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29 January 2021

Mr Charles Millstead  
Chief Executive Officer  
Queensland Competition Authority  
GPO Box 2257  
Brisbane QLD 4001  
(<https://www.qca.org.au/submissions>)

Dear Mr Charles Millstead

**Requests for Comments (November 2020): Statement of regulatory pricing principles for the water sector**

Urban Utilities welcomes the opportunity to provide comment on the Queensland Competition Authority (“QCA”) November 2020 ‘Statement of regulatory pricing principles for the water sector’ (“the Principles”).

Set out below are Urban Utilities general views of the Principles on which the QCA are seeking stakeholder feedback:

- 1) The pricing principles should align with contemporary regulatory precedent.
  - 2) QCA should consider a holistic approach to regulatory oversight by ensuring and explicitly stating that the pricing principles apply to all monopoly services (water and sewerage services) provided by a Distributor-Retailer.
  - 3) QCA should consider including additional pricing principles relating to price shock minimisation and customer control.
  - 4) The pricing principles should recognise the prerogative of a utility business to prioritise practical simplicity of design and managing customer impacts over pricing efficiency and complexity.
  - 5) The statement document should provide clarity on how a transition towards QCA’s long term regulatory framework would be accommodated.
  - 6) The pricing principles should recognise that the allocation of residual costs between fixed and variable tariff components is an important consideration in balancing the need for economic efficiency with the desire for customers to have an ability to respond to price signals and hence have a degree of control over their bills.
  - 7) Locational pricing is not supported. In relation to bulk water provision, all customers in South-east Queensland are beneficiaries of the water security provided by Seqwater’s bulk water infrastructure, and headworks costs associated with these assets should be spread across all customers according to demand and not location. In relation to distributor-retailer service provision, the institutional history
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of the SEQ water industry would make it very difficult to implement locational pricing that was not aligned with existing, or previous, council boundaries. In addition, cost-reflective locational prices would result in significant customer impacts across some of Urban Utilities' service area.

Further comments on the Principles are provided in Appendix A for QCA consideration.

Should you have any queries in relation to our submission please contact James Benjamin, Head of Strategic Finance on 3855 6161 or [James.Benjamin@urbanutilities.com.au](mailto:James.Benjamin@urbanutilities.com.au).

Yours sincerely



Ruth Coulson  
**Chief Financial Officer**  
**URBAN UTILITIES**

Cc. Mr Russell Silver-Thomas, Queensland Competition Authority  
Enc. Appendix A: Urban Utilities comment on the Principles

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**Appendix A – Urban Utilities Responses to the Principles.**

<b>Section</b>	<b>Urban Utilities Comment</b>
1.1	No comment
1.2	Pricing principles should also align with contemporary regulatory precedent, in addition to being transparent and predictable. This comment also applies to section 2.2.5
1.3	No comment
1.4	<p>Urban Utilities notes that the principles do not explicitly reference sewerage pricing, developer charges nor the range of fee or quoted service charges that distributor-retailers provide to customers. Urban Utilities considers QCA should take a holistic approach to regulatory oversight by ensuring and explicitly stating that the pricing principles apply to all monopoly services provided by a distributor-retailer. This comment also applies to section 3.</p> <p>Urban Utilities also considers regulatory oversight should cover capital revenues as well as recurrent revenues. QCA has previously focused only on recurrent revenues and has treated capital revenue pricing as an input rather than an aspect of pricing that requires specific regulatory oversight. Assessing capital revenue pricing as part of a holistic regulatory framework is entirely consistent with the allocative efficiency principle, and Urban Utilities would expect a review of capital revenue pricing is necessary to ensure an effective price signal can be achieved.</p> <p>Urban Utilities also considers that prices associated with regulated monopoly business activities should also be set with regard to ringfencing arrangements where a utility business engages in the provision of regulated and non-regulated service provision. This comment also applies to section 3.1</p> <p>Urban Utilities also notes the statement document does not provide clarity on how a transition towards QCA’s long term regulatory framework would be accommodated.</p>
1.5	No comment
2	No comment
2.1	Urban Utilities as a water service provider also provides sewerage services as part of the regulated monopoly business activities. Explicit reference to sewerage service provision should be made in this section.
2.1.1	Please substitute “Urban Utilities” for all references to “Queensland Urban Utilities” and “QUU”.
2.1.2	No comment
2.2	No comment
2.2.1	No comment
2.2.2	No comment
2.2.3	No comment
2.2.4	No comment
2.2.5	No further comment (other than that noted for section 1.2)
3	No further comment (other than that noted for section 1.4)
3.1	Urban Utilities considers there are additional pricing principles relating to <i>price shock minimisation</i> and <i>customer control</i> , which do not appear to be referenced in this section.

Section	Urban Utilities Comment
	<p>The <i>price shock minimisation</i> principle upholds that price shocks to customers should be minimised using smoothed price paths and transitional arrangements where appropriate. Consistent with contemporary regulatory precedent, this principle is applied in other regulated industries (such as electricity and gas distribution network pricing) to minimise price volatility for customers.</p> <p>The <i>customer control</i> principle requires that tariffs should provide customers with some ability to influence the total charges faced through managing their water consumption or sewerage usage, and that customers should have the ability to respond to price signals inherent in the price structures.</p>
3.2	No comment
3.2.1	<p>Urban Utilities considers that capital revenue offsets should be included in the cost base considerations set out under Principle 1.</p> <p>Urban Utilities notes there is no reference to the determination of asset lives in the Return of Capital section. Urban Utilities considers the choice of asset lives to be an important consideration in the determination of regulatory depreciation.</p>
3.2.2	<p>Urban Utilities agrees an efficient alternative to marginal cost pricing is a two-part tariff, but the key consideration is the allocation of residual costs to the volumetric component. As noted by the QCA, the marginal cost of water and sewerage service provision is generally very low, which would necessitate a relatively high fixed charge if residual costs were not allocated to the volumetric component. High fixed charges afford customers little ability to control their bills or respond to efficient price signals. The allocation of residual costs between fixed and variable tariff components is therefore an important consideration in balancing the need for economic efficiency with the desire for customers to have an ability to respond to price signals and hence have a degree of control over their bills.</p> <p>Urban Utilities seeks to understand QCA’s interpretation of “marginal cost”. That is, whether QCA interprets this to be the marginal cost of providing water and sewerage services using <i>the current assets, technologies and service delivery mechanisms employed by water utilities</i>, or whether the marginal cost is set with regard to the <i>lowest cost alternative</i> which could provide the same level of service provision.</p> <p>Urban Utilities considers the application of scarcity pricing (as a pricing principle within the domain of economic regulation) to be incongruent with QCA’s assertion in section 2.2.3 that social equity factors can be more effectively addressed by using the tax and transfer system (i.e. that targeted industry assistance can be more effective at addressing temporary shocks such as droughts). Urban Utilities seeks to understand the principles QCA might seek to employ in balancing economic factors (such as introducing scarcity pricing) with social factors (such as supporting targeted industry assistance in favour of a price signal) in future price investigations.</p> <p>Current bulk water prices are purely volumetric, allowing distributor-retailers to “pass through” bulk water price signals to customers without distortion. However, bulk water tariff structural reforms and/or scarcity pricing arrangements which</p>

<b>Section</b>	<b>Urban Utilities Comment</b>
	<p>move away from this arrangement could create a tension in trying to balancing the need for simplicity with the need to avoid inefficient distortion of scarcity price signals. Urban Utilities seeks clarification on the principles QCA would apply in assessing whether future scarcity price signals are being appropriately signalled to customers.</p> <p>Urban Utilities notes that water is relatively price inelastic (as generally observed for most distributor-retailer customers, but less so for other bulk water users such as irrigators). For this reason, Urban Utilities considers that water pricing does not necessarily represent a good allocative efficiency tool as outlined in this section. Urban Utilities seeks to understand QCA’s views on the effectiveness of water pricing as a mechanism for achieving allocative efficiency, particularly as it relates to distributor-retailers.</p> <p>Urban Utilities considers that the pricing principles should place greater priority on managing customer impacts over pricing efficiency. Urban Utilities notes that price changes and reforms that improve pricing efficiency tend to disproportionately impact lower socio-economic customers that are least able to adjust their consumption decisions and that tend to spend a greater proportion of their disposable income on utility services. Urban Utilities therefore considers the pricing principles should prioritise managing customer impacts in those circumstances where tension exists between customer impact and achieving price efficiency.</p>
3.2.3	No comment
3.2.4	No comment
3.3	No comment
3.4.1	No comment
3.4.2	No comment
3.5	<p>Urban Utilities considers that a separate set of pricing principles should be established for the provision of potable water services and non-potable water services. The cost drivers, delivery mechanisms and customer choice for potable and non-potable water supply differ markedly and Urban Utilities considers the principles for regulatory oversight of these services should be clearly delineated in recognition of these differences.</p> <p>Recycled water provision, which is referenced in this section, could be considered a subset of non-potable water provision. However, in an environment of increasing water scarcity, recycled water provision could also be considered a form of potable water substitution. Where appropriate, pricing should reflect the role of recycled water as part of an integrated water resource planning system and be based on a beneficiary pays approach, with specific cost share across beneficiaries based on the scheme’s drivers.</p> <p>Similarly, Urban Utilities considers that a separate set of pricing principles should be established for the provision of bulk water services, as distinct from the services provided by distributor-retailers. This is because the assets, services, customers and operational risk profiles of bulk water service providers are markedly different those of distributor-retailers. There is well established precedent for this in other regulated industries (e.g. electricity transmission and distribution, which is analogous to bulk water and water distributor-retailer respectively), whereby</p>

<b>Section</b>	<b>Urban Utilities Comment</b>
	electricity transmission and distribution businesses have different sets of pricing principles reflecting the different nature of the services they provide.