Queensland Competition Authority

Irrigation price review 2020-24

Initial consultation

Today's session

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Purpose of this workshop

- Role of the QCA
- Proposed process
- Approach to recommending prices
- Government’s pricing principles in the referral notice
- Identify and discuss issues requiring review
- Next steps

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QCA’s role

- The Queensland Competition Authority (QCA) is the independent economic regulator for Queensland under the QCA Act 1997.
- The QCA does not have a standing remit to investigate water issues in Queensland.
- The QCA investigates water issues in Queensland where we have been referred an investigation by the Treasurer under the QCA Act 1997.
- The QCA:
  - does not make policy
  - does not make the final decision.
- The Irrigation Price Review 2020-24 is a separate regulatory process to other activities undertaken by the QCA (e.g. setting regulated retail electricity prices under the Electricity Act).

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Referral notice

The QCA has been asked to make recommendations on:

- appropriate prices from 1 July 2020 to 30 June 2024 (including drainage prices, drain diversion prices, water harvesting prices and termination fees)
- appropriate price triggers to manage the risks associated with material changes in allowable costs
- two pricing options related to dam safety upgrade capex
- alternative tariff groupings for specified schemes (Dawson Valley, Three Moon Creek, St George).

Indicative timeline for investigation

Milestone	Indicative date
QCA publishes notice of investigation	31 October 2018
Regulatory submissions due from businesses	30 November 2018
Initial stakeholder submissions identifying key issues	30 November 2018
QCA to hold community workshops	January/February 2019
Submissions due on businesses' submissions	8 March 2019
Draft report to the Queensland Government	by 31 August 2019
QCA to hold community workshops	September/October 2019
Final report to Queensland Government	by 31 January 2020

How we must recommend prices

Under the QCA Act, the QCA must recommend prices while regarding:

- Section 26 matters, including:
  - efficient costs
  - efficient resource allocation
  - social welfare and equity considerations
  - economic and regional development issues.
- matters required by the Treasurer's referral notice:
  - allowable costs and the government's pricing principles
  - balancing legitimate commercial interests of businesses with interests of their customers
  - where possible, transparent and simple revenue and pricing outcomes
  - having regard to our findings in Seqwater's bulk price review 2018-21
  - having regard to customer agreements in line with requirements in referral
  - providing an estimate of customer bills arising from recommended prices.

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Referral notice – cost-reflective prices

Cost-reflective prices that incorporate costs allowable under referral:

- prudent and efficient costs allowable under the referral:
  - operational, maintenance and administrative costs
  - appropriate allowance for expenditure on renewing existing assets
  - QCA fees (up to $2.5 million cap).
- includes costs required to meet regulatory obligations or deliver agreed service levels.
- costs recoverable from prices exclude:
  - the recovery of capex prior to 1 July 2000 used to build existing assets
  - subject to certain exceptions:
    - recreational costs incurred from 1 July 2020
    - costs associated with augmentation of existing assets, new assets, or any capex that is not like-for-like or does not reflect regulatory requirement.

Referral notice – QCA recommended prices

Key changes from previous review:

- Fixed prices to be derived independent of the changes in volumetric prices.
- Fixed bulk (Part A) price for distribution customers no more than cost-reflective.

Government pricing principles:

- QCA's recommended prices transition to cost-reflective prices.
- Tariff split should have regard to fixed and variable nature of underlying costs:
  - Fixed prices (separately assessed for Part A, and Part A + C where relevant)

Existing (2019-20) fixed price	New (2020-24) fixed prices
Above efficient costs	Held constant*
Equal efficient costs	Indexed by inflation
Below efficient costs	2019-20 price + inflation + $2.38/ML ($2020-21)

* Except Part A for distribution system customers, which should be reduced to cost-reflective.

  - Volumetric prices (Part B and Part D): have regard to cost-reflective immediately , considering less than cost-reflective to moderate bill impacts.

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QCA proposed approach

- Identify key issues
  - From referral notice
  - Arising from previous review
  - Arising from consultations and submissions.
- Targeted consultation approach
  - Key priority for the QCA is to identify material issues during the initial submission process, and through early engagement with stakeholders
  - This will enable us to explore issues that may require further consultation.
- Consultation approaches
  - Targeted consultation papers (e.g. dam safety upgrade costs)
  - Workshops – based on complexity of issues and stakeholder interest.

Renewals costs

- Businesses' November 2018 submission:
  - Updated opening 2012-13 annuity balance, mainly to incorporate flood costs net of insurance recoveries (2010-11 flood event)
  - Historical renewals costs (2012-13 to 2017-18) based on actual costs (including flood costs, less any insurance recoveries received)
  - Forecast renewals costs (2018-19 to 2023-24)
  - Proposed 30 year (rather than 20 year) annuity period.
- Initial stakeholder submissions:
  - Concerns with substantial increases in negative renewals annuity balances as a result of unforeseen historic costs (e.g. flood costs).
- Key considerations:
  - Length of annuity period – 20-year vs 30-year.
  - Under referral notice, costs to be recovered include an appropriate allowance for renewals costs, taking into account prudent and efficient renewals costs incurred in previous price path periods.
  - QCA has engaged consultant to assess prudency and efficiency of past and future renewals costs.

Electricity costs

- SunWater's November 2018 submission:
  - Forecast electricity costs fully allocated to the volumetric tariff.
  - Recommended volumetric tariff (Part B and Part D) should include adjustment factor to true up difference between actual and forecast electricity costs.
  - e.g. 2022–23 prices would include an adjustment for the 2020–21 true up.
- Initial stakeholder submissions:
  - Concerned with impact of electricity prices on water prices.
  - Material step-up in electricity costs in the event that transitional and obsolete tariffs are phased out on 1 July 2020.
  - Practical and fair methodology for passing through electricity costs given expected volatility in electricity prices over forecast period.
- Key considerations:
  - Prudency and efficiency of forecast electricity costs.
  - In our previous review, where costs change relative to forecast (and not 'controllable') then within-period or end-of-period adjustment to future prices.
  - Under referral notice, QCA is required to recommend mechanisms for managing risks associated with material changes in costs outside the control of businesses.

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Dam safety upgrade costs - background

- For this review, we have been asked to develop and apply an appropriate approach for apportioning dam safety upgrade capital expenditure.
- We will consider extent to which the allocation of dam safety upgrade costs should reflect possibility that both irrigators and the broader community may contribute to the need for, or may derive benefits from, dam safety upgrades.
- This means that we will provide two sets of recommended prices for the price path period:
  - one that excludes all dam safety upgrade capital expenditure
  - one that includes a share of the capital expenditure associated with dam safety upgrades forecast to be incurred from 1 July 2020.
- Recommendations by QCA not to specify which set of prices should apply.

Dam safety upgrades - drivers

Regulatory requirements

- The Water Supply (Safety and Reliability) Act 2008 is the key instrument used to regulate dam safety for referable dams
- Requires dams to meet safety requirements in DNRME guidelines:
  - selection of an acceptable flood capacity (AFC)
  - upgrade schedules for achieving 100% of AFC.

Recent developments

- BoM's 2003 review of 'probable maximum precipitation' suggested much larger extreme rainfall event may be possible than previously assessed.
- An improvement to collective knowledge of dam safety risks based on experience and learnings from significant flood events.
- Revised population downstream for some dams.

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Dam safety upgrade program 2020-24

SunWater's proposed dam safety upgrade costs (November 2018 submission)

WSS	Dam	Forecast ($m)	Pricing ($m)
Barker Barambah	Bjelke-Peterson Dam	10.0	5.0
Bowen Broken Rivers	Eungella Dam	2.1	1.1
Bundaberg	Fred Haigh Dam	4.4	2.2
Burdekin-Haughton	Burdekin Falls Dam	344.3	344.3
Macintyre Brook	Coolmunda Dam	5.7	2.9
Nogoa-Mackenzie	Fairbairn Dam	9.6	9.6
Pioneer River	Teemburra Dam	8.5	4.3
Upper Burnett	Wuruma Dam	8.9	4.4
Upper Condamine	Leslie Dam	24.0	12.0
Total		**417.6**	**385.7**

Seqwater – no dam safety upgrades planned for completion during 2020-24.

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Approaches in other price reviews

- **Other QCA reviews**
  - Dam safety upgrades – considered a normal cost of operation in supplying water services to users (Seqwater bulk 2018-21, GAWB 2015-20).
  - Flood mitigation works (naturally occurring floods) – should be shared among beneficiaries in broader community (Seqwater irrigation 2013-17).

- **IPART**
  - Excluded legacy costs – costs of bringing pre-1997 assets up to 1997 dam safety standards.
  - Other dam safety costs apportioned using impactor pays approach:
    - Final decision to increase customer share from 50% to 80% (Feb 2019).
    - Reflects broader community as minor impactor, to extent some costs associated with flood management activities are required to manage risk posed through naturally occurring floods.
    - Valley-specific cost shares for valleys with dams constructed to provide specific flood mitigation services.

Dam safety upgrades – key issues

- Prudency and efficiency of dam safety upgrade capital expenditure.
- Who should be allocated costs, and on what basis?
- Expected impacts on the interests of irrigator customers of forward-looking prices that include dam safety upgrade costs?
- Any issues relevant in the context of the public interest (including equity and fairness) that we should consider in developing an appropriate approach?
- Time period for recovery:
  - As annuity or roll into asset base
  - Need to avoid double counting if rolled into asset base.

Key considerations for the QCA:

- Economic efficiency
- Public interest (including fairness and equity)
- Transparency, simplicity and cost effectiveness.

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IGEM costs

- SunWater’s November 2018 submission:
  - Actual and forecast expenditure includes one-off non-routine establishment costs and ongoing routine expenditure related to the IGEM Review recommendations.
  - Treated as indirect costs and apportioned to each scheme in proportion to the number of referable storages located within each scheme.
- Initial stakeholder submission:
  - Some stakeholders consider that this is not appropriate as these services are for 'the benefit of the broader community'.
- Key considerations:
  - Under the referral notice, costs to be recovered through prices include costs incurred by the businesses to implement the 2015 recommendations made by Inspector-General Emergency Management (IGEM) review.
  - Prudency and efficiency of proposed costs.
  - Allocation of costs by service contract.

Moderating bill impacts

- The referral asks the QCA to have regard to balancing the legitimate commercial interests of the businesses with the interests of their customers, including considering less than cost reflective volumetric prices which are necessary to moderate bill impacts for customers.
- Under the terms of the referral notice, bill impact will potentially be highest from 2019-20 to 2020-21 prices.
- Prices beyond 2020-21 will increase by no more than inflation plus $2.38 per ML (in $2020-21).
- Key considerations:
  - Our initial focus is generally on our assessment of prudent and efficient costs and the appropriate allocation of costs. Our assessment of these matters could have implications for the eventual bill impact.
  - We generally revisit public interest matters as part of our eventual pricing recommendations and determine whether there are any specific implications.
  - Under referral notice, prices are to be based on all tariff groups transitioning to cost-reflective prices.

Tariff structure

- Businesses’ November 2018 submissions:
  - Businesses’ proposed fixed/variable cost splits are based on high level analysis rather than the scheme-level cost category approach previously used by QCA.
  - The businesses have argued that their proposed approaches are simpler and more transparent than the approach in the previous review.
- Initial stakeholder submissions:
  - Concerns regarding the fixed/volumetric split.
  - Concerns with paying a fixed fee when there is no/little water supplied.
- Key considerations:
  - The QCA has been directed to have regard to the fixed and variable nature of the underlying costs.
  - In previous review, the QCA recommended fixed price (Part A and C) reflected fixed costs and volumetric price (Part B and D) reflected variable costs.
  - Sought to send an efficient price signal and promote increased trading and higher value production by active irrigators. Also manage business’s volume risk.

Other issues

- Other issues?

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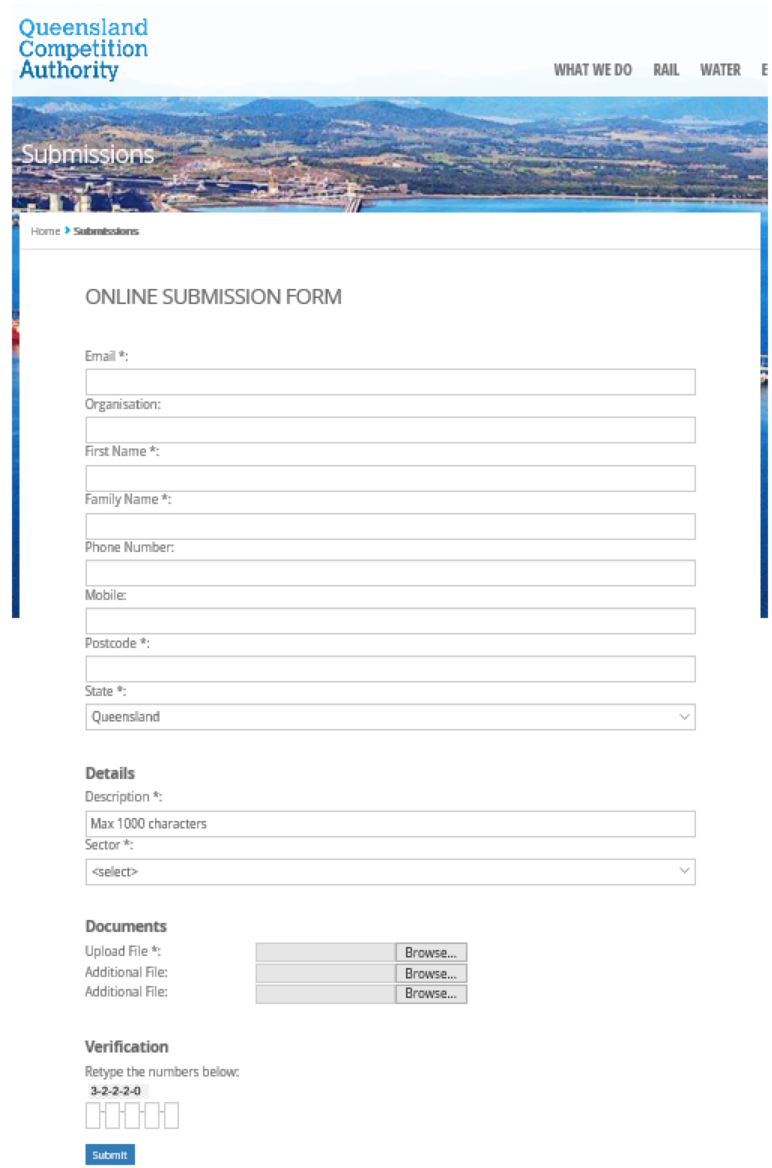
Next steps

- Submissions on business submissions and dam safety paper (8 March)
- Online submission form at www.qca.org.au/submissions
- Or by post: QCA, GPO Box 2257, Brisbane Q 4001
- Submissions are encouraged, considered and addressed
- Transparency – submissions published
- QCA draft report (by 31 August 2019)
- Scheme level workshops on draft report (September/October 2019)
- QCA final report (by 31 January 2020).



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Questions?

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