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Queensland Competition Authority
GPO Box 2257
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By Email to: gawb.investigation@qca.org.au

Attention: Mr Matthew Rintoul

Gladstone Area Water Board: 5 Yearly Investigation of Pricing Practices

Thank you for the opportunity to submit comments in regard to GAWB's first submission toward this investigation of pricing practices.

QER's response and comments are submitted as a six page attachment under this cover.

Should you have any enquiries in regard to QER's submission could you please direct your enquiries to Richard Seton, Manager Infrastructure (Phone 07 3222 0610 or email rseton@qer.com.au).

Yours sincerely



Pearce Bowman
Chief Executive Officer

Queensland Energy Resources Limited
Submission of comments to the Queensland Competition Authority
in regard to Gladstone Area Water Board 2010 Submission 1
Investigation of Pricing Practices

12 October 2009

	GAWB Proposal	Section	QER Response and Comment
1	Form of Regulation	2.1	SUPPORT – Given the prevailing operational circumstances of GAWB, its proposal of a Revenue Cap seems appropriate and better reflects the prevailing commercial/economic circumstances of the entity, most certainly until secure augmentation of supply has been afforded, after which a further review may indicate a more sustainable commercial environment and the potential return to a Pricing Cap could be reconsidered.
2	Planning Period	2.2	SUPPORT – The proposed five year planning period is an appropriate timeframe given the nature of commercial/industrial demand and development within the GAWB domain.
3	Demand Management Measures	2.3.2	SUPPORT – GAWB proposal is appropriate and reflective of the prevailing environmental circumstances supporting supply.
	Analysis of Options	2.3.5	SUPPORT
	Including Demand Management Costs in Prices	2.3.6	SUPPORT – Given the consultation and engagement proposed by GAWB, providing Customers the opportunity to self implement demand management with transparency to GAWB demand management costs, indicates that this cost transfer is appropriate.
4	Price Transition	2.4	SUPPORT – Reflects appropriate NPV Neutrality principles.
5	Scarcity Pricing	2.5	SUPPORT – GAWB’s proposal to exclude scarcity pricing is appropriate.
6	Demand Forecast Methodology	3.2	SUPPORT – Strongly reflects an appropriate methodology given the GAWB customer base and future augmentation planning.
7	Revenue Components	4.1	SUPPORT – The incorporated allowances are appropriate.

	GAWB Proposal	Section	QER Response and Comment
8	WACC Parameters		
	Risk Free Rate	4.4.2	CONDITIONALLY SUPPORTED – GAWB’s proposed methodology is appropriate, however given the reversal of the Financial Market trends since submission it would be appropriate for the QCA to further review the 10-year government bond rate and apply a consideration in regard to potential market direction before setting this rate for GAWB.
	Capital Structure	4.4.3	SUPPORTED – To retain a credit rating of BBB
	Debt Margin	4.4.4	CONDITIONALLY SUPPORTED – GAWB’s proposed methodology is appropriate, however given the reversal of the Financial Market trends since submission it would be appropriate for the QCA to further review both the mid-point 20 day average (and apply a consideration in regard to potential market direction before setting this rate for GAWB) and seek further historic GAWB debt raising costs to ascertain the sufficiency or otherwise of the nominated 12.5 basis point allowance.
	Debt Beta	4.4.5	SUPPORTED – A zero value for GAWB’s debt beta is appropriate.
	Asset Beta	4.4.6	SUPPORTED - The 0.40 asset beta should be retained.
	Market Risk Premium	4.4.7	CONDITIONALLY SUPPORTED – The notional range of 6% to 7% is appropriate. Whilst the suggested 6.5% was appropriate given the conditions at the time of the GAWB submission it would however be appropriate for the QCA to further review the market risk premium rate, given the reversal of the Financial Market trends since submission and apply a consideration in regard to potential market direction before setting this rate for GAWB.
	Gamma	4.4.8	SUPPORTED – A zero value for GAWB’s gamma is appropriate.
9	Return of Capital	4.5	SUPPORTED – The retention of the straight-line depreciation is appropriate for GAWB.
10	Capital Contributions	4.6	SUPPORTED – The framework as referred to in Appendix C is appropriate.

	GAWB Proposal	Section	QER Response and Comment
11	Asset Values	4.7	SUPPORTED - The treatment of asset valuations based on the valuation at a depreciated optimized replacement cost is appropriate for the GAWB assets and the regulated asset base set as articulated at 4.7.1 is correct and relevant.
12	Zonal Pricing	5.1 & 5.1.2	SUPPORTED - The proposed rezoning supports an appropriate industrial supply and basis for price setting.
13	Price Differentiation Contract Length	5.2.2	<p>NOT SUPPORTABLE – 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 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.</p> <p>For example: An un-contracted small volume and short run customer of industrial raw water should not bare the significant price surcharge of 25% when there is a residual oversupply (as presently prevails) and the supply is physically able to be provided within the existing operating cost parameters and without any capacity expenditure. A set of small customers may positively affect the resource allocation. This customer will get no NPV neutral benefit from the surcharge, where as other long run customers will disproportionately benefit.</p>

	GAWB Proposal	Section	QER Response and Comment
13	Price Differentiation Setting the Surcharge	5.2.2.3	NOT SUPPORTABLE – There is a requirement for additional mechanisms to reflect the industrial development processes of customers and consequential relevance to contract durations. Whilst there is mention of ‘quantum of price-duration relationships as observed in other markets’ there is no supportive rationale as to how this mechanism will be adopted and applied. Many proposed commercial/industrial developments for the Gladstone region are not single/one off developments, in fact many are planned as long term staged developments requiring adjustment for future ramp-up of water demand. Consequentially 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 surcharge. It would be inappropriate for a potential long term customer to bare a 20% surcharge on initial supply arrangements for say the first five years, and then further 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 returnable deposit which is cost reflective of the costs borne by GAWB. This may also go some way to support the SUPPORTABLE Default Risk at 5.2.3.2
14	Over-Run Charges	5.3	NOT SUPPORTABLE – There is no evidenced validating either the level of surcharge or incremental thresholds as proposed. Whilst the notion of an over-run price signal is appropriate the following two reasons of; evidenced system and supply stress on GAWB and for informing and shaping of Customer behavior. The proposed methodology implies a stepped charging regime which may not reflect the justifications outlined above. For Example: The over-run of raw industrial water may have no adversarial cost impact in terms of supply and distribution for GAWB, if in fact the over-run occurs at a time when other Customers within the designated network are under using a non capacity constrained network.

	GAWB Proposal	Section	QER Response and Comment
15	Prices for GRC	5.4	SUPPORTED
16	Instantaneous Flow Rate Pricing	5.5.3 & 5.5.4	<p>NOT ENTIRELY SUPPORTABLE – The justification of an Instantaneous Flow Rate price signal is appropriate for the following two reasons: alleviation of system and supply stress and consequential cost recovery for GAWB; and for informing and shaping of appropriate Customer behavior.</p> <p>There may very well be instances where a Customer initiates a flow rate significantly above the contracted instantaneous flow rate, and where this exercises system supply stress a charge is appropriate.</p> <p>However there may be occasions where an under capacity, or temporarily under utilized, system only evidences an event of flow rate capacity being exceeded when the flow meter is read at a later date. Hence there is no recognized GAWB cost impact and the notion of ‘no change in total revenue recovered’ is thus questionable.</p> <p>For Example: An instantaneous flow rate of raw industrial water may have no adversarial cost impact in terms of supply and distribution for GAWB, if in fact the event occurs at a time when other Customers within the designated network are under using a non capacity constrained network.</p> <p>The second element, that of informing an improvement in Customer behavior should be incentivized through appropriate pricing signals. However, there may be mechanisms available for the Customer to notify GAWB of an impending exceeding of its Contracted Instantaneous Flow Rate so that this may be accommodated in a window of opportunity without undue system stress and hence no additional penalty should be levied. Alternatively if Customer behavior is such that the supply system is repeatedly stressed implying a low level of cognizance for the cost penalty then additional mechanisms (such as further penalty multiplier within a reasonable timeframe) could be brought to bare.</p> <p>As with the over-run charges discussed above, there needs to be further work undertaken to fully justify and validate either the level of surcharge or incremental thresholds proposed.</p>