ATTACHMENT 2 – DATA REQUEST – SEQWATER IRRIGATION REVIEW 2013-17

RE: **Framework Issue – Irrigation Cost Allocation and Recovery**

Version: 14 June 2012

1.1 Purpose

This paper sets out issues for the Seqwater irrigation review, which were identified (but, appropriately, not addressed in relation to irrigation charges) during the SEQ bulk water Grid Services Charges (GSCs) review.

The information presented has potential implications for Volume 1 Chapter 3: Regulatory Framework, Chapter 4: Pricing Framework, Chapter 5: Renewals Annuities and/or Chapter 6: Operating Expenditures.

The document is being provided to Seqwater for the purpose of seeking confirmation that the observations about irrigation cost allocation and cost recovery are correct.

Confirmation and any necessary further clarification are sought from Seqwater by 28 June 2012.

1.2 Allocation of Irrigation Costs and Revenues

The Seqwater Grid Service Provider ~~submission~~ submission for 2012-13 does not allocate bulk costs between schemes or types of customers (that is, between bulk urban, industrial and irrigation customers). Instead, it applied

the interim arrangements that have been in place since the first year of Grid Service Charges, 2008-09. It was expected that these interim arrangements would come to an end at the end of the current irrigation price paths.

In general terms, the interim arrangements were to include irrigation costs ~~are included~~ in the ~~bulk~~ costs (relating to urban and industrial customers) and then apply revenue offsets ~~are applied~~ (reducing those costs) equivalent to irrigation revenues, including CSO, ~~received by~~to Seqwater.

The irrigation revenues were effectively determined in 2005-06 as part of Tier 1 price setting.

This approach varies, however, particularly for irrigation capital expenditure (that is, renewals expenditure).

Specifically, the treatment of irrigation renewals expenditures and renewals annuity revenues varies, depending on whether a scheme is *irrigation only* or *mixed-use* (irrigation, urban and industrial customers).

Of the nine tariff groups involving irrigation customers (subject to this review) there are:

(a) five irrigation only (unrelated to grid service charges) tariff groups: Cedar Pocket WSS, Central Lockyer WSS (including Mortonvale Distribution System), Lower Lockyer Valley WSS and Pie Creek (within Mary Valley WSS); and

(b) four mixed-use tariff groups (where the WGM holds WAE in addition to irrigators): Central Brisbane WSS, Logan River WSS, Mary Valley WSS (excluding Pie Creek tariff group) and Warrill Valley WSS.

1.2.1 Treatment of Irrigation Only Costs and Revenues – Interim Arrangements

Capex

In irrigation only tariff groups, renewals expenditures are excluded from the GSCs. That is, no irrigation renewal expenditure is included in urban and industrial costs. Instead, the irrigation renewals annuity (that is, the renewals revenues determined during Tier 1) is accounted for using an Asset Restoration Reserve (ARR). The ARR then funds the irrigation renewals expenditures and positive or negative balances arise depending on the extent to which actual expenditure and revenues vary compared to the Tier 1 forecast renewals expenditure.

Opex

By contrast, the interim arrangements provided for all irrigation operating expenditures (opex) are initially included in Seqwater's bulk costs. However, the irrigation revenues relevant to opex (that is, total Tier 1 irrigation revenue less renewals annuities) are then applied as a revenue offset, reducing recoverable bulk costs. In effect, therefore, urban and industrial customers do not pay irrigation only opex, due to the application of this revenue offset.

However, this is true only to an extent that actual irrigation opex reflects forecast irrigation opex, determined in 2005-06 as part of Tier 1 prices. It is possible that actual opex ~~incurred~~ (including non-directs) by Seqwater ~~exceeds~~ has been higher or lower than the opex revenues based on Tier 1 forecasts. If so, the revenue offset applied may be inadequate or excessive to that extent. Conversely, given the prevalence of drought during current price paths, it is conceivable that actual opex may be lower than forecast. Either way, past variances between forecast and actual opex for current prices paths cannot be addressed as part of this review, as a price cap (not revenue cap) applied in Seqwater irrigation WSSs.

Comment [r1]: Angus, this is predicated on an assumption that costs did or could reduce substantially with drought – should not this be left for other sections in the report.

The current Seqwater approach is an interim measure that ensures to the extent that the irrigators pay relevant opex costs and urban and industrial customers do not pay irrigation opex (except where variances between forecast and actual opex render irrigation revenues and the revenue offset as being somewhat insufficient – refer above). Cost reflectivity will need to be addressed going forward.

Comment [r2]: Refer above – suggest this is drawn out earlier for context.

1.2.2 Treatment of Irrigation Costs and Revenues in Mixed-Use Tariff Groups

Capex

In mixed-use tariff groups, all capital expenditure for all customers (including irrigation renewals expenditure) is recovered from urban and industrial customers as part of the GSCs. ~~The~~ In accordance with the interim arrangements established from 2008-09, irrigation renewals annuity revenues are set aside in escrow (that is, ~~banked in a separate irrigation renewals annuity trust account~~accounted for separately are reported annually through grid service charge reviews). To date, these funds have not been applied as revenue offset to reduce the GSCs in accordance with the interim arrangement. Rather, the treatment of these revenues was to be resolved once irrigation prices were re-set at the end of the current price paths.

The total renewals costs applicable to irrigation customers were determined during the Tier 1 process resulting in the irrigation renewals annuity (in these mixed schemes). The full amount of the irrigation renewals annuity revenue collected has been set aside.

Thus, the ~~urban and industrial customers~~Water Grid Manager (via GSC) and irrigators are currently (in effect) both paying for irrigation renewals expenditure (that is, the required amount is being collected twice). This could be considered 'double dipping' by Seqwater, except that to avoid this, Seqwater has set aside the irrigation renewals annuity revenues (refer above), pending resolution by this review.

To address this issue, Seqwater's submission to the QCA proposed that the RAB for GSCs be reduced by the actual renewals expenditure attributed to the ARR balance since 2008-09. This would result in a small, retrospective adjustment to Grid Service Charges while preserving the renewals pricing arrangements originally established in 2006 under the existing price paths.

~~This approach to renewals is not consistent with that adopted by the Authority for SunWater irrigation customers and requires further consideration. What is Seqwater's preferred option to address this? What is the proposed approach to appropriate allocation of renewals expenditure to irrigators?~~

~~Treatment of the irrigation renewals annuity funds and irrigation renewals expenditures, as part of determining opening ARR balances for 1 July 2013, will require further investigation. When is Seqwater expected to submit further on this matter (that is, the outcome of Indec's analysis)?~~

Opex

In mixed use tariff groups, the interim arrangements provided all opex (including that incurred for irrigation services) ~~is~~ to be recovered from urban and industrial customers via the GSCs. The irrigation opex revenues (total irrigation revenue less renewals annuity revenue) are then applied as a revenue offset, reducing recoverable bulk costs. In effect, therefore, urban and industrial customers do not pay irrigation opex in mixed-use schemes, due to the application of this revenue offset.

This review of irrigation prices provides the trigger for these interim arrangements to be regularised, and instead the costs allocated to irrigators as a result of this pricing review to be removed from the cost base for GSCs.

~~Further consideration is warranted to ensure consistency with SunWater, in terms of direct and non-direct operating cost allocation to tariff groups and customers, where this can be achieved in a practical, cost-effective manner.~~

Table 2 summarises the current treatment of irrigation costs and revenues presented in Section 1.3.

Table 2: Current Cost Allocation

	Irrigation Only WSSs	**Mixed WSSs**
Capex	Interim arrangements: No urban and industrial costs as irrigation only. Irrigation only renewals expenditures are excluded from the WGM's costs. Irrigation only renewals annuity revenues accounted for using ARRs. ARRs fund renewals expenditure. This is consistent with SunWater. New arrangements post irrigation price review: No change.	Interim arrangements: Urban and industrial costs and GSCs include irrigation renewals expenditure. But irrigation renewals annuity revenues have not been applied as revenue offsets against bulk costs. So urban and industrial customers are paying these irrigation costs. Irrigation renewals annuity revenues have been set aside in a renewals annuities trust account, but not drawn upon. Urban and industrial customers and irrigators are both paying for irrigation renewals expenditure. This could be double dipping, except that the irrigation revenues are being set aside pending resolution as part of this review. ~~This is inconsistent with SunWater and requires resolution.~~ New arrangements post irrigation price review: Adjust the RAB for Grid Service Charges to account for renewals capex from 2008-09. Allocate future capex to the RAB for Grid Service Charges according to the cost allocation approach decided for irrigation charges.
Opex	Interim arrangements: As bulk opex is not allocated between Seqwater schemes or customer types, the total urban and industrial bulk costs for Seqwater initially includes all irrigation opex. Irrigation opex revenues are applied as revenue offsets, reducing bulk costs. Thus, urban and industrial customers do not pay for irrigation opex. ~~This is inconsistent with SunWater and requires resolution.~~ New arrangements post irrigation price review: Allocate operating operating costs to Grid Service Charges according to the cost allocation approach decided for irrigation charges.	Interim arrangements: As bulk opex is not allocated between Seqwater schemes or customer types, the total urban and industrial bulk costs for Seqwater initially includes all irrigation opex. Irrigation opex revenues are applied as revenue offsets, reducing total bulk costs by that amount. Thus, urban and industrial customers do not pay for irrigation opex. ~~This is inconsistent with SunWater and requires resolution.~~ New arrangements post irrigation price review: Allocate operating operating costs to Grid Service Charges according to the cost allocation approach decided for irrigation charges.

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Please confirm, by 28 June 2012, that the above is correct or provide clarification where it is not.