

Our ref: A2349291

Dr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

30 June 2014

Dear Malcolm

Unitywater response to QCA Position Papers

Thank you for the opportunity for Unitywater to provide input into the QCA's response to the Ministers' Direction Notice (the Direction) requiring the QCA to investigate and report on a long-term regulatory framework for the SEQ Distribution Retailers (DRs).

Unitywater notes that the QCA is undertaking a number of parallel pieces of work to respond to the Direction therefore Unitywater has prepared this submission as a combined response to the Long-Term Regulatory Framework and Pricing Principles Position Papers that the QCA released in February and March 2014 respectively.

This letter summarises Unitywater's view on both papers and is supported by more detailed comments in the attached submission.

Unitywater's response is also in the context of the QCA's recent recommendation that Unitywater, QUU, Gold Coast Water and Logan Water have satisfied the QCA's criteria in order to immediately transition to the new framework of light-handed annual performance monitoring as the preferred long-term regulatory framework for SEQ water retailers from 1 July 2015.

In terms of the QCA's response under the Direction, Unitywater is seeking the following:

- a. Clear articulation of the desired outcome from application of the recommended long-term regulatory framework to the eligible entities;
- b. The processes recommended by the QCA are aligned to achievement of the desired outcomes;
- c. The benefits of the form of regulation outweigh the costs to the customer; and
- d. The recommended form of light handed regulation recognises:
 - i. The DRs ownership structure and associated alignment of interests between customers and owners; and
 - ii. That the light handed framework only applies to those DRs that have satisfied the necessary criteria to transition to a new light handed framework.

Unitywater is of the view that the current recommendations as set out in these position papers and their application to DRs:

- a. Are unlikely to result in any reduction in the extensive information obligations of DRs under the current arrangements;
- b. Are unable to be linked to a desired outcome as this is not stated;
- c. Does not consider the operating environment of the DRs, in particular customer pressure on utility prices and the fact that customers are the central beneficiaries of returns paid by DRs; and
- d. Do not satisfy the requirement that the benefits outweigh the costs as the regulatory benefits suggested by the QCA would not necessarily accrue to customers when DRs are under-recovering against maximum allowable revenue (MAR). Where prices are below MAR, prices must be efficient even if the costs themselves are not. It is the owners that are disadvantaged not the customer.

In considering the desired outcome from the form of regulation of DRs, Unitywater considers that there are three principal rationales for regulation. In decreasing order of materiality, these are:

- a. Ensuring no monopoly pricing. Monopoly pricing (where prices are above long run marginal cost, not just an annual MAR), is considered a problem as it creates economic inefficiency and distorts resource allocation and consumption. Over the period 2010 to 2013 the QCA undertook annual reviews of DRs prices/revenues and costs and found no evidence of monopoly pricing. As such, concerns over DR monopoly pricing are unlikely to justify ongoing regulation where a cost benefit test is applied.
- b. A second order concern of economic regulation is to ensure prudent and efficient costs through the operation of an incentive regulation framework. This is only necessary where there are no other factors placing pressure on a business to improve productivity. The legal and operating framework under which DRs operate ensures that the businesses face continuous pressure to increase productivity and the QCA has noted the DRs significant success in cost cutting both in terms of operating and capital costs. As such, using economic regulation to drive DR service quality improvements and/or efficiency improvements is unlikely to be justified where a cost benefit test is applied.
- c. A third argument often used to support the application of regulation is that the regulator can act as an independent umpire providing information to consumers on the reasonableness of prices and service quality for utility services (especially in the face of concerns over increasing utility charges as is occurring at present). However, there are likely to be limited benefits from this role as it is in effect often duplicating what already occurs through voluntary performance reporting by DRs or performance reporting under arrangements such as the Statewide Water Information Management database coordinated by the Department of Energy and Water Supply. As such, cost benefit analysis would suggest this option would only justify very light handed regulation.



Unitywater

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Unitywater acknowledges that the QCA currently does, and is expected to continue to fill a valuable role in developing well researched discussion papers and guidelines on issues such as economic approaches to pricing services provided by businesses with monopoly characteristics. Unitywater will continue to rely on the well-reasoned arguments developed in such papers and guidelines to underpin and support Unitywater's pricing approach and development of water and sewerage prices.

Unitywater also wishes to acknowledge that in discussions the QCA has indicated a clear recognition of the need to balance economic principles with pragmatic recognition of the environment within which DRs operate. However, Unitywater's comments are by necessity limited to responding to the content of the Papers as published.

Overall, Unitywater considers both Papers to be a valuable summary of the issues surrounding options for economic regulation and the economic pricing of water and sewerage services but remain concerned over the implementation and compliance issues that could arise should Unitywater be subject to detailed, prescriptive regulatory requirements.

In Unitywater's view there are other more efficient options for addressing concerns by Government and customers over water and sewerage prices. Unitywater proposes an appropriate integrated communication strategy involving key stakeholders such as Government, DEWS, DRs and Councils would be a more efficient and effective method to address concerns. Finally, Unitywater would be pleased to work with the QCA in developing and trialling the implementation of an appropriate form of light handed regulation.

Yours sincerely

Pauline Thomson
Chief Financial Officer

CC: Mr George Theo, Chief Executive Officer, Unitywater
Ms Louise Dudley, Chief Executive Officer, QUU
Mr Andre Kersting, Gold Coast Water
Mr David Kelloway, Logan Water
Ms Sandra Carseldine, Redland City Council