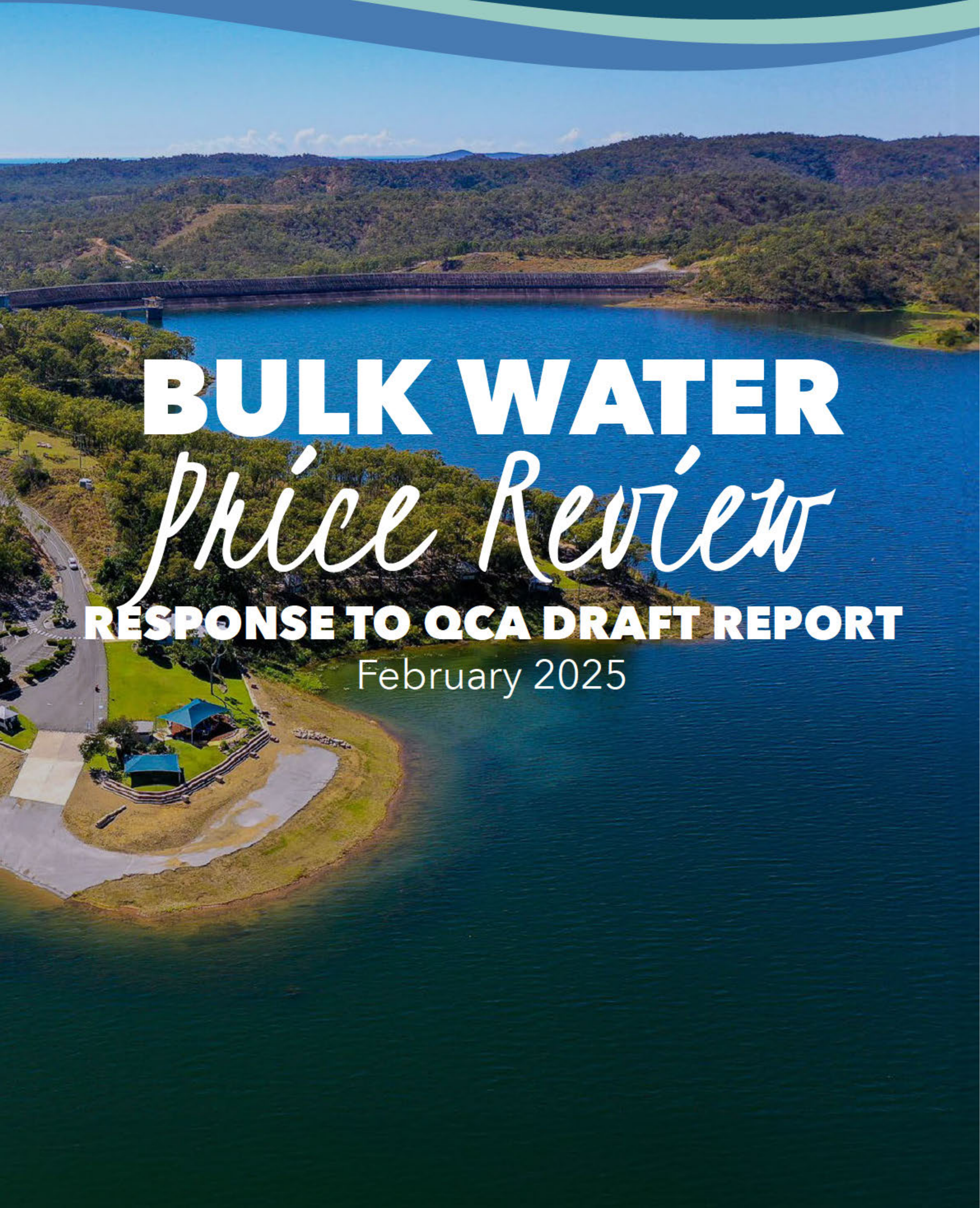
Gladstone Area Water Board



BULK WATER Price Review

RESPONSE TO QCA DRAFT REPORT

February 2025

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1. Introduction and overview

1.1 Introduction

The Gladstone Area Water Board (GAWB) welcomes the opportunity to respond to the Draft Report published by the Queensland Competition Authority (QCA) on 12 December 2024. The Draft Report presents the QCA's preliminary (or draft) findings for its price monitoring investigation for the period of 1 July 2025 to 30 June 2030 (the FY2026-30 regulatory period), in response to the amended Referral and Directions Notice (the Amended Referral Notice) issued on 23 May 2024.

As the QCA acknowledges, its "price monitoring findings are not directly binding – we do not set GAWB's costs, revenues or prices."[1] Its draft findings set out its view on the appropriate prices to apply for the FY2026-30 regulatory period based on its assessment of GAWB's prudent and efficient costs, along with forecast demand. These findings "are indicative and will be subject to further consideration"[2] before the QCA presents its Final Report to Government by 30 April 2025.

The focus of this response to the QCA's Draft Report is limited to those matters where GAWB:

- strongly disagrees with the QCA's draft findings;
- wishes to address analysis or conclusions made by the QCA that GAWB considers to be factually incorrect; and/or
- has additional information, including where the QCA has requested or invited further information or input from GAWB.

As flagged by GAWB in its regulatory proposal lodged with the QCA on 31 May 2024 (the initial regulatory proposal), the timing of the QCA's price monitoring investigation coincides with a period of considerable uncertainty for GAWB, especially in relation to hydrogen development. This could result in changes impacting GAWB's forecasts for the FY2026-30 regulatory period, primarily for forecast demand and the capital program. GAWB will work with the QCA as required as new information becomes available prior to the release of its Final Report.

1.2 Stakeholder submissions

GAWB acknowledges the submissions made by stakeholders in response to its initial regulatory proposal, including concerns regarding the overall magnitude of the indicative price increases that would be necessary to enable it to recover its efficient costs over the FY2026-30 regulatory period.

Further, while the Amended Referral Notice required the exclusion of the costs associated with the Fitzroy to Gladstone Pipeline (FGP), a number of stakeholders expressed concerns with this. These concerns are understandable, given the magnitude of this investment and the late timing of the release of the Amended Referral Notice to exclude the FGP from the scope of the current QCA process. As stated in the Amended Referral Notice, GAWB understands

[1] Queensland Competition Authority (2024). Gladstone Area Water Board Pricing Monitoring Investigation 2025-30, Draft Report, November, p.2.

[2] Queensland Competition Authority (2024). p.2.

that the FGP will be the subject of a separate review, noting that the specific timing and nature of that review is yet to be determined by Government.

Overall, a number of the issues raised by customers relate to GAWB's pricing approach, including the allocation of costs to pricing zones. In particular, the allocation of costs between existing and new (i.e., hydrogen) customers. Even though GAWB considers that its current zonal pricing approach enables it to address this, the tariff review that it plans to undertake in the FY2026-30 regulatory period will provide the opportunity to review the appropriateness of the current approach and allow for opportunities for improvement to be identified. GAWB identified the need for this review in its initial regulatory proposal and this is discussed further in this response.

Since lodging its regulatory submission, GAWB has offered one-on-one meetings with all existing and prospective customers, including Gladstone Regional Council (GRC). It also met with the Board of Directors and CEO of the Gladstone Industry Leadership Group in October 2024 to discuss GAWB's 2025-30 Price Monitoring Investigation and regulatory submission.

In the one-on-one meetings, GAWB has provided detail on its proposed treatment of expansion capital expenditure, i.e., specifically related to the augmentation of GAWB's delivery network to accommodate prospective future hydrogen demand, to ensure customers are not unfairly impacted. GAWB also provided detail on the key themes and cost inputs that informed GAWB's submission and the key drivers of the change in pricing for the next regulatory period. Importantly, these meetings provide the opportunity to directly address the issues raised by customers in their submissions (including the allocation of costs) and having regard to the relevant impacts on each individual customer.

Consistent with the approach that was undertaken by GAWB following the finalisation of prices for the current FY2021-25 regulatory period, in communicating those final prices to each customer GAWB will identify and explain any key differences in its final methodologies and/or inputs compared to the QCA's Final Report. Customers will also be able to request any further information required to understand how those prices have been determined. GAWB must also report this to the QCA as part of the mid-term review that will occur in 2028.

2. GAWB's commercial and regulatory framework

2.1 QCA's draft findings

In a number of areas in the Draft Report the QCA refers to GAWB's bulk water prices as being determined by commercial negotiation between GAWB and its customers, and that it "would expect GAWB and its customers to depart from our price monitoring findings and set different prices, subject to their commercial arrangements and changing market circumstances."[3]

2.2 GAWB's response

Overall, GAWB agrees in principle with the QCA's statements regarding a section 23A price monitoring investigation in giving primacy to commercial negotiations, particularly in a mature industry where both the service provider and customers have the willingness and ability to effectively negotiate. However, it is important to highlight that the unique regulatory and commercial framework within which GAWB's declared bulk water services are currently delivered means that in practice, the QCA's findings and recommendations have a significant influence on actual pricing outcomes.

It is now over 20 years since GAWB's bulk water services were declared as monopoly business activities under the *Queensland Competition Authority Act 1997* (the QCA Act) and hence subject to price investigations by the QCA under Part 3 of that Act. Under its commercial framework, which has developed in parallel, GAWB seeks to enter into long-term (i.e., generally at least 20 year) contracts with its customers. This provides a degree of surety to customers and GAWB regarding the commercial arrangements that will apply to water supply services. Given these services are also subject to prices oversight by the QCA, those contracts must necessarily have regard to GAWB's regulatory framework and the implications of this for the prices that it charges for bulk water supply.

Under Part 3 (Division 3) of the QCA Act, the relevant Minister may refer GAWB's monopoly business activities for either an 'investigation of pricing practices' (section 23) or 'a price monitoring investigation' (section 23A). Since 2000, these referrals have been made by the Minister every five years, via the issuance of a Referral Notice, which sets the parameters for the QCA's review.

Between 2000 and 2015, the QCA was requested to undertake an investigation of pricing practices. Since 2015, the nature of the review has changed to a price monitoring investigation. The nature of this investigation is very important. Under a section 23 review, the QCA is required to make recommendations in relation to GAWB's proposed prices to the Minister, who then either accepts or rejects those recommendations. Under a section 23A price monitoring investigation (as most recently applied), the QCA only presents findings to the Minister, with GAWB remaining responsible for setting its final prices. The type of investigation could change again under future Referral Notices.

Apart from listing matters that the QCA must have regard to (section 26), the QCA Act does not specifically address how the review is to be conducted, nor distinguish between the approach the QCA is to take under a section 23 or section 23A review. However, it is generally

[3] Queensland Competition Authority (2024). p.8.

recognised in economic regulation that ‘price monitoring’ implies a more light-handed approach.

As noted above, GAWB’s current contractual framework has been established and negotiated within the context of this prices oversight regime. The pricing arrangements applied in GAWB’s contracts are based on the Pricing Principles (contained in a schedule to the contract), which prescribes a pricing approach. Importantly, these Pricing Principles are founded on the QCA’s water pricing principles and the recommendations and findings it has made in its investigations of GAWB since 2000. The terms of the contract currently provide for a five-yearly price reset that is aligned with the frequency of the QCA’s price investigations. They require GAWB to have regard to the outcomes of the QCA’s investigation that have been endorsed by the relevant Minister and also legally oblige GAWB to ‘act reasonably’ in any deviation from these.

While this significantly limits flexibility in terms of setting prices under GAWB’s contracts, it also provides customers with certainty. This also recognises the value in a periodic and independent review of GAWB’s forecasts and proposed bulk water prices by the QCA.

In setting its final prices following the release of the QCA’s Final Report, GAWB must be able to clearly and robustly substantiate any deviations from the QCA’s findings as it is required to undergo a mid-term review. This is a new obligation, introduced in the Referral Notice issued by the Minister for the current FY2021-25 regulatory period, which is to also apply in the FY2026-30 regulatory period. As part of the mid-term review, the QCA is to also provide a Mid-Term Report comparing the QCA’s findings against GAWB’s actual prices charged for the first three years of the relevant regulatory period. To inform that review, GAWB lodges a submission to the QCA explaining all deviations between the QCA’s findings and the approaches and inputs used by GAWB to set its final prices.

Additionally, in dealing with its customers, including negotiating long-term contracts with new customers, it is evident to GAWB that many rely on the QCA’s analysis of efficient pricing conducted under its pricing investigations and have an expectation that GAWB will largely align with this.

In conclusion, while the QCA’s price monitoring investigations do not compel GAWB to set prices consistent with its findings, GAWB’s current contractual framework heavily refers to those findings and practically limits the ability to deviate from them.

3. Operating expenditure

3.1 Overview

The QCA's draft findings as to GAWB's prudent and efficient operating expenditure for the FY2026-30 regulatory period is $236.74 million (nominal), which is $7.97 million below GAWB's forecast. Acknowledging that this is the first application of the base-step-trend methodology to forecast GAWB's operating expenditure, GAWB was pleased to see the QCA acknowledge the effort taken to provide it with the appropriate information to support its regulatory proposal. GAWB has continued to take this approach in responding to Requests for Information (RFIs) from the QCA and in this response.

The QCA endorsed GAWB's base year expenditure of $30.76 million ($2022-23), which is below the forecast it assessed for that year of $31.04 million ($2022-23) in the FY2021-25 price monitoring investigation.

The main sources of the difference between GAWB's forecast operating expenditure and the QCA's draft findings are some of the step changes. The QCA also has a different view on the approach used to forecast the Wage Price Index (WPI), along with the premium for regional labour market conditions that GAWB has proposed for its labour and contractor cost categories. These matters are the focus of this chapter.

3.2 Step changes: increase in unit costs

In terms of two of GAWB's proposed step changes, being chemicals and ICT costs, part of the concerns expressed by the QCA relate to allowing for above-CPI increases in unit costs within the step change. The QCA considers that this should either be absorbed by the business or be addressed through the escalation rates, as opposed to including it in the relevant step change amount. It states that "selectively" re-opening items within the base year "would introduce a level of unnecessary complexity and promote regulatory intrusion, where the costs would outweigh the benefits."[4]

GAWB considers that the material and sustained increases in these costs warrant inclusion in the step change rather than the escalation rate. This is a more transparent way of accounting for these costs, noting that escalation occurs via the application of a weighted escalation rate rather than directly applying the relevant escalation rate to each cost category.

In any case, for both chemicals and ICT the step changes account for increases that have occurred, or are expected to further occur, between the 2022-23 base year and the start of the FY2026-30 regulatory period. GAWB's forecast step changes for these costs are based on a flat profile, that is, they do not allow for any further above-CPI growth over the FY2026-30 regulatory period beyond the initial step-up in costs compared to the 2022-23 base year. It would therefore not be appropriate to allow for above-CPI escalation as part of the trend factor to capture this step-up in unit costs. If further increases in unit costs do occur above this forecast, GAWB will need to manage this within its operating expenditure envelope.

GAWB considered that the price component of the proposed chemical and ICT step changes is of sufficient materiality that it cannot be effectively absorbed into GAWB's business-as-usual forecast. For example, the unit price component of GAWB's proposed chemical step change

[4] Queensland Competition Authority (2024). p.42.

represents a 19% increase compared to the base year, with the QCA's consultant acknowledging the increase in these costs[5]. One major provider of GAWB's ICT applications has indicated two additional price increases totalling 10% between 2024-25 and 2025-26.

3.3 Step change: labour costs

3.3.1 QCA's draft findings

The proposed step change for the increase in GAWB's labour costs is the most material of the step changes forecast for the FY2026-30 regulatory period. The QCA accepted that GAWB's labour cost base is required to increase and that this reflects GAWB's strategy to respond to the challenging labour market conditions and the demands of its operating environment.[6] This increase was underpinned by a new remuneration and benefits strategy that was implemented by GAWB from 1 July 2023, along with additional staff.

One of the benefits implemented as part of the new remuneration and benefits strategy was a change to GAWB's policy in relation to the eligibility period for long service leave, which is now accessible by employees after five years of service. The QCA has sought additional information from GAWB on this amount, although has not made any adjustments in its draft findings.

In terms of the additional roles, the QCA's draft assessment of this step change is to include the positions filled in 2023-24. This accounts for the majority of the additional roles included in GAWB's proposed step change, apart from a small number of roles that GAWB has identified as necessary in the FY2026-30 regulatory period.

3.3.2 GAWB's response

GAWB will be providing further information to the QCA explaining the calculation of the component of its step change that relates to the change in the eligibility of employees for long service leave (from ten to five years of service). This includes how GAWB accounts for the probability that not all staff will access these benefits if they leave within five years of service.

3.4 Step change: hatchery

3.4.1 QCA's draft findings

GAWB proposed a step change of $1.38 million over the FY2026-30 regulatory period for the increase in costs associated with the operation of its new hatchery facility. While this new facility was initiated by the need to relocate from the former site, this also enabled GAWB to design and build a facility that would enable it to meet its regulatory obligations in relation to the restocking of the Awoonga Dam with certain migratory fish species.

In its Draft Report, the QCA has expressed concerns as to the efficiency of these costs and has requested further supporting information, stating that it is "minded to include this as a necessary step change if GAWB can provide sufficient justification that increasing its hatchery

[5] Aither (2024) Prudency and Efficiency Review: Review of Gladstone Area Water Board's forecast capital and operating expenditure for 2025-30, section 3.4.7

[6] Queensland Competition Authority (2024). p.30.

production above its 2022-23 level is a requirement of its fisheries licence and associated fisheries management plan."[7]

3.4.2 GAWB's response

GAWB has submitted more detailed information to the QCA in response to its request to further demonstrate the prudency and efficiency of this proposed step change.

The QCA acknowledges that GAWB is obligated to restock Awoonga Dam as a condition of its Environmental Impact Statement for the 2001 raising of the dam wall.[8] Key to its concerns is questions regarding the 'optimal' restocking rate and how this relates to the maximum rate specified in GAWB's current General Fisheries Permit. That maximum is based on a stocking rate of 200 fingerlings per hectare per year, as set by the Queensland Government and specified in the Awoonga Dam Management and Stocking Plan 2022 to 2025. The overall objective of this plan is to "create, maintain and monitor a sustainable, multi-species recreational fishery in Awoonga Dam."

The QCA considers that while it was prudent for GAWB to invest in expanding the hatchery facility to accommodate production up to the maximum rate, the optimal rate may be something less than this, stating that "we have not seen evidence that GAWB's production forecasts consider optimal restocking rates from an ecological or economic standpoint".[9] In GAWB's discussions with the QCA, it is evident that it is seeking information to demonstrate that a certain production rate (whether that be the maximum rate or some other rate above 2022-23 production levels), is an obligation or "requirement"[10] imposed on GAWB by Government.

As GAWB has sought to explain to the QCA, each year it will target production to achieve the maximum rate and it is an expectation of Government that it will do so. Importantly, while GAWB has a formal obligation to restock the dam, it is not formally obligated to achieve a particular restocking rate. A formal obligation implies that GAWB must achieve this restocking rate and further, that failure to do so represents a breach of an obligation, with potential consequences or penalties.

The operation of a fishery is a complex process and there is a myriad of factors that need to be considered and managed, including (but not limited to) climatic, environmental and ecological[11] factors.[12] GAWB is unable to control all of these factors and hence it cannot guarantee that it will be able to achieve its maximum restocking rate in any year. This is recognised by the industry and the Department – hence the maximum restocking rate has not been imposed as an obligation.

[7] Queensland Competition Authority (2024). p.41.
[8] Queensland Competition Authority (2024). p.40.
[9] Queensland Competition Authority (2024). p.41.
[10] Queensland Competition Authority (2024). p.41.
[11] The nature of barramundi as an apex predator, as noted by the QCA in its Draft Report, is only one of these factors.
[12] For example, in 2022 GAWB had to respond to a major fish kill event, which was driven by cold weather and high winds.

GAWB therefore targets its maximum restocking rate as the “optimal” rate and the activities it must undertake to achieve this in any year (including the number and size of production batch runs) will vary depending on the relevant factors. The quantum of GAWB’s hatchery step change has been determined based on GAWB targeting this rate year on year. This process will continue to be developed and refined with the continued operation of the new hatchery.

The QCA also acknowledges that the monitoring framework that would inform future restocking rates has not yet been developed.[13] GAWB continues to work with Government on this and has also been putting internal strategies in place in anticipation of the Government releasing a guideline under the Awoonga Dam Management and Stocking Plan 2022 to 2025.

Overall, GAWB considers that the evidence it has provided supports the full amount of this step change as prudent and efficient expenditure.

3.5 Step change: tariff review

3.5.1 QCA’s draft findings

GAWB has proposed a step change totalling $0.75 million for the FY2026-30 regulatory period for costs that it is forecasting to incur in undertaking a comprehensive review of its tariff structure.

The QCA’s draft finding is that GAWB has not demonstrated that this step change is necessary and that “it is unclear how this is a new requirement for GAWB.”[14] It further states that:[15]

> In the absence of a direction to GAWB from government, or broad customer support for the review, we consider that this is a business-as-usual matter for GAWB and its customers, and not necessary for this price monitoring period.

3.5.2 GAWB’s response

Issues raised in stakeholder submissions

GAWB considers that the issues raised by a number of customers in their submissions highlight the drivers behind seeking to undertake a fulsome review of its tariff structure. This includes concerns regarding the allocation of costs across the network, as well as the extent to which certain augmentation costs should be shared between new and existing customers. Some of these comments relate to the recovery of costs associated with the FGP, which in accordance with the Amended Referral Notice, is not within the scope of the current price monitoring investigation.

Some of the key comments made in submissions (excluding those relating to the FGP) are provided below.

[13] Queensland Competition Authority (2024). p.41.
[14] Queensland Competition Authority (2024). p.43.
[15] Queensland Competition Authority (2024). p.43.

Submitter	Comments
Cement Australia and Mitsubishi Gas & Chemical Company Gladstone Renewable Methanol Projects	Recommends a broader process review, which in reviewing the reasonableness of prices, would include assessing "Alternative pricing approaches that would deliver lower upfront prices for energy transition customers to mitigate the higher start-up costs new hydrogen related projects experience during the ramp up to full production." (p.3)
Fortescue Energy	"Further the introduction of new pricing zones to accommodate increased customer demand raises additional concerns about the allocation of costs. Fortescue is seeking assurance that these new pricing zones and the associated charges will be equitable and that existing customers will not disproportionately bear the burden of the costs associated with new infrastructure." (p.2)
Rio Tinto	"Rio Tinto submits that the GAWB Submission does not correctly allocate the cost of providing services to specific GAWB customers, and in particular the costs proposed to be incurred by GAWB to extend or expand its existing infrastructure … Rio Tinto submits the QCA should consider the fairness of existing users bearing capital costs incurred for a (sic) expansion and extension costs triggered by new users." (pp.2-3)

GAWB currently addresses the issue of cost allocation (including between new and existing customers) via its zonal pricing structure. This can result in the creation of new pricing zones where necessary. There are also major investments being undertaken that will benefit all customers, including the FGP and the Awoonga Dam safety upgrade. GAWB notes that the QCA has more recently considered the issue of allocating costs between new and existing users in reasonable detail, although in the context of expansions to rail and port capacity, not water infrastructure.[16] It also did consider this in assessing the treatment of costs incurred in the raising of the Awoonga Dam wall.

These issues are potentially complex. The key purpose of the tariff review is to re-assess the extent to which the current pricing arrangements remain the most appropriate framework within which to address these issues (based on specified pricing principles), or whether a different approach is needed.

QCA's comments re the need for a tariff review

As noted above, in its Draft Report the QCA has questioned the need for a tariff review, stating that:[17]

> …the simplification of tariffs will not itself reduce allowable costs, but rather simply result in a reallocation of costs in a different manner. Moreover, GAWB's commercial tariff structure is already cost reflective and has been found to be appropriate.

16 https://www.qca.org.au/project/research/capacity-expansion-pricing/
17 Queensland Competition Authority (2024). p.43.

However, while the QCA has found GAWB's pricing practices to be "economically sound", in its 2020 Final Report it said that:[18]

> …there may be benefits in GAWB simplifying its pricing practices in future reviews, after appropriate consultation with its customers. In particular, greater simplicity would increase transparency.

GAWB acknowledges that this was not a specific request or direction from the QCA, noting that this was not within the scope of the Amended Referral Notice and that the QCA's price monitoring role is "informative rather than deterministic"[19]. However, GAWB's intention to undertake a tariff review in the FY2026-30 regulatory period recognises the QCA's comments made in the 2020 Final Report, including the potential for a 'simpler' approach.

The QCA suggests that this "is not a new requirement for GAWB"[20]. It also refers to tariff reviews undertaken by Melbourne Water and Greater Western Water, which were funded as part of their business-as-usual budgets. GAWB does not consider that it is necessary for this to be a "new requirement" to qualify as a step change. It is material, one-off expenditure that is not part of its business-as-usual activities.

Any tariff review needs to occur within a framework that is founded by the extensive regulatory precedent on this issue, both specifically within the context of GAWB's pricing approach as well as best practice water pricing more generally (and as guided by the QCA's water pricing principles). This will necessitate a thorough, transparent and consultative process, which requires material investment by GAWB, including specialist external expertise.

GAWB also does not consider that comparisons with Melbourne Water and Greater Western Water are reasonable in this context, noting that:

- Melbourne Water's approved operating expenditure budget over its current five year regulatory period is $4,626.8 million ($2020-21)[21]; while
- Greater Western Water's approved operating expenditure over its current four year regulatory period is $2,497.8 million ($2023-24)[22].

This contrasts with GAWB's proposed operating expenditure allowance of $244.72 million ($2023-24) over the five year FY2026-30 regulatory period. There are also other activities that it will undertake during the period (including those that cannot be anticipated in advance) that will need to be managed within this allowance.

Conclusion

A comprehensive tariff review provides the opportunity to revisit the approach used to recover GAWB's costs across its customer base (including from new customers), based on best practice pricing principles. This includes finding an appropriate balance between simplicity and transparency, and economic efficiency. While this could identify a need for substantive

[18] Queensland Competition Authority (2020). Final Report, Gladstone Area Water Board Price Monitoring 2020-25 Part A: Overview, p.118.
[19] Queensland Competition Authority (2024). p.1.
[20] Queensland Competition Authority (2024). p.43.
[21] Essential Services Commission (2021). Melbourne Water Final Decision, 2021 Water Price Review.
[22] Essential Services Commission (2024). Greater Western Water Final Decision, 2024 Water Price Review.

change, it is also possible that this could lead to no change, or minimal change, to the current pricing arrangements. GAWB therefore considers it reasonable to allow for a specific step change to the base year expenditure to recover the costs of this material and one-off exercise.

3.6 Trend factor: escalation rates

3.6.1 QCA's draft findings

The QCA is proposing to accept the type of escalator that GAWB is proposing to apply for each cost category, as well as the weighting factors. It has also accepted GAWB's approach to forecasting CPI, which is based on its preferred approach. However, it is not proposing to accept:

- GAWB's approach to forecasting WPI
- the inclusion of a premium above WPI to account for the expected continuation of tight conditions in the Gladstone labour market (the 'Gladstone premium').

3.6.2 GAWB's response

GAWB has obtained further advice from Frontier Economics (Frontier) (refer Attachment 1) on the two issues identified by the QCA in relation to WPI.

As previously submitted by GAWB in its initial regulatory proposal (and based on Frontier's advice), the use of a linear glide path in forecasting WPI is seen as consistent with the QCA's preferred approach to forecasting CPI, as set out in its 2021 Inflation Forecasting Position Paper (noting that this paper did not address the QCA's preferred approach for WPI).

GAWB also remains of the view that the labour market in Gladstone is likely to remain tight over the FY2026-30 regulatory period. As noted by Frontier, independent economic advice obtained by GAWB (and supplied to the QCA) highlights a number of drivers of this, which will continue to fuel the already strong demand for construction and engineering resources. While hydrogen development is one of these, there are also other drivers, including rail, road and port investments, as well as mining and (non-hydrogen) renewable energy projects.

While the changes to GAWB's remuneration and benefits package implemented from 1 July 2023 allowed a degree of 'catch up' with the wages and conditions being offered by other organisations in the Gladstone market, it does not address further pressures persisting over the course of the FY2026-30 regulatory period. That is, if the organisations with whom GAWB is competing for labour continue to offer more attractive salaries above the growth in WPI, GAWB will again become challenged in attracting and retaining the right staff. GAWB is continuing to see this, including in the context of ongoing enterprise bargaining negotiations by other organisations.

Frontier questions the evidence standard the QCA requires to support the case for a Gladstone premium. As it notes, this is considered particularly important given:

- there is no region-specific wage data produced by independent and reputable sources that is readily available;
- the independent economic advice obtained by GAWB concludes that it appears likely that above-WPI growth in wages will continue.

GAWB considers that the relatively modest premium it has proposed above WPI (linearly declining to zero by the end of the FY2026-30 regulatory period) is conservative in the context of these risks and is a necessary inclusion to address the tight conditions expected in the Gladstone labour market.

4. Capital expenditure

4.1 QCA's overall draft findings

The QCA's draft findings are that:

- GAWB's estimated actual capex of $84.2 million (nominal) for the FY2021-25 regulatory period is a reasonable estimate of prudent and efficient capital expenditure; and
- GAWB's forecast capitalisation of $504.9 million (nominal) for the FY2026-30 regulatory period is acceptable, although it notes the difficulties in forecasting this given the current levels of uncertainty.

In view of the uncertainty associated with the forecast capital program, the QCA considers it appropriate to adopt GAWB's proposed capital expenditure as an "indicative capital budget"[23], in conjunction with an ex-post true-up mechanism to adjust for the difference between actual and forecast capital expenditure at the end of the FY2026-30 regulatory period.

4.2 GAWB's response

GAWB welcomes the QCA's draft findings in relation to its current period and forecast capital expenditure. This includes recognition of GAWB's forecast capital expenditure as an "indicative capital budget"[24], which provides it with the necessary flexibility to manage its capital program over the FY2026-30 regulatory period within that capital budget (or allowance).

This is important to support prudent and efficient decision-making in the planning and management of GAWB's capital program over the forthcoming regulatory period, which can accommodate changes to the capital program. These changes, necessitated as projects mature and GAWB adapts to its evolving business needs, can be to the budget and timing of projects, the deferral or cancellation or projects, and the initiation of new projects that were not included in the original capital forecast. GAWB submits that this flexibility is required under any circumstances, but particularly when the forecast capital requirements are subject to such uncertainty.

In its Draft Report the QCA has acknowledged the uncertainty characterising GAWB's business and operating environment as it approaches the FY2026-30 regulatory period. GAWB also agrees that in conjunction with setting an overall capital allowance, an ex-post true-up mechanism is an appropriate way to deal with the uncertainty associated with forecasting its capital program. If applied, it is important that this mechanism works symmetrically, that is, it applies whether actual (prudent and efficient) capitalisation is higher or lower than forecast.

If required, GAWB will make further adjustments to its capital expenditure forecast for the FY2026-30 regulatory period prior to setting final prices. As noted previously, GAWB will work

[23] Queensland Competition Authority (2024). p.51.
[24] Queensland Competition Authority (2024). p.51.

with the QCA to the extent that there are any material changes to this forecast prior to the release of its Final Report.

5. Rate of return

5.1 QCA's overall draft findings

The QCA has assessed an indicative Weighted Average Cost of Capital (WACC) of 7.39% (post-tax nominal, vanilla), compared to GAWB's proposed WACC of 7.88%. The differences are driven by:

- the QCA's slightly lower estimate of the Market Risk Premium (MRP) (6.3%, compared to GAWB's estimate of 6.5%), which is because the QCA's update includes more recent data;
- its proposal to apply a lower asset beta (0.39, compared to GAWB's estimate of 0.45); and
- the QCA's slightly lower estimate of the debt risk premium (DRP), which also updates its preferred extrapolation method applied to the Reserve Bank of Australia (RBA) data.[25]

The most significant difference is the asset beta, which is discussed further below.

5.2 Beta

5.2.1 QCA's draft findings

In its initial regulatory proposal, GAWB submitted that there was no evidence to support a revision to its current asset beta estimate of 0.45. This was informed by independent analysis from Synergies Economic Consulting (Synergies) provided in Attachment 4 to GAWB's initial regulatory proposal[26].

The QCA calculated updated asset betas for its sample of regulated energy and water businesses using the preferred approach from its most recent Rate of Return Report, using ten years of returns data and the Brealey-Myers formula to convert between asset and equity betas (which is a change from the Conine approach that it applied historically). Its updated asset beta of 0.39 aligns with its most recent median estimate calculated for Seqwater.[27]

The QCA considers that regulated energy and water businesses have similar attributes to GAWB's provision of bulk water services. While it acknowledged GAWB's smaller and less diverse customer base, it considers that this is largely mitigated by its price monitoring framework and "potential" contractual arrangements.[28] It refers to GAWB's ability to execute long-term commercial contracts and in relation to new demand, observes that it "has been working with several proponents, with a view to entering into long-term water supply contracts."[29]

Other features that it highlights that are considered to mitigate GAWB's systematic risk include:

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[25] While GAWB noted this alternative extrapolation approach in its initial regulatory proposal (based on advice from QTC), GAWB used the QCA's (former) preferred approach from its Rate of Return Report (version 3).
[26] Synergies Economic Consulting (2024). GAWB's WACC for 2025-30 price monitoring period, May.
[27] Queensland Competition Authority (2022). Final Report, Seqwater Bulk Water Price Review 2022-26.
[28] Queensland Competition Authority (2024). p.81.
[29] Queensland Competition Authority (2024). p.80.

- "the ability to provide a revenue cap framework, review triggers and the ability to require customers to fund single-user assets"[30];
- customers' "resilient" demand for water services;
- that (potential) customer demand is now exceeding GAWB's Awoonga Dam allocation.

5.2.2 GAWB's response

The key issue underpinning the difference of view on beta is GAWB's risk profile and the extent to which this differs from the QCA's comparator sample, along with other regulated bulk water providers, especially Seqwater. Previously, including in assessing GAWB's current asset beta of 0.45 in the FY2021-25 price monitoring investigation, the QCA did conclude that GAWB's systematic risk was materially different to Seqwater and other urban water providers. It has now changed this view.

GAWB has procured further advice from Synergies on the issues raised by the QCA in its Draft Report (refer Attachment 2).

It is GAWB's opinion, which is also supported by the Synergies report, that the fundamental difference warranting the application of a different beta compared to Seqwater (and other energy and water utilities) is the nature of its customer base. Energy and water utilities that service a 'conventional' customer base that comprises a mix of residential, commercial and industrial customers, including Seqwater, have much greater long-term surety over their future demand profile. Residential demand tends to be a key driver of this, such that over the long-term, demand growth will have a reasonable correlation with future population growth, and limited if any correlation with economic activity. These utilities are also not exposed to the loss of a major industry or customer, nor are they as exposed to the risks associated with significant new industry growth opportunities.

As Synergies highlights, while GAWB has contractual arrangements with some of its industrial customers, it has limited risk diversification across a much smaller customer base. The large, lumpy investments that GAWB periodically makes in its network, including the FGP, do not diversify its operations or service offering to mitigate the risk of its concentrated customer base.

GAWB's ability to recover revenue from its industrial customers ultimately depends on their continued commercial viability, which is also more closely correlated to economic activity (in contrast with residential demand). Over the longer term GAWB remains exposed to the loss of one or more major customers, as well as changes in the performance of key industries and commodities. If this occurs, it is uncertain as to whether GAWB could recover the costs from remaining customers, regardless of its hybrid revenue cap.

The current uncertainty as to the path of future hydrogen development, as well as other issues such as the ageing infrastructure of key customers, highlights GAWB's exposure to risk and

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[30] Queensland Competition Authority (2024). p.80.

how this is fundamentally different to Seqwater.[31] While Synergies' recommendation that GAWB's current asset beta of 0.45 remains the most appropriate estimate, independent of its exposure to the emerging hydrogen industry[32], the uncertainty in relation to hydrogen further illustrates the types of risks to which GAWB is exposed.

GAWB therefore disagrees with the QCA's characterisation of GAWB's demand for water services as "resilient", particularly when compared with Seqwater, or other regulated energy and water utilities. The QCA also notes that "GAWB has been able to execute long-term commercial agreements"[33] however that is true for some, not all customers. Not all contracts are long-term, nor have water supply contracts been entered into with all existing customers. While the QCA also observes that demand for capacity currently exceeds GAWB's current allocation from Awoonga Dam, this remains highly uncertain. It remains plausible that this situation could reverse, and it could do so relatively quickly.

The QCA also refers to "the ability to provide a revenue cap framework"[34]. GAWB is not subject to a pure revenue cap. It is currently subject to a hybrid approach, where it bears the first 10% of any variations in its annual revenue relative to the allowance used to set prices. While the QCA has "no objections" to GAWB's proposal to reduce this to 5%[35], as highlighted in its initial regulatory proposal, given the projected growth in the revenue required to recover its efficient costs over the FY2026-30 regulatory period, such a reduction will mean that GAWB retains similar, and material, revenue at risk compared to the current FY2021-25 regulatory period (with a 10% deadband). In contrast, Seqwater is subject to a pure revenue cap based on a revenue true-up at the end of the regulatory period. There is also a true-up for demand-related variable costs.

The QCA also refers to the existence of review triggers, which can only be applied in limited circumstances, although it remains uncertain as to how this would be applied in practice. In terms of GAWB's ability to require customers to fund dedicated infrastructure, this is not always feasible for the proponent, nor will it necessarily cover the costs of augmenting shared network infrastructure.

The QCA also potentially attributes the change in GAWB's asset beta to the change in the approach it uses to convert between asset and equity betas (where in its Rate of Return Report, it determined that the Brealey-Myers approach will replace the Conine approach as its preferred method):[36]

> An asset beta of 0.45 was applied in the 2020-25 price monitoring period. However, due to the previous review using a different levering formula, the asset beta applied in the 2020-25 price monitoring period is dissimilar to the current review's asset beta.

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[31] It is relevant to note that in the case of hydrogen, Synergies suggested that in its view, a higher rate of return should be applied to those investments. That is, the maintenance of GAWB's current asset beta of 0.45 is independent of those investments, even though this highlights the nature of GAWB's exposure to systematic risk.

[32] The initial Synergies report suggested that a higher rate of return would be more appropriate for the future hydrogen-related investments.

[33] Queensland Competition Authority (2024). p.80.

[34] Queensland Competition Authority (2024). p.80.

[35] Queensland Competition Authority (2024). p.100.

[36] Queensland Competition Authority (2024). pp.81-82.

GAWB submits that a change in approach between regulatory periods to convert between asset and equity betas should not be a driver of a change in the beta applied in the WACC (whether that be an increase or decrease). The impact should be neutral. A change in the beta applied should reflect a change in the systematic risk of the business, not a change in methodology. In any case, analysis undertaken for GAWB by Synergies estimates that using the Conine formula only results in a 0.01 difference in the asset beta estimate.

In conclusion, GAWB submits that its risk profile is sufficiently and materially different from Seqwater, as well as the QCA’s sample of energy and water utilities, to continue to justify its existing asset beta estimate of 0.45.

5.3 Final updates to the WACC and nominated averaging periods

Consistent with past practice, GAWB’s WACC will be updated prior to setting final prices to ensure that it reflects (then) prevailing market rates. This update is limited to the risk-free rate and debt risk premium, using an averaging period nominated in advance by GAWB.

GAWB will confidentially submit its proposed averaging periods to the QCA prior to the release of its Final Report, based on the requirements stipulated in the QCA’s Rate of Return Report and summarised in its Draft Report[37]. This includes GAWB’s nominated averaging periods for updating the trailing average return on debt in each year of the FY2026-30 regulatory period.

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[37] Queensland Competition Authority (2024). p.78.

6. Pricing practices

6.1 Cost allocation approach

6.1.1 QCA's draft findings

The QCA has questioned GAWB's allocation approach for the following capital projects that have been nominated as part of GAWB's hydrogen augmentation program:

- the offline storage and pump station upgrades ($[redacted])
- Awoonga Dam pump station improvements ($[redacted]).

The QCA questions GAWB's proposal to allocate these costs to the new Northern Raw Extension pricing zone, which will result in those costs only being borne by new hydrogen customers that use assets captured in that zone. It has questioned why the investments were not allocated to the same pricing zones as the original assets that are being upgraded.

Its initial finding is that these costs should be allocated to the two existing pricing zones based on the physical location of the assets (being the Awoonga to Toolooa and Awoonga pricing zones). This is mainly based on its view that these upgrades "are designed to improve or maintain system-wide redundancy and resilience", delivering a reliability benefit to all customers downstream of those upgrades.[38] It has applied this approach in its Draft Report however has invited further information from GAWB to justify an alternative allocation.

6.1.2 GAWB's response

In response to the QCA's questions, GAWB has obtained advice from Synergies (refer Attachment 3) as to the most appropriate allocation approach to apply having regard to accepted regulatory pricing principles, including the QCA's water pricing principles.[39]

The key point to highlight is that these upgrades are required to preserve existing system reliability and resilience but only as a consequence of investments that GAWB is undertaking as part of its hydrogen augmentation program. In other words, the need for this investment has been triggered by new water demand from hydrogen customers – in the absence of that demand, these upgrades would not currently be required. It is therefore possible that the QCA is interpreting the investment need as being independent of new hydrogen demand (and for the benefit of existing customers) rather than being contingent on it.

As the Synergies advice highlights, the fact that the upgrades are occurring in the same physical location as the original assets is irrelevant to the question of appropriate pricing and cost allocation. The relevant matter is the driver of GAWB's decision to invest in these upgrades.

Synergies concludes that it would not be economically efficient or equitable for existing customers to bear the costs of upgrades that are not caused by them, nor will those customers receive any material incremental improvement in reliability compared to their current standard

[38] Queensland Competition Authority (2024). p.96.
[39] Queensland Competition Authority (2021). Statement of Regulatory Pricing Principles for the Water Sector, Final Statement.

of service. However, those upgrades will be necessary to prevent a degradation in that reliability upon augmentations to the network to accommodate new hydrogen demand.

GAWB also notes that from the perspective of its own commercial and financial risks, it would be better off if these costs were allocated to the current pricing zones and shared between new and existing customers (as the QCA proposes). However, GAWB has sought to apply the approach that satisfies accepted regulatory pricing principles, which are founded in the promotion of economic efficiency.

It is also clearly evident from stakeholder submissions that the allocation of costs between new and existing customers is a contentious issue. This will need to be considered as part of the review of GAWB's tariff structure that it proposes to undertake in the FY2026-30 regulatory period, which will remain underpinned by accepted regulatory pricing principles.

6.2 Prudent discounts

6.2.1 QCA's draft findings

In its Draft Report the QCA notes that GAWB applies prudent discounts to customers in limited and targeted situations, for example, where customers who only require raw water are (necessarily) being supplied by treated water. It also notes there may be cases where network augmentations planned for the FY2026-30 regulatory period will enable some of these customers requiring raw water to be switched from treated to raw water supply.

While it recognises that this is not a controversial practice, and that GAWB does not benefit from this, it has requested further information from GAWB to account for this within its price.

6.2.2 GAWB's response

GAWB acknowledges the request from the QCA. At this stage, it is unclear whether there will be changes to the water supply services that may potentially impact any current prudent discounts.

The implications and impacts of any changes during the FY2026-30 regulatory period are yet to be fully understood and further work is required before consultation with relevant customers can occur on this matter. Depending on the outcomes of this, GAWB will (confidentially) advise the QCA of any prudent discounts that remain in place as part of the mid-term review.

7. Updates prior to the setting of final prices

Consistent with the approach applied in previous regulatory periods, certain inputs into GAWB's Annual Revenue Requirement (ARR) will be updated prior to the setting of final prices. These are updated as close as is practicable to the start of the next regulatory period to ensure that the ARR reflects the most recent information and forecasts. This will also have regard to the QCA's findings in its Final Report, which is required to be published by 30 April 2025.

Consistent with the approach for the current FY2021-25 regulatory period, in informing each customer of the final pricing outcomes for the FY2026-30 regulatory period, GAWB will provide information on adjustments made following the release of the QCA's Final Report, along with the identification and explanation of any key deviations from the QCA's findings in that Final Report. This is communicated via letter, along with providing each customer the opportunity to meet with GAWB in one-on-one meetings.

All adjustments made by GAWB in setting prices to apply from 1 July 2025 will be identified and provided to the QCA as part of the mid-term review.

The key inputs that will be updated are set out below.

7.1 Demand

The QCA's draft finding is that GAWB's proposed demand forecasts are reasonable. Having regard to the uncertainty associated with the demand forecast for the FY2026-30 regulatory period, the QCA has endorsed GAWB's interpretation of "reasonably expected future demand" from the terms of the Amended Referral Notice, as well as the methodology it has used to forecast this, especially for new customers.

GAWB will update its demand forecast prior to setting final prices using the same methodology applied in its initial regulatory proposal and endorsed by the QCA in its Draft Report. This heavily relies on information provided by customers.

GAWB is in the process of corresponding with all existing and potential customers seeking confirmation of their demand reservations for the FY2026-30 regulatory period. Once confirmed, these demand requirements will be used to set prices as at 1 July 2025 and will be the basis of customers' water charges for the FY2026-30 regulatory period. Noting the uncertainty associated with future new customer demand, this may (or may not) see a material revision to the demand forecast that is used to set prices, which in turn, may effect customer prices (this can result in prices moving up or down dependant on final demands).

7.2 Operating expenditure

Updates to GAWB's operating expenditure forecast are limited to cost forecasts that are linked to other key inputs that have also been updated, as well as ensuring that GAWB's forecast CPI and escalation rates reflect the most recent market data. The following components will be updated.

7.2.1 Electricity step change

The approach used to forecast GAWB's electricity costs that form the basis of its electricity step change includes electricity usage forecasts, which are influenced by the demand for water. The QCA has endorsed GAWB's forecast electricity cost step change and has reviewed its whole-of-business electricity cost forecasting model.[40] As relevant, GAWB will update its electricity usage forecast in that model in line with any changes to its final demand forecast. Any relevant actual or forecast CPI used in the electricity cost forecasting model will also be updated to align with the finalised CPI. This will then flow through to an updated forecast of its electricity cost step change.

7.2.2 Insurance step change

GAWB's proposed step change for increases in insurance costs includes an allowance for the increase in its Industrial Special Risk (ISR) premium to account for the forecast increases in the size of its Regulated Asset Base (RAB) over the FY2026-30 regulatory period. The QCA has endorsed GAWB's forecast step change and agreed that it is necessary to account for the significant increase in its RAB.[41]

It is standard practice for GAWB's forecast RAB to be updated, as relevant, for any updates to GAWB's actual capitalisation or asset disposals for 2023-24 and 2024-25, as well as forecast capital expenditure from 2024-25 to 2029-30 (see below). As relevant, GAWB will therefore update that part of its forecast insurance step change, being the increase in its ISR premium, that is linked to forecast RAB growth for the final forecast RAB for the FY2026-30 regulatory period. This could result in a higher or lower amount.

7.2.3 Allocation approach

It is expected that the allocation of operating expenditure to pricing zones will also vary slightly to the allocation assumed in the QCA's Final Report. This is due to some of the cost allocation methods being linked to other inputs that may need to be adjusted. For example, allocation of some operating costs to pricing zones is linked to the demand forecast. If the demand forecast is adjusted, the allocation of operating costs to pricing zones will adjust accordingly.

7.3 Capital expenditure

GAWB's initial regulatory proposal was lodged in May 2024. It included a forecast of asset capitalisation into GAWB's RAB for 2023-24 and 2024-25. The RAB will be updated to capture actual capitalised expenditure for 2023-24. 2024-25 capitalisation will also be updated based on actual capitalisation up to May 2025 (or as close as practical to the end of 2024-25) and forecast capitalisation for the remainder of 2024-25.

GAWB will also update its forecast capital expenditure for FY2026-30 where appropriate. As noted in Chapter 4, the QCA's draft finding is to establish an indicative capital budget of $505 million for the FY2026-30 period. GAWB may update this forecast based on the most recent information prior to setting final prices. It is expected that, where adjustments are deemed necessary, these updates will be limited to material deviations from the capital forecast included in the QCA's Final Report. GAWB expects this to primarily be relevant for hydrogen-related investments.

[40] Queensland Competition Authority (2024). pp.36-37.
[41] Queensland Competition Authority (2024). pp.41-42.

GAWB will also update the following prior to setting final prices for the FY2026-30 regulatory period.

- The weighted escalator applied to forecast capital expenditure, comprising 70% WPI and 30% CPI. The WPI and CPI will be updated (see below). As noted in section 3.6, In its Draft Report the QCA has endorsed GAWB's proposed escalation approach, including the weighting factors.
- The calculation of Interest During Construction, which will be updated based on the final WACC.

7.4 WACC

As outlined in section 5.3, the final WACC used to set prices will be updated to reflect the most recent risk-free rate and debt risk premium, as calculated over the averaging period that GAWB will submit to the QCA.

7.5 CPI and escalation factors

GAWB will update its forecast of CPI and WPI, having regard to the QCA's findings.

These updates will flow through to the relevant pricing inputs. For example, the updated CPI impacts a number of inputs, including (but not limited to) operating expenditure, the RAB roll forward, price smoothing, other income and revenue adjustments.

7.6 Other

As appropriate, GAWB will also update its prior period adjustments (refer Chapter 10 of GAWB's initial regulatory proposal), including revenue from over-run charges received up to May 2025, along with asset disposals and accelerated depreciation for the FY2026-30 regulatory period.