

31 July 2014

Dr Malcolm Roberts  
Chairperson  
Queensland Competition Authority  
GPO Box 2257  
Brisbane QLD 4001

Dear Malcolm,

### **Submission to Long-Term Regulatory Framework Review: Technical Paper**

Thank you for the opportunity to provide feedback on the Queensland Competition Authority's ("QCA") Technical Paper for the proposed regulatory framework to apply post 1 July 2015. We acknowledge that the QCA and its staff have been working diligently to develop a long-term regulatory framework that is consistent with the Ministers' Direction Notice.

As with our submission to the Position Papers, QUU continues to be of the view that the governance of the framework is an important consideration for the QCA. QUU considers that a Performance Monitoring Determination should be developed by the QCA to provide transparency on the rules of the proposed framework and to hold regulatory decisions to account. Further Guidance Papers can be developed under the Performance Monitoring Determination to provide details on the application of specific elements of the framework.

The Technical Paper seeks to provide further details and transparency to the Distributor-Retailers (DRs) on how the proposed long-term regulatory framework will operate. In responding to the Technical Paper, QUU provides a number of suggestions in relation to the draft recommendations put forward by the QCA and where we see that further clarity could be provided. The following outlines some of the key messages of our submission.

#### Information Requirements

QUU is concerned with the level of information the QCA is requiring DRs to submit even when there is no breach of the CPI-X price threshold. If a DR's self-assessment reveals that it is at Level 1 (i.e. no breach of CPI-X), it is still required to provide a significant amount of information. An attachment to our submission highlights the various pieces of information being requested by the QCA at each of the levels identified in the Technical Paper.

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There is a risk (as outlined in the Position Paper on the Regulatory Framework<sup>1</sup>) that in attempting to improve the performance monitoring over time, the QCA will further expand its data requirements and impose higher compliance costs. QUU suggests that the QCA should consider, for each piece of information that it is requesting, whether that piece of information will assist it in determining whether a DR is exercising market power or not.

QUU is also concerned that under the lowest level of information requirements (Level 1), the QCA is requesting examples of how processes are being implemented. QUU is of the view that under Level 1 (where no breach of the CPI-X threshold has occurred), DRs should only provide governance and process documentation; however where a significant breach of CPI-X has occurred and further investigation is required, then further documentation (i.e. examples) can be provided to show how the DR has applied the processes.

QUU is of the view that currently, the level of information that is sought by the QCA at Level 1 is significant, especially given the light handed intent of the regulatory framework as provided in the Direction Notice.

#### Multiple year scenarios

The information presented by the QCA only considers the application of the CPI-X price threshold in a one-off scenario (i.e. in one year), there does not appear to be a consideration of multi-year scenarios. An example of this is, if a DR breaches the threshold in one year, but is accepted by the QCA, what happens to the Reference MAR and analysis for the next year if the threshold is breached again? Alternatively, if a DR breaches the threshold and it is not accepted by the QCA, what happens to the assessment in the subsequent years? QUU considers that explanation of multi-year scenarios by the QCA will assist in the DRs' understanding of the application of the framework over time.

#### Exercising of monopoly power – multiple years

The QCA has previously stated that:<sup>2</sup>

“The most evident exercise of market power would occur where prices were set by entities to explicitly result in forecast revenues in excess of MAR over a sustained period”

A consideration of performance over multiple years recognises the fact that breaches of a CPI-X constraint in a single year, including minor breaches, will not be indicative of the exercise of market power by a DR. It is well accepted in regulatory and competition literature that any such assessments of market power must be based on evidence revealed over a number of years.

Therefore the QCA needs to be mindful of this during its assessment of the DR with regard to Level 3 and Level 4 breaches, and in considering whether to undertake a Cost of Service Review.

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<sup>1</sup> QCA, Long-Term Regulatory Framework: Position Paper, Feb 2014, p.17

<sup>2</sup> Ibid, p.60.

### Information level thresholds

QUU does not understand the difference between Level 1 and Level 2 of the information requirement and assessment process outlined in Table 4. The imposition of the CPI-X “constraint” on individual tariffs and the components of each tariff class has no economic basis, as the impacts on customers from changes in retail tariffs is based on the interaction between the components of the relevant tariff structure and the customer’s demand profile, and not the impact of each tariff component in isolation. Furthermore, CPI-X constraints seen in other Australian jurisdictions are applied at a higher aggregate level to MAR or to Weighted Average Prices, they are not applied at the individual tariff component level.

QUU considers that it will be more meaningful for the QCA to consider average water and sewerage, residential and non-residential, retail tariff changes as proposed for Level 2. As a result, QUU proposes that the focus on components of individual tariffs be removed from the long-term framework.

QUU also does not understand the difference between Level 3 and Level 4 thresholds. The QCA states that the difference between the levels relates to number of costs increases (“limited” vs “wide range”) that lead to the breach of CPI-X. QUU considers that the number of cost items that change from one year to the next is not an appropriate metric to consider whether a business should trigger a more stringent level of information burden. This is because this is not a relevant indicator of whether a business is exercising monopoly power. QUU suggests that the threshold between Level 3 and Level 4 be related to the materiality of the breach of the CPI-X price constraint rather than the number of costs items that increased. This price threshold needs to be clearly specified prior to the commencement of the long term framework.

Furthermore, QUU would like to understand what the difference is between Level 4 and a Cost of Service Review. At this stage, the information requirements under Level 4 look very similar to a Cost of Service Review, while the Technical Paper does not actually outline what analysis QCA will be undertaking under Level 4 (unlike its analysis regarding the other levels).

### Further clarity

QUU acknowledges the tight timeframe under which the QCA has had to develop a whole new framework; however, QUU has concerns about the number of details that are yet to be bedded-down. QUU suggests that the QCA outline how these further details will be addressed prior to the first submission for the new framework is required in 2015. The following are some of the issues that QUU considers are yet to be addressed with sufficient clarity for the DRs:

- How will regulatory discretion be applied?
- How will growth be incorporated into the threshold consideration?
- How will the weighted average cost of capital (WACC) be incorporated into the proposed framework?
- How will the QCA assess service standards?
- What processes and due diligence will the QCA use when making decisions on whether to undertake a Cost of Service review?

- What is the specific process for establishing the initial year for the framework?

QUU look forward to continue working with the QCA in developing the long term regulatory framework. If you have any comments in relation to our suggestions made above and those outlined in our submission (attached) please feel free to contact Tim Ryan (07 3855 6161).

Yours sincerely



**LOUISE DUDLEY**  
**Chief Executive Officer**  
**Queensland Urban Utilities**

cc. George Theo, Unitywater  
George Passmore, Queensland Competition Authority

Enc. Queensland Urban Utilities Submission: SEQ Long-Term Regulatory Framework Review – Technical Paper