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Transmission via: [www.qca.org.au/submissions](http://www.qca.org.au/submissions)

Dear Mr Millstead

The Gladstone Area Water Board (GAWB) welcomes the opportunity to comment on the Queensland Competition Authority's (QCA) draft *Statement of Regulatory Pricing Principles for the Water Sector* (Pricing Principles).

### **The Need for Pricing Principles**

The Pricing Principles are an important element of the regulatory framework as they provide stakeholders (e.g. regulated businesses, consumers) with an essential level of transparency and predictability on how the regulatory framework will be applied. Due to the various legislative provisions that make up the Queensland regulatory framework for water, GAWB is generally supportive of the structural approach taken by the QCA. That is, to use the Pricing Principles as a general guide for its regulatory assessments and then rely on recent water pricing reports and guidance material to guide how the principles will be applied on a case-by-case basis.

Notwithstanding the above, at times this approach will be insufficient to deliver the level of transparency and predictability needed to achieve good regulatory practice (as defined in section 1.2 of the draft Pricing Principles). In order to facilitate the best possible outcome, pre-emptive and timely communication of the regulator's expectations on key elements of the regulatory framework (i.e. Pricing Principles, guidance materials) may need to be provided. This point can be illustrated in the context of GAWB's recent price review, for bulk water prices commencing on 1 July 2020, where<sup>1</sup>:

*At various points during the price review process ... the lack of regulatory guidelines has caused misunderstandings around the way in which information should be presented and the methodologies to be applied to develop expenditure forecasts. This level of misunderstanding has had a material impact on the way ... GAWB's operational forecasts (have been assessed).*

*The lack of guidance materials has also resulted in the consultant setting out their expectations for future reviews. ... Whilst several of the consultant's recommendations reflect current trends in economic regulation, they do not*

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<sup>1</sup> GAWB.2020. GAWB's Response to the QCA's Draft Report on the 2020-25 Price Monitoring Investigation: Part A. March. p 22.

*reflect regulatory practice and/or water policy as it currently applies to Queensland water businesses.*

*The imposition/assumption of these expectations sets an unfair basis for the assessment of a Queensland water business's expenditure forecasts. For example, a water business is not able to ensure it presents its expenditure forecasts in the most practicable and convincing way if it is only after the consultant delivers its draft report that it becomes aware of the framework that has been applied to assess prudence and efficiency.*

As noted below, there may be times that additional certainty needs to be provided to ensure efficient investment decisions and appropriate levels of stakeholder engagement are undertaken. This could be via the Pricing Principles or guidance materials.

## **Pricing Principles**

According to the current pricing principles (i.e. Statement of Water Pricing Principles, 2000), to achieve the objectives of monopoly price regulation, including promoting economic efficiency, prices should:

- be cost reflective - that is, reflect the costs of providing the service and, usually where the demand for water exceeds its supply, potentially incorporate a value for the resource;
- be forward looking - in that they represent the least cost which would now be incurred in providing the requisite level of service over the relevant period;
- ensure revenue adequacy - the revenue needs of the business must be addressed where possible;
- promote sustainable investment - where the services are to be maintained into the future, the investor must be given the opportunity to enjoy an appropriate return on investment;
- ensure regulatory efficiency - the pricing method which minimises regulatory intrusion and compliance costs relevant to a particular circumstance should be adopted; and
- take into account matters relevant to the public interest. Many such matters are identified in the Queensland Competition Authority Act 1997 (the QCA Act).

## *Revenue Adequacy*

Most of the elements contained in the 2000 Pricing Principles are reflected in the draft Pricing Principles, albeit presented/grouped in a different way. However, the requirement for revenue adequacy is not. This is a concern for GAWB, given the importance of financial sustainability in the long term. It is necessary for the renewal and maintenance of long-lived assets, but to also encourage future investment in the sector. Be that by the private or public sector.

The importance of maintaining revenue adequacy is widely acknowledged by jurisdictional regulators and revenue bodies. For example, the Productivity Commission in 2017, outlined a national set of principles to govern independent economic regulation in each jurisdiction. This framework included the following principle for revenue adequacy<sup>2</sup>:

*Regulatory decisions should consider the long-term financial viability of utilities. While regulatory decisions typically constrain prices, they should not do so in a way that compromises the financial viability of utilities, as this*

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<sup>2</sup> Productivity Commission. 2017. *National Water Reform*. Report No 87. Canberra. p 215.

*could distort investment and operational decisions and increase long-run costs.*

It could be argued that the current drafting of the updated Pricing Principles, specifically the first principle of the recovery of efficient costs of providing the relevant services, implies revenue adequacy. However, it is noted that this principle only allows for prices to “generally” recover efficient costs and falls short of the fundamental requirement for a business to be able to achieve revenue adequacy through the recovery of efficient costs.

### *The Need to Exercise Judgement*

Whilst the draft Pricing Principles note they will generally apply, it should be acknowledged that at times the individual Pricing Principles may be in conflict with each other. For example, the requirement to achieve efficient costs (draft Pricing Principle 1) and the tariff structure preferences of customers (draft Pricing Principle 5). In such instances, discretion will need to be applied having regard to a wide range of factors such as the legislative and policy obligations of the water business and regulatory precedent. Such a situation is not currently acknowledged in the draft Pricing Principles.

The need to exercise judgement was previously acknowledged by the QCA, during its review of the long-term regulatory framework to apply to the retail water sector in South East Queensland<sup>3</sup>. As further clarification was provided on the matters that were considered relevant in assessing the public interest, having regard to the requirements of the *Queensland Competition Authority Act 1997* (QCA Act). In this context it was noted that what is considered equitable may be interpreted differently by different stakeholders, with relevant issues including managing price shocks, the effects of pricing policies on vulnerable groups and the implications of subsidies and cross-subsidies.

The QCA also commented that prices that satisfy the efficiency objective are more likely to be seen as ‘fair’. It noted that:

- the user or impactor pays principle of cost recovery “is consistent with the proposition that it is fair for a user of a service, or an individual that causes costs to be incurred (the impactor), to pay for the relevant costs”<sup>4</sup>; and
- the beneficiary pays principle may also be relevant when determining who should pay for a service.

### *The Role of Customer Engagement*

At various points throughout the draft Pricing Principles the role of customers, for example to inform potential pricing structures and investment plans, is noted. GAWB is supportive of the need for customer engagement, as it is an essential element of effective regulatory frameworks. It is also reflective of contemporary regulatory practice, in that regulated businesses (including water utilities) have become increasingly focused on providing value to their customers and better engaging with them on the products and services provided.

To ensure the utility–customer relationship is appropriately reflected in the regulatory framework, it should be up to the water business (in consultation with its customers) to determine the form of customer engagement to be undertaken. By doing so, it will enable the water business to tailor its

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<sup>3</sup> Queensland Competition Authority (2014). Final Report, SEQ Retail Water Long-term Regulatory Framework – Pricing Principles – Part C.

<sup>4</sup> Queensland Competition Authority (2014). p.4.

engagement activities to suit the content of consultation, and the circumstances facing the water business and its customers. The need for this flexibility is implied in the draft Pricing Principles.

Consistent with best practice frameworks, a water business should start customer engagement early in its planning. Also, that the engagement should be ongoing, to keep testing proposals with customers. Due to the long lead time for effective consultative frameworks, a more definitive statement should be provided in the Pricing Principles on the form of customer engagement rather than waiting until the price review. By providing further clarity it will mitigate against the potential for confusion at the time of evaluating the pricing proposal.

If you have any questions in relation the matters raised above, please do not hesitate to contact Angela Moody (Regulation and Planning Manager) on 07 3020 8014 or myself on 3020 8015.

Yours Sincerely

Hugh Barbour  
**Chief Financial Officer**  
**Gladstone Area Water Board**