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UrbanUtilities

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1 March 2013

Mr E J Hall
Chief Executive Officer
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GPO Box 2257
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Dear Mr Hall

**Submission to the Queensland Competition Authority - Draft SEQ Interim Price Monitoring Report**

This submission is the Queensland Urban Utilities (QUU) response to the Queensland Competition Authority's (the Authority's) request for comments on the Draft Report SEQ Interim Price Monitoring for 2012/13 (the Report), Parts A and B.

QUU acknowledges the Authority's findings that it found no evidence of QUU exercising monopoly power in setting its prices for 2012/13. QUU is generally satisfied with the overall findings of the Authority as set out in the Report, however it has concerns about some of the analysis undertaken to arrive at several of the findings.

QUU is committed to minimising price increase impacts for its customers, this commitment was demonstrated through the freezing of residential water and sewerage prices for 2012/13. QUU continues to work hard to keep prices under our control as much as possible and ensure our customers receive value for money from their services.

Given this, QUU is supportive of the overarching processes of the regulatory regime and seeks to ensure that the process provides value to both businesses and customers. The comments contained within this response relate to the analysis undertaken within the process and are designed to gain a better understanding of the analysis and therefore add further value to the process.

Our response to the Draft Report is structured with initial general comments followed by our response on specific issues. An attachment at the end of this letter provides QUU's comments on some specific issues within the Draft Report.

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**General Comments**

QUU firstly wants to outline that the timing throughout the review process did not lend itself to delivering the best outcome.

The consultants provided a report to the Authority that significantly differed from an earlier draft report. While this may not normally be an issue, the timing of the revised report meant that there was little time to correct for some factual errors in the analysis undertaken by the consultants prior to the finalisation of its report and subsequent incorporation into the Authority's Draft Report. Furthermore, the consultant's report does not seem to take account of further information that was provided to them throughout the review process (this will become evident later in the response). While the consultant's may disagree with the responses provided and continue to hold the same opinion, a consideration of the responses in the report should be provided and reasons if the response is not taken into account.

Given that QUU has committed to providing its submission for the next regulatory period 2 months earlier than previously, we consider it appropriate that more suitable timeframes are adopted for dealing with consultants and their reports/analysis.

The Authority has, in undertaking its review, made adjustments to reflect information only available post the setting of the 2012/13 budget. It is not possible and in some cases not practical for the ongoing revision of budgets for the latest information. A cut-off time has to be struck to allow for finalisation of the budget.

QUU does not believe it is reasonable to expect that new information received after the finalisation of the budget should be incorporated into the Information Template provided to the Authority. The use of more updated information by the Authority and the consultant seems to be selective throughout the review process.

In other jurisdictions, regulatory reviews are undertaken and completed prior to the start of the regulatory period, therefore information that is available at the time of the review can reasonably be expected to be incorporated into the upcoming period. In addition to this, other jurisdictions operate under price deterministic regimes, which means that the regulator actually sets the price and therefore it can use information that is available to it at a later date – this is not the case in SEQ. In making its recommendation, the Authority does not appear to be mindful of:

- the materiality of the adjustment, in the case of the electricity price this was not significant;
- the effort required post-budget approval to provide a reconciliation of changes from the budget in completing the information requirements template;
- the fact that QUU is currently subject to price monitoring which is generally implemented to ensure that revenue/price increases are reasonable given the underlying costs; and
- assisting readers of the Report to focus on any material findings by the Authority.

Throughout the Draft Report and the consultant's report, benchmarking has been widely used as a tool for comparison between QUU and other water businesses. While

QUU acknowledges the benefits that can be derived from benchmarking, QUU has an issue with the level of detail at which the benchmarking was undertaken and how it was used. Benchmarking of cost categories can be problematic as it does not take account of shifts in expenditure from these categories – either into other operating expenditure categories or into capital expenditure.

QUU considers that further justification is required in a number of instances where benchmarking is being used to determine a finding. In a number of cases, the analysis assumes a causal relationship, without identifying whether such a relationship exists. An example of this is a reference made to QUU network's being less asset intensive than Unitywater and therefore a lower unit operating cost is expected for employee expenditure. However this doesn't take into account other factors relating to having a denser network, such as traffic management, service interruption and permits to work.

The following sections of the letter address specific issues raised in the Authority's Draft Report.

**Specific Issues**

**1. Employee Expenses**

The Authority states that Halcrow was concerned with the efficiency of QUU's employee expenses, in particular:

a) QUU has higher labour costs that its peers, particularly for water services;
b) Incurring excessive additional labour costs on the shift of emphasis from reactive to proactive maintenance planning (there should be offsetting savings); and
c) Engaging a greater number of employees than would otherwise be required to meet the expedited separation program stemming from a change in timing and project scope.

The following addresses these three points.

*a) QUU has higher labour costs that its peers, particularly for water services*

Halcrow makes this definitive statement with no definitive evidence to support it.

Firstly, Halcrow notes that it does not have sufficient information to accurately compare QUU's employee expenditure with Unitywater's. Furthermore, the reference to the comparison with other peers is undertaken at a total operating expenditure level and Halcrow makes the subsequent assumption that this must mean that QUU's employee expenditure must be higher. This disregards the earlier discussion on the issues of undertaking comparisons on simply employee expenditure as different in-sourcing and out-sourcing policy decisions are not taken into account. Therefore Halcrow cannot definitively state that QUU has higher labour costs that its peers.

*b) Incurring excessive additional labour costs on the shift of emphasis from reactive to proactive maintenance planning (there should be offsetting savings)*

Halcrow's finding also states that QUU is "incurring excessive additional labour costs on its shift of emphasis from a reactive to a proactive maintenance program". Given that QUU has an increase of only $880k in additional employee expenditure related to the increase in planned maintenance, it is not clear how Halcrow can justify this statement.

On the one hand it is stating that QUU is spending too much on planned maintenance and therefore reducing QUU's expenditure allowance for the program by nearly $7 million (discussed later), but then it is also using it as justification to reduce QUU's employee expenditure. Furthermore, by using the one justification twice, Halcrow and the Authority are essentially penalising QUU twice for the one finding/recommendation (in addition to this, QUU disputes the finding that it has incurred excessive costs in this program, as is discussed in section 3 of this letter).

The Authority also states that Halcrow stated "there should be offsetting savings" resulting from the shift of emphasis from reactive to proactive maintenance. Halcrow did not have this as part of its findings. While it is true that there is an anticipation of a reduction in reactive maintenance going forward as a result of the increase in proactive maintenance, this is not expected to occur at the same time as the increase in proactive maintenance. There is a lag before any offsetting benefits would be derived through this shift in focus. The wording in the Authority's report indicates that the "offsetting savings" should be achieved at the same time as the initial increase in proactive maintenance.

QUU considers that this statement should be adjusted to reflect the actual finding that Halcrow has in its report.

*c) Engaging a greater number of employees than would otherwise be required to meet the expedited separation program stemming from a change in timing and project scope.*

In relation to the statement regarding a greater number of staff being required to complete the separation project, QUU would like to understand how Halcrow has arrived at this finding, whether it benchmarked FTEs and costs for similar projects from other organisations or another approach.

Based on this, QUU does not consider that Halcrow has provided sufficient justification for the reduction in employee expenses.

## 2. Corporate Costs

QUU has a number of comments in relation to the analysis undertaken by Halcrow in assessing QUU's corporate costs. QUU notes that while benchmarking can provide a reasonable guide for comparative purposes, effort is required to ensure the process is worthwhile (i.e. that the benchmarking is of the same functions across the businesses).

Comparisons with Sydney Water

While Halcrow made an attempt to compare QUU with other similar organisations, specifically Sydney Water, the analysis did not fully account for the differences between the organisations and highlights a number of issues that arise when basing decisions on benchmarking between organisations.

In response to Halcrow's findings in their draft report QUU stated that for benchmarking to be of value there needs to be an accurate 'like for like' comparison. Benchmarking analysis that does not consider the actual activities that are being benchmarked can lead to outcomes that are not reflective of the actual positions of the businesses being benchmarked. QUU put forward the view that various corporate costs (which are found in QUU's corporate costs) have not been included in Sydney Water's defined corporate costs, and therefore this does not allow for a fair and reasonable comparison between the companies.

In our response to the revised report from Halcrow, QUU had two primary concerns with the analysis – corporate functions did not necessarily align and capitalisation of corporate costs.

QUU pointed out that the following functions within QUU's corporate costs were not captured in Sydney Water's:

- Strategy and growth
- Procurement and contracts
- Marketing and communications
- Government relations and community relations
- Property management
- Administrative costs of COO team

In addition to this, QUU also noted that capitalisation policies in relation to corporate costs also contribute to the outcome of the analysis and that this needs to be taken into account.

Halcrow responded that rather than adding costs to Sydney Water corporate costs, some of QUU's corporate costs should be removed to provide a more accurate comparison. It should be noted however that this leads to QUU having corporate costs that are different to that defined in the SEQ Interim Price Monitoring Information Requirements 2012/13.

Furthermore, the Authority's Draft Report states that "Halcrow noted even when both issues were accounted for, QUU's revised estimate of corporate costs of $58.7 million accounts for 22% of non-bulk operating costs". This statement is incorrect as this value neither excludes all of the costs highlighted by Halcrow for removal (it still incorporated 'procurement and contracts' and 'property management') nor is it net of capitalised costs and non-regulated costs. QUU had supplied Halcrow with the value of $53.4 million which excluded capitalised and non-regulated costs. This error was pointed out to the Authority and Halcrow prior to the finalisation of the reports, however it was deemed there was insufficient time to rectify the error.

Table 1.79 also requires reviewing to correct for the reduction from $58.7 million to $53.4 million.

QUU does not have sufficient information on Sydney Water's corporate costs, nor sufficient time and resources to further allocate the costs within QUU, to undertake a more useful benchmarking exercise. If Halcrow and the Authority are to make findings and recommendations on benchmarking it should at least state the limitations or seek to eliminate limitations to enhance the level of analysis that has been undertaken.

Furthermore, Halcrow's statement, "Notwithstanding the presentation of QUU's costs in comparison with those of Sydney Water" implies that QUU's corporate costs do not compare unfavourably with Sydney Water's corporate costs. Regardless of this, they have made their recommendation based on a benchmark with little underlying detail (see below).

10-12% Benchmark

It appears as though Halcrow has relied on a source that was used by a previous consultant in a review for the Authority (not Unitywater as is stated) to state that corporate overheads should be between 10 and 12% of overall operating costs. The source is from the Cost and Quality of Government in NSW, however no reference of the document is made, therefore it is difficult to determine how useful the benchmark is for benchmarking corporate costs of an urban utility business.

QUU considers that either further details need to be provided, or further work needs to be undertaken, to use a benchmark such as this for decision-making purposes.

Providing corporate costs in the Authority's template

QUU has previously highlighted to the Authority the issues with their requirement to provide operating expenses based on categories that are not mutually exclusive. As the majority of the expense categories are based on expense type such as electricity and employee costs and this format has the benefit of allowing application of cost indices by expense type, QUU developed its financial models to align with this.

Removal of corporate costs, i.e. a functional type, from these expense categories is complex and can result in incorrect conclusions when making comparisons. For example employee expenses are no longer employee expenses but a subset of employee expenses. Additionally when lower level data is viewed based on management accounts it becomes increasingly difficult to make comparisons and the reconciliation process becomes time consuming.

QUU has previously provided the Authority with an example approach that outlines how this different type of expenditure should be requested, rather than the current format which is actually impossible to completely comply with given the nature of the expenditure items and the fact that they are not mutually exclusive.

Statement that 2011/12 corporate costs may be under-reported

In reference to Halcrow questioning whether QUU's statement that the subsequent $6 million adjustment to the 2011/12 corporate costs could have been a double-counting issue, the 2011/12 budgeted corporate costs did include the $6 million ICT Investment Program new initiative and was included in the Authority's Data Template. It was however mistakenly omitted when totalling corporate costs for the Information Return to the Authority.

QUU confirms that there is no double counting, as while the $6 million was included in the words on page 60 of the QUU Information Return to the Authority, highlighting the new initiatives held in the corporate costs, this $6 million was not in the $52 million stated for corporate costs.

Ratio benchmarking

In Halcrow's report, it used ratio benchmarking of corporate costs for a number of businesses, similar to what was undertaken for the 2011/12 review (the table for this should be reviewed given statements above). QUU is seeking clarification from either Halcrow or the Authority as to why the two NSW businesses that were considered in the 2011/12 comparison were not used in the 2012/13 comparison.

Halcrow considered that 'the key ratio is that of corporate costs to customer numbers'. Its justification is that it shows most clearly the impact of the level of corporate costs on customers' bills. However, given that QUU does not charge every customer a simple, standard fixed charge for their entire bill, this statement would appear incorrect. Customers' bills are a reflection of both fixed and variable, and therefore the comparison based on revenue is more appropriate if Halcrow intended to show the impact of corporate costs on customers' bills.[1]

QUU therefore considers that the use of the revenue ratio is more accurate to reflect the impact of corporate costs on customers' bills.

Halcrow/Authority Recommendation

Halcrow's report states that given the inherent difficulties of comparing corporate cost across entities, that after taking into account various factors they have used their judgement in applying approximately 25 percent or $4 million of the additional $14.2 million (increase year on year of $10.2 million and $4 million estimate of transfer of staff) is inefficient. As $9.4 million is a result of new initiatives and the bulk of that relates to the ICT Separation Program, the conclusion of inefficiency needs to be investigated further.

In the 2011/12 SEQ Price Monitoring Final Report the ICT Strategy was found to be prudent and efficient for the 3 years covered by this report. All ICT expenditure including capital and operating moved from $70.0 million to $64.3 million for the three years 2011/12 to 2013/14. There was a move from capital to operating expenditure, with

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[1] A revenue based comparison means that "for every dollar on the customers' bill, the organisation spends *(x)* dollars on corporate costs"

a drop in capital expenditure of $11.0 million and an increase in operating expenditure of $5.3 million. This re-allocation of expenditure was undertaken due to the application of accounting standards. Given this, it is hard to see on what basis the conclusion of these expenses being inefficient was made given that the overall impact is a decrease in expenditure.

The regulatory framework is designed to ensure that there are no perverse incentives between a regulated business incurring costs on operating or capital expenditure, however it appears from the analysis in the Draft Report that the Authority, and its consultant, have focused primarily on the operating expenditure for the ICT expenditure rather than the expenditure as a whole.

QUU also notes that the discussion on the efficiency of corporate costs does not flow in an easy to understand manner – the section discusses issues within the analysis, but these issues are not referenced in the conclusion whereas new information is brought forward in the conclusion that had not previously been considered in the analysis, i.e. the inefficiency of ICT Separation Program.

In addition to the above, Halcrow's estimate of $4 million for the transfer of administrative staff from corporate costs to Operations is an over estimate, the annual employee costs related to these staff were $2.3 million in 2011/12.

### 3. Planned Maintenance

Halcrow proposed, and the Authority accepted, a reduction of $6.82 million in 'Other Materials and Services' as a result of its estimate of a "more likely scenario" of sub-contractors required for the extra planned maintenance. In the first instance, Halcrow has used a wrong number in its analysis. QUU advised both the Authority and Halcrow of this prior to the Authority's Draft Report being finalised, however due to the timing constraints outlined earlier, no revisions were made to the reports to correct for this prior to their public release.

Halcrow used the 2011/12 actual sub-contractor expenses as a starting point for their proposal for a reduction of $6.82 million for sub-contractor expenses in 2012/13 related to additional planned maintenance. However the value for sub-contractors was incorrectly used and reported in Table 1.83 as $4.41 million rather than the correct value of $7.35 million. The value used by Halcrow does not include all the sub-accounts for sub-contractors that must be used to make a like-for-like comparison with the 2012/13 budget.

Allowing for inflation of 2.5% on 2011/12 sub-contractors costs of $7.35 million, the base for comparison becomes $7.54 million. The difference to $15.55 million in 2012/13 is $7.99 million rather than the $10.8 million stated by Halcrow.

Halcrow then make a very high level estimate of a "reasonable allowance" for sub-contractors of $4 million based on five four person crews at $100,000 per person plus the same for materials and plant costs. Halcrow's estimate is not based on any analysis of required work. Halcrow conclude that this would lead to a net reduction of $6.82 million recommended by Halcrow. Correcting for the wrong starting value the net reduction would be $4 million.

Even following correcting for data errors, QUU still has an issue with the proposed reduction. The increase in planned maintenance costs are based on planned maintenance jobs costed through the use of a costing database. The planned maintenance program is derived following analysis of asset condition assessments and reliability and serviceability trends and failures.

Further breakdowns of targeted areas for planned maintenance will be provided to the Authority.

**4. "Low appetite for risk"**

QUU disagrees with Halcrow's assertion that it has a very low appetite for risk. Halcrow states that some of QUU's funded programs are based on a 'zero failure' driver, however it appears as though Halcrow's finding is based on one project – Sewer Pump Reliability Improvement Program. This project does have a low risk profile due to the circumstances that led to the development of the program – further information in relation to the program is discussed in section 7 of this letter.

The fact that the overarching statement relates to a project that QUU was required to implement using a low-risk approach (with a zero overflow target, outlined in section 7), it should not be considered reflective of QUU's overall approach to asset management. Given the nature of this statement, QUU requests the Authority/Halcrow to review this position prior to the Final Report.

QUU adopts four fundamental strategies for the maintenance and renewals of its existing asset base – periodic maintenance, condition based, run to fail and design out/renew. A combination of these four strategies is applied to QUU's asset base, taking into consideration the various factors such as standards of service, consequence or likelihood of incident, legislation requirements and expected life. This approach of using a variety of strategies ensures that QUU encapsulates a reasonable degree of risk within its capital program and that customers are not required to pay for unnecessary costs due to a capital program that is heavily risk-averse.

**5. Contingencies**

Halcrow adjusted the contingency allowance to several renewals programs due to its view that contingencies set by QUU were excessive. QUU disagrees with the adjustments undertaken by Halcrow (and adopted by the Authority in its Draft Report) due to the reasons outlined below.

QUU determines contingences for its stand-alone projects and rolling programs after careful consideration of the scope, scale, risks and complexity of each project. The project risks and by association, its contingencies are evaluated at various stages of the project life-cycle prior to construction. These stages include pre-feasibility stage, pre-market and at the post market stage.

Project risks and contingencies also differ between "Greenfield" and "Brownfield" sites, and also between, mechanical and electrical works and network augmentation work.

QUU was able to demonstrate that project contingencies are assessed on a case by case basis through the Sewer Rising Mains Renewals (SRMR) Program, and other programs which were submitted for review. Individual projects within the SRMR program were allocated project specific contingencies based on specific risks. For projects which were straight-forward and like-for-like replacements with little or no stakeholder involvement, contingencies of 10% were allocated, other more complex works were allocated 20%. In the case of Indooroopilly Road Railway Bridge Crossing (BWWCAA03A17), Queensland Rail (QR) and Brisbane City Council (Bikeways) are major stakeholders in the project delivery and a higher contingency allowance was applied to allow for changes to scope that arise out of detailed negotiations with these stakeholders.

As an example of the impact of these stakeholders, there are approximately 1200 circumstances where QUU and QR's infrastructure intersects. QR has highly sensitive infrastructure with very robust risk management procedures for any work that may be undertaken on or near rail corridors. QUU therefore needs to factor this into account when developing infrastructure near QR assets and may need to 'engineer-out' the QR risk.

With regard to Indooroopilly Road High Points Rising Mains Project (BWWCAA03A019), the project listing contains multiple stakeholders, two Schools, Queensland Rail, Local Business Owners, Brisbane City Council, bikeway users and motorists. Given the amount of stakeholders involved in the project a contingency allowance of 40% was used in estimating this project.

QUU previously provided explanations in relation to a number of these programs; however this information does not appear to have been incorporated in the analysis undertaken by Halcrow.

Furthermore, QUU does not agree with the use of the Evans and Peck report supplied by the Authority as a benchmark for small to medium renewals projects grouped together to form rolling renewals programs for the following reasons.

- The Evans and Peck Report is focused on projects that would be included in Priority Infrastructure Plans (PIP's) and Infrastructure Charge Schedules (ICS). These projects tend to be large projects aligned to meeting population growth and not small to medium renewals projects.
- The projects covered by PIP and ICS's tend to be for new infrastructure and this is being compared to the renewals of existing infrastructure where the exact condition of the infrastructure may not be known until the asset is removed from service for renewal refurbishment.
- The small to medium renewals projects in the QUU programs reviewed by the Authority and Halcrow require that the service provided by the existing infrastructure must be maintained on a 24 by 7 basis which is not the case with the types of projects covered by Evans and Peck report.

Given the increased risk profile of the QUU small to medium risk renewals projects assessed by the Authority and Halcrow, when compared to the projects covered by the Evans and Peck Report, QUU believes that slightly higher contingencies are justifiable for the more high risk projects in these programs.

In cases where it is perceived that a project may have a higher than normal risk profile the Evans and Peck Report recommends that a formalised risk assessment process be undertaken to determine the appropriate level of contingency for the project. QUU has previously stated that an individual risk assessment is undertaken of the delivery of each project within the programs assessed by the Authority and Halcrow. This risk assessment is undertaken at both the pre and post-market stage of projects and is subsequently assessed by QUU's Project and Procurement Advisory Group (PPAG). Where the project sponsor believes that an increased contingency is warranted then it is applied to that particular project. This approach taken by QUU aligns with the recommendations of the Evans and Peck report.

Ultimately, QUU considers that the levels of contingency for each project reflect the level of project and scope risk associated with each of the projects and therefore requests the Authority reconsider the reduction of contingencies in light of the comments provided above.

### 6. Manly St Elevated Steel Tank

Halcrow recommended that only expenditure associated with making the structure safe be recognised as being prudent and efficient. Based on this view, Halcrow reduced the cost of the project by 50%. QUU accepts the recommendation that only costs associated with making the structure safe be allowed into the cost base, and therefore, QUU has provided a detailed breakdown of the contract value ($978,172.50) for the project in Appendix 1 which shows the work and associated costs that have been undertaken thus far to make the structure safe, and the works which were undertaken to make the tank operational. The following table shows the breakdown of the capital budget.

| **Project Item** | **Project Cost** |
|---|---|
| Contract Value | $978,172.50 |
| Contingencies | $62,577.50 |
| Internal Costs | $200,000.00 |
| **Total Capital Budget** | **$1,240,750.00** |

Of the $977,672.50 contract value, $900,095.50 was spent on making the structure safe and maintainable into the future, while $78,077 was spent on making the tank operational. Therefore, $78,077 should be removed from this project, and in addition to this, the proportionate values of the contingencies and internal costs should be removed. Given that $78,077 represents 8% of the contract value, the proportionate allocations are 8% of the contingencies ($5,006) and 8% of the internal costs ($16,000).

Therefore, in total, $99,083 (ie. $78,077+$5,006+$16,000) should be removed from the capital budget of the Manly St Elevated Tank.

In addition, QUU does not agree with Halcrow's assertion that the removal of existing coating and repainting of Internal Tank Surface was not required from a safety and corrosion protection point of view. The protection of the internal surface from corrosion is no different to the protection of the external surface from corrosion. Upon inspection of the internal surfaces of the manly elevated steel tank QUU's RPEQ[2] engineer noticed moderate to severe corrosion of the internal surfaces and a large number of areas were the thickness of the tank steel wall had been reduced by corrosion. It was obvious that the internal surfaces of the tank needed to be cleaned and recoated to prevent ongoing deterioration to the point where the safety and aesthetics of the structure would be compromised. It would not have been appropriate to leave the internal surfaces untreated even if the tank was not going to be used as a reservoir in the future. Given the costs of site establishment and access costs and the current condition of the internal surfaces QUU decided to clean and recoat the internal surfaces of the tank. Therefore it was QUU's view that this work was also required as part of the refurbishment of the heritage structure, and was not done for the sole purposes of continuing to operate the structure as a reservoir.

## 7. Sewer Pump Reliability Improvement Program

The Brisbane Sewerage Pump Station reliability Improvement Program was initiated as a result of a dry weather overflow incident that occurred at the Heroes Avenue pump station in August 2004. In that particular incident 9.5 million litres of sewage overflowed into Toowong Creek.

Following this event, the Environment Protection Agency (EPA) applied for (and was granted) an Enforcement Order by the Planning and Environment Court requiring Brisbane City Council to secure reports with respect to the reliability of sewage pump station control systems and thereafter to adopt the recommendations that were practicable and reasonable in order to minimise overflows from its pump stations.

In accordance with the court order an independent review was undertaken by consultancy firm Integran, and a number of recommendations and conclusions (attached in Appendix 2) where provided in its final report[3].

In particular, the independent consultant considered that the Sewerage Pump Station Reliability Improvement Project and other projects that Brisbane City Council was undertaking to minimise dry weather overflows were 'appropriate for an organisation such as Brisbane Water'[4].

Furthermore, the independent consultant commented that SPS Reliability Improvement Program (along with other projects) 'needed to be managed to completion'[5].

From this standpoint, QUU is of the opinion that the SPS Reliability Improvement Program is prudent, and this is justified on the basis of compliance to legal and regulatory obligations.

QUU disagrees with Halcrow's comments regarding program delivery being inefficient. While the costs of electrical switch boards are standard across all sites, each sewerage

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[2] Registered Professional Engineer Queensland

[3] Review of Practical Measures For Minimising Dry Weather Overflows From Sewerage Pumping Stations, Integran, April 2006

[4] Ibid page 37

[5] Ibid Table 5 page 35

pump station is unique and therefore each installation would have its own challenges and costs. Therefore Halcrow's suggestion that a long term framework could potentially introduce economies of scale fails to acknowledge that contractors could potentially submit higher prices during the tender to take into account the uncertainty that arises from installation costs varying from site to site. Going to the market with smaller packages allows QUU to 'package up' works which are similar in nature, and thereby reducing the uncertainty, risks and costs for the program. QUU is of the view that the current program is efficient. From this perspective, QUU does not agree with Halcrow's views that the delivery of the program is inefficient.

**8. Brisbane Meter Replacement Program**

The two estimates – $170 per meter replacement taken from the business case and $150 per meter taken from the program listing – reflect different work scope and does not indicate the possibility of saving in QUU's water meter replacement program. The differences are explained in the table below.

| Cost in Business Case | Cost in Program List |
|---|---|
| $170 per meter is the estimated average cost per meter replacement over the period of time covered in the Business Case (2011-2014).<br><br>The work identified in the business case consists of a number of meter groups and this estimate has been prepared based on the physical attributes of this range of groupings. | $150 per meter is based on the specific characteristics of the meter groupings that were planned to be replaced in the 2012/2013 financial year |

As such QUU believes that there is no justification for a reduction in the proposed budget for meter replacements in the 2012/13 financial years or future years.

The Report also states that sourcing multiple meter types is unlikely to be the most efficient approach in the longer term. QUU's major installation contractor has been given the freedom to drive market competition between QUU approved suppliers (this is currently a list of five suppliers of both small and large meters). This preferred supplier list has been established though thorough engagement with the market. Independent testing of meters is undertaken prior to their listing as an approved supplier.

The use of a single contractor to engage with suppliers allows for the contractor to ensure economies of scale are achieved through the purchasing of meters and removes QUU from interactions with the various suppliers. The use of a list of approved suppliers was designed to allow competition through the market when the contractor is seeking to purchase meters.

While QUU uses 5 meter types across the whole meter fleet, with respect to small meters (which primarily all residential meters are small meters), due to the reliability of service and the competitiveness within the market, two suppliers have become the supplier of choice for the independent installation contractor. Of these two preferred suppliers, one supplier provides 95% of small meters.

This highlights that QUU does not have a wide variety of meter types throughout its network. The reason for any variations in the meter type relates to specific conditions that may be required to be met and therefore a different meter type may be needed.

Given the above explanation, QUU considers this program to be prudent and efficient and does not agree to the reduction to the capital budget as proposed in the Authority's Draft Report.

### 9. Demand Forecasting

SKM recommended that the updated forecasts be adopted for feasibility planning rather than the higher estimate. QUU acknowledges that this statement comes from its User Guide - Short-Term and Long-Term Demand Forecasting Procedure.

Further investigation with QUU staff has revealed that the wording in the User Guide needs to be adjusted. Step 3 for the Feasibility Unit outlined in the User Guide states 'ensure conservative (higher) estimate is used for infrastructure planning purposes', however this is not necessarily the case. When QUU staff assess updated growth projections against those used in developing the Master Plan, the growth projections are refined and updated rather than simply using the more conservative (higher) estimate. QUU acknowledges that the use of the higher estimate in all circumstances would lead to adverse outcomes and will adjust the wording in its User Guide to reflect the actual processes undertaken by staff.

While QUU acknowledges the level of sophistication in demand forecasting compared to other, more mature, jurisdictions, the benefits of undertaking detailed sophisticated demand modelling needs to considered against the cost of implementing such an approach. Implementing more sophisticated demand modelling would require a significant change to the data that the businesses in SEQ currently have and will require a material level of investment to improve the processes. The benefits resulting from more sophisticated demand modelling will need to be considered in this context.

### 10. Unders and Overs Mechanism

The Authority's assertion that QUU wants to limit the application of an unders and overs mechanism to the years in which the price cap applies is incorrect. QUU will be proposing to incorporate an unders and overs mechanism in the next regulatory period based on actual information and looks forward to working with the Authority in formalising its format.

As mentioned earlier, while QUU has identified a number of issues it has with the analysis that has been undertaken so far, it does understand the value associated with the process within which it operates and acknowledges the level of work that has been undertaken from all parties to get to this point. The comments contained within this response are designed to determine a better understanding of the analysis undertaken within the review and ensure that the process provides value to all stakeholders.

Thank you for the opportunity to provide our response.

Yours sincerely

[redacted]

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

Cc: Mr Rick Stankiewicz, Queensland Competition Authority

## Appendix 1

The following table provides a breakdown of expenditure on the Manly Elevated Steel Tank. Each item is identified by a description, the contracted price and classified as either being carried out for safety or operational reasons.

| Item Description | Contract Price Ex GST | Safety and corrosion protection costs | Operational Costs |
|---|---|---|---|
| Site Establishment and Demobilisation | $41,400 | $41,400 | |
| Preparation of the contract management Plan | $51,800 | $51,800 | |
| Design | $17,000 | $17,000 | |
| Replacement of significantly corroded section of steel members | $25,700 | $25,700 | |
| Removal of existing coating and repainting of External Tank Surface | $148,880 | $148,880 | |
| Removal of existing coating and repainting of Internal Tank Surface | $114,600 | $114,600 | |
| External and External scaffolding of tank to allow works to be carried out | $222,500 | $222,500 | |
| Removal on recoating of tank support structure | $149,300 | $149,300 | |
| Replacement of external Ladder safety enclosure | $7,600 | $7,600 | |
| Installation of new roof hatch | $4,855 | | $4,855 |
| Internal floor gate replacement | $6,120 | | $6,120 |
| External ladder safety system | $5,503 | $5,503 | |
| Replacement of External Tank roof platform | $14,387.50 | $14,387.50 | |
| Replacement of internal surface coating of central structural support | $ 67,800 | $ 67,800 | |
| Replacement of external and internal ladder and platform supports | $12,625 | $12,625 | |

| Item Description | Contract Price Ex GST | Safety and corrosion protection costs | Operational Costs |
|---|---|---|---|
| Removal of external coating and repainting of internal scaffolding supports | $21,000 | $21,000 | |
| Installation of external senor box | $4,915 | | $4,915 |
| Welding repairs to internal surface to ensure that the tank can operate as a water retaining structure | $54,697 | | $54,697 |
| Replacement of external Roof Vents | $7,490 | | $7,490 |
| Total | $978,172.50 | $900,095.50 | $78,077.00 |

## Appendix 2 – Further specific comments in response to the Draft Report

| Chapter/Topic | Page | Issue | QUU Response |
|---|---|---|---|
| Non Capped Pices | 5 | Footnote states QUU doesn't provide seepage services | Under certain circumstances QUU can accept seepage water and in 2012/13 was providing this service. |
| Non Capped Pices | 6 | Table 1.2 indicates significant increase in Trade Waste forecast which could be misunderstood as high tariff increases rather than growth | The reason for the significant growth in Trade Waste revenue for 2012/13 is an increase in growth, it doesn't reflect a significant price increase for Trade Waste customers. |
| Average Prices | 7 | "QUU's average water and wastewater prices increased in 2012/13" - this does not seem the case in looking at Chart 1.3 | Chart 1.3 shows the average price for distributor-retailer water has fallen by $0.03.kL from 2011/12 to 2012/13. If the assumed residential use of 200 kL/a is used (low compared to residential and non-residential use) the water revenue difference is a decrease of $8, $386 - $378. Wastewater difference is a increase of $7, $757 - $751. This leaves a net decrease of $1, therefore the statement does not appear to be correct. |
| QCA Demand Recommendation | 14 | "The entities should develop and compare different approaches to demand forecasting for future use in SEQ" | Why develop and compare different approaches? May be better to work with the other utilities in working out the best approach to demand forecasting in SEQ. |
| Rolling Forward RAB | 75 | $200k difference in RAB at 1 July 2012 - QCA concludes that difference appears to relate to estimates of depreciation and will investigate further for Final Report | QUU will discuss this further with the Authority. |
| Corporate Costs | 96 | Table 1.77 Note why negative in IT employee exp | This is due to the capitalisation of labour including employee and contractor expenses, however in the table it is only offset against employee expenses. |
| New Initiatives | 105 | Halcrow concluded that some 40% of the 'new initiatives' identified by QUU would be appropriately identified as 'business as usual' expenses | QUU will look to further refine its processes for defining New Initiatives |
| Summary | 110 | QCA has adjusted 2013/14 onwards to account for QUU's internal savings target of 10%. | As previously advised to the Authority, the target is not 10% in 2013/14. |
| Findings | 119 | e) states an increase of 28% in tax | This is not mirrored in the numbers in the table 1.98. |