Gladstone Area
Water Board

Gladstone Area Water Board

Submission to the Queensland Competition Authority

Response to Stakeholder Submissions

GAWB's Commercial Framework and Pricing Principles Submission
for the 2010 Price Review

18 February 2010

Table of Contents

1.0 Introduction

GAWB provided its *Commercial Framework and Pricing Principles* submission for the 2010 price review to the Queensland Competition Authority (Authority) in September 2009. The following stakeholders have provided public submissions to the Authority in response to GAWB's proposals:

- Gladstone Regional Council (GRC)
- QER Pty Ltd (QER)
- Callide Power Management Pty Ltd (CPM)
- CS Energy (CSE)
- Queensland Alumina Limited (QAL)
- NRG Gladstone Operating Services Pty Ltd (NRG).

GAWB takes this opportunity to respond to the issues raised by stakeholders in their submissions to the Authority.

2.0 GAWB's proposals

2.1 Form of regulation

GAWB currently operates under a price cap form of regulation and has proposed that the form of regulation to apply from the 1 July 2010 regulatory control period be changed to a revenue cap. Table 1 summarises the issues that have been raised by stakeholders in relation to GAWB's proposal.

Table 1

Customer	Issues raised
GRC	*Council has no preference for one cap over the other, however it is essential that whichever cap is approved, does not create incentives to overstate future demand thereby unnecessarily bringing forward supply augmentation to the great cost of existing and future customers.* *GAWB comment* As outlined at GAWB's submission[1] and source augmentation process, GAWB contends that prices should only incorporate major augmentation costs (excluding efficient preparatory costs) following the completion of the augmentation. This allows for the correct pricing signals to be provided to customers on the cost of an augmentation once the most appropriate response (be it source augmentation, demand management measure or otherwise) has been determined.

[1] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p24

Customer	Issues raised
CPM	*The QCA (Authority) should request that GAWB quantify the benefits gained by mitigating demand risk upon moving to a revenue cap form of regulation, and ensure that this benefit is able to be passed through to the customer base in some way. CPM notes there is some argument that a transition to a revenue cap approach should be accompanied by a reduction in the allowed regulatory return, on account of the service provider's reduced exposure to market/demand risk.* *..CPM is concerned that the side constraint on annual tariff reviews of CPI+5% could result in annual increases that are excessive and above market.* *GAWB comment* As outlined in GAWB's submission[2], GAWB does not believe that the current regulatory framework (which includes a price cap form of regulation) compensates GAWB for its exposure to demand risk. GAWB therefore contends that a change in the form of regulation should not result in a reduction in the allowed regulatory return. While the move towards a revenue cap will reduce GAWB's exposure to demand risk (a risk best managed by customers), it will not provide any additional benefits to GAWB other than allowing it to earn its annual revenue requirement (or target revenue) that will be determined as part of the 2010 price review process. Any over-recovery of target revenue by GAWB will be returned to customers through the revenue cap mechanism. GAWB further contends that the proposed side constraint of CPI +5% for annual price increases is reasonable as it provides certainty to customers as to the maximum possible annual price increase. Customers will also benefit from any additional demand over that forecast through price reductions or lower than CPI price increases.

[2] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p9-12

Customer	Issues raised
QAL	*QAL prefers a price cap to a revenue cap, as per the existing system.* • *QAL does not support price increases where demand decreases. This removes incentives for users to develop and implement water conserving innovations.* • *A move to a revenue cap will effectively remove GAWB's exposure to quantity risk.* • *The incentive for productivity and efficiency savings that are available under the price cap are not present under the proposed revenue cap model.* *GAWB comment* GAWB agrees with QAL's statement that the revenue cap proposal will reduce GAWB's exposure to demand risk. GAWB however contends that demand risk should be allocated to customers who are best placed to manage this risk. GAWB's demand is highly idiosyncratic in nature and, unlike most other bulk water providers, a decision made by one customer can have a significant impact on GAWB and other customers. GAWB has no ability to influence or control these decisions and ultimately to manage this demand risk. The revenue cap proposed also ensures that customers benefit from any additional demand (over that forecast when setting prices) during the regulatory control period while preserving GAWB's annual revenue requirement in the event forecast demand does not eventuate or subsequently declines. GAWB also contends that the incentives for productivity and efficiency savings are the same under either a revenue cap or price cap form of regulation. GAWB's revenue cap proposal does not extend to the recovery of differences between forecast and actual operating expenditure.
NRG	*NRG supports a price cap methodology as it drives behaviour delivering efficiency gains.* *GAWB comment* As discussed in GAWB's response to issues raised by QAL, GAWB contends that there is no difference in delivering efficiency gains under either the revenue cap or price cap form of regulation.

Customer	Issues raised
CSE	*CS Energy has a preference for the Price Cap or alternatively a Price Cap for the Access Charge, which, owing to its relationship to the capital base, is not volatile and a Revenue Cap for the Volumetric Charges as the variable costs have the potential to be more volatile. CS Energy would support GAWB in respect of allocating demand risk to customers to encourage forecasting accuracy.* *GAWB comment* GAWB's revenue cap proposal does not extend to the recovery of differences between forecast and actual expenditure. Movement in either fixed or variable costs within a regulatory control period will have no impact on the prices charged under either the proposed revenue cap or the current price cap form of regulation. GAWB also notes that the access charge is not directly related to the capital base. The total revenue target for a particular pricing zone is related to the depreciated optimised replacement cost (DORC) value of assets and forecasts of fixed and variable operating costs. The volumetric charge is based on the estimated long-run marginal cost of supply (both marginal capital costs and marginal operating costs are included). The access charge is set to recover the difference between the total target revenue and the volumetric charge revenue.

2.2 Planning period

GAWB has proposed that the planning period to apply from the 1 July 2015 regulatory control period is reduced from a 20-year period to a five-year period. Table 2 summarises the issues that have been raised by stakeholders in relation to GAWB's proposal.

Table 2

Customer	Issues raised
CPM	*CPM does not support GAWB's proposal to shorten the planning period....This change would result in:* • *Current customers paying for excess capacity installed by GAWB to meet longer-term demand;* • *Significant potential price shocks, depending on the level of excess capacity held at 2015; and* • *New customers paying lower charges in the future on account of existing users 'funding' capacity on their behalf.* *Although this changed is flagged to occur during the next regulatory period review, it is CPM's view that a 5 -year planning period has the potential to lead to significantly higher pricing by 'front loading' the cost of capacity for demand that is required in later periods. It also limits the opportunity to smooth impact over a longer period.*
CSE	*CS Energy does not agree to the blanket application of 5-year price averaging rather 20-year price averaging. For customers where their demand requires augmentation, a 5-year price averaging may be justified*

Customer	Issues raised
	however this is not so for customer where demand is satisfied by existing assets.
NRG	*NRG has always stated it requires a reliable water source with certainty of supply and pricing to enable NRG to meet its commercial obligations. A 20-year planning period is consistent with supply reliability and price certainty....NRG supports a 20 year planning period and does not support migrating to a 5 year planning period.* *GAWB comment* The proposed change to a five-year planning period relates only to GAWB's pricing practices and not to its planning process. GAWB wishes to assure all customers that GAWB would retain a long-term planning view consistent with the current Strategic Water Plan process. The proposed change to a five-year planning period will reduce the complexity and uncertainty associated with preparing 20-year forecasts. GAWB does not intend for the change to have adverse price implications for customers. The commencement date of 1 July 2015 was proposed to provide GAWB with sufficient opportunity to evaluate the full impact of this change on customers, including whether any transitional arrangements or other changes to the regulatory framework will be required.

2.3 Price transition

GAWB has proposed that it should not bear the financial costs associated with price transition arrangements and any such arrangements should be net present value (NPV) neutral to GAWB. GAWB has further proposed the principles on which a transition path should be based.

Table 3 summarises the issues that have been raised by stakeholders in relation to GAWB's proposal.

Table 3

Customer	*Issues raised*
NRG	*NRG as agents for the Participants in the GPS Joint Venture requests price increases not take place immediately and be phased in over 5 years commencing from the start of the next regulatory control period on 1 July 2010.* *GAWB comment* If the Authority considers that a price transition path is appropriate at the 2010 price review, the implementation of such a transition path should be based upon the principles proposed in GAWB's submission.[3]

[3] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p21

Customer	*Issues raised*
CPM	*CPM does not support price transition arrangement(s) limited to a single 5 year regulatory control period - especially if the planning period is reduced from 20 year to 5 years. CPM is of the view that a price transition period consistent with the customer's current or remaining contract term should be adopted.* *While a price transition period of 5 years could be reasonable where the change in price is not substantial, it could have a significantly harmful impact on a commercial customer's operations where it is.* *GAWB comment* GAWB contends that the price transitioning period must occur within a single five-year regulatory control period. GAWB believes that this approach is equitable for both customers and GAWB. Transitioning periods greater than a single five-year regulatory control period would result in additional administrative complexity as well as adding considerable pricing complexity at subsequent price reviews, particularly if further price transitioning is accepted as a result of that review.

2.4 Weighted Average Cost of Capital (WACC)

GAWB has proposed various changes to the WACC methodology and parameters in its submission to the Authority. Comments on GAWB's WACC proposals have been received from GRC, QER and CPM. While GAWB acknowledges these comments, it recognises that the Authority will consider GAWB's current operating environment and other regulatory decisions, including those made by the Authority, when determining the WACC methodology and parameters to apply for the next regulatory control period.

2.5 Zonal pricing

GAWB has proposed to retain geographical differential pricing for all customers based on their utilisation of specific components of GAWB's infrastructure network. Table 4 summarises the issues that have been raised by stakeholders in relation to GAWB's proposal.

Table 4

Customer	Issues raised
CPM	*CPM is generally comfortable with the proposal to retain geographical differential pricing for its customers, provided that the 'source zone' does not change.* *CPM continues to be of the view that it is not appropriate for GAWB to recover preparatory costs related to the Contingent Supply Strategy (CSS) until such time that the physical infrastructure associated with the CSS is commissioned. This is consistent with CPM's submission to the QCA in respect to GAWB's recent Gladstone to Fitzroy Pipeline "Part (C)"submission.* *GAWB comment* The inclusion of the efficient preparatory costs for the CSS in the source zone is consistent with proposals contained in GAWB's May 2009 submission to the Authority *Gladstone to Fitzroy Pipeline QCA Investigation - Part (C) Submission to the QCA*. namely: • equity requires that all customers pay the same water and reservation and storage price for a common reliability product as customers will experience system-wide rather than source specific reliability; • economic efficiency requires that all customers should see the marginal capacity cost in their water reservation and storage price as all customers' consumption decisions affect aggregate demand; and • in the event augmentation infrastructure is not expected to be commissioned within the 20 year planning period, efficient preparatory costs should be included in the regulated asset base and priced and depreciated over the economic life of the preparatory works.

Customer	Issues raised
NRG	*The GRC will source potable water form a number of pricing zones for residential, commercial and industrial purposes. The GAWB has up until this submission, undertaken to charge the Council & Shires that make up the GRC one price for potable water.* *The GAWB has in the past managed the averaging of water pricing across connections. It now proposed moving to a zonal pricing system with prices reflective of that particular zone………….* *In a submission to the QCA on GAWB Pricing Practices dated November 2001, NRG on behalf of the GPS Joint Venture successfully argued that GPS should not be exposed to cross subsidisation or equalisation schemes….Our position on equalisation arrangement across the parts making up the GRC has not changed.* *The price of water charged to the GPS by the GRC should consist of the following components:* *1. The Glenlyon Road Junction zonal price for potable water,* *2. Plus the GRC reticulation charges.* *GAWB comment* The current water charges for all customers, including the GRC, are based on the zonal price for each respective connection. NRG is a customer of the GRC and as such, is subject to their water pricing arrangements. GAWB has no ability to influence the methodology used to determine the water prices charged by GRC to its customers.

Customer	Issues raised
QAL	*QAL believes that existing users should not pay increased charges as water is sourced from an additional source (Fitzroy River) and that only those users whose new/increased demand requires the augmentation should be charged accordingly.* *The Qld Government promotes Gladstone as an industrial hub and as such the Qld Government should provide support and contribute to development costs where augmentation becomes necessary.* *GAWB comment* An augmentation may be triggered due to additional demand or drought. The inclusion of the efficient preparatory costs for the CSS in the source zone is consistent with proposals contained in GAWB's May 2009 submission to the Authority *Gladstone to Fitzroy Pipeline QCA Investigation - Part (C) Submission to the QCA* namely: • equity requires that all customers pay the same water and reservation and storage price for a common reliability product as customers will experience system-wide rather than source specific reliability; • economic efficiency requires that all customers should see the marginal capacity cost in their water reservation and storage price as all customers' consumption decisions affect aggregate demand; and • in the event augmentation infrastructure is not expected to be commissioned within the 20 year planning period, efficient preparatory costs should be included in the regulated asset base and priced and depreciated over the economic life of the preparatory works.

2.6 Price differentiation

GAWB has proposed to apply a price differentiation surcharge to all reservation and storage and delivery contracts that are defined as short-term contracts from 1 July 2010. As outlined in GAWB's submission[4], it is not GAWB's intention to benefit financially from price differentiation based on contract length. Under GAWB's proposed revenue cap, long term customers will benefit as any over-recovery of target revenue will be returned to customers through lower prices. Table 5 summarises the issues that have been raised by stakeholders in relation to GAWB's proposal.

[4] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p35

Table 5

Customer	Issues raised
GRC	*In principle, Council would support the proposal to include a price surcharge based on a current contract and the length of that contract. However it would appear that the GAWB has done very little to negotiate new contracts with their long term customers whose previous contracts have lapsed.....It could be argued that this provision is really GAWB's attempt to put a gun to the head of existing customers to sign a contract or face the consequences of significantly higher water prices.* *GAWB comment* GAWB is continuing to negotiate the signing of contracts with customers including addressing issues that are specific to their circumstances.
QER	*Whilst it would be appropriate to have a surcharge mechanism differentiating the price signal based on contract length, however there needs to be further truthing and validation of the proposed rationale (5.2.2.2) and the price surcharges premiums before adoption. It is debatable, given the lack of evidence provided, as to the justification for the levels of price surcharge, and could be construed as price gouging, as any over- target recovery would only be returned to customers in future years......* *Consequently the setting of price differentiation and surcharge based solely on contract duration exclusively is inappropriate and GAWB should be tasked to further review and augment its justification for this mechanism and the levels of the surcharge. It would be inappropriate for a potential long- term customer to base a 20% surcharge on initial supply arrangements for say the first five years, and then exercise a contract for additional supply for an additional 20 years, when they are the same customer. Perhaps some of the GAWB perceived risk and administrative costs could be recovered from a proportionately refundable deposit which is cost reflective of the costs borne by GAWB.* *GAWB comment* As highlighted above, it is not GAWB's intention to benefit financially from the introduction of price differentiation based on contract length. Under GAWB's proposed revenue cap, any over-recovery of revenue will be returned to customers through lower prices. GAWB has also included at Appendix 1 the quantification of the levels of price differentiation surcharges proposed in GAWB's submission.

Customer	Issues raised
CPM NRG	*CPM wishes to clarify the statement that "a short term contract is one which has an original term from less than 2 years to 20 years". CPM interprets this statement as meaning that current contracts which initially had a term of 20 years or more, but where the remaining term is less than 20 years, would not be considered a short term contract. Many of GAWB's customers initially would have executed such long-term agreements, and the benefit to GAWB of this should be recognised. It would be unrealistic to expect customers to maintain 'evergreen' 20- year agreements to avoid any price surcharge.* *NRG submits that contracts with an original term greater than 20 years be allocated 0% surcharge throughout the entire term as indicated in the table above.* *GAWB comment* All contracts that have an original term of 20 years or more will not be subject to a short duration surcharge regardless of the remaining term of the contract.
CS Energy	*In general, CS Energy agrees with GAWB's view on the relationship between price and contract term whereby long- term customers obtain a price benefit over short term customers.* *However there may be occasions where it is commercially sensible for GAWB (and therefore benefits for its other customers) to provide water for a short term project at a price that covers variable costs plus a small margin.........* *It is CS Energy's view that there should be no surcharge for contracts in excess of 7 years.* *GAWB comment* GAWB agrees that there are situations where waiving of the surcharge (and indeed charging a lower-than-standard price) may be in the best interests of GAWB and all customers. The Authority sets pricing practices for calculating maximum prices. There is nothing in the current framework that prevents GAWB agreeing to charge a lower price in exceptional circumstances. GAWB therefore submits that the current regulatory framework is consistent with efficient commercial practices. GAWB does not agree that the benefits of long-term contracts do not exceed seven years. GAWB makes commitments to construct long-lived assets (lives are typically 20 to 100 years) and there is considerable benefit in obtaining demand commitments in excess of seven years. GAWB therefore contends that a price differentiation surcharge should apply to all contracts that have an original term of less than 20 years.

2.7 Over-run charges

GAWB has proposed to retain the current methodology for determining over-run charges including retaining its sole discretion to waive or reduce over-run charges in exceptional circumstances or where there are no consequential costs incurred by GAWB. QER does not support this proposal as *"there is no evidence(~~d~~) validating either the level of surcharge or incremental thresholds as proposed"*. GAWB contends that the Authority, as part of the 2005 price review[5], has previously investigated this issue in considerable detail and believes that a further review of this pricing principle is not warranted at this time.

2.8 Instantaneous flow rate (IFR) pricing

GAWB has proposed to introduce IFR pricing for delivery services from the regulatory control period commencing 1 July 2015. As outlined in GAWB's submission to the Authority[6], the change to IFR pricing will not result in GAWB recovering any additional revenue. The purpose of the change is to better reflect the economic cost of capacity to customers. Table 6 summarises the issues that have been raised by stakeholders in relation to GAWB's proposal.

Table 6

Customer	Issues raised
QER	*...there needs to further work undertaken to fully justify and validate either the level of surcharge or incremental thresholds proposed.* *GAWB comment* GAWB has proposed to retain the current methodology for setting over-run charges under IFR pricing. GAWB contends that the Authority, as part of the 2005 price review[7], has previously investigated this issue in considerable detail and believes that a further review of this pricing principle is not warranted at this time.
CPM	*CPM is seeking clarification that the proposed IFR principles would not apply to Raw Water access contracts ex Awoonga Dam.*
CSE	*Specifically, the nature of CS Energy's offtake arrangement, which is directly from Awoonga Dam, does not require an IFR pricing system.* *GAWB comment* GAWB is only proposing to introduce IFR pricing for delivery services. Storage and reservation charges will continue to be based on the annual volume of water delivered (or contracted to be delivered) for those customers that do not utilise GAWB's delivery network.

[5] Refer Queensland Competition Authority, *Gladstone Area Water Board: Investigation of Pricing Practices (2005)*, p46-50.

[6] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p39

[7] Refer Queensland Competition Authority, *Gladstone Area Water Board: Investigation of Pricing Practices (2005)*, p46-50.

Customer	Issues raised
GRC	*Council would ask that consideration be given to see if there are peak and off-peak periods and if there are, whether an off peak rate should be considered.* *GAWB comment* There is almost certainly some component of GAWB's cost of supply related to the time of day and seasonality of consumption. However, the distribution of reservoirs throughout a water supply network reduces the importance of intra-day peaks compared with other network industries (electricity, gas, and telecommunications). GAWB's costs are influenced by customers' consumption behaviours over many different time periods, including: • anytime maximum flow • maximum flow coincident with local peak periods • maximum flow coincident with system peak periods • maximum daily consumption and • annual consumption. However, in constructing a tariff, GAWB must consider both signalling costs (efficiency) and customer equity. Furthermore, a tariff that is overly complex may not be effective in communicating to customers the opportunity to modify consumption to minimise both their bill and the economic cost of supply. GAWB considers a delivery price based on monthly maximum instantaneous flow appropriately balances efficiency, equity and simplicity. GAWB proposes to introduce IFR based on anytime maximum instantaneous demands. However, GAWB will continue to monitor cost behaviour. If intra-day consumption changes would significantly change costs, GAWB will investigate whether 'peak' and 'off-peak' tariff components might be useful.
NRG	*NRG submits it can not support IFR pricing until further information is made available.* *GAWB comment* NRG has raised valid concerns as to how the application of IFR pricing would impact it. GAWB's introduction of IFR pricing is not intended to be directly applied to NRG as it is a customer of GRC and not of GAWB. GAWB's proposals will apply to GRC connections on GAWB's delivery network, not individual connections off GRC's reticulation system. GAWB has no ability to influence the methodology used to determine the water prices charged by GRC to its customers.

Appendix 1 - Price differentiation for contract length

1.0 Background

As outlined in GAWB's *Commercial Framework* submission to the Queensland Competition Authority (Authority)[1], GAWB has proposed to differentiate prices on the basis of length of contract. A price differentiation surcharge was proposed to apply to all reservation and storage and delivery contracts that are defined as short-term contracts from 1 July 2010. A short-term contract is one which has an original term from less than two years to 20 years.

GAWB has proposed to apply the following surcharges to prices from 1 July 2010.

Table 1 – Proposed short duration contract price surcharge

	Contract length				
	Less than 2 years (incl. uncontracted)	2 to <5 years	5 to <10 years	10 to <15 years	15 to <20 years
Price surcharge	25%	20%	10%	5%	3%

In its *Commercial Framework and Pricing Principles* submission, GAWB proposed specific price surcharges for short-duration contracts. That submission sets out the basis for quantifying the surcharge as follows:[2]

> GAWB has set the proposed schedule of surcharges to support its ability to efficiently conduct its long-run operations by reference to several factors, including:
>
> - GAWB's desire to provide incentives to customers to sign long-term contracts (providing customers with reasonable incentives to enter long-term contracts benefits all customers by ensuring that GAWB is best able to plan to meet customers' needs at least cost)
> - the security of GAWB's long-run operations, recognising the high concentration of GAWB's demand in a relatively small number of non-municipal customers with the attendant risk that they may cease operations (and terminate their demand) at short notice in response to the prevailing condition of domestic and international markets
> - matching the duration of price averaging with the contract term (using the 2005 – 2010 regulatory control period model) and
> - quantum of price-duration relationship observed in other markets.

---

[1] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p34

[2] GAWB *Commercial Framework and Pricing Principles for the 2010 Price Review* (September 2009), p35

The following provides further details as to the methodology used for calculating the level of the surcharges.

2.0 Matching the duration of price averaging with the contract term

One method for calculating the price for short-duration contracts is based on the matching the duration of price averaging with the contract duration. Under QCA-recommended pricing practices, prices are calculated with reference to a 20-year planning period. Using a 20-year planning period allows current customers to benefit from expected future demand growth. Because demand is expected to grow over time, the longer period considered the greater the demand available over which to spread the largely fixed costs of GAWB's business. That is, the longer the planning period, the lower the price that is calculated.

GAWB contends that it is inequitable for customers that are unwilling to commit to long-term contracts to be provided with the same price reduction benefit caused by demand growth forecast to occur after their short-duration contract has expired. As a result, customers who have committed to long-term contracts effectively:

- bear the risk of forecast demand not eventuating through higher water prices in the future and
- subsidise the current cost of water for those customers on short-duration contracts.

2.1 2005 pricing model

At the time the *Commercial Framework and Pricing Principles* submission was drafted, the 2010 pricing model was still under development. Therefore GAWB used the 2005 pricing model to assess the effect of the duration of price averaging.

Figure 1 shows the effect of shorter demand averaging periods on price for the Awoonga Zone using GAWB's 2005 pricing model.[3]

[3] This analysis uses the standard building blocks from the 2005 pricing model but excludes the revenue carryover from previous regulatory periods. It is not reasonable for short-duration customers to pay the building block price for the duration of their contract and contribute to recovery of building block revenue from previous regulatory control periods. While the revenue carryover for Awoonga zone comprised only 3% of the 20-year price, the effect of including the revenue carryover would be to significantly increase the price for short duration contracts.

Figure 1 - Awoonga Zone price by price averaging period

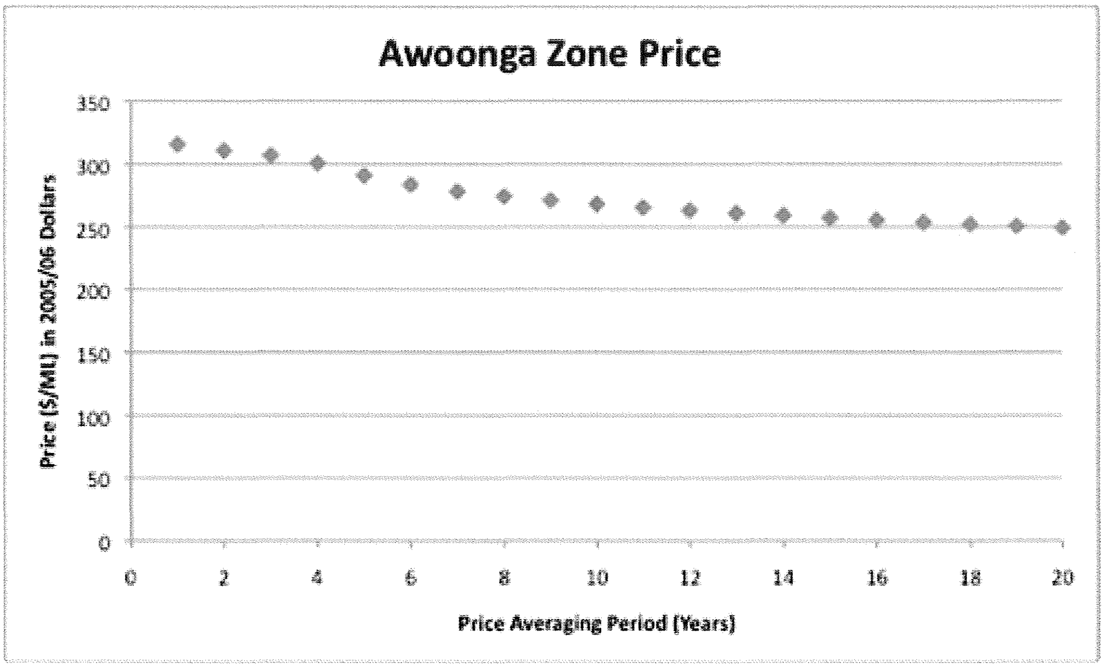
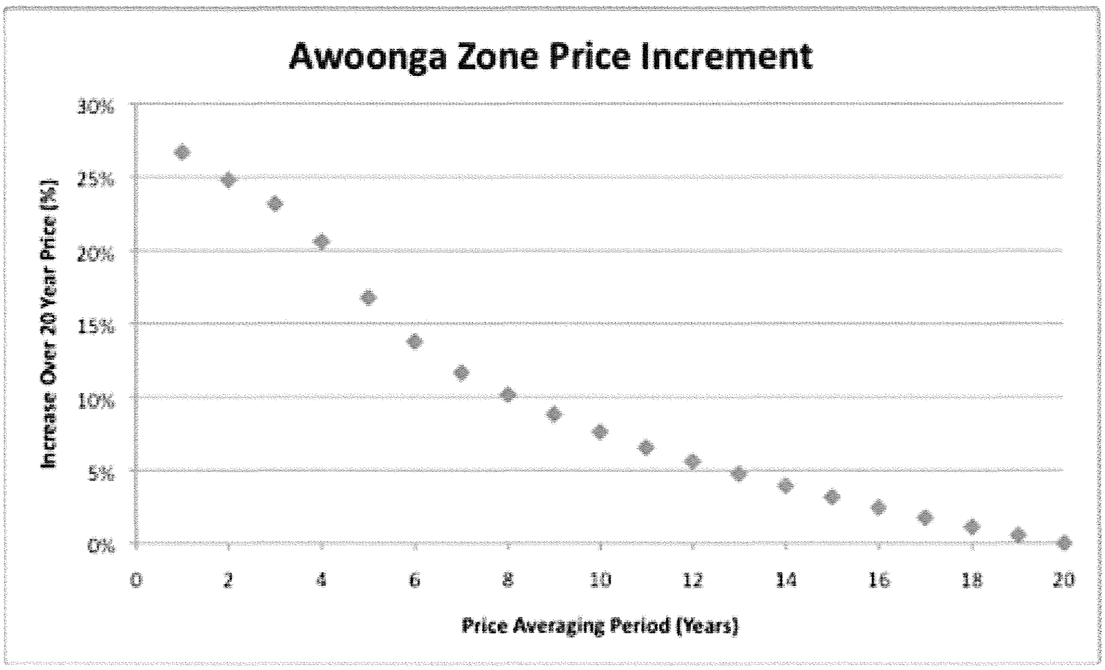


Figure 2 shows the percentage increase in zone price that would occur if a shorter price-averaging period was adopted. Other shared network raw water zones have a similar profile. While it would be possible to calculate a specific price averaging period chart at each point in the network, in the interests of simplicity, GAWB proposes to use the Awoonga zone price-averaging characteristic to establish general surcharges for short-duration contracts to apply to all connections.

Figure 2 - Awoonga Zone price increase by price averaging period



2.2 2010 pricing model

The 2010 pricing model has now been developed and submitted to the Authority. This has allowed GAWB to sense check the previous analysis undertaken with GAWB's proposed expenditure data (see Figure 3).

Figure 3 – Updated Awoonga Zone price increase by price averaging period

The curve developed from the 2010 model is 'flatter' than that from the 2005 model because:

- the rate of growth of demand is lower in the 2010 model and
- there is additional capital expenditure in the first few years of the 2010 model.

GAWB notes that any recommendations made by the Authority to reduce GAWB's expenditure proposals or increase the forecast demand in the first five years of the period would result in price surcharges more similar to that calculated under the 2005 pricing model.

3.0 Summary

GAWB's proposed levels of surcharge were influenced by the above price-averaging analysis but also had regard to the other factors discussed in the 'Background' section. In particular, GAWB requires surcharge levels for very short-duration customers to be sufficient to incentivise customers to sign long-duration contracts, which enhances the overall efficiency of the system.

Using the price averaging period as a starting point for setting the surcharges is a conservative mechanism for pricing short-duration contracts. GAWB has not inflated prices with additional costs of short-duration contracts; it merely requires that prices for customers on short-duration contracts recover the building block cost of supply over the term of their contracts.

GAWB submits that the proposed surcharges are appropriate because:

- this analysis is conservative (it shows only the effect of the price averaging period, it does not add additional costs associated with short-duration contracts)
- the proposed surcharges will provide required incentives for long-duration contracting
- notwithstanding that the inputs to the 2010 model have not yet been finalised, the updated analysis shows the figures calculated using the 2005 model are reasonable and
- surcharges calculated by sole reference to price averaging are sensitive to changes in expenditure and demand at each review but customers deserve greater pricing stability (so surcharges should not be set based on the price averaging characteristic at a single review).

Finally, it is not GAWB's intention to benefit financially from charging a price differentiation surcharge. Under GAWB's proposed revenue cap, long-term customers will benefit as any over-recovery of target revenue will be returned to customers through lower prices.