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CITY OF
GOLDCOAST.

QLD COMPETITION AUTHORITY

- 1 JUL 2014

DATE RECEIVED

Mr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Mr Roberts

Long Term Regulatory Framework (and Pricing Principles) for South East Queensland Water Entities

The Council of the City of Gold Coast (Council) appreciates the opportunity to provide a written submission to the position papers developed by the Queensland Competition Authority (QCA) in response to the Minister's Direction Notice released on 28 June 2013. Whilst the City supports the continuation of regulation from 30 June 2015, the benefits of regulation should not exceed costs.

It is acknowledged that the review of cost of capital currently being undertaken by the QCA will inform the Long Term Regulatory Framework. This matter will be addressed in a subsequent submission once QCA has completed this review. The attached submission seeks to address key issues raised in the following position papers:

- Long Term Regulator Framework for SEQ Water Entities (February 2014) and
- SEQ Long Term Regulatory Framework - Pricing Principles (March 2014).

We look forward to working further with the QCA and other South East Queensland water entities to finalise the Long Term Regulatory Framework (and Pricing Principles). Should you wish to discuss these issues further please do not hesitate to contact Mr Andre Kersting, Coordinator Pricing and Regulation on (07) 5582 9006.

Yours faithfully



Dale Dickson
CHIEF EXECUTIVE OFFICER
Council of the City of Gold Coast

City of Gold Coast Submission

Long Term Regulatory Framework for SEQ Water Entities - Position Paper

Date: June 2014

1. Benefit-cost analysis

The Ministers' Direction Notice (dated 28 June 2013) specified that 'the recommended regulatory framework must ensure the costs of implementation do not exceed the benefits'.

Preliminary work undertaken by QCA indicates their annual cost to administer the proposed framework will be around \$500,000 assuming prices do not increase by more than the consumer price index (CPI) minus the efficiency factor (X) (i.e. CPI-X). These estimates are based on a 'Level 1' information requirement as described at QCA's workshop on 29 May 2014. Whilst QCA has considered their internal costs for administering the framework, the cost benefit analysis has not quantified anticipated costs that will be incurred by each of the water entities.

City of Gold Coast considers that the total impact on South East Queensland (SEQ) water customers should be considered as part of the cost-benefit analysis.

Under the recommended regulatory framework, QCA proposes to expand existing regulatory requirements to include:

- the development of a customer engagement strategy
- long term investment strategy
- service quality performance reporting
- pricing principles (which entities are required to consider when reviewing tariffs).

As a consequence of these additional regulatory requirements, City of Gold Coast (Council) suggests the cost benefit review be expanded to include additional costs that may be imposed on entities as a consequence of QCA recommendations. As most entities anticipate their information submissions to be based on a 'Level 3' information requirement, Council proposes the cost benefit review consider the total regulatory costs for levels 1 through to 5.

2. Information requirements

QCA has advised that, under the new regulatory framework, QCA will no longer rely on external consultants to provide specialist advice (i.e. engineers) in an attempt to reduce administration costs. While Council supports QCA's intention to reduce administrative costs, this raises concerns in relation to the availability of expertise to examine the broad and extensive list of supporting documentation that entities will be required to submit on an annual basis under the new framework (as outlined in the position papers).

For example, information returns for the strategic approach to long term investment require submission of documents as listed in table 1 below.

Table 1 – Documentation re Strategic Approach to Long Term Investment

NetServ Plan A and B which includes the following plans, statements, strategies and guidelines:
Water Supply Infrastructure Asset Management Plan
Sewerage Infrastructure Asset Management Plan
Recycled Water Asset Management Plan
Gold Coast Water Demand Management Plan
Gold Coast Water Leakage Management Plan
Gold Coast Water Sewage Overflow Management Plan
Gold Coast Drinking Quality Management Plan
Gold Coast Water Cycle Management Plan
Gold Coast City Council Total Water Cycle Management Plan
Gold Coast Water Compliance, Quality and Environmental Commitment Statement
Gold Coast City Council The Nature Conservation Strategy (NCS)
Trade Waste Guidelines
Trade Waste Quality Control Plan for implementation in 2014
Gold Coast Water Recycled Water Management Plan
Additional Information requirements include:
Annual Capital Works Plan (or Performance Plans)
Internal asset management standards including demonstration of compliance
Top six business cases

To comprehensively review all of the above mentioned documents, QCA will require expertise from a range of disciplines. The review of the proposed material will be time consuming and costly. Council supports the provision of the proposed information returns on an annual basis, provided the QCA clearly articulates how they intend to use these documents. Council questions the resources available within the QCA to review these technical documents.

Council seeks the QCA's guidance in regards to assessment of compliance with asset management standards. For example, would internal executive signoff suffice or does QCA expect third party accreditation from an external auditor? Should this be the case the Council would like QCA to acknowledge the additional costs this will impose on water entities.

3. Pricing Principles

City of Gold Coast supports the application of pricing principles to apply to the provision of urban water services. Pricing principles should not set rigid rules for entities, rather they should provide scope and give entities the ability to design tariff structures that are tailored to the customer and industry and, where feasible, promote innovation.

As part of the long term regulatory framework, QCA has recommended 60 pricing objectives and principles. The draft principles set out in the position paper are prescriptive and, in some circumstances, not practical. For example, pricing principle 1.5 as outlined in QCA's draft assessment of Council's transition to performance monitoring states the following:

Prices reflect the long run marginal cost (LRMC) of providing a particular service.

Pricing to long run marginal cost for the provision of sewerage services is not practical. The inability to accurately measure sewage discharge to sewer removes the ability to inform customers of their discharge levels. It is the provision of this information that enables customers to respond to a variable price signal.

The application of long run marginal costs can be at odds with what customers want. For example, Council recently conducted a survey exploring customers' preferences for tariffs. The survey found the majority of survey participants were supportive of inclining block tariffs. Pricing to LMRC would result in lower prices as volume increases – the opposite of inclining block tariffs, and contrary to fundamental water conservation principles.

The merit of recommended pricing principles regarding tradeable water entitlements and third party access (Draft Recommendation 2.29) is queried by Council. An entity must first be assigned legal entitlements before it can consider trading water entitlements. Retailers in South East Queensland (SEQ) do not have legal water entitlements and as a result, pricing principles regarding such entitlements are not practical for SEQ water entities in the current environment.

While the Council agrees with the concept of third party access, it would prefer to see the establishment of a formal access regime prior to the consideration of associated pricing principles.

Third party access can be costly and complicated. In addition to issues of pricing, other issues such as licencing and 'retailer of last resort' should be considered and formally prescribed. Council considers these principles to be policy issues that should be addressed via reform driven by government before consideration is given to their inclusion in QCA's pricing principles.

With regard to stormwater drainage, QCA has suggested charges pertaining to stormwater drainage be transparently identified on customer bills. Stormwater drainage services are not currently within the purview of SEQ water entities. Accordingly, Council does not consider it appropriate for this matter to be addressed within QCA's pricing principles.

QCA pricing principles suggest, where appropriate, SEQ water entities consider scarcity based pricing. The practical application of scarcity pricing requires tariff reform at the bulk water level. In addition, more extensive changes to retail billing frequency would be required to ensure timely signals are sent to customers to allow them to respond accordingly.

In its draft assessment of Council's transition to performance monitoring, QCA noted adherence to the pricing principles will be considered a priority issue for attention. As discussed above, 60 principles have been proposed. As some principles are contradictory, Council suggests it would be prudent for QCA to provide guidance as to what are considered primary principles vs. secondary order principles.

4. CPI-X

Council continuously endeavours to incorporate business efficiencies in its operations. Based on current trends, Council expects operating costs, influenced by exogenous factors, to increase by more than CPI-X. Examples include electricity, chemicals, labour costs and bio-solids removal. As a result, the proposed framework, by default, is likely to revert back to an annual price monitoring review. At a minimum, Council anticipates future submissions to be reflective of its 2013-15 submission. That submission did not include the provision of additional information requirements listed above.

In regards to the Regulatory Asset Base (RAB), QCA proposes accepting the QCA forecast RAB at 1 July 2015 as established in the 2013-15 price monitoring review. Council suggests the QCA use actuals submitted each October to recalibrate the RAB rather than rely on forecast data. Council believes this would avoid confusion in future regulatory periods.

Council suggests QCA provide guidance in relation to the efficiency proposal outlined in the position paper which appears to reflect an efficiency carry over mechanism. Such a mechanism is usually associated with a price deterministic framework.

Council suggests the use of 'competition by comparison' in lieu of such a mechanism. 'Competition by comparison' has been proven to drive efficiencies and eliminates the need for complicated efficiency carry over mechanisms which contradict the objectives of a light handed regulatory framework.

5. Coordination with regulatory processes

The concurrent review and development of other regulatory instruments provides an opportunity for QCA and Department of Energy and Water Supply (DEWS) to ensure the overarching regulatory framework balances the interest of the public whilst reducing red tape.

Regulatory instruments currently under development / review include:

- Long Term Regulatory Framework for SEQ Water Entities
- Water and Sewerage Services Code for Small Customers in SEQ
- DEWS Service Standard Framework, and
- 30-Year Water Sector Strategy.

Council also encourages collaboration with other government departments such as the Department of Environment and Heritage Protection (DEHP) and Department of State Development Infrastructure and Planning (DSDIP) to identify other areas for red tape reduction and streamlining regulatory processes.

To promote coordination with other regulatory processes, Council suggested QCA consider entering into a Memorandum of Understanding (MOU) with other regulatory authorities such as DEWS, DEHP, and DSDIP. Although QCA rejected this idea, Council continues to seek assurance that QCA is interacting with other regulators to ensure streamlining and alignment of regulatory requirements and objectives.

By way of example, we note that Draft Recommendation 2.8 from QCA's Pricing Principles document states:

"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."

In contrast, the Department of Energy and Water Supply's *WaterQ: a draft 30-year strategy for Queensland's water sector* states:

"Service providers will investigate new ways of pricing to meet customer and business needs. These may include: fixed charge for water and sewerage, with tiered consumption charging for water....."

Such lack of alignment between regulatory objectives introduces significant uncertainty to the industry and will ultimately result in a less effective outcome for customers.

Over the coming years the water industry will be going through change. Rather than an 'input' approach, industry is evolving to an 'outcomes' approach with a customer-centric focus and broader regional outcomes.

For the 2015 review, Office of Water Services (OFWAT) is moving to this approach. To align with these emerging trends, regulators must work in a collaborative manner to ensure regulatory requirements accommodate these changes. This means roles and responsibilities for setting regulatory requirements and delivering services need to be clear, transparent and effectively aligned with Government's policy objectives.

The Victorian Government in February 2014 appointed Professor Graeme Samuel to independently review the economic regulation, governance and efficient operation of the Victorian water sector. Rather than a MOU, Samuel recommends a 'Letter of Expectations' that would serve as a binding performance contract. The recommendation states:

The setting of these expectations should be co-ordinated across Government and its regulatory agencies to ensure they are consistent with the Government's overarching objectives and its regulatory agencies to ensure they are consistent with the Government's overarching objectives for the sector.¹

Whilst not suggesting the implementation of a 'Letter of Expectations', Council does see merit in the establishment of a formal framework that coordinates Government and regulatory agencies to ensure consistency for the industry.

¹ Preliminary advice from the Independent Reviewer, May 2014, Economic regulation, governance and efficiency in the Victorian water sector, page 52.

6. Service Quality Performance Framework

The indicators proposed by the QCA need to be clearly defined to ensure performance expectations are clear and actual performance against these expectations is assessed and reported on a comparable basis. This should include the assessment of data submitted to ensure accuracy. For example, each entity could define the term 'urgent'² differently resulting in some entities appearing to perform better than others when this may not be the case. Additionally, terms such as 'response'³ should also be clearly defined to ensure comparability of performance indicators. For example, is a follow-up telephone call a 'response' or does 'response' constitute actually fixing the issue?

It is important to consider business characteristics including age and type of assets, geography and customer types when introducing a service quality performance framework. Where characteristics are not controllable by the water entity, a distinction should be made between what is considered a performance measure and a service standard. A service standard for example is influenced by the characteristics of a water entity, whereas a performance measure is something the entity can control such as response time to water main breaks.

In addition to the indicators proposed to be submitted to the QCA, entities will also be required to submit key performance indicators (KPIs) to DEWS. Council has received advice from DEWS that these KPI's will be submitted electronically via the State Wide Information Management System (SWIMS) database. Council supports the use of this data repository for both DEWS and QCA indicators as consolidation of reporting requirements (i.e. both QCA and DEWS indicators submitted via SWIMS database) will reduce administrative and reporting burden on entities.

7. Stakeholder engagement strategy

In terms of stakeholder engagement, Council has implemented a number of strategies to better understand its customers. One of these included a residential customer survey (forms part of City of Gold Coast's Tariff Review Project) to increase understanding of customer attitudes towards water and sewerage tariff structures.

Council has also engaged the Queensland Council of Social Services (QCOSS) on a number of issues including the above mentioned residential customer survey, customer hardship and tenant billing. In terms of Council's Tariff Review, QCOSS is a member of the Project Reference Group which provides peer review to the Project.

In response to the requirement to establish a customer consultation committee, Council believes this should only be mandated when other proposals are not put forward. Council has an existing forum it proposes to use called Gold Coast Engage (GCE). This forum is an innovative, cost-effective tool which will enable the Council to ensure a broader representation of customers.

² Recommended QCA indicator – Response to *urgent* incidents (per cent within 1 hour).

³ Recommended QCA indicator – *Response* to urgent incidents (per cent within 1 hour).

GCE members (i.e. local Gold Coast residents) are randomly selected and invited to participate and opt into the group which has been operational since December 2012. GCE is a closed group comprising around 1,700 local residents (with plans to increase this to over 3,000) who have been randomly selected to represent the Gold Coast community across qualifiers such as age, sex and geographic location (i.e. north, south, east and west of the City) with even representation across each of the demographic criteria.

Each GCE member receives around ten to twelve surveys a year, with the expectation they complete at least six surveys per annum (equating to a commitment of around two hours per member).

To test the statistical validity of GCE, the City of Gold Coast presented a customer survey to both GCE members and GC residents (i.e. a 'traditional' customer survey) to compare responses received. The comparison indicated responses received from GCE members were closely aligned and reflective of responses received via the traditional survey option.

In addition, there would be a strong view from elected representatives that they represent their constituents who are the customers of Gold Coast Water. The suggestion that an additional 'customer consultation committee' was required may be considered to be a cost burden that should not have to be borne by ratepayers.

8. Regulatory Certainty

There are a number of areas in QCA's position paper that concern Council in terms of regulatory uncertainty. The proposed framework broadens the scope of regulation by introducing additional parameters that allow the QCA to review tariff structures, service performance and customer engagement, in addition to the review of costs to determine maximum allowable revenue.

While QCA has provided high level trigger indicators that could initiate a more formal review or possibly the application of price determination; triggers should be more transparent to provide regulatory certainty and not impede entities' future investment decisions.

QCA proposes not to define thresholds which would trigger a cost of service review and price determination. As the proposal creates regulatory uncertainty, Council suggests QCA provide a formal Guidance Paper addressing a number of proposed regulatory parameters. The guidance paper should include but not be limited to the following:

- formalised rules applicable to the framework
- comprehensive list of information requirements including template requirements to ensure adequate regulatory recordkeeping is maintained;
- definitions for the proposed service standards
- a proposed appeal mechanism to complement the potential for price determination;
- QCA's expectations re the application of pricing principles, and
- an illustration of how the proposed efficiency mechanism is to work.

A good example of the style of guidance Council seeks from QCA is that provided by the Essential Services Commission (Victoria) to water entities in preparation for the 2013 Water Price Review.