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29 February 2012

Mr E J Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane Qld 4001

Dear Mr Hall

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

This submission is Queensland Urban Utilities ("QUU") response to the Queensland Competition Authority's ("the Authority") request for comments on the Draft Report SEQ Interim Price Monitoring for 2011/12 (the Report), Parts A and B.

QUU acknowledges that the Authority's findings found no evidence of QUU exercising monopoly power in 2011/12.

We note the Authority's findings that:

- *"In 2011-12, QUU increased the retail and distribution component of residential and non-residential water and wastewater prices by less than 3.6%", the cap imposed by the Queensland Government;*
- *All of the sampled capital projects were found to be prudent and efficient;'*
- *"QUU's operational expense forecast for 2011-12 is generally prudent and efficient, including savings that are consistent with the Authority's targets."*

QUU is generally satisfied with the findings of the Authority as set out in the Report.

Our submission is structured with initial general comments followed by our response on specific issues.

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General Comments

The QCA has, in undertaking its review, made adjustments to reflect information only available post price setting decisions. It is not possible and in some cases not practical for the ongoing revision of pricing decisions for the latest information. A cut-off time has to be struck to allow for finalisation of pricing.

An example of an adjustment made post the setting of the budget was the Authority updating QUU forecasts for new OESR population series available in May 2011.

In doing this the Authority does not appear to be mindful of:

- the materiality of the adjustment, in the case of the population change this was not significant;
- the effort required post budget approval to provide a reconciliation of changes from the budget in completing the information requirements template;
- the fact that QUU is currently subject to price monitoring which is generally implemented to ensure that revenue/price increases are reasonable given the underlying costs; and
- the assistance of readers for the Report to focus on any material findings by the Authority.

QUU would like to discuss and agree with the Authority a reasonable cut-off time after which revisions would not be made to submitted estimates for the purposes of price monitoring.

Specific Issues

1. Flood event

It is outlined in QUU's submission to the Authority, that QUU has estimated the cost of the January 2011 floods on its assets and has begun the process of recovering these costs through its insurance policies. QUU does not expect to include these costs in future data templates and submission requirements to the Authority, however QUU would like to re-emphasise that this may change if there are material differences in the costs to QUU of the floods, and the payments received through its insurance policy.

2. Unders and overs

QUU notes that the Authority reported that they consider it appropriate for businesses to recover prudent and efficient costs on a net present value neutral basis, whilst acknowledging that this is not always possible in times of significant

price increases. QUU welcomes this approach and while QUU has not proposed an unders and overs approach to date QUU may do so in future submissions. Through the development of the five year price path QUU may propose the implementation of a fully documented approach to unders and overs. A key incentive for introducing an unders and overs approach would be to address fairly to all parties, the effects of annual variability in capital revenues.

3. Roll forward of regulatory asset base

The Authority has rolled forward the regulatory asset base (RAB) using the actual consumer price index for 2010-11 March to March and QUU acknowledge that this matches current regulatory practice. However, QUU would like to emphasise the importance of the real weighted average cost of capital (6.71% based on benchmark nominal WACC of 9.35% and 2.48% inflation) being maintained in reviews of prior year maximum allowable revenues (MAR). This can occur either through the use of the nominal benchmark WACC of 9.35% and an indexation adjustment in the MAR based on inflation forecast of 2.48% or recalculation of the nominal benchmark WACC to 10.55% and using actual inflation of 3.6% for the indexation adjustment in the MAR. The maintenance of the real WACC will be crucial to the introduction of an unders and overs approach.

4. Average Prices

In Part A of the Report there are two charts, 1.2 and 1.3 that show average prices for water and wastewater. Also included is the Authority's calculation for 2011-12, however, the charts do not make it clear to the reader that the QUU calculations are based on forecast revenue divided by water usage or property connections but that the Authority's calculation are based on maximum allowable revenue, or the maximum that QUU could have charged without a price cap in place, divided by water usage or property connections.

QUU acknowledge that this is made clear in Part B Table 1.3 but believe that readers who only read Part A could mistakenly conclude that the Authority calculated that QUU's correct average prices were higher than those calculated by QUU.

5. Growth Assumptions

SKM recommended the use of the OESR May 2011 low series growth forecasts in the Report, which the Authority subsequently adopted. As the May 2011 release of the OESR data did not include a dwelling forecast, SKM had to adjust the 2008 medium dwelling growth forecast to account for the low population growth forecast. QUU has questioned the methodology used in this adjustment as the occupancy rate implied by the 2008 medium series should remain constant, with

only the dwelling numbers changing due to the lower population growth. QUU believe this correction should be addressed in the final report.

Thank you for the opportunity to provide our response.

Yours sincerely



LOUISE DUDLEY
Acting Chief Executive Officer
Queensland Urban Utilities

cc: Mr Rick Stankiewicz,
Queensland Competition Authority