Sun

Submission to the

QUEENSLAND COMPETITION AUTHORITY

Interim Consultation Notice re Benchmark Retail Cost Index (BRCI) for Electricity 2008/09

1. Introduction

As a large electricity user in Queensland, with an annual electricity bill in the order of $15 million, SunWater has a significant interest in the cost of electricity. In making this submission on the Queensland Competition Authority's (QCA) Interim Consultation Notice on the Benchmark Retail Cost Index (BRCI) for electricity 2008/09 SunWater will highlight the adverse impact any proposed increase will have on SunWater's business, particularly in relation the delivery of water to Queensland's irrigation sector.

This submission addresses the key issues and impacts of potential BRCI increases in excess of CPI 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 2005/06 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 2006/07 SunWater's electricity bill was $14.2 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 pricing[1]. 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 (2010/11);
- prices will be increased annually in accordance with CPI; and
- 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

Non recovery of lower bound costs

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

An increase of say 10% above CPI will amount to in excess of $2.5 million over the current price path. This would be on top of the $2.6 million generated for last year's BRCI increase. 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 significantly. This gap between costs and revenues can only be met by offsetting the costs against other revenues obtained from commercial customers. This subsidy will 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.

Impact on the next round of price path negotiations

The under recovery of costs by SunWater in the price path period to 2010/11 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

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

Any increase of BRCI above CPI 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.