

Queensland Competition Authority

Draft Assessment

Transition to performance monitoring – Redland Water

May 2014

We wish to acknowledge the contribution of the following staff to this report:

Catherine Barker, William Copeman, Keith Hutchinson, George Passmore and Rick Stankiewicz

© Queensland Competition Authority 2014

The Queensland Competition Authority supports and encourages the dissemination and exchange of information. However, copyright protects this document.

The Queensland Competition Authority has no objection to this material being reproduced, made available online or electronically but only if it is recognised as the owner of the copyright and this material remains unaltered.

SUBMISSIONS

Closing date for submissions: 30 June 2014

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore submissions are invited from interested parties concerning its assessment of water retailers' transition to annual performance monitoring. The QCA will take account of all submissions received.

Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority
GPO Box 2257
Brisbane Q 4001
Tel (07) 3222 0545
Fax (07) 3222 0599
water@qca.org.au

www.qca.org.au

Confidentiality

In the interests of transparency and to promote informed discussion, the QCA would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (i.e. the complete version and another excising confidential information) could be provided. Where it is unclear why a submission has been marked 'confidential', the status of the submission will be discussed with the person making the submission.

While the QCA will endeavour to identify and protect material claimed as confidential as well as exempt information and information disclosure of which would be contrary to the public interest (within the meaning of the *Right to Information Act 2009* (RTI)), it cannot guarantee that submissions will not be made publicly available.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office, or on the website at www.qca.org.au. If you experience any difficulty gaining access to documents please contact us on (07) 3222 0555.

Table of Contents

SUBMISSIONS	I
Closing date for submissions: 30 June 2014	i
Confidentiality	i
Public access to submissions	i
THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS	III
1 INTRODUCTION	1
1.1 Purpose	1
1.2 Background	1
1.3 Transition to long-term framework	1
1.4 Criteria	2
2 ASSESSMENT	3
2.1 Introduction	3
2.2 Assessment against core criteria	3
2.3 Assessment against other criteria	6
2.4 Conclusions	18
REFERENCES	20

THE ROLE OF THE QCA – TASK, TIMING AND CONTACTS

The Queensland Competition Authority (QCA) is an independent statutory authority to promote competition as the basis for enhancing efficiency and growth in the Queensland economy.

The QCA's primary role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

In 2012, that role was expanded to allow the QCA to be directed to investigate, and report on, any matter relating to competition, industry, productivity or best practice regulation; and review and report on existing legislation.

Task, timing and contacts

The QCA has conducted four price monitoring reviews of distribution-retail water providers in south east Queensland covering the pricing periods from July 2010 to June 2015.

On 28 June 2013, the QCA received a Ministerial Direction to investigate and develop a long-term regulatory framework (and pricing principles). The purpose of the review is to improve the regulatory framework and reduce the regulatory costs for water businesses – while providing protection to water users from monopoly power.

Key dates

Ministerial Direction	28 June 2013
Position Paper - Regulatory Framework	24 February 2014
Position Paper - Pricing Principles	28 March 2014
Position Paper - Return on Capital	30 May 2014
Submissions due on Position Papers	30 June 2014
Submissions due on Draft Assessments (transition)	30 June 2014
Final Report	30 September 2014

Contacts

Enquiries and registrations of interest regarding this project should be directed to:

ATTN: George Passmore
Tel (07) 3222 0545
water@qca.org.au
www.qca.org.au

1 INTRODUCTION

1.1 Purpose

This draft assessment outlines whether Redland Water should transition to light-handed long-term performance monitoring. The assessment is based on the information available to the QCA from its price monitoring investigations and the transition criteria outlined in the QCA's position paper on the *Long Term Regulatory Framework for SEQ Water Entities* (QCA 2014a).¹

Comments are sought by **30 June 2014**. All submissions will be taken into account in the QCA's Final Report, due 30 September 2014.

1.2 Background

The Ministers have directed the QCA to investigate and report on a long-term regulatory framework for the monopoly distribution and retail water and sewerage activities of the five south east Queensland (SEQ) distributor-retailers (the retailers) — Unitywater, QUU, and the Logan, Redland and Gold Coast City Councils. If accepted, the framework would apply from 1 July 2015.

The overarching regulatory objective is to protect the long term interests of the users of SEQ water and sewerage services by ensuring the prices of these services reflect prudent and efficient costs, while promoting efficient investment in and use of these services, having regard to service reliability, safety and security over the long term.

SEQ water retailers have been subject to different forms of price monitoring since 2008. Over 2010–15 the QCA has reviewed the costs of water and sewerage services, monitored changes in prices and compared the retailers' revenues against the maximum allowable revenue (MAR). The maximum allowable revenue reflects the QCA's assessment of prudent and efficient costs.

Allconnex Water provided services to the Gold Coast, Logan and Redland areas in 2010-12. On 1 July 2012, Allconnex Water ceased operations and its participating councils became responsible for retail water and sewerage services in their respective areas. The councils were not referred to the QCA for review for 2012-13.

The Ministers required that the form of prices oversight should minimise the administrative burden on the retailers and facilitate a move to a more light-handed framework over time.

1.3 Transition to long-term framework

In its position paper, the QCA recommended a light-handed performance monitoring framework which 'tracks' retailers' performance against:

- (a) CPI-X and certain financial information
- (b) recommended pricing principles
- (c) desired customer engagement practices
- (d) strategic approach to long term investment

¹ The QCA's Draft Position Paper *Long Term Regulatory Framework for SEQ Water Entities* is available from the QCA website. Comments on this paper are also due by 30 June 2014.

- (e) service quality standards (including performance targets).

The QCA also recommended that depending on the outcome of the 2013-15 review, a transition to performance monitoring may be required. The length and nature of the transition may vary between retailers

1.4 Criteria

The position paper outlined the criteria for an immediate transition to long-term performance monitoring as including:

- (a) absence of public interest or equity issues that may warrant regulatory review
- (b) regulated services are clearly defined and separated from non-regulated services
- (c) evidence that market power is not being exercised
- (d) absence of imminent material changes in circumstances or major infrastructure costs
- (e) demonstrated capacity to provide the required information accurately and on time, based on prior regulatory processes.

Performance in customer engagement, strategic planning for long term investment, service quality and application of pricing principles would also be relevant in assessing readiness.

It is also considered that water retailers may be required to provide additional information or resolve outstanding issues in the intervening period before commencement of annual performance monitoring from 1 July 2015.

Where criteria are not met

Should a retailer be considered not ready to move to annual performance monitoring, the existing arrangements should continue until outstanding elements are addressed. This would require a further detailed review - for a one-year period (2015-16). The scope of the one-year review would depend on the nature of the outstanding issues.

2 ASSESSMENT

2.1 Introduction

The QCA has assessed Redland Water against the criteria using the outcomes of the 2013-15 investigation and information from publicly available sources.

2.2 Assessment against core criteria

2.2.1 Public interest and equity

The criteria require that there be an absence of public interest or equity issues that may warrant regulatory review for a retailer to transition to long-term performance monitoring.

The QCA is not aware of any public interest or equity issues that would warrant regulatory review and prevent Redland Water from transitioning to long-term performance monitoring.

The QCA is not aware of any rebates provided by Redland City Council on water and sewerage bills, or any likely changes to these arrangements.

The Department of Energy and Water Supply (DEWS) is undertaking a review of the Water and Sewerage Services Code for Small Customers in South East Queensland and will consider the water businesses' current policies (including hardship) in relation to supporting customers.

2.2.2 Regulated services are defined

The criteria require that regulated services be clearly defined and separated from non-regulated services.

In the 2013-15 price monitoring review, the QCA requested retailers to list all regulated services, their tariffs and corresponding volumes and revenues. Redland Water complied with this requirement, providing the tariffs, volumes and revenues from their price setting process. Further, Redland Water provided a detailed price list for its services.

The QCA also requested retailers to exclude the revenues and costs of non-regulated services, with only the regulated revenues and costs falling under review. The retailers were also required to provide explanation of the basis of any allocations made to non-regulated services that would assist the QCA in its assessment of their submissions. Relevant definitions were as follows:

- (a) a non-regulated service was defined to mean a service provided by a retailer that is not required to satisfy any specified legal obligation or is provided by other service providers in a competitive market in which the business has no legal power to influence a customer's selection of the business as the service provider. For example, this could include laboratory services. Non-regulated services are not to be disaggregated between water and wastewater
- (b) non-regulated revenue includes interest on investments, but not interest paid by customers on overdue accounts.

In the 2013-15 review, the delineation between regulated and non-regulated services has not been specifically investigated by the QCA: non-regulated services have not been a material segment of costs and revenues. The precise boundary of regulated and non-regulated services may change over time as the nature of relevant services and markets develops.

In its 2013-15 submission Redland Water did not identify any non-regulated services, costs, revenues and assets.

Overall, the QCA considers that regulated services are clearly defined. The revenues and costs of non-regulated services are not material enough to warrant further investigation.

However, the QCA has not reviewed whether costs have been appropriately allocated between service categories. The QCA needs to be confident that prices reflect the cost of providing services. This is an issue to be addressed in assessing retailers' compliance with pricing principles.

2.2.3 Market power

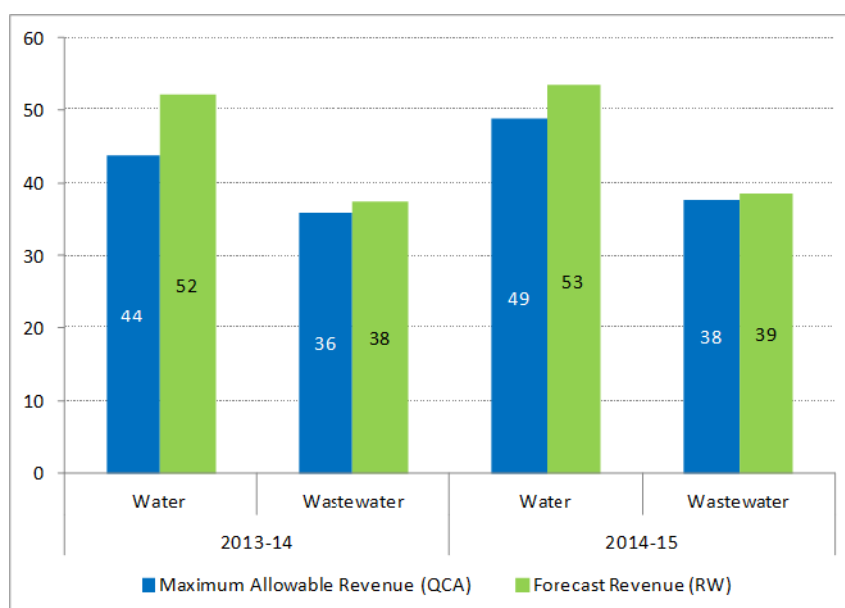
The criteria require evidence that market power is not being exercised, that is, the opening cost base is efficient and further cost increases comply with the CPI-X mechanism (with above referenced qualifications) and service quality is in line with expectations.

In the 2013-15 review, the QCA found that Redland Water's revenues lie above the QCA's MAR in both years, largely because Redland Water has smoothed price increases over 10 years. This means that over-recoveries in the 2013-15 period are forecast to be gradually returned to users from 2017-18 onwards.

The QCA supports the principle of price smoothing. However, the QCA has concerns with the 10-year model applied by Redland Water and the negative retail-distribution prices in future years.

In view of these concerns, the QCA cannot establish whether there is an exercise of market power by Redland Water in 2013-15. Setting 2014-15 prices provides an opportunity for Redland Water to address these concerns and demonstrate there is no exercise of monopoly power. Redland Water has advised it will take the QCA's concerns into account in setting 2014-15 prices.

Figure 1 Forecasts of Redland Water costs (MAR) and revenues (\$m)



Source: QCA 2014

It is noted that:

- (a) QCA's estimates of total prudent and efficient costs (the MAR) was higher than Redland Water's estimate by 4.0% in 2013-14 and 8.3% in 2014-15. However, Redland Water revenues were forecast to be above the QCA MAR (and its own estimates of costs) in both years
- (b) Redland Water's capital expenditure proposal was reviewed by independent consultants. The sample of capital projects subject to prudence and efficiency review accounted for 48% of forecast capital expenditure (excluding contributed assets). Over 2013-15, the QCA's prudent and efficient capital expenditure was lower than Redland Water's by 26.4%, this reduction being mainly due to deferral of a major capex item until after the 2013-15 period
- (c) the QCA opening regulated asset base (RAB) value as at 1 July 2010 was \$24.99 million (5.5%) lower than Redland Water's submitted value. The QCA closing RAB as at 30 June 2015 was (6.92%) below that of the Redland Water. The difference arises due to the use of the QCA RAB as at 1 July 2010 and the use of actual data for 2010-12 from the most recent Allconnex Annual Report
- (d) non-bulk operating expenditure was also reviewed by an independent consultant in the 2013-15 review. The QCA's estimate of prudent and efficient non-bulk operating expenditure was lower than Redland Water's by -13.7% and -10.4% in 2013-14 and 2014-15 respectively, largely as a result of differences in tax (QCA 2014b).

Overall, the QCA cannot conclude that market power is not being exercised. The key issues relate to the Redland Water pricing model and future prices.

2.2.4 Imminent change in circumstances

The criteria require that there is an absence of imminent material changes in circumstances or major infrastructure costs.

Redland Water's pricing model included information on post 2015 costs and revenues as it implemented a ten-year smoothed model in setting prices.

However, Redland Water only provided two years of data in its price monitoring submission for 2013-15. Bulk water prices until 2017-18 are publicly available on the DEWS website.

The QCA noted significant inconsistencies between the two sources of information. This partly reflected that the Redland Water pricing model was prepared at the time of setting prices while information in the price monitoring submission was prepared after prices were set. Further, issues were identified with the calculation of costs in the Redland Water pricing model.

Therefore, and as required under the Ministerial Direction, the QCA used the price monitoring submission as the basis for its review of prudent and efficient costs.

The QCA is not aware of any imminent material changes in circumstances or major infrastructure costs that would impede Redland Water's transition to the long-term framework.

2.2.5 Information provision

The criteria require that there is demonstrated capacity to provide information accurately and on time.

To date, Redland Water has provided all submissions to price monitoring on time. Redland Water has responded to further requests for information in a reasonable timeframe but has yet to address the identified concerns expressed above relating to revenues for 2013-15.

As noted above the QCA identified inconsistencies between Redland Water's pricing model used to set prices for 2013-15 and the information return submitted for price monitoring. Redland Water should ensure consistency in its information provision.

However, the QCA considers there is demonstrated capacity to provide information accurately and on time.

2.3 Assessment against other criteria

2.3.1 Introduction

The position paper noted that performance in customer engagement, strategic planning for long term investment, service quality and pricing principles are relevant to the assessment. Only a partial assessment can be made in relation to many of these criteria, as some were not monitored in the past and complete information is not readily available.

The QCA has sought to identify whether there is any information on these criteria that would delay or impede transition by assessing the entities' performance to date and predisposition to further improvement. To assist entities improve their performance, areas of potential improvement that would be expected to be addressed in subsequent annual performance monitoring are identified.

2.3.2 Customer engagement

Excerpt of draft recommendations in position paper

- 5.1 Each SEQ entity, in consultation with its customers, develop a strategy for customer engagement based on best practice principles.**
- 5.2 Customer engagement should:**
 - (a) promote understanding of customer's needs and be representative and responsive of customer views**
 - (b) be relevant, evidence based, open and transparent, timely, collaborative, and cost-effective.**
- 5.3 The customer engagement strategy should include a customer consultation committee.**
- 5.4 SEQ entities submit by 31 October 2015 an initial statement of their customer engagement strategy.**
- 5.5 The QCA will assess these customer engagement strategies and provide, where appropriate, advice to entities on possible improvements to ensure best practice.**

In its Annual Performance Plan for 2013-14, Redland Water stated that it will collect community feedback and participate in community consultations. Feedback from surveys and consultation will be used to gauge acceptance of service levels. Customer feedback may be collected through some or all of the following forms:

- (a) recording unsolicited complaints and comments
- (b) management or staff attendance at community consultation sessions

- (c) formal surveys by a third party consultant or formal surveys by in-house staff as part of council process.

In its 2013-15 review, the QCA noted that retailers should explain the reasons for the change in each part of the bill as well as the overall change.

Redland Water does not have a customer consultation committee. However, Redland Water does have a framework for customer consultation and processes for customer research through surveys. The QCA considers that based on available information Redland Water's activities incorporate many of the desired attributes of effective customer engagement.

Accordingly, current performance should not impede Redland Water moving to light-handed annual performance monitoring.

Redland Water will be required to provide more information on customer engagement practices as part of annual performance monitoring.

2.3.3 Strategic planning for long term investment

Excerpt of draft recommendations in position paper

- 6.1 The council water businesses be subject to the same legislative and regulatory planning requirements as the DRs.**
- 6.2 Entities should provide evidence of board/council approval and Ministerial endorsement of their relevant Water Netserv Plans to the QCA.**
- 6.3 Entities annually report to QCA on their annual capital works plans or annual performance plans.**
- 6.4 Annual updates to Water Netserv Plans also be submitted.**
- 6.5 SEQ entities provide to the QCA annually, details of their compliance with the asset management standard they have implemented and report on progress in addressing areas of improvement to achieve good industry practice.**
- 6.6 Should a cost of service review be triggered, the QCA assess entities asset management practices against PAS-55.**
- 6.7 Entities report on the project evaluation practices used for significant capex projects.**
- 6.8 Entities submit details of project evaluation, including options analysis and risk analysis, for up to the six largest capex items, where required as part of a request for further information.**

In the 2013-15 price monitoring review, the QCA made adjustments to two of Redland Water's capital expenditure projects, based on its consultant SKM's advice following its detailed review of six sampled projects. However, the overall reduction of \$7.69 million was predominantly due to a deferral of \$7.50 million for a project (Point Lookout STP) to be commissioned after 2013-15.²

SKM also reviewed Redland Water's policies and procedures for capital expenditure, including in its Water Netserv Plan. SKM noted that Redland City Council has not yet endorsed its Water Netserv Plan, nor submitted it to the Planning Minister for endorsement for consistency with

² In July 2013, Redland Water included expenditure on the Point Lookout STP of \$15 million for 2013-15 (\$0.5 million in 2013-14 and \$14.5 million in 2014-15) in the 'RCC 10 Year Capital Programme' provided to the QCA for selection of projects for prudence and efficiency review. In October 2013, Redland Water advised SKM and the QCA that the Point Lookout STP expenditure profile in its (September 2013) information return was incorrect: budgeted expenditure in 2014-15 is \$14.5 million, not \$7.5 million as per the information return.

the SEQ Regional Plan, pending advice from DEWS on legislative amendments to the requirements for Water Netserv Plans.

A summary of SKM's findings are provided in Table 1.

Table 1 Capital expenditure policies and procedures

<i>Criteria</i>	<i>Findings</i>
Standardised approach to cost estimating	Redland Water's cost estimating processes were not consistent with good industry practice, due to the absence of a procedural document setting out a requirement to use a standardised approach to cost estimating.
Gateway review	Redland Water's project 'phasing' did not meet the requirements of a gateway process but the council's new processes for delivering operating and capital programs contain a benefits realisation assessment which is consistent with good industry practice.
Detailed analysis of options for major projects	Redland Water has processes in place which provide for detailed analysis of options for major projects.
Commissioned capital expenditure from 1 July 2010 in the RAB	For Redland Water, the QCA adopted data from the Allconnex Annual Report for July 2011 - September 2012 to populate capital expenditure on an as-commissioned basis from 2010-12.
Compliance	As there was no connection between Redland City Council's draft 'Programme and Project Management Framework' (and associated documents) and Redland Water's Netserv Plan Part B, Redland Water's policies and procedures were not consistent with good industry practice.
Considers regional perspective	Redland Water participates in the SEQ Water Service Provider Partnership, SEQ Operations Committee, and SEQ Strategy and Planning Committee. Redland Water's documents did not comply with the need to address regional requirements at key decision points While Redland Water is committed to participating in regional initiatives, the QCA considers that the realisation of benefits due to a regional perspective should be captured and reported, to demonstrate regional efficiencies are being pursued and achieved.
Asset management system	SKM identified a range of issues with Redland Water's asset management system; for example, coverage of various requirements was found to be 'too preliminary' to comply with good industry practice, documentation requirements were not addressed or referenced adequately, and management review was not addressed. SKM also reported, however, that Redland City Council's 'Enterprise Asset and Services Management Strategy' (March 2011) has a comprehensive program of (30) planned improvements to asset management processes. The improvement opportunities align with the Asset Planning and Management sub-framework of the National Framework for Local Government Financial Sustainability, endorsed by the Local Government and Planning Ministers' Council in 2009.
Procurement	Procurement in Redland Water is conducted in accordance with legislative requirements of the respective local governments.

Source: SKM (2014).

The QCA notes Redland Water's capital planning policies and procedures were not always consistent with good industry practice but Redland Water was generally aware of, and plans to address, these issues. Overall, while Redland Water has a Netserv Plan, and demonstrated good practice in options analysis and procurement procedures, there are some shortcomings in cost estimating processes, compliance procedures, requirements relating to regional planning and asset management practices. However, the shortcomings are not considered material enough to prevent Redland Water moving to annual performance monitoring.

The QCA proposes to seek evidence that the issues raised by SKM (Table 1) are being progressed as part of future performance monitoring.

2.3.4 Service quality

The position paper recommended 38 service quality indicators to be used as a basis for initial service quality reporting: 8 on baseline information, 13 on water and sewerage reliability and service, 4 on water quality, 5 on water consumption, recycling and reuse, 4 on customer responsiveness and service, and 4 on the environment.

These indicators were released after the price monitoring reviews from 2010-15 were finalised. Therefore, the price monitoring reviews to date have not investigated Redland Water's service quality against these principles and have not requested relevant information to do so.

However, a preliminary assessment can be made based on information that is publicly available for Redland Water's service standards (Table 2).

Table 2 Redland Water service standards

	KRA and Goals	RW SCORECARD WATER & WASTEWATER INDICATORS – 2012/13	Monthly Target	Unit	Reporting Frequency	Annual Target
Community and Customers	Natural Environment Ensure the enhancement of koala and wildlife habitat including bushland, greenspace, waterways, catchments, air and coastal ecosystems	Average residential water consumption per person a day	max 200 max 230	litres/ day/ person	Monthly	max 200 (Medium QWC) max 230 (Perm QWC)
		Nitrogen load from effluent discharge	max 110	avg kg/ day	Monthly	max 110
		Average response or reaction time to wastewater incident	max 60	minutes	Monthly	max 60
		Average response or reaction time to water main breaks within the distribution system	max 60	minutes	Monthly	max 60
		Number of poor pressure complaints	max 3	#	Monthly	max 36
Financial	Financial Management Ensure the long term financial viability of the city and provide public accountability in financial management.	Earnings before interest tax & depreciation (EBITD)	0-5%	%	Monthly	0-5%
		Operating costs per megalitre of water treated	max 2400	\$	Monthly	max 1289
		Operating costs per property serviced (wastewater)	max 330	\$	Monthly	max 274
		Operating performance (expenditure to budget)	+/- 5	%	Monthly	+/- 5
Internal Processes	Deliver Essential Services Provide and maintain water, waste services, roads, drainage and support the provision of transport and waterways infrastructure to sustain our community.	Number of dry weather overflows	max 7	#	Monthly	max 84
		% wastewater service interruptions restored within 5 hrs	min 95	%	Monthly	min 95
		Number of wastewater odour complaints	max 3	#	Monthly	max 36
		Number WWTP non conformances with EPA licence over compliance year	max 0.5	#	Monthly	max 6
		% compliance with Australian Drinking Water Guidelines within distribution system. Does not include non compliant water received at the point of transfer to the distribution system, i.e. from the bulk water authority or the bulk transport authority.	min 98	%	Monthly	min 98
		Number of water main breaks and leaks within the distribution main	max 8	#	Monthly	max 96
		Unplanned water interruptions caused by the distribution network restored <5hrs	min 97	%	Monthly	min 97
		Number of water quality incidents caused by the distribution network	max 12	#	Monthly	max 144
People and Learning	People Management Development of organisational cultural values and people behaviours in order to meet agreed community expectations.	LTI hours	max 10	Hours lost due to injuries incurred in the workplace	Monthly	max 20

Source: Redland Water 2013.

Redland Water's Customer Service Standards outline its commitments, responsibilities and standards for water and sewerage services. Based on these, Redland Water has identified 20 key performance indicators in relation to service quality for reporting purposes. Redland Water reports to council on its performance against 18 key performance indicators set out in its Annual Performance Plan to Redland City Council as shown in Table 2.

While some of the Redland Water KPIs overlap with some of those identified by the QCA for performance reporting, some of the precise indicators and measures differ. Redland Water's customer service standards and KPIs represent 11 of the QCA's 38 recommended indicators.

Therefore, 27 additional indicators are recommended by the QCA. Many of these are captured in the NWC performance reporting process. Redland Water has previously participated in this process, but has not taken part in the 2012-13 reporting (NWC 2014).

The QCA has not previously monitored service quality performance and Redland Water has not been required to report against all of the QCA's indicators.

Having regard to Redland Water's commitment to service quality performance monitoring, the QCA considers that the identified shortcomings should not impede Redland Water moving to light handed annual performance monitoring.

However, the QCA proposes that Redland Water will be required to report against the full range of indicators as part of the light-handed framework. Redland Water should also resume participation in national performance reporting.

2.3.5 Pricing principles

The QCA position paper *SEQ Long Term Regulatory Framework - Pricing Principles* (QCA 2014c) recommended a range of pricing principles to apply to urban water, sewerage, trade waste, recycled water and stormwater reuse.

These principles were released after the price monitoring reviews from 2010-15 were finalised. Therefore, the price monitoring reviews to date have not investigated Redland Water prices against these principles and have not requested relevant information to do so.

The QCA has not previously reviewed Redland Water's pricing practices and there is insufficient available information in many instances to allow a detailed assessment (see Table 3).

Pricing is important both to ensure customers are aware of the implications of their consumption and to allow Redland Water to manage its risks.

Nevertheless, previous detailed price monitoring has not required adherence to the proposed pricing principles. It would therefore seem inappropriate to impede Redland Water from moving to more light handed performance monitoring.

The QCA notes that for all retailers this is considered a priority issue for attention.

Table 3 General pricing objectives and principles

		<i>Draft Recommendations - Redland Water Assessment</i>
Pricing objectives	1.1	<p>That pricing of urban water, sewerage, trade waste, recycled water and stormwater re-use services provided by SEQ entities:</p> <p>(a) promotes economic efficiency</p> <p>(b) ensures revenue adequacy</p> <p>(c) takes account of the public interest (including fairness and equity)</p> <p>(d) is transparent, predictable, simple and cost-effective to apply.</p> <p><i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i></p>
Pricing Principles	1.2	<p>Entities initially establish that the pricing principles are being applied and subsequently advise of any departures, the reasons for the departure and provide relevant supporting analysis.</p> <p><i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i></p>
	1.3	<p>Pricing reflects marginal cost, together with a two-part tariff where necessary to achieve revenue adequacy.</p> <p><i>Comment : Insufficient information for assessment. Redland Water has a fixed charge and a three-block inclining block tariff for residential customers for 2013-14, with a two-part tariff (fixed charge and a single block) for non-residential customers. Fixed water charges vary by meter size for residential and non-residential connections.</i></p>
	1.4	<p>Prices be set between incremental (marginal) cost and stand-alone cost.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
	1.5	<p>Prices reflect the long run marginal cost (LRMC) of providing a particular service.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
	1.6	<p>Prices reflecting short run marginal cost (SRMC) be considered when SRMC for a particular period significantly exceeds the LRMC (estimated for a longer period) for a particular service. This is sometimes referred to as scarcity charging.</p> <p><i>Comment: Insufficient information for assessment. Bulk water prices are set by the Queensland Government (not Redland Water) and do not vary with supply constraints.</i></p>
	1.7	<p>LRMC be estimated on the basis of the perturbation or AIC method.</p> <p><i>Comment: Insufficient information for assessment.</i></p>

Table 4 Application of pricing principles

Chapter	Topic	No	Draft Recommendation - Redland Water Assessment
Urban Water	Demand forecasting	2.1	Long term forecasts used for capital planning be based on SEQ Water Strategy forecasts. <i>Comment: Redland Water uses population and employment projections from council planning models. Capital planning employs the parameters in the SEQ Design and Construction Code.</i>
		2.2	Short term demand forecasts be based on estimated water use per customer/connection and population forecasts (number of connections) and take account of any bounce-back effect as well as local circumstances. <i>Comment: Redland Water has broadly applied this principle in setting sewerage prices, as noted in past price monitoring reports. Redland Water did not include bounce-back in its assumptions in 2013-15.</i>
		2.3	Demand forecasting practices and alternative models (including demand elasticities) be reviewed by a working group including the entities, QCA and other relevant parties. <i>Comment: Insufficient information for assessment.</i>
	Volumetric charges	2.4	The volumetric charge for urban water services should reflect LRMC. <i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i>
		2.5	Where prices exceed average costs, short-term over-recovery of revenues be addressed by ex-post rebates with adjustments made to the fixed charge. <i>Comment: Insufficient information for assessment. Past price monitoring has adopted annual water and sewerage cost/revenue comparisons.</i>
	Fixed charges	2.6	Fixed charges be set to recover the MAR not covered by the volumetric charge. <i>Comment: Insufficient information for assessment. Fixed water charges vary by meter size for residential and non-residential connections.</i>
		2.7	Charges not encourage customers to bypass or disconnect from the network. <i>Comment: No information to indicate customers are seeking to bypass or disconnect from Redlands network. Past price monitoring has not investigated cost allocation, including to customer types.</i>
	Inclining and declining block tariffs	2.8	Inclining and declining block tariffs not be introduced, and where they are in place be phased out over time to a single volumetric charge. <i>Comment: Redland Water has a three-block inclining block tariff for residential customers for 2013-14, with a single block usage tariff for non-residential customers.</i>
	Location-based or nodal pricing	2.9	Location-based charges for urban water services be applied where the location cost differences are material and where it is practical and cost effective. <i>Comment: Redland Water does not apply nodal pricing.</i>

Chapter	Topic	No	Draft Recommendation - Redland Water Assessment
	Peak period and seasonal charges	2.10	Time of day or seasonal charges be considered for urban water services where there are identified economic efficiency benefits and where practical and cost effective. <i>Comment: Redland Water has no time of day or seasonal charges.</i>
	Self-selecting tariffs	2.11	Self-selecting tariff options be considered where there is sufficient information for customers to make choices, provided they do not result in cross-subsidies or introduce unmanageable revenue risks for the entity. <i>Comment: Redland Water does not offer self-selecting tariff options.</i>
	Service quality differentials and interruptible tariffs	2.12	Price/service quality tariff options are supported, where material cost differentials are associated with different levels of service. <i>Comment: Redland Water does not have any service quality differentials and interruptible tariffs.</i>
	Metering and billing arrangements	2.13	Individual metering of flats and units be adopted where economic and practical. <i>Comment: As of 1 Jan 2008 all new unit/apartment complexes are required to be fitted with individual meters per dwelling.</i> <i>For existing complexes, Redland Water takes instructions from the owner of the complex or body corporate as to the method of billing (either individual invoices or a single invoice to the owner or body corporate). If individual invoices are chosen, the owner or body corporate also advises of an appropriate apportionment.</i>
2.14		Where water is separately metered, and where practical, tenants be billed the fixed and variable charges for water and sewerage. <i>Comment: Landlords are entitled to pass the volumetric proportion of a bill to a tenant provided the premises are individually metered and meet water efficiency standards.</i>	
2.15		Customers with unmetered connections be charged a deemed amount for usage, reflecting average use for similar property types. <i>Comment: Insufficient information for assessment. No published tariff for unmetered connections.</i>	
2.16		Customers with unmetered connections be given the option of paying for meter installation. <i>Comment: Insufficient information for assessment. No published tariff for unmetered connections.</i>	
2.17		For vacant land where water and services are available for connection, the water access charge that applies to connected properties (the relevant domestic or commercial charge) be applied. <i>Comment: Redland Water charges vacant land the same water and sewerage access charge that applies to connected properties.</i>	

Chapter	Topic	No	Draft Recommendation - Redland Water Assessment
		2.18	<p>Concessions and rebates:</p> <ul style="list-style-type: none"> (a) reflect a consistent approach between the entities (b) be set to apply to either the fixed charge or as a total direct adjustment to the gross invoice amount (c) be capped so as not to subsidise discretionary use (d) be transparent with acknowledgement of the source of, and purpose for, particular concessions/rebates.- <p><i>Comment: Redland Water implements Qld Government Pension subsidy under which pensioners can receive a subsidy of up \$120 (maximum) each year off the cost of water access and usage charges. The pensioner subsidy is applied as a direct adjustment to the total bill.</i></p>
		2.19	<p>Concessions associated with excess water use caused by leaks, be determined by the entities in consultation with customers.</p> <p><i>Comment: Redland Water has a form to apply for a remission in relation to a concealed leak that is publicly available (Redland Water 2014a).</i></p>
		2.20	<p>Hardship arrangements be consistent with legislative or operating requirements and avoid cross-subsidies where practical.</p> <p><i>Comment: Redland Water's website states that customers that cannot pay their bills should contact council as soon as possible to discuss payment options, as noted in 2013-15 price monitoring. DEWS is undertaking a review of the SEQ Customer Code and will consider the water businesses' policies (including hardship) in relation to supporting customers.</i></p>
		2.21	<p>Meter-reading and billing be undertaken at least quarterly.</p> <p><i>Comment: Redland Water applies quarterly billing.</i></p>
	Tradeable water entitlements	2.22	<p>Tradeable urban water entitlements be considered only where the efficiency gains are sufficient to justify the administration and transactions costs.</p> <p><i>Comment: No tradeable urban water entitlements.</i></p>
Sewerage	Demand forecasting	3.1	<p>Demand for sewerage services be based on forecast growth in connections, linked to population growth.</p> <p><i>Comment: Redland Water has applied this principle in setting sewerage prices, as noted in past price monitoring reports.</i></p>
	Efficient pricing	3.2	<p>For residential customers:</p> <ul style="list-style-type: none"> (a) sewerage charges generally be based on a single part tariff with a fixed charge per customer or connection (b) volumetric charges (based on discharge factors) be applied where the LRM is significant and should be based on discharge or return factors linked to the LRM of providing the water volumes. <p><i>Comment: Redland Water applies a single part sewerage tariff for residential connections.</i></p>
		3.3	<p>For non-residential customers:</p> <ul style="list-style-type: none"> (a) fixed sewerage charges be based on the impact of the customer on the system. In the absence of direct metering, water connection size is considered a reasonable proxy (b) if appropriate, volumetric charges be applied based on relevant discharge factors established by customer type. Customers

Chapter	Topic	No	Draft Recommendation - Redland Water Assessment
			<p>should be able to negotiate a variation in the discharge factor.</p> <p><i>Comment: Redland Water applies a single part sewerage tariff for non-residential connections.</i></p>
		3.4	<p>Nodal pricing for sewerage services be applied where cost effective.</p> <p><i>Comment: Redland water does not apply nodal price to sewerage services</i></p>
Trade Waste	Demand forecasting	4.1	<p>Where the customer base changes in line with growth, trend information be used to provide reasonable forecasts of demand for trade waste services.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
		4.2	<p>Entities consult with large customers to monitor any step changes in demand for trade waste services.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
	Efficient pricing	4.3	<p>Trade waste prices be based on the impactor pays principle.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
		4.4	<p>Charges be based on the LRMC of transport, treatment and disposal of trade waste, with variable charges based on volume and contaminant load.</p> <p><i>Comment: Redland Water's trade wastes charges are comprised of a fixed access charge, a volume change and contaminant load charge.</i></p>
		4.5	<p>Specific charges for the management of trade waste services (inspection and monitoring) be applied on a cost reflective basis.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
		4.6	<p>Charges be differentiated according to customer type and risk factors, and by location (as part of risk assessments) if considered cost effective.</p> <p><i>Comment: Redland Water's trade wastes charges are comprised of a fixed access charge, a volume change and contaminant load charge.</i></p>
	Compliance	4.7	<p>Consistent with regulations, entities to apply penalty charges for non-compliance and recover costs associated with breaches.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
Recycled Water	Efficient pricing	5.1	<p>The revenue requirement for recycled water services be based on the total additional cost of recycling less avoided costs and less developer contributions.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
		5.2	<p>Direct and avoidable costs be allocated between relevant parties on a beneficiary pays basis.</p> <p><i>Comment: Insufficient information for assessment.</i></p>
		5.3	<p>Recycled water volumetric prices be based on LRMC for the established recycled water scheme where possible, based on marginal operating costs less marginal avoided costs. Where the volumetric charge is then higher than the potable water volumetric charge, it may be necessary to reflect demand sensitivities to ensure demand clears supply.</p> <p><i>Comment: In 2013-14, Redland Water provided Class B recycled water at \$2.20/kl.</i></p>

Chapter	Topic	No	Draft Recommendation - Redland Water Assessment
		5.4	If still required to ensure revenue adequacy, fixed charges in a two-part tariff should be set to recover remaining revenues, also subject to willingness to pay. <i>Comment: See above, no fixed charges apply for recycled water.</i>
		5.5	If the revenue requirement is still not achievable, unrecovered amounts should be allocated to potable and sewerage charges in proportion to avoided cost allocations. <i>Comment: Insufficient information for assessment.</i>
		5.6	Charges to be periodically reviewed, as customer acceptance increases. <i>Comment: Insufficient information for assessment.</i>
	Sewer mining	5.7	Charges for sewer mining be set on a case-by-case basis to reflect relevant direct costs, a share of sewerage system common costs, service costs for any returns, less avoided costs. <i>Comment: No sewer mining takes place in Redland.</i>
Stormwater Reuse		6.1	Stormwater reuse pricing be subject to the same pricing principles as recycled water. <i>Comment: Redland Water does not provide stormwater re-use services.</i>
Stormwater drainage		6.2	Rate-based charges continue to be used for recovery of stormwater drainage costs. <i>Comment: Stormwater drainage charges are incorporated in Redland City Council general rates.</i>
		6.3	Charges pertaining to stormwater drainage are to be transparently identified on customer bills. <i>Comment: Insufficient information for assessment.</i>
Industry-wide issues	Externality pricing	7.1	The inclusion of externality prices be supported where material impacts can be valued accurately and cost effectively. <i>Comment: Insufficient information for assessment.</i>
		7.2	Prices incorporating estimates of externalities avoid duplication with other mechanisms and be transparent. <i>Comment: Insufficient information for assessment.</i>
		7.3	Licences and market mechanisms (where practical) be considered by Government where the benefits are considered to justify the costs. <i>Comment: Insufficient information for assessment.</i>
	Third party access	7.4	Third party access prices be based on the cost of service methodology, and take account of relevant joint or common costs. Any departure from this methodology (such as applying the retail minus methodology) is to be justified. <i>Comment: Insufficient information for assessment.</i>
		7.5	Where retail prices are averaged across user groups (postage stamp tariffs) an adjustment apply to ensure that access prices do not result in increased costs of service delivery for remaining customers. <i>Comment: Insufficient information for assessment.</i>

Chapter	Topic	No	Draft Recommendation - Redland Water Assessment
	Cost allocation	7.6	Common costs be allocated to services and customers on the basis of a causal relationship between the costs incurred and the water, sewerage, recycled water or other service performed. <i>Comment: Insufficient information for assessment.</i>
		7.7	If a causal relationship cannot be established between costs incurred and the relevant service, a reasonable cost allocator needs to be established. <i>Comment: Insufficient information for assessment.</i>
	Price paths	7.8	Price paths be applied where there are substantial price increases, having regard to customers' ability to pay and the impacts on the service provider's financial viability. <i>Comment: Redland Water is seeking to smooth prices over ten years in its pricing model but has not published a future price path. QCA has concerns with the pricing model and future negative retail-distribution future prices as stated in 2013-15 review. Redland Water will take these concerns into account in setting 2014-15 prices.</i>
		7.9	Price paths be set on a revenue neutral basis. <i>Comment: Insufficient information for assessment. Redland Water has not published a future price path. In previous price monitoring the QCA has noted Redland Water has developed a 10-year pricing model. The QCA has a number of concerns with this model as noted above.</i>

Source: QCA 2014c.

2.4 Conclusions

On the basis of its assessment against core criteria (see Table 5), Redland Water needs to provide a convincing case that it is not exercising market power, before it can transition to the annual light handed performance monitoring framework.

To meet this objective, Redland Water should address the QCA's concerns with regards to the data and methodology underpinning its pricing model and resultant negative future prices.

Setting 2014-15 prices provides an opportunity for Redland Water to address the QCA's concerns and demonstrate there is no exercise of monopoly power. Redland Water has advised it will take the QCA's concerns into account in setting 2014-15 prices.

Redland Water should therefore provide to the QCA by 15 August 2014:

- (a) revised pricing model addressing the QCA's concerns (including sufficient details relating to forecast capital and operating costs to enable the QCA to assess their appropriateness)
- (b) 2014-15 prices and supporting information.

The QCA will review this information and release its final recommendation in its September 2014 Final Report.

It is also noted that apart from the application of proposed pricing principles (where a detailed assessment has yet to be undertaken), Redland Water has showed a commitment to and performed well against other elements of the proposed performance monitoring framework.

Potential areas of improvement with respect to the non-core criteria are identified in Table 5.

Table 5 Summary of draft assessment - Redland Water

<i>Criteria</i>	<i>Achieved?</i>
Core criteria	
Absence of public interest or equity issues that may warrant regulatory review	Yes
Regulated services are clearly defined and separated from non-regulated services	Yes
No evidence of an exercise of market power and opening cost based is efficient	Given concerns with the Redland Water pricing model and future prices, the QCA cannot establish whether there is an exercise of market power by Redland Water in 2013-15. Setting 2014-15 prices provides an opportunity for Redland Water to address the QCA's concerns and demonstrate there is no exercise of monopoly power. Redland Water has advised it will take the QCA's concerns into account in setting 2014-15 prices.
Absence of material changes in circumstances or major infrastructure costs	Yes
Demonstrated capacity to provide information accurately and on time	Yes – notwithstanding inconsistencies between 2013-15 submission and pricing model as these reflected a lack of familiarity with information requirements that can be addressed in future.
Other criteria	
Performance in customer engagement	Existing customer engagement practices are consistent with many desired features. Redland Water is well placed to build on these to achieve best practice.
Strategic approach to long term investment	Broadly addressing many desired elements. Capital planning policies and procedures not always consistent with good industry practice but Redland Water was generally aware of, and plans to address, these issues.
Service quality	Redland Water has committed to and is reporting on a limited number (11) of the QCA's 38 recommended measures.
Pricing principles	Insufficient information for full assessment. Concerns with pricing model and future negative retail-distribution future prices. This is considered a priority area for consideration in future performance monitoring.

Submissions on this assessment are due **30 June 2014**. All submissions will be taken into account in the QCA's Final Report, due 30 September 2014.

REFERENCES

NWC 2014, *National performance report 2012-13*, urban water utilities

QCA 2011. *SEQ Interim Price Monitoring for 2010-11 Part B - Detailed Assessment*. Final Report. March.

QCA 2012. *SEQ Interim Price Monitoring for 2011-12 Part B - Detailed Assessment*. Final Report. March.

QCA 2013. *SEQ Price Monitoring for 2012-13 Part B - Detailed Assessment*. Final Report. March.

QCA 2014a. *Long Term Regulatory Framework for SEQ Water Entities*. Draft Position Paper. February .

QCA 2014b. *SEQ Price Monitoring for 2013-15 – Part B Redland Water*. Final Report. March.

QCA 2014c. *SEQ Long Term Regulatory Framework - Pricing Principles*. Draft Position Paper. February.

Redland Water 2013. *Performance Plan 2013/14*.

http://www.redland.qld.gov.au/SiteCollectionDocuments/Plans_Reports/Environment_plans/Item6.1.2-Redland-Water-Annual-Performance-Plan2013-2014.pdf

Redland Water 2014a. *Concealed Water Leak 2013-14*.

www.redland.qld.gov.au/SiteCollectionDocuments/RCC_Forms/Water/CSRW001%20Concealed%20Leak.pdf

SKM 2014. *Prudency and Efficiency Assessment - Redland City Council, Price Monitoring of South East Queensland Water and Wastewater Distribution and Retail Activities 2013 - 2015*. Final Report. January.