BRIA
Burdekin River Irrigation Area

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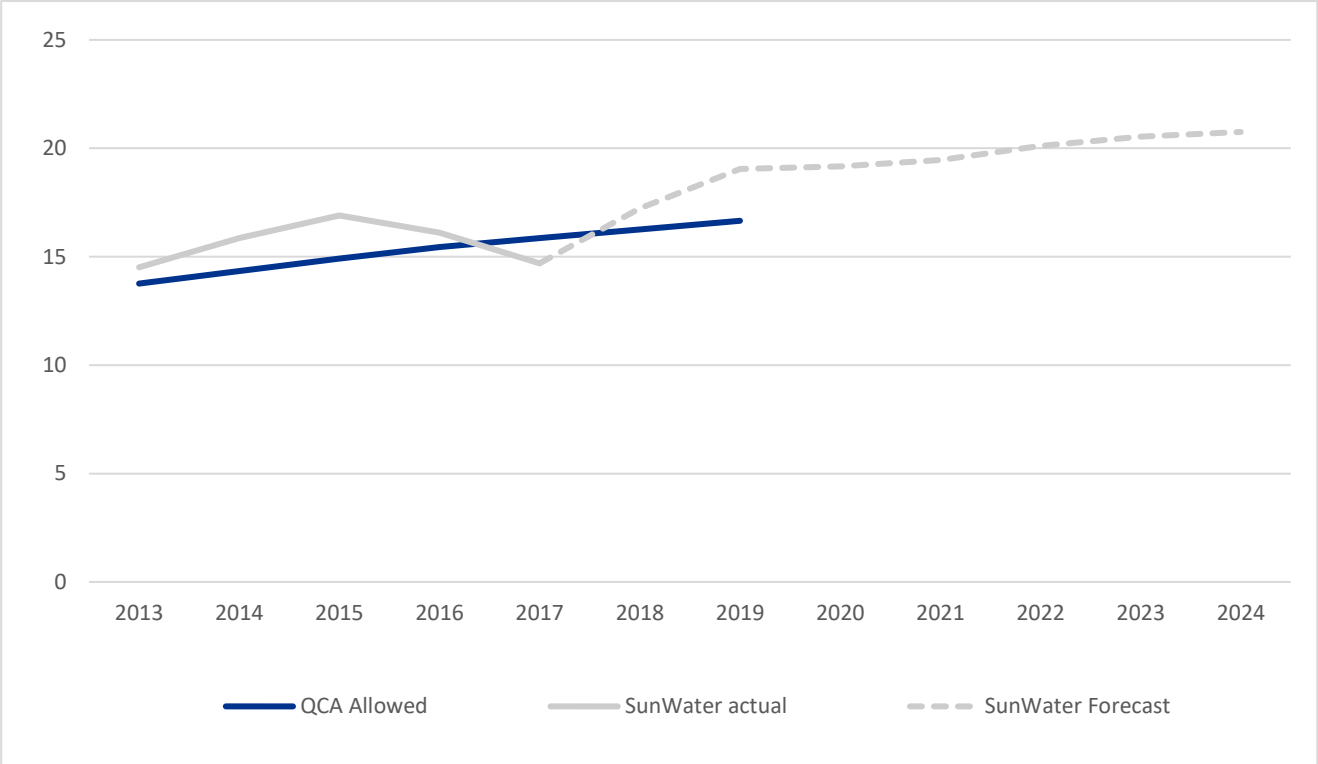
BRIA's key issues for QCA's review of SunWater irrigation prices

Preamble

SunWater's network service plans (NSP) 2018/19 to 2023/24 propose considerable increases in costs and prices from 2020 to 2024. SunWater is proposing a 30 per cent increase in its routine distribution costs and a 35 per cent increase in bulk costs between 2016-17 (the last year of actuals presented in the NSP) and 2018-19. Approximately half of this increase is caused by a 52 per cent increase in non-direct costs over two years.

Figure Error! No text of specified style in document.**1 : Comparison of QCA allowance and SunWater actual / forecast**



SunWater spent $3.8 million more than the QCA allowed on distribution routine costs. However, in 2016-17, the last year of actuals presented in the NSP, SunWater met the QCA budget, even when the impact of electricity is removed. SunWater needs to carefully justify why their costs are forecast to increase by 30 per cent over the next two years.

During the Local Management Arrangement (LMA) investigations BRIA was told to expect future price increases in the order of CPI, as the Burdekin Haughton Distribution Scheme was very close to cost-reflective pricing.

SunWater's reissued 2019 NSP (9 Nov 2018) has the distribution scheme requiring a subsidy of $4.70 per ML Part C fixed charges and $6.66 per ML increase on the Part D variable charges.

Previous Government policy was to cap the total price increase at CPI plus $2 per ML (real). The current *Referral and Direction Notice* (hereafter, referral notice) states that the current policy is CPI plus $2.38 per ML (real) until prices reached lower bound or cost-reflective.

The current referral notice issued by the Deputy Premier and Treasurer, has volumetric prices (Part B & D) moving to cost-reflective volumetric prices immediately in July 2020. Given the per ML increase in variable costs, this is **deeply concerning to BRIA** and its customer members as we do not consider that the capacity to pay exists to absorb this variable charge increase plus the $2.38 per ML (real) increase in fixed charges until cost-reflective pricing is reached.

For the Burdekin Haughton Water Supply Scheme (BHWSS) – Distribution Service Contract this will mean an increase in Part C fixed charges of $2.38 per ML (plus CPI) as well as the $6.66 per ML (plus CPI) increase in the Part D volumetric charge. **This suggests a $9/ML (real) increase in the first year of the new price path plus CPI. This is well above any irrigators capacity to pay and will not only have a negative impact on the irrigators, but the Burdekin community.**

We will submit that cost increases need to remain as per the previous Queensland Government policy and capped at increases of $2.38 plus CPI. [This increase only refers to the distribution component of the cost and does not include the bulk cost of water or Part A and B].

Issues that will need reviewing by the QCA include but not limited to:

1.1 Provisions for Dam Safety

SunWater is proposing significant capital expenditure (capex) on dam safety in the BHWSS. The referral notice states (in relevant sections):

> 1.2: The recommendations made by the Authority under B (1.1) should include *two sets of appropriate prices in relation to prudent and efficient capital expenditure associated with dam safety upgrades*, one set where all dam safety upgrade capital expenditure is excluded and one set where an appropriate allowance for capital expenditure forecast to be incurred from 1 July 2020 onwards is included. The recommendations made by the Authority are not required to specify which set of prices are to apply.
>
> 1.3: In making its recommendations under B (1.2), the Authority is to develop and apply an appropriate approach for apportioning dam safety upgrade capital expenditure and explain this approach and its application as part of its recommendations. (Ministerial Referral and Direction Notice, 2018, emphasis added)

BRIA will submit that these costs should be met by Government as dams were built to benefit the region, the state and the nation, and that irrigators are not the sole beneficiaries or impactors.

Irrigators cannot be expected to assess the need for, and costs of implementing dam safety upgrades in the absence of meaningful detail and costing on the proposal. Any meaningful contribution to the projected spend by SunWater on the Burdekin Dam will be well beyond irrigators' capacity to pay.

1.2 Flood Monitoring and Reporting

We understand that these are Inspector General Emergency Management (IEGM) requirements, however, BRIA does not accept that irrigators should be responsible for costs of services that are provided for the benefit of the broader community.

1.3 Insurance

BRIA requires transparency that SunWater's outstanding insurance claims are not being included in non-routine expenditure going forward, or affecting the renewals annuity balance, and that SunWater is only insuring assets that can be successfully claimed against.

1.4 Asset Management and Renewals Annuity

BRIA requires that SunWater's Asset Management System will be fully investigated to ensure that it is a fit for purpose system that delivers cost-effective (efficient) and prudent asset management and ensures that costs do not significantly exceed forecast expenditure.

It is time to show the cost of reporting on asset conditions compared to the cost of replacing assets.

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1.5 Cost Reflective Water Charges

An immediate increase to cost reflective volumetric charges in the BHWSS would require a $6.66/ML increase to Part D (plus CPI) based on SunWater's updated NSP (Nov 2018).

BRIA contends that this (when coupled with the added fixed charges Part A and C) is beyond irrigators' capacity to pay and that the total of the annual increases in **total fixed and variable water charges should be contained to the $2.38/ML plus CPI**.

As noted in the preamble (above), during the LMA process, BRIA and customers of this scheme were told to expect future price increases in the order of CPI, as the Burdekin Haughton Distribution scheme was very close to cost-reflective pricing. In contrast, SunWater's reissued 2019 NSP and addendum (9 November 2018) has the distribution scheme requiring a subsidy of $4.70/ML Part C fixed charges and $6.66/ML increase on the Part D variable charges.

Previous Government policy was to cap the increase at CPI plus $2 per ML (real). The Ministerial Direction states that the current policy is CPI plus $2.38 per ML (real) until prices reached lower bound or cost-reflective.

The current referral notice has volumetric prices (Part B & D) moving to cost-reflective volumetric prices immediately. This is **deeply concerning to BRIA** and its customer members as we do not consider that the capacity to pay exists to absorb this variable charge increase plus the $2.38 per ML (real) increase in fixed charges until cost-reflective pricing is reached.

For the BHWSS – Distribution Service Contract this will mean an increase in Part C fixed charges of $2.38 plus CPI (until cost-reflective prices are reached) and a $6.66 per ML plus CPI increase in the Part D volumetric charge. **This suggests a $9 per ML (real) increase in the first year of the new price path plus CPI.**

This increase only refers to the distribution component of the cost and does not include the application of CPI to Part A and B charges.

This is well above any irrigators capacity to pay and will not only have a negative impact on the irrigators, but the Burdekin community

1.6 Electricity

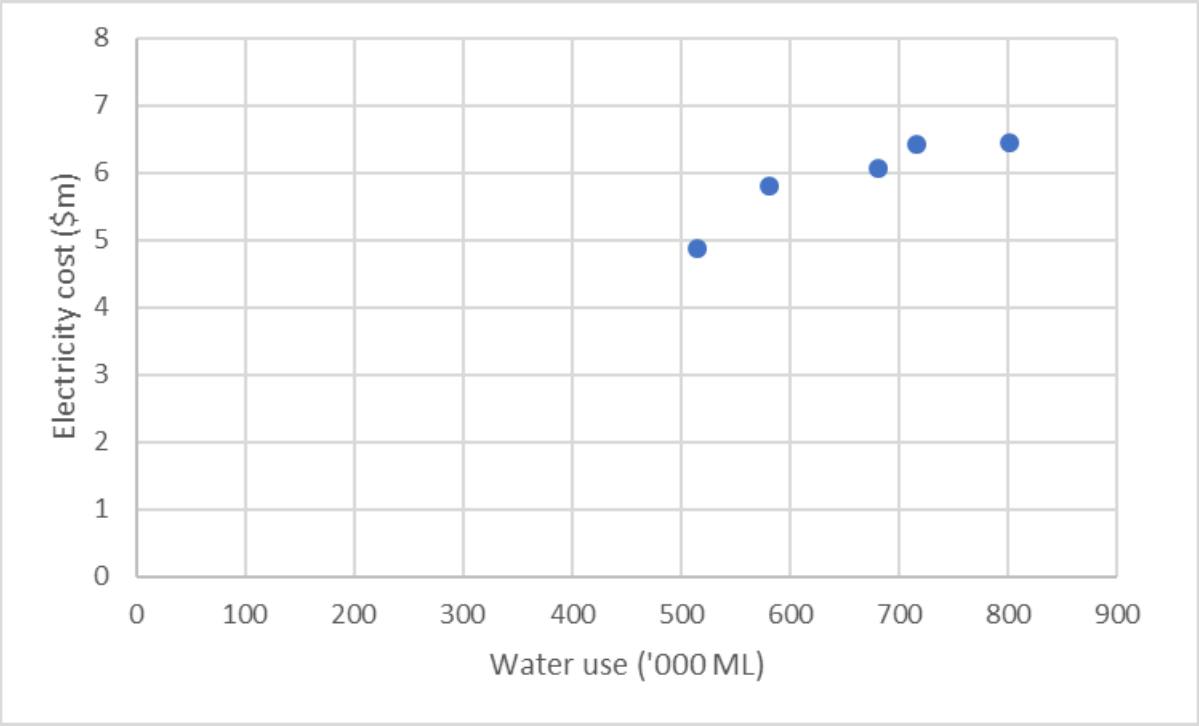
Electricity costs are a significant and increasing component of total water charges. Ergon's tariffs are made up of the following charges including:

- a flat daily connection charge
- a demand charge based on the maximum amount of power used in each month above a demand threshold, measured in kVA
- a usage charge based on the amount of energy used in, measured in kWh.

BRIA suggests that:

1) Fixed components of electricity charges such as the flat daily connection charge should be allocated to the fixed component of water charges. This is consistent with the QCA's principles established in Volume 1 of the previous SunWater review, where it recommended that fixed costs be recovered via fixed charges and variable costs be recovered via variable (water use) charges.
2) The demand charge should also be treated as a fixed cost as it does not vary directly with water use. This charge is typically incurred whenever a pump is turned on during the month, whether for 15 minutes or for 30 days. Accordingly, the demand charge is paid in most months, however, the volume of water supplied is very variable. As is shown below, the cost of electricity is relatively constant over the past five years.

Figure 2 : Electricity cost vs water use



Note: Electricity costs have been escalated at 2.5% to 2018-19 dollars.

Source: SunWater NSPs

If SunWater recovered demand charges through the volumetric charge only, then SunWater would face significant revenue risk. It would need to pay for the monthly demand tariff irrespective if the amount of water delivered. The demand charge could exceed the revenue received from water deliveries.

In the past, the QCA has allocated costs to the party best able to manage the risk and therefore concluded that whomever that party is, should bear that cost. Customers have limited or no control over the management of peak demand / load management; whereas SunWater as the pump operator has a high degree of day-to-day operational control about how and when pumps (and other electricity using equipment) are deployed.

As importantly, reducing semi-fixed or demand charges – peak lopping – is within SunWater's control, for example, in most cases it can invest in a variable speed drives, soft starts or other devices to reduce peak load. SunWater can also introduce in-channel monitoring and optimise delivery of water to a distribution scheme to reduce peak electricity use. By contrast, customers cannot control SunWater's peak demand. Finally, as indicated in its submission (2019 NSP) SunWater can change tariffs to minimise such charges.

In addition, it would be appreciated if SunWater's projected **escalation rate for electricity** charges were to be reviewed by the QCA, to ensure that forecast future price decreases (if any) – or a softening of increases – are reasonably captured in SunWater's forecast costs and prices.

1.7 Reviewing SunWater's variable costs

The two recommendations above – on which BRIA will submit further by February – are part of a body of analysis that the QCA may wish to consider in reviewing SunWater's so-called or deemed variable costs.

The increase in variable costs and the pricing policy that cost-reflective variable charges be adopted at the start of the price path, may have potentially unexpected and unacceptable impacts on customers, exceeding their capacity to pay.

BRIA considers that it would assist the QCA in managing price impacts on customers, if it were to review the nature of SunWater's variable costs and – **subject to further analysis by BRIA and the QCA** – reallocate costs that are fixed or semi-fixed to SunWater's fixed cost pool for recovery via fixed charges. Semi-fixed costs should certainly be re-assigned as fixed costs where SunWater has control (and customers do not). BRIA requests more detailed information and time to analyse the nature of fixed and variable costs in this scheme.

BRIA's policy will reflect our deepening understanding of this issue, which we will develop by February 2019.

The result of reassigning fixed and semi-fixed costs (currently included in variable charges) would be to help manage the referral notice's requirement to have regard to balancing future price impacts on customers against SunWater's requirement to recover its prudent and efficient costs.

We note there are alternative approaches, including leaving variable costs as they are currently defined, and instead not pass through cost-reflective variable costs in full.

1.8 Metering

Inefficient metering of water usage results in increased distribution losses and results in inequitable allocation of costs across the BHWSS. SunWater should be required to ensure that all water delivery is accurately metered to address this issue. This includes SunWaters own bulk metering.

1.9 Distribution Losses

The cost of distribution losses is increasing materially due to the projected increases in bulk water charges, driven by substantial increases in SunWater's operating and capital costs for this scheme including increases in the renewals expenditure and potential inclusion of a portion of dam safety costs (which BRIA does not support on beneficiary pays and capacity to pay grounds).

Distribution losses are stored in the dam – so are allocated the bulk water charge – which is then charged to channel customers for that storage, noting that channel loss allocations (both high and medium priority loss allocations) provide a service to all high and medium priority channel customers. It is not the case that high priority losses provide a service to only high priority customers. Rather, high priority losses are required at the start of the water year to fill the channel for the benefit of all customers.

BRIA submits that the volume of distribution losses used as an input to pricing should be based on the efficient requirement for those allocations and not the current nominal allocation for losses and potentially not even the allocation that the QCA recommended in the previous review. It is time to reassess the loss allocation that underpins current prices in this scheme to ensure an efficient approach is adopted for the next price path, incorporation recent losses / use data up to and including 2017-18.

It would be appreciated if QCA reviewed the appropriateness of the loss allocation for pricing in the BHWSS. In doing so we ask that the QCA recommend an approach that will provide SunWater with an economic incentive to drive efficiencies within the scheme (i.e. reducing its unnecessary reliance on excessive distribution losses). Recent years of data – recording actual losses – may assist the QCA to come to a view on this material cost driver. The benefit of not allowing SunWater to recover the cost of its unnecessary loss allocations is to drive such allocations into the temporary and permanent trading market – seeing SunWater monetise its surplus loss allocations – reducing costs to customers, increasing regional economic activity and development, moving water to higher value uses and increasing the liquidity of the trading market particularly at times of scarcity.

We would like to see a focus on this issue to ensure a fair outcome for customers.

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1.10 Review of Costs Allocations

BRIA submits that QCA should review cost allocations over all sections of the BHWSS. BRIA are seeking to support the QCA's endeavours to increase the common sense and transparency of prices arising from this review. Accordingly, we ask the QCA to consider SunWater's proposed cost allocation methodology for overhead and indirect costs. If there are opportunities to suggest an alternative or modified method that is more equitable and transparent, we would be grateful to the QCA.

Additional cost allocation issues are discussed further below:

- BRIA notes, for example, that in response to a previous QCA recommendation, SunWater has submitted that it may be appropriate for the QCA to review discounted charges which currently apply in the Giru Benefited Area and Gladys Lagoon.
- BRIA will submit that the QCA review the cost allocation of all diversions from the Haughton Main Channel into the Haughton River and Gladys Lagoon, together with the metered usage in those sections of the scheme, to determine whether the current pricing arrangements are appropriate.

1.10.1 Giru Benefitted Area and Glady's Lagoon sustainable pricing methodology

SunWater has submitted that the QCA review discounted water prices which currently apply in the Giru Benefitted Area (GBA) and Gladys Lagoon. BRIA's view is that pricing currently applied in the GBA and Gladys Lagoon requires resolution as part of the long-term risk management for the scheme and to provide certainty to all BHWSS customers and SunWater.

To address this as part of the price review BRIA asks the QCA to consider developing an equitable and sustainable pricing approach utilising both Owen Droop's hydrology assessment and the GBA Haughton Zone A Review commissioned by SunWater. BRIA understands that both reports have been provided to the QCA.

We ask that the QCA develop a position that improves the current pricing methodology for both areas using contemporary metered water diversions and metered customer usage together with relevant cost data which can be provided by SunWater.

1.11 Recreation Costs

BRIA will submit that the process of excluding recreation costs from irrigation pricing should not contain any transitional costs to be borne by irrigators. For example, is it appropriate that SunWater go through major works in and around the recreation area during this price path and pass the cost through to the next by putting it in non-routine expenditure. The referral notice is clear in excluding recreational area costs for the next price path.

1.12 Fixed price increases $2.38/ML plus CPI only for bundled Part A and C charges

We would appreciate it if the QCA could clarify in writing – early in the process – its interpretation of the referral notice, in relation to the application of the $2.38/ML real increase, to fixed tariffs.

Does it apply *to the combination* of fixed Tariffs A and C only once (preferred) or does it apply separately to each of Tariff A and C, resulting in a $4.76 per ML per annual real increase (strongly opposed by BRIA)?

It is our understanding that the referral notice implies the former interpretation was intended (i.e. the combined Tariff A and C will only increase by $2.38 per ML in real terms). However, clarity is sought from the QCA.

1.13 Duration of price path

The referral notice requires that the QCA recommend irrigation prices for the period 1 July 2020 to 30 June 2024. This implies the following financial years: 2020-21, 2021-22, 2022-23 and 2023-24. This suggests a four-year price path.

Given the effort required for such a review and that the previous review set prices for five-years, BRIA requests clarification if new prices will apply for four or five years. If it is four, we would appreciate it if the QCA could explain the Queensland Government's reasons for implementing a review for a shorter price path.

BRIA trusts that this document makes a helpful contribution to the QCA's identification of issues.

Kind regards

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