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Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

To whom it may concern,

Submissions to QCA Draft Position Papers

Please find attached Redland City Council's submissions in relation to the following QCA papers:

- ❖ Long Term Regulatory Framework for SEQ Water Entities February 2014
- ❖ SEQ Long Term Regulatory Framework – Pricing Principles March 2014
- ❖ Transition of Performance Monitoring – Redland Water April 2014

Redland City Council would like to thank Queensland Competition Authority for the opportunity to provide submissions in response to the QCA draft position papers.

Yours sincerely,

Bill Lyon
Chief Executive Officer
Redland City Council

Redland City Council
Response to QCA Position Paper: Long Term Regulatory Framework for SEQ
Water Entities February 2014

Summary of QCA Position Paper

In February 2014 the QCA circulated a report titled "Long Term Regulatory Framework for SEQ Water Entities". This paper is in response to the Ministers' Direction Notice instructing the QCA to "investigate and report on a long-term regulatory framework for the monopoly distribution and retail water and sewerage activities of the five SEQ distributor-retailers". This paper is aimed at Unitywater, Queensland Urban Utilities and Logan, Gold Coast and Redland City Councils.

The Ministerial Direction also required that the regulatory framework must ensure that the costs of implementation do not exceed the benefits, take into account the different characteristics of each of the entities and must be proportionate with the risk of misuse of market power.

Response to the paper is due to be lodged to the QCA by 30 June 2014, with the QCA report due 30 September 2014. The framework is to apply from 1 July 2015.

QCA Key Recommendations

QCA key recommendations include:

- A light-handed monitoring of the performance of water retailers, rather than the annual audit style approach that is currently undertaken, once the entity is proven ready to transition from the current approach;
- Use of annual performance monitoring against a range of measures including:
 - Prices,
 - Revenues,
 - Certain costs (currently not identified),
 - Recommended procedures and policies,
 - Service quality standards,
 - Application of appropriate pricing principles (in a separate paper).
- Changes in pricing will be measured against prices in the broader economy (CPI), with an additional adjustment (X) to be included for the productivity gains that QCA expect water entities to achieve - CPI-X;
- Price deterministic powers where QCA deem the performance of a water retailer to be unacceptable, which is in line with Victoria and New South Wales. Precise triggers for a full cost of service review are not yet defined. This also includes the power to freeze prices during any detailed price investigation.

Redland City Council response to QCA paper

The following topics and draft recommendations contained within this QCA position paper are areas that Redland City Council wishes to respond to:

- The paper is targeted at implementing framework to monitor the potential for monopoly distribution, retail and sewage activities of the five SEQ distributor-retailers – Unitywater, Queensland Urban Utilities (QUU), and the Logan, Gold Coast and Redland City Councils. No mention has been made regarding the remainder of water entities within Queensland. The costs and benefits associated with implementing a framework of this magnitude only on SEQ are questionable. It could be reasoned that framework of this type would be most effective if implemented on a state-wide basis, particularly in respect of some of the QCA recommendations for higher authority levels.
- QCA draft recommendations around customer engagement are not yet provided in any detail, but rather as a principle only. Of particular note is the recommendation for SEQ entities to develop a strategy for customer engagement, including a customer consultation committee. The costs associated with the implementation and running a committee of this type have the potential to be quite significant. The QCA has not at any stage when summarizing the Ministerial Direction made mention to Section 1 (a) under the Conduct of the QCA pursuant to this referral, whereby they should consider the over-arching principle of ensuring that the costs of implementing the regulatory regime do not exceed the benefits. It could also be contended, within a local Council scenario, that the customers are represented by their elected representative, thereby eliminating the requirement for such a committee and the additional costs associated with said committee.
- This paper makes reference to establishing a prudent and efficient cost base, with further pricing measured against CPI-X. With regards to the X-factor, QCA have not provided any information regarding what impact or considerations will be given to economies of scale. This report is very much a one size fits all, in appearance, and fails to recognise it deals with entities of very different scale, ie Queensland Urban Utilities against Redland City Council.

Critical considerations of how to manage these disparities are vital to implementing this framework in order to ensure no entity is disadvantaged by the impacts of economies of scale.

- As a starting point to this light-handed approach, the paper makes reference to establishing a prudent and efficient cost base. Page 65 of the QCA paper recognises that the most generic means of assessing efficient costs is to benchmark the performance of an entity against other relevant businesses. They also go on to state that internal benchmarking is another accepted methodology but that the QCA adopted approach is to under-take a bottom-up expert analysis of the efficiency of a sample of operating cost items and extrapolate, where possible. Clarification is sought around this recommendation and how it will translate into real terms.

- The fact sheet for this paper introduces the concept of CPI-X for measuring the price increases, year on year. The paper defines this as increases to pricing 'measured against prices in the broader economy (CPI), with an additional adjustment (x) for the productivity gains we expect water retailers to achieve'. The example contained within the paper of Sydney Water having up to 2% OPEX efficiency gains per year, as identified by IPART (2012a) is ambitious and unachievable in smaller council owned entities.

The paper also makes note that the value of X will be established in consultation with the entities by 30 May 2014. Should this be 2015?

- The QCA introduce the concept of 'unacceptable performance' (see Draft Recommendation 3.2), however there is little in the way of a clear definition of what this encompasses. With the recommendation of the QCA being granted price deterministic powers in the event of unacceptable performance, having a clearly defined indication of what this entails and how an entity has to perform in order to fail is vital.
- Of most concern is the QCA recommendation for price deterministic powers to be granted. This is heavy-handed in its approach. Currently, none of the five SEQ entities have been founded to be exercising price monopolistic powers, so this regulatory framework appears to be excessive. The paper doesn't recognise or consider that there may be better, more viable options than regulation in the first instance, or that these levels of regulation will only be imposed upon identifying a clear failure of performance within the water entities. Another concern is certainly around how significant the issue needs to be to rationalise this type of imposition of regulation.
- Draft Recommendation 3.12 makes reference to prices being frozen (in real terms) during any detailed investigation. Further information and criteria regarding what triggers a detailed price review and price determination are required, as a twelve month price freeze is a very heavy-handed approach. Clarification is also sought whether, whilst prices are frozen, if the entity is returned to the detailed review approach for the 5 year period following that happenstance.
- Who is regulating the regulator? In the event that a SEQ water entity is found to be performing unacceptably or prices are frozen by the QCA is there an ombudsman or appeal process that may be applied in fairness to both parties? More detailed consideration is required in the instances that the QCA choose to execute the price deterministic powers that they seek.

Redland City Council

Response to QCA Position Paper: SEQ Long Term Regulatory Framework – Pricing Principles March 2014

Summary of QCA Position Paper

This paper has been released in conjunction with several others, including Long Term Regulatory Framework for SEQ Water Entities February 2014 and Transition to performance monitoring – Redland Water April 2014.

These papers are in response to the Ministers' Direction Notice instructing the QCA to 'investigate and report on a long-term regulatory framework for the monopoly distribution and retail water and sewerage activities of the five SEQ distributor-retailers'. These papers are aimed at Unitywater, Queensland Urban Utilities and Logan, Gold Coast and Redland City Councils.

The Ministerial Direction also required that the regulatory framework ensure that the costs of implementation do not exceed the benefits, take into account the different characteristics of each of the entities and must be proportionate with the risk of misuse of market power.

Response to the paper is due to be lodged to the QCA by 30 June 2014, with the QCA report due 30 September 2014. The framework is to apply from 1 July 2015.

QCA General Pricing Objectives

The QCA have acknowledged that these pricing principles should continue on from the requirements within the QCA Act. This necessitates the QCA to consider the 'protection of consumers from abuses of monopoly power, the promotion of competition, the efficient use of resources, and other relevant public interest concerns'.

QCA Pricing Objective Draft Recommendations

Draft Recommendation 1.1 – that pricing of urban water, sewerage, trade waste, recycled water and stormwater re-use services provided by SEQ entities:

- a) Promotes economic efficiency,
- b) Ensures revenue adequacy,
- c) Takes account of the public interest (including fairness and equity),
- d) Is transparent, predictable, simple and cost effective to apply.

QCA Pricing Principles

QCA recommend 'that prices for all water supply and sewerage activities be forward-looking cost reflective and set according to marginal cost. Marginal cost pricing ensures that a consumer only

purchases services where the value to the customer is equal to or greater than the marginal cost of production, while ensuring that producers receive a return equivalent to the opportunity cost of supplying an additional unit of the service’.

QCA Pricing Principle Draft Recommendations

Draft Recommendation 1.2 – entities initially establish that the pricing principles are being applied and subsequently advise of any departures, the reasons for the departure and provide relevant supporting analysis.

Draft Recommendation 1.3 – pricing reflects marginal cost, together with a two part tariff where necessary to achieve revenue adequacy.

Draft Recommendation 1.4 – prices be set between incremental (marginal) cost and stand-alone cost.

Draft Recommendation 1.5 – prices reflect the long run marginal cost (LRMC) of providing a particular service.

Draft Recommendation 1.6 – prices reflect short run marginal cost (SRMC) be considered when SRMC for a particular period significantly exceeds the LRMC (estimated for a longer period) for a particular service. This is sometimes referred to as scarcity charging.

Draft Recommendation 1.7 – LRMC be estimated on the basis of the perturbation or AIC method.

Redland City Council response to QCA paper

The following topics and draft recommendations contained within this QCA position paper are areas that Redland City Council wishes to respond to:

- The paper is targeted at implementing framework to monitor the potential for monopoly distribution, retail and sewage activities of the five SEQ distributor-retailers – Unitywater, Queensland Urban Utilities (QUU), and the Logan, Gold Coast and Redland City Councils. No mention has been made regarding the remainder of water entities within Queensland. The costs and benefits associated with implementing a framework of this magnitude only on SEQ are questionable. It could be reasoned that framework of this type would be most effective if implemented on a state-wide basis, particularly in respect of some of the QCA recommendations for higher authority levels.

- There are inconsistencies between the QCA recommendations and the DEWs WaterQ 30 year strategy.

QCA draft recommendation 2.8 - *Inclining and declining block tariffs not be introduced, and where they are already in place be phased out over time to a single volumetric charge* – Redland City Council have implemented this recommendation within the 2014/15 price determinations.

However, strategic priority 1.1 in the WaterQ draft strategy states that water service providers will investigate new ways of pricing in order to meet customer demands and business needs. WaterQ suggest that this may be done by 'fixed charge for water and sewerage, with tiered consumption charging for water'. Some congruence is sought between QCA and DEWs.

- The QCA introduce the concept of long run marginal costing (LRMC), which is not a requirement in the current pricing methodologies. This will require an additional model to be built and maintained in order for Redland City Council to meet this requirement. It could be contended that this requirement fails the Ministerial Direction for the regulatory framework to ensure that the costs of implementation do not exceed the benefits due to the additional costs associated with constructing and sustaining a model of this type. This will in turn create additional fixed costs to the entity that would flow through to the consumer, which is not aimed at promoting economic efficiency (pricing objective 1.1a) or taking into account the public interest (pricing objective 1.1c).
- QCA draft recommendation 2.9 broaches the subject of location based charges for urban water services to be applied where the location cost differences are material and where it is practical and cost effective. In the case of Redland City Council, of the approximate sixty four thousand rateable properties, nearly fourteen thousand are island based – that is 21 per cent of the total rateable properties. Were this draft recommendation to be enforced, this would have a significant negative impact to the island ratepayers and doesn't satisfy the QCA draft recommendation for taking the public interest into account (pricing objective 1.1c).
- There are several recommendations suggested by the QCA that aren't able to be supported by the current rating and billing system that Redland City Council utilises. Should these recommendations be a requirement, the cost of a new rating and billing system would be passed through to the customer, at significant cost and this would be directly against QCA draft pricing objective 1.1(c).

These recommendations include QCA draft recommendation 2.10 that suggests billing based on the time of day or seasonally should be considered.

QCA draft recommendation 2.11 proposes self-selecting tariff options be considered. Again, the current billing system of Redland City Council doesn't support this type of functionality and a re-structure of this magnitude would not be cost effective to the customer.

QCA draft recommendation 2.12 advocates that price/service quality tariff options be adopted, where material cost differentials are associated with different levels of service.

- QCA draft recommendation 2.13 states that individual metering on flats and units should be adopted where economical and practical. Redland City Council complies with this requirement in all future development, however retrospective metering is not undertaken, which is in accordance with legislation. It would be neither economical nor practical to retrospectively refit meters to older flats and units.

- Draft recommendation 2.14 suggests billing tenants for the fixed and variable water and sewerage charges, rather than the landowner, where the water is separately metered. It could be contested that this is not practical for a number of reasons. The rating and billing system holds a list of landowners for rating purposes, but it would be required to maintain additional data on the tenants for each property, along with lease expiry dates. This would create extra administrative functions, would necessitate additional water reads at the termination of a lease (similar to electricity arrangements). These requirements would significantly increase the administrative requirements and create additional costs, which are considered neither practical nor cost effective.
- Draft recommendation 2.18 raises the idea of concessions and rebates and would require amendments to policies within Redland City Council in regards to Community Service Obligations, Water charges and Wastewater charges policies. Along with these policy changes, significant consideration is required in how to administratively manage such a program.
- QCA also raise the issue of efficiently pricing for residential sewerage output – see draft recommendation 3.2. A volumetric charge for sewerage is neither practical nor cost effective and raises a significant issue around how to capture the volumes.
- Recommendation 3.4 refers to nodal pricing for sewerage services. In the case of Redland City Council, nodal pricing would increase the complexity of setting prices for Council. It could also be argued that it would significantly disadvantage ratepayers on the islands as well, as costs for those nodes are significantly higher than those on the mainland. Another issue with this type of pricing is actually identifying and assigning costs to each node.
- Interestingly, draft recommendations 7.8 and 7.9 make reference to price paths. Redland City Council currently are on a 10 year price smoothing path, which has raised significant concerns within the QCA, who refuse to make a determination into whether or not Redland City Council is exercising price monopolistic powers. These recommendations contradict the QCA's very own findings previously and further clarification around how to price smooth effectively to meet the QCA requirements is sought.

Conclusion

Review of this draft paper of SEQ Long Term Regulatory Framework – Pricing Principles, as released by the QCA in March 2013 would tend to indicate that a great number of the recommendations are simply neither cost effective nor sustainable and have the potential to significantly disadvantage the island ratepayers of Redland City Council. The QCA has failed to take into account the size, demographical location of the Redlands or the fact that a significant proportion of the rateable properties lie outside the mainland.

Redland City Council

Response to QCA Position Paper: Transition to performance monitoring – Redland Water April 2014

Summary of QCA Position Paper

In April 2014 the QCA circulated a report titled “Transition to performance monitoring – Redland Water”. This cover letter states that the QCA is proposing a transition of the water retailers of SEQ to move to the new framework after a successful assessment against the criteria outlined in the paper and a favourable outcome from the 2013-15 price monitoring investigation. The QCA go on to state that they are still to be convinced that Redland Water (RW) is not exercising market power. RW are ‘urged’ to address the concerns of the QCA by providing a revised pricing model by 15 August 2015.

Response to the paper is due to be lodged to the QCA by 30 June 2014.

This paper refers to the content in the QCA Position Paper – Regulatory Framework. Section 1.4 of the Transition paper states that the criteria for transition to long-term performance monitoring include:

- a) Absence of public interest or equity issues that may warrant regulatory review
- b) Regulated services are clearly defined and separated from non-regulated services
- c) Evidence that market power is not being exercised
- d) Absence of imminent material changes in circumstances or major infrastructure costs
- e) Demonstrated capacity to provide the required information accurately and on time, based on prior regulatory processes.

They have also stated that criteria such as performance in customer engagement, strategic planning for long term investment, service quality and application of pricing principles would also be relevant in assessing the readiness of moving to the light-handed framework.

Should a retailer not be ready for transition, the standing arrangements would remain into the 2015-16 year.

Key dates

Ministerial Direction	28 June 2013
Position Paper – Regulatory Framework	24 February 2014
Position Paper – Pricing Principles	28 March 2014
Position Paper – Return on Capital	30 May 2014
Submissions due on Position Papers	30 June 2014
Submissions due on Draft Assessments (transition)	30 June 2014
Final Report	30 September 2014

QCA Assessment of Redland Water readiness to transition to light-handed framework

2.2.1 Public interest and equity

- Criteria require that there be an absence of public interest or equity issues that warrant regulatory review.
- QCA is not aware of any issues relating to this that would stop RW transitioning.

2.2.2 Regulated services are defined

- Criteria require regulated services need to be clearly defined from non-regulated services.
- In the 2013-15 review, QCA requested retailers to list all regulated services, tariffs and corresponding volumes and revenues – RW complied.
- In the 2013-15 review, QCA hasn't specifically investigated the delineation between regulated and non-regulated services.
- In 2013-15 RW hasn't identified any non-regulated services, costs, revenues and assets to the QCA.
- QCA haven't reviewed whether costs have been properly assigned between service categories.
- Issue is to be addressed by QCA by assessing retailers' compliance with the pricing principles.

2.2.3 Market power

- Criteria require retailer to provide proof that market power is not being exercised.
- In the 2013-15 review, QCA observed that the revenues for RW are above the QCA's MAR, due to price smoothing.
- QCA support price smoothing.
- QCA have concerns with the 10 year model Redland Water are using, which has been independently developed by Queensland Treasury Corporation (QTC).
- QCA state that they cannot establish whether there is an exercise of market power, due to:
 - a) QCA MAR was 4% higher than RW in 2013/14 and 8.3% in 2014/15, however RW is above both MAR calculations
 - b) QCA's capital expenditure was lower than RW by 26.4%, due to the deferral of a major Capex item
 - c) QCA RAB was 5.5% lower than RW; QCA closing RAB at 30 June 2015 is 6.92% below RW - the difference is due to the use of QCA RAB at 1 July 2010 and use of actual Allconnex data for 2010-12
 - d) QCA's estimate of non-bulk operating expenditure was lower than RW by 13.7% in 2013/14 and 10.4% in 2014/15.

2.2.4 Imminent change in circumstances

- Criteria require the absence of imminent material changes in circumstances or major infrastructure costs.
- QCA is not aware of any issues relating to this that would stop RW transitioning.

2.2.5 Information provision

- Criteria require a demonstrated capacity to provide information accurately and on time.
- QCA considers RW has demonstrated a capacity to provide information accurately and on time.

2.3 Assessment against other criteria

- The new regulatory framework for moving to light-handed framework provides recommendations about customer engagement and strategies. QCA found no reason that RW can't move to a light-handed approach, but further information will be required on customer engagement strategies as part of the annual reporting.
- QCA found several issues with Strategic Planning for long term investment – Netserv Plan hasn't been endorsed by Council, capital planning policies and procedures aren't always consistent with good industry practise, etc. QCA have determined that these aren't considered material enough to stop RW transitioning to a light handed approach.
- In regards to Service Quality criteria, QCA have identified that not all KPI's recommended are being reported upon by RW. This being the case, to transition to light handed framework, RW will be required to report against all indicators. QCA has also made the recommendation that RW resume participation in national performance monitoring.

QCA Conclusion on Redland Water's readiness to transition to light-handed framework

QCA require RW to provide a 'convincing case' that market power isn't being exercised, before a transition to the light handed performance monitoring is possible. QCA require for this objective to be met by addressing their concerns with RW 'data and methodology underpinning its pricing model and resultant negative future prices'.

QCA require a revised pricing model and 2014/15 prices and supporting information to be submitted to the QCA by 15 August 2014.

Redland City Council response to QCA paper

The most significant issue facing Redland Water in moving to the QCA light handed regulatory framework is that QCA haven't established if price monopolistic powers are being exercised and that the resultant negative future pricing.

Redland City Council would like to advise the QCA that they have taken into consideration the concerns regarding the negative future pricing. A one tier pricing structure has been adopted for the 2014/15 financial year, at the recommendation of the QCA, thereby eliminating the negative future pricing concerns.

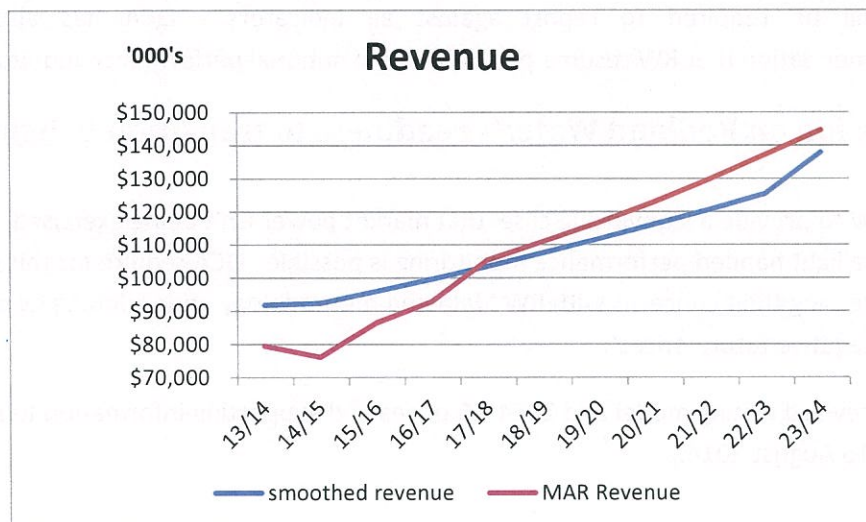
Redland City Council would also like to advise QCA that a new pricing model will be implemented for the 2015/16 financial year to address concerns that the QCA have shared regarding the current model.

As the QCA undertakes a year-on-year audit of Redland Water it is difficult for price smoothing to be validated. QCA have stated within this report that they support the principle of price smoothing, however the audit doesn't facilitate the review of such a price path.

Redland City Council has on prior occasions advised the QCA that the 10 year price smoothing has been undertaken with the intent of minimizing the impact of the bulk water prices to our residents. In 2017/18 there is a scheduled 31% price increase in bulk water, which will significantly impact our residents, with the most impact on low income earners and pensioners within our city.

The following is a representation of the over and under recovery of revenue over the 10 year period. Of note, the overall revenue of both streams is identical.

Table 1: Smoothed versus unsmoothed (MAR) revenue streams



Redland City Council and QCA also have differing views on the real population growth within the City. QCA have estimated that the growth for Redland City is 1.7%, however historical and actual data indicate that this is closer to 0.5%.

Conclusion

Review of this draft paper of the QCA report titled "Transition to performance monitoring – Redland Water, April 2014" establishes that they are of the opinion that Redland Water aren't ready to transition to the light handed regulatory framework that they are currently proposing.

Redland City Council has made in-roads in addressing the issues raised by the QCA. Specifically the issue of negative future pricing has been eliminated by adopting a one tier price structure, at the QCA's recommendation. Concerns with the QTC pricing model, as used by RW, are also being addressed with a new pricing model currently being developed, with expected implementation for the 2015/16 financial year.

In regards to the QCA concerns about being able to establish if RW is exercising price monopolistic powers, submissions have been made to establish that RW are not exercising price monopolistic powers. Redland City Council are taking pro-active steps in making the 2017/18 scheduled 31% increase in bulk water is introduced to our residents as moderately as possible, with mindful attention to low income earners and pensioners. QCA need to audit periods of longer than a year at a time for this price path to be accurately monitored and correctly identified as no monopolistic powers being exercised.

Redland Water and Redland City Council would contend that they are ready to be transitioned across to the light-handed framework, in consultation with the QCA.