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Your ref:

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22 May 2007

Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Sir/Madam

SUBMISSION ON THE DRAFT DECISION ON THE BENCHMARK RETAIL COST INDEX (BRCI) FOR ELECTRICITY 2006107 – 2007108

SunWater is pleased to be able to submit its comments to the Queensland Competition Authority (QCA) on its draft decision on the Benchmark Retail Cost Index (BRCI) for electricity 2006107 – 2007108.

As a significant user of electricity SunWater, has a keen interest electricity prices. In preparing this submission SunWater has addressed the key issues and impacts of this draft decision on SunWater and its customers, with particular emphasis on rural water delivery to irrigators in Queensland.

Whilst pleased to have had this opportunity to make its submission, SunWater is concerned that the short time frames allowed for consultation on this matter will not allow the QCA to fully contemplate the impacts associated with the decision. SunWater strongly recommends that the QCA alters the draft decision, or puts other measures in place to cap the increase in electricity charges at CPI until such time as a mechanism exists to enable these increases to be incorporated into end user charges.

If you have any queries, please contact Deborah Silver on telephone 3120 0088.

Yours sincerely



Peter Noonan
CHIEF EXECUTIVE

Enc (1)



**Submission to the
QUEENSLAND COMPETITION AUTHORITY**

**Draft decision on the Benchmark Retail Cost Index (BRCI)
for electricity 2006107 – 2007108**

1. Introduction

As a large electricity user in Queensland, with an annual electricity bill in the order of \$14 million, SunWater has a significant interest in the cost of electricity. In making this submission on the Queensland Competition Authority's (QCA) draft report on the Benchmark Retail Cost Index (BRCI) for electricity 2006107 – 2007108 SunWater will highlight the adverse impact that the proposed increase will have on SunWater's business, particularly in relation the delivery of water to Queensland's irrigation sector.

In making this submission, SunWater would also like to express its significant concern with the short time frame in which interested parties have had to respond to this submission request and the lack of consultation that was available to stakeholders in the preparation of the draft decision. This is particularly important given that the price rises proposed are likely to have a material impact on a large portion of the economy.

Having noted these concerns, this submission addresses the key issues and impacts of this draft decision on SunWater and its customers, with particular emphasis on rural water delivery to irrigators in Queensland.

2. Background

SunWater

SunWater, a government owned corporation, owns and operates bulk water supply and distribution infrastructure located throughout regional Queensland. SunWater, through its 27 water supply schemes, provides water to approximately 6,000 customers across Queensland including irrigators, local governments, power stations and mining, industrial and manufacturing companies.

In 2005106 SunWater's net cashflow from its operating activities was over \$30 million, of which approximately 48% was derived from the irrigation sector. In providing its services, SunWater uses significant amounts of electricity, particularly in its channel and pipeline distribution networks. In 2005106 SunWater's electricity bill was \$13.6 million.

Irrigation Price Path

SunWater delivers water to customers under contractual arrangements. Under current state government policy, the charges for the delivery of water to customers vary depending upon the use to which the water is put. Where water is used for irrigation purposes, the state government has directed SunWater, through its shareholding Ministers, to negotiate a five year price path for customers with a view to achieving lower bound pricing¹. Based upon the framework approved by government, SunWater has negotiated a set of five year price paths with irrigators. These prices commenced on 1 July 2006 and are not reviewable within the five year period.

¹ Lower Bound pricing refers to the recovery of operations, maintenance, administration and refurbishment costs only, with no contribution to profit and no return of or on capital.

The key features of the negotiated irrigation price path are:

- prices reflect the government's objective that lower bound costs for water are fully recovered through water charge, by the end of the new price path (2010111)
- prices will be increased annually in accordance with CPI
- price paths cannot be reviewed within the price path period.

In determining the water charges, detailed studies were undertaken to determine the cost of providing SunWater services, with electricity a significant cost component.

Within the irrigation sector electricity accounts for, on average, \$6.255 million of the annual costs. The majority of SunWater's electricity is taken at either the Franchise Tariff 22 or 43.

3. Impact of the BRCI

It has been assumed in this submission that the proposed 9.88% BRCI will be applied consistently across all Franchise Tariffs.

Non recovery of lower bound costs

Current irrigation prices have been set to recover lower bound costs. An increase in electricity costs of 9.88% in 2006107 – 2007108 or 6.95% higher than the CPI, will result in significant under-recovery of costs by SunWater.

In the best case scenario, assuming electricity prices will increase at CPI after 2007108 until the end of the price path, the under-recovery of these costs will amount to approximately \$2.2 million over the period. There is no opportunity for SunWater to recover this cost by passing it onto its irrigation customers as there are no review provisions in the price path agreement. Further, there is no opportunity to recover the lost revenue in future years either, as the pricing arrangements with irrigators are future based.

Financial impact on SunWater

Without any opportunity to recover these additional costs, SunWater operating costs will increase by at least \$2.2 million. This gap between costs and revenues can only be met by offsetting the costs against other revenues obtained from commercial customers. This is effectively an ongoing cross subsidy from the commercial sector to the irrigation sector, a position that is not favoured under the National Water Initiative (NWI). The cross subsidy will also result in a reduced dividend to government from SunWater, whilst proving increased revenue to other government owned and private sector energy companies.

Implications for Federal and State Government objectives

The increases in electricity costs will mean that, in those irrigation schemes where electricity is a significant component of costs (particularly those schemes with channels or pipelines), the government's objective that lower bound costs are recovered will not be achieved. This non-achievement is significant in a climate where, under NWI and COAG requirements, state governments are required to meet water pricing objectives.

Impact on the next round of price path negotiations

The under recovery of costs by SunWater in the price path period to 2010111 will mean that significant price shocks are likely to result in the next round of irrigation pricing negotiations due to the cumulative gap that will open up between costs and prices. It could be expected that this will have consequential economic, social and political implications within our regional communities, especially if the current drought conditions remain.

4. Summary and proposal

It is assumed that a decision to increase the BRCI above CPI will most likely result in a similar increase to electricity tariffs.

SunWater is not able to pass increased electricity costs greater than CPI to its irrigation customers.

This will result in substantial financial losses for SunWater, reduced dividends to government from commercial contracts because of the need to cross subsidise, and potential for the pricing outcomes which have been negotiated with significant effort to be seen as inconsistent with the NWI.

SunWater accepts that there are increasing costs within the energy sector, and that these costs need to be recovered by the energy companies. However, SunWater does not accept that there has been adequate consultation on the nature of these costs, nor has there been sufficient notice of the increase in costs to enable an adjustment to business practices.

Accordingly, SunWater asks that the QCA recommends capping increases in electricity charges to levels that can be managed through SunWater's current pricing regime. That is, the BRCI should be capped at CPI. Alternately, SunWater would be pleased to discuss options for transitional measures that provide an incentive for both the supplier and the user to adjust business practices and deliver business productivity improvements.