

The Chief Executive Officer. Queensland Competition Authority. GPO. 2257. Brisbane. Q. 4001.
Attn. Ms. Cath Barker.

26 August 2010.

Dear Ms Barker,

without prejudice.

ENC,

As the Qld. Competition Authority has invited public comment regarding its prices monitoring role for water and sewerage services provided by government owned business entities providing natural monopoly services throughout South East Qld. I submit my opinions.

Reference material: R.J. Koerner Ph.D.(Qld), M.E.Sc., B.C.E.(Melb)MICE

Strategic Management / Economic Market Analysis - ABN 26 021 850 787.

Letter of 26 July 2010 from the office of the Treasurer and Minister for Employment and Economic Development to Dr. Richard Koerner. Enc. with permission of Dr. Koerner and to assist in submission.

I believe charges incorporated in the Unitywater 2010/11 Budget exceed statutory ceiling levels because no effective prices oversight was performed by the Board of Unitywater prior to adoption of that Budget despite public statements to the contrary by the CEO. Had thorough prices oversight been performed the Board would have discovered improper manipulation of the written down replacement value of non-current distribution assets of Maroochy Water Services (MWS) that is recorded in the financial reporting period just prior to its amalgamation into Sunshine Coast Water. Since there appears to be in Maroochy Council's financial Statements for 2007/March 08 such irregularities raises most serious questions regarding the integrity of Local Government practices and audit processes in Qld.

The Qld. Treasurer letter of the 26 July 2010 (Ref: QTO-09535) copy enclosed, has been provided to assist me in this submission. The letter states in the last paragraph of page 1 that KPMG applied for a discounted cash-flow methodology to determine non-current asset valuations for SEQ bulk water assets purchased from S.E. QLD. councils as at 30 June 2008. Use of this methodology is at variance with Principle 3 (17) of the NW1's Principles for the Recovery of Capital Expenditures that mandates use of the Optimised Deprival Value approach described on page 33 of QCA's " Statement of Regulatory pricing Principles for the Water Sector". Its use has resulted in inflated valuations of all bulk water non-current assets throughout S.E. Qld.. Consequently capital recovery charges developed by the Qld. Water Commission, now endorsed by the Minister for Natural Resources, are inflated and at variance with the methodology mandated in NW1 agreements.

Correspondence from the Treasurer (Ref: QTO-09535) also states that the Minister for Natural Resources has determined that distribution asset valuations based on the cash -flow methodology used by KPMG would form the regulatory asset base (RAB) for pricing purposes. Such RAB determination for Unitywater is in direct breach of NW1's Principles for the Recovery of Capital Expenditures Principle 3 (17), and Principle 6 (23).

QCA's terms of reference require provision of transparent information to customers about the costs and other factors underlying annual increases in water and wastewater prices etc. for 2010/11, 2011/12, and 2012/13.

However the QCA is not authorised by the Ministers QCA to perform independent investigation of 2009/10 and prior year determinations that established the foundation these increases are based on..

Given these examples of non-compliance with NW1 Pricing Principles described above, the community can have no confidence that pricing principles contained in the Water market Rules established under the Qld. Water Act (2000) comply with all principles set out in the NW1 Regulatory Pricing Agreement or the QCA's " Statement of Regulatory Pricing Principles for the Water Sector"

Yours sincerely,

Note Amalgamation of councils was forced on us despite 77.1 being against amalgamation. The results of the recent election clearly told all Governments. ENOUGH IS ENOUGH. in a way that all parties had to listen. Government bodies forgot they are the servants of the people.



QTO-09535

26 JUL 2010

Dr Richard Koerner
Strategic Management / Econometric Market Analysis
31 Fauna Terrace
COOLUM BEACH QLD 4573

Dear Dr Koerner

I refer to your letter of 10 June 2010 to the Honourable Andrew Fraser MP, Treasurer and Minister for Employment and Economic Development, regarding water pricing in South East Queensland (SEQ), and have been asked to respond on his behalf.

The Government has undertaken a range of structural, institutional and regulatory reforms to enhance regional water security and improve the way water services are provided. Key elements of this program have been the separation in ownership of regional water assets, and the reduction in the number of entities involved in managing SEQ's water supply. In particular, you will be aware that Unitywater, created from the amalgamation of the water business of the Moreton Bay and Sunshine Coast Regional Councils, commenced operations on 1 July 2010.

The Government considers that economic regulation of the SEQ water sector will make an important contribution to the success of these reforms. To this end, the Queensland Competition Authority (QCA), as the state's independent regulator, will have a central role in regulating prices charged by the new distributor-retailers and the Government-owned bulk water entities, Linkwater, WaterSecure and Seqwater.

In 2007, the Government retained KPMG to carry out the financial due diligence for the purchase of SEQ councils' bulk water assets. KPMG applied a discounted cash-flow methodology, based on generally-accepted economic regulatory principles, to establish a 'line-in-the-sand' valuation for each council water business as at 30 June 2008. These valuations were broken down into separate bulk and distribution components.

27/05/11

In March 2010, the Honourable Stephen Robertson MP, Minister for Natural Resources, Mines and Energy and Minister for Trade determined that the distribution valuations would form the regulatory asset bases for the distributor-retailers and be used for regulatory pricing purposes. This means that, from 1 July 2010, the written-down value of assets will no longer be used as the basis for setting or measuring returns for water and wastewater prices.

As an interim measure for the next three years, the QCA will monitor water and wastewater prices charged by Unitywater, Queensland Urban Utilities and Allconnex Water on the basis of a framework which it has recently proposed to Government. This will ensure that water and wastewater prices in SEQ are appropriate and reflective of costs. As part of its price monitoring assessment, the QCA will undertake prudency and efficiency reviews of proposed new capital expenditure.

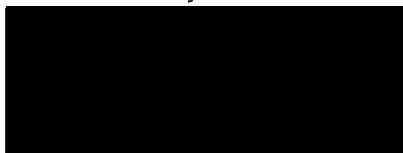
It is intended that the interim framework will subsequently transition to a deterministic regime from 1 July 2013, at which time the QCA will become responsible for setting retail water and wastewater prices. The regulated asset base set on 30 June 2008 will continue to be applied and 'rolled forward' consistent with standard regulatory practice. The Government will shortly direct the QCA to recommend a regulatory framework and key regulatory pricing principles for this purpose. As part of its review, the QCA will undertake an open consultation process, providing all interested stakeholders with an opportunity to express their views.

Currently, prices paid by the Water Grid Manager to the bulk water entities (grid service charges) are recommended to Government by the Queensland Water Commission (QWC), based on pricing principles contained in the Water Market Rules established under the *Water Act 2000*. These principles require full recovery of costs and reflect a number of key Government policies, including the limiting of returns on those assets constructed under the *Water Amendment Regulation (No 6) 2006* to their cost of debt.

The Government also intends for the QCA to assume responsibility for setting grid service charges under the *Queensland Competition Authority Act (1997)* from no later than 2013-14. In the near future, the QCA will conduct a public review to propose a framework for the deterministic regulatory regime, taking account of the Government's existing policies in relation to the bulk entities.

As a transitional measure, from 2011-12, the QCA will assume the QWC's existing role in recommending grid service charges to Government on the basis of the Market Rules.

Yours sincerely



Sharon Humphreys
Principal Advisor