quality of life for our customers, and deliver value for our shareholders.

Comments on the draft report

QUU appreciates the level of analysis and work undertaken to publish the draft report, however there a number of issues that QUU would like to provide further comment on. The following are some of the key points on which QUU would like to clarify and provide further information. At the end of this letter, Annexure A provides more detailed discussion on other specific issues.

Fact Sheets/Residential Bills

QUU acknowledges the steps that the QCA has undertaken to promote customer understanding of the regulatory review through the use of Fact Sheets. This method of communication is highly effective because it allows time-poor people to digest complex information quickly and easily.

As Fact Sheets are potentially the only source of information for some customers, it is important that the information and key messages are presented as clearly as possible.

Given that the primary focus of the review is to determine whether water service providers have misused monopoly power, QUU believes this finding should be more prominently positioned on the Fact Sheet and also presented so as to enhance customer understanding. For example, "*We therefore found no evidence of QUU exercising its monopoly power in 2013-15. This means that the prices set by QUU for 2013/14 (and expected 2014/15 prices) are appropriate and are below the prices that would provide the maximum allowable revenue*".

The QCA's finding that there was no evidence of QUU exercising monopoly power should be the first message on the Fact Sheet, rather than the last, so customers can process that important top-line message at a glance.

In the current Fact Sheet, the first and most prominent message is the increase in the average residential bill, of which QUU had limited control.

The following table provides a breakdown of QUU's pricing announcement, outlining the increase in the distribution-retail prices and the bulk water prices and the impact of these price increases on the average residential bill for the year. The impact of the one-off rebate was not included as it was a State-Government initiative that was only applied to one quarter. Similarly, QUU does not alter percentage changes due to impacts of remissions – such as pensioner remissions – that are the control of other authorities.

Table 1: QUU's pricing announcement

Price Adjustments	Brisbane	Ipswich	Lockyer Valley	Scenic Rim	Somerset
QUU Price Increase	3.9%	3.9%	3.9%	3.9%	3.9%
Bulk Water Price Increase	11.9%	12.3%	10.9%	10.3%	9.3%
Increase in average residential bill (149kL)	*6.2%*	*5.9%*	*6.1%*	*5.7%*	*(Esk: 5.7%)* *(Kilcoy: 5.8%)*

QUU is of the view that the QCA's analysis on residential bills should also include the impact of the price increases without the one-off State Government bulk rebate as it would provide the public with a more informed view on the drivers behind the price changes. In the 2012/13 Price Monitoring Review, the QCA reported this information, and this has been left out in its current Draft Report.

The following table provides a breakdown of the components that contributed to the increase in the average residential bills presented by the QCA. It can be seen from this that across QUU's five regions, the distribution-retail component contributed less than one-quarter (25%) to the increase in the average bill. Therefore more than three-quarters (75%) of the increase was outside of QUU's control. Rather than providing general statements about the increase in the average residential bill, the QCA should provide the breakdown of the contributions to this increase to ensure customers are aware of the contribution of each of these reasons to the overall increase.

Table 2: Breakdown of QCA increase in average residential bill

	Brisbane	Ipswich	Lockyer Valley	Scenic Rim	Somerset
QUU	2.7%	2.9%	2.6%	2.8%	2.5%
Bulk and Rebate	11.6%	9.8%	11.6%	9.6%	10.1%
Total	*14.4%*	*12.8%*	*14.2%*	*12.4%*	*12.7%*

Given that this would be a similar scenario for other distributor-retailers that are being reviewed; the presentation of the figure in the Draft Report overview Fact Sheet (change in residential bills) gives the impression that the increases in the average residential bills are wholly owned/controlled by the distribution-retail businesses. This could be addressed by including a figure that distinguishes the breakdown of the increase between distribution-retail, bulk water and the removal of the rebate.

QUU has reservations about whether the comparison of the average residential bill is covered by the Ministerial Direction requirements. In determining whether the businesses have misused monopoly power, the Ministerial Direction requires the QCA to monitor the change in distribution and retail prices of water and sewerage services for residential and non-residential customers, and to allow for the pass through of bulk water costs.

Given that the removal of the bulk water rebate to residential customers does not in itself represent a price and is outside of the distribution and retail sector, it is unclear whether the analysis is captured under the Ministerial Direction.

QUU Feedback: Based on the discussion outlined above, QUU recommends that the QCA consider amending its Fact Sheets as outlined above. QUU is of the view that presenting any increase in average residential bills should provide customers with greater clarity of the drivers of the increase.

Corporate Average Salaries

With regard to the QCA's reduction of corporate employee costs, there are two data calculation inconsistencies and after adjusting for these inconsistencies there is no material increase in average salaries for 2013/14. These inconsistencies relates to:

- not including contractor costs within the employee costs as contractors are included in the FTE numbers.
- the exclusion of the capital program and non-regulated service costs in the calculations, as the FTEs also deliver these services.

Adjusting for these two corrections within the analysis results in increases over the two years of much less than the 3 per cent labour index (0.1 per cent for 2013/14 and a reduction in 2014/15). Given that the 2014/15 FTE numbers had not been reduced to reflect the reduction in employee cost for 2014/15, the average salary decreases, if the number of FTEs are adjusted on a pro-rata basis (using the average salary from the previous year) this results in an increase in 2014/15 of 3 per cent (which is equal to the labour index). Further details and comments are provided in Annexure A below.

QUU Feedback: Given the justification provided above, QUU considers that there should be no reduction of corporate employee costs due to changes in average salaries and that the analysis should be adjusted to reflect this in the Final Report.

Reduction in FTEs for People and Safety Division

QUU has previously informed the QCA that benchmarking analysis does not provide meaningful outcomes if like-for-like comparisons are not made. In this instance, the QCA has reduced QUU's FTE's in the People and Safety Division based on previous work undertaken for Sunwater without considering the different functions that the departments of the two organisations perform. From an initial assessment of the Sunwater analysis, QUU's People and Safety Division conducts two business activities that Sunwater's HR department does not undertake, these being Business Support Services and Work Health and Safety activities.

QUU is not certain whether Sunwater undertakes these two activities through other parts of the business or outsources these activities. SKM's recommendation (that the QCA has relied on) is not based on any robust analysis of the different activities of the departments, or the provision of an efficient benchmark level of corporate cost.

QUU Feedback: Based on the discussion above, QUU considers it appropriate that the QCA review SKM's recommendation and outline whether the benchmarking analysis remains valid.

Demand forecasting/calculation of under-recovery

Based on previous QCA findings, QUU had adjusted its demand forecasting approach to more closely align with the QCA's position. For this review, the QCA however, has adjusted its position on forecasting usage (from 10 months ago) and now considers a lower end target usage per person is correct. This results in a slight difference in the forecast bulk water volumes, however this is translated into a material impact on the bulk water cost for 2014/15.

It is not clear whether actual demand volumes for the year would be used to adjust the QCA-determined maximum allowable revenue (MAR) under any future under-recovery mechanism. Given the pass-through nature of the bulk water costs and the lack of influence that QUU has over this, QUU is of the view that the calculation of any under(over)-recovery should be based on the QCA-determined MAR adjusted for the actual demand volumes for the year. This would reduce the risk of error associated with demand forecasting.

QUU Feedback: QUU considers it appropriate that the QCA provide further guidance on the demand volumes that would be used for determining any under (over) recoveries.

Benefits Realisation Framework

With regard to the QCA's finding that QUU needs to develop a benefits realisation framework, QUU would point out that prior to the start of the 2013-15 Price Monitoring Review, QUU undertook a review of its capital planning and delivery governance framework and considered it essential to incorporate a benefits realisation framework within this process. A benefits realisation framework will ensure that there is a drive for continuous improvement within the business as information on the projects' performance will be communicated back to decision makers. This framework is currently being developed.

The Enterprise Excellence Review (EER) undertaken by QUU in 2012/13 also identified the need to incorporate a benefits realisation framework within operational expenditure projects and programs. The Enterprise Excellence Program which is now implementing the EER has integrated a benefits realisation framework for the various operational initiatives.

QUU Feedback: QUU recommends that the QCA note that a benefits realisation framework has been integrated into QUU's governance framework with regard to operational expenditure. As for capital projects and programs, a benefits realisation framework is being developed for integration into the capital planning and delivery framework.

Recovery of price cap under-recoveries

For 2011/12 and 2012/13, the distribution-retail business had a CPI-based price cap imposed on the distribution-retail component of price increases. The imposition of this cap led to QUU being in a materially under-recovered position in relation to the QCA-determined MAR for these two years. QUU sought to recover the under-recovery related strictly to the imposition of the price cap.

While for 2012/13 QUU did not price to the cap (residential prices were frozen for the year), QUU has not sought to recover this amount of foregone revenue under the cap.

QUU agrees with the QCA's position that regulated businesses should be NPV neutral over time. It is for this reason that QUU put forward the recovery of the price cap under-recovery in future years.

We acknowledge that the ideal approach to recovering under-recoveries is through an Unders and Overs Mechanism however given restrictions in the information template, an alternative method had to be used.

QUU Feedback: QUU recommends that the QCA provides clear guidance on this matter prior to the first submission under the long term regulatory framework.

Presentation of under-recovery of MAR

The QCA presents the under-recovery of MAR based on a calculation of the QCA-determined MAR (based on the QCA's forecast demand volumes) against QUU's forecast revenue (based on QUU's forecast demand volumes). While there is a subsequent table at the end of the section that provides a more consistent calculation (based on the same demand volumes), this consistent approach should be used as the primary presentation of the under-recovery of MAR. Having a comparison of revenue based on one demand forecast and costs (MAR) based on another demand forecast is inconsistent and does not provide a meaningful comparison.

QUU Feedback: QUU suggests that the QCA alter the way the under-recovery of MAR is presented by adopting a consistent approach which is based on the same demand forecasts.

Concluding remarks

QUU appreciates the opportunity to respond to the QCA's Draft Report. QUU understands the benefits of, and the need for, economic regulation and wishes to continue to work with the QCA to ensure that customers see the benefits of regulation.

If you wish to discuss specific aspects of this submission, please contact Tim Ryan Manager for Economic Regulation & Pricing on 07 3855 6161.

Yours sincerely

Louise Dudley

LOUISE DUDLEY
Chief Executive Officer
Queensland Urban Utilities

Enc.

Annexure A

Page	QCA Comments/Issue in Draft Report	Queensland Urban Utilities' Response
p7	Chart 1 Residential Bills Chart includes bulk rebate, but does not include a bar chart which excludes the rebate.	QUU recommends that the chart be amended to include a bar chart which shows the price increases without the bulk water rebate – as was presented in the 2012/13 Price Monitoring Review. Furthermore, the QCA needs to outline the contribution of each of the different components to the overall increase.
p18	Demand for capital planning editorial comment last paragraph	"QUU also estimated non-residential demand using councils' forecasts of land use, which are converted into EPs, before non-residential demand peaking factors, specified in the Design and Construction Code, are applied." QUU recommends that the wording be changed to the above.
p24	Deferment of Brisbane Bartleys Hill	QUU's proposed 'commissioned' projects for 2013-15 were current at the time of its submission to the QCA in June 2013. In August 2013, QUU began to consider deferring the project. QUU suggests that the QCA reflect this in its Final Report. QUU suggests that the QCA changes the wording in its Draft Report so that this distinction is made clear. i.e that the decision to defer the project occurred after QUU made it submission to the QCA. In addition, it was QUU who informed SKM and QCA that this project was being differed.
p.25	Table 16. Brisbane Bartleys Hill / Wellers Hill Zone Connection and Twin River Crossing	The table is confusing and misleading. QCA is interchanging the concept of capital expenditure "as-incurred" with the capital expenditure "as-commissioned". As it stands, the table gives the impressions that no money has been spent on this project. QUU has incurred capital expenditure in these three years; however, the project will not be commissioned until it is completed in 2015/16. The costs that have already been incurred involve internal labour costs, external consultancies etc. These costs will be capitalised once the project is completed and commissioned in 2015/16.
p29	Brisbane Water Meters – efficiency of 5% and reduction of budget	While the QCA and its consultants (SKM and Halcrow) continue to advocate potential efficiencies from directly

		procuring the meters through long term supply contracts, this ignores the costs associated with warehousing the meters and the overheads associated with the meters once they are procured. This analysis was undertaken by Brisbane Water and concluded that the additional costs of warehousing and tracking of the stock of meters resulted in the outsourcing model for meter purchases being the most efficient. QUU recommends that the QCA reconsider its position in relation to this proposed efficiency.
p29	Minor Projects > $5m should be classified as Major Projects SKM considered the program to be a major project for which all requirements of a major project should be undertaken and that classification as a minor project was not appropriate	Individual projects within rolling programs are rarely above $5M. However, the programs containing these individual projects are. A business case for each minor project is developed and assessed, prior to it being included in a program. Furthermore, the rolling programs all have signed off business cases and other documentation that outline the processes and do the justification. QUU reiterates that the water meter replacement program is subject to the rigours of its capital planning governance frameworks. Furthermore, all projects and programs are assessed according to risk. High risk projects which are less than $5m are treated as major projects and undergo the assessment rigour of a major project. QUU is of the opinion that while the water meter program has a high costs which is greater than $5m, the risks associated with the program (i.e. replacing a meter) is a low risk exercises. Furthermore, this program has been market tested by QUU when Skilltech was appointed by QUU to be the contractor to replace the meters.
p31	Brisbane Sewer Retic Systems Renewals Program	QUU suggests that the QCA change the wording in the 2nd paragraph of page 32. While SKM considered that project management allowances may have been excessive, the majority of the reduction was due to an error in QUU's forecasting model, which QUU corrected.
p52	Ipswich Bundamba Creek Trunk Gravity Main Stage 1a and 1b.	Under the current regulatory framework, capital expenditure enters the RAB once it is commissioned. The commissioned value reflects only the amount which is incurred in undertaking the project. Therefore at the conclusion of the project, any unused contingencies are excluded from the commissioned value. While QUU

		agrees with reducing the contingencies given the late stage of the project, this excess would not have entered the RAB at the conclusion of the project if unused. There is also a further point that the QUU wishes to make with regard to contingencies. The stage at which the project is in should not determine the level of contingencies that should be in the projects' budget. Contingencies in project budgets should only be 'given up' once associated project risks have been mitigated/removed. While this particular project was 90% complete at the time the QCA (and SKM) review was undertaken, there were significant risks that were unrealised which caused QUU to adopt a more cautious approach to managing the final stages of this project.
p53	Operating Costs Table 45	The tax values in the table for 2011-12 (forecast) and 2012-13 (budget) do not match the 2011-12 (actuals) and 2012-13 (forecast) data on which they are calculated. This results in a lower reported reduction in distributor-retailer operating costs in the paragraph below the table. This also affects Figure 6 in a minor way.
p56	Table 46 Assessment of operating costs policies (REGIONAL PERSPECTIVE)	Please refer to comments on the Benefit Realisation Framework
p56	Table 46 Assessment of operating costs policies (ASSET MANAGEMENT)	QCA states the following "Not consistent with good industry practice. A range of asset management requirements have been assessed by SKM as not consistent with the ISO 55001 standard." The QCA's comments are misleading. Firstly, the ISO55001 is in Draft form, and has yet to be finalised. QUU suggests that the wording be changed to reflect that the ISO5501 is in draft form and that QUU is working towards being consistent with this standard once it becomes final.
p56	Table 46 Assessment of operating costs policies (PROCUREMENT)	Please refer to comments on the Benefit Realisation Framework
p56	Table 46 Assessment of operating costs policies (BUDGET FORMATION)	As previously outlined to the QCA, QUU has reservations regarding the use of benchmarks for budgeting purposes. To gain any meaningful benefits from a benchmarking exercise there needs to be a like for like comparison between QUU and comparator firms. There are difficulties in the way costs are defined (i.e. business activities) between different entities and how they are

		captured (i.e. different accounts and, some costs are expensed while others are capitalised). Undertaking a benchmarking exercise without having proper regard to these issues leads to distorted outcomes.
p29 p31 p56	Benefit Realisation Framework Various comments made on these pages with regard to the Benefit Realisation Framework	QUU has undertaken a number of reviews of various governance frameworks within the business. Recently it reviewed its capital planning and delivery framework as QUU identified the need to review and measure the benefits from its capital expenditure program and communicate this back to planners and decision makers to improve future decisions. QUU is currently developing a framework to integrate a benefits realisation framework into the capital planning and delivery processes, to enable continuous improvement and support the drive for efficient and cost effective service delivery. The Enterprise Excellence Review undertaken in 2012/13 also revealed that a benefit realisation framework was needed with regard to its operational expenditure. As part of the Enterprise Excellence Program, QUU is now working on integrating a benefit realisation framework on matters relating to operational initiatives, such as information technology, research, business improvement and procurement.
	Brisbane Flood Resilience Program	The proposed capital expenditure that was reviewed by SKM for the QCA was based on preliminary planning work documented in various minor capital project submissions completed in late 2012. The total capital cost of the STP flood resilience program in these submissions was \$23.059M. QUU broadly accepted the SKM finding that additional savings may be found by increased reuse of existing assets and enhanced management of redundant assets. The original planning work was based on conservative assumptions to ensure sufficient budget would be available, noting that condition assessments to evaluate exactly which assets could be economically reused or refurbished were not available at the initial planning stage. During the development of the concept designs QUU undertook rigorous evaluation of the reusability of assets was undertaken via inspections and condition assessments of assets to be relocated. Senior QUU and consultant electricians undertook these inspections.

		After undertaking the concept design evaluation and obtaining more detailed knowledge of the efficiencies from re-using assets, QUU has been able to determine a more reliable estimate of the program costs.
p59	Employee and contractor costs	The draft report states at the end of section 5.6.2 that "In light of the reduction in regulated FTEs and other analysis, SKM did not recommend any further reduction to budgeted FTEs. The QCA accepts SKM's recommendation." This follows table 50 on all regulated FTEs which shows a reduction in Corporate FTEs. Later under Corporate Employees SKM propose a reduction in People and Safety staff which QCA accept. These statements are in conflict.
p61	Corporate Employee Costs – 2013-14 reduction	The QCA recommended reduction in corporate employee costs in 2013-14 is based on a calculated 6.8% increase in average costs per FTE from 2012-13 to 2013-14. QUU has found two data inconsistencies with this calculation. SKM has only used the employee costs however the FTE numbers include contractors. This can be rectified through the inclusion of the Contractor costs. The second inconsistency is the exclusion of the cost allocations to the capital program and non-regulated service costs as the FTEs are delivering these as well as water and sewerage services. Adjusting for these two corrections within the analysis results in increases over the two years of much less than the 3 per cent labour index (0.1 per cent for 2013/14 and a reduction in 2014/15). Given that the 2014/15 FTE numbers had not been reduced to reflect the reduction in employee cost for 2014/15, the average salary decreases, if the number of FTEs are adjusted on a pro-rata basis (using the average salary from the previous year) this results in an increase in 2014/15 of 3 per cent (which is equal to the labour index). The cost data as provided in the QCA data template does not allow segregation into the required format to allow this correct analysis (In the QCA template the capital program is excluded and contractors include consultancies). QUU will provide a supporting spreadsheet with these costs.
p61	Corporate Employee Costs – 2014-15 reduction	Table 54 also shows a QCA recommended reduction for 2014-15, however this was not based on a recommendation by SKM (although SKM are written as the source under the table) nor is there further

		information in the draft report in support of this recommendation. As the information being provided for 2013-14 shows corporate average salaries in 2014-15 are already below the 2012-13 average escalated at 3% each year and there was no step up in the average salary in 2013-14 there is no requirement for reductions in 2014-15.
p62	Electricity	The draft report states the appropriate price increase for small sites is the QCA's electricity retail tariff adjusted for the 19% discount that QUU receives. In applying this, the QCA appear not to have allowed for the 2011-12 value already including the 19% discount, hence applying the discount twice. In revising the carbon price down to 2.169 c/kWh the QCA does not appear to have taken account of the uplift for the Net Loss Factor (NLF). The average NLF is about 4% across sites. QUU recommends that the QCA amend its electricity analysis.
p74	Table 64 – Costs and Revenues	Total Revenue in QCA columns are QUU Total Revenues