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Cotton Australia

QCA Draft Report

Nogoa and Mackenzie Bulk and Distribution Scheme Submission

Thank you for the opportunity in allowing Cotton Australia to Submit on behalf of the irrigators with in the Nogoa Mackenzie irrigation area. We strongly indorse the submission put forward by QFF (Queensland Farmers Federation) and will continue to work with QCA (Queensland Competition Authority) throughout this process through QFF. We would also like to reserve the opportunity to Submit at a later date if required. We will make ourselves available to QCA if further information is required on issues put forward in this Submission.

Consultation and Transparency

This pricing process has been slowed and hindered by the flow of information from SunWater, this is apparent by the comments in the consultants reports regarding the lack of, access to, breakup, and timeliness of supply of the data require for the consultants to do their jobs. The consultants have also been hindered by the scope and time lines given to them by QCA which was caused by the inadequate flow of data from SunWater. This has led to a draft report with recommended prices that are based on far too may estimations with a very large step increase in SunWater costs without any supporting data why this is the case. QCA and irrigators are now reliant on the outcomes of reports from consultants in set prices for the next 5 years without any certainty of the data they were produced from.

Consultation between SunWater and customers has failed to exist during the current price path and has left irrigators bewildered at the cost blow outs above the budgeted costs agreed to by SunWater at the end of the last pricing process. This has led to a 33.5% increase across the state in costs above budget in 2011. This is with the exclusion of renewals and the intersafe program.

RECOMMENDATIONS:

1. **With the lack of confidence in data from SunWater and no reasons given for the large cost blow outs we recommend that QCA adopt the prices set in the last pricing review and carry them forward for the next 5 years.**
2. **Any cost item that exceeds the budgeted cost for the price path should go through a consultation process with customers before it can be costed to the scheme. This will achieve two things;**
 - a. **One being a constant approach from one pricing process to next for the allocation of costs and;**
 - b. **No price shocks at the start of the next price path.**

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Fixed and Variable costs

- QCA is recommending that water use in this scheme be at 83.2% Bulk and 74.9% distribution for setting the variable charge, this will have an impact on water users that are consuming above 83.2% or 74.9% of their WAE (Water Access Entitlement).
- Should we be using a pricing approach that penalises those who use the service more, and keeping the costs down for those who use the service less?
- In this scheme SunWater is a service provider where only 83.2% or 74.9% of the service is utilised. Should QCA be recommending a pricing process which allows SunWater to continue to recoup costs from the remaining users without promoting the availability of service or restructuring the current service to reflect use and reduce costs?
- The water use data for distribution has included distribution losses allocation distorting the water use data for this scheme. The losses allocation has already been costed at 100% usage.
- Electricity costs were over forecasted well in excess of the drop in water use in the last price path leaving irrigators questioning any data produce by SunWater on electricity costs.
- Distribution fixed and variable costs for 2012/13:
 - 80% fixed \$1 528 000 /WAE (MP 86145 + HP 1172) 87317ML = \$17.50 not \$22.24 Cost reflective in report.
 - 20% variable \$382 000/water use (75%x 87317ML) =\$5.83 not \$8.26 Cost reflective in report.
 - It is impossible to get any of the numbers in report to total to the cost reflective prices. A detail model review is required to gain some confidence in the data being presented.

RECOMMENDATIONS:

1. **A review by QCA of water availability compared to water used, and establish what steps SunWater has taken to increase usage and reduce costs to be more reflective of the usage. It is only then that we can comment on cost reflective fixed and variable costs.**
2. **A detail review of the model used to establish prices.**
3. **There are large differences in water use data for distribution which requires clarity from SunWater and QCA. The water use model should not include losses allocation.**
4. **Electricity costs must be based on actual costs paid in arrears not forecasts as this scheme only uses electricity at low storage levels.**

(Prices impact per ML/year) Modelled cost reflective price compared to calculated = \$7.00

Termination Fees

- The fall out of the comments above is the termination fees. The recommended fees are up to \$337.00 for every ML shifted back to the river. This will ensure that even if a SunWater customer wishes to stop receiving a service they will have to pay a cost that is over 25% of the current value of the WAE.

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- This means if all distribution customers were to exit the total termination fees would exceed \$38 000 000 and at 4% interest SunWater would recover more than the yearly total cost of supply without providing any service. With those numbers there is no incentive for SunWater to look after the customers it services.
- The recommendation from QCA is allowing SunWater to impose a charge per ML to shift water from the channel which is only at cost recovery, to the river which is above cost by \$2.90/ML/year. All termination fees should be reduced by $\$2.90 \times 20 \text{ years} = \58.00
- Should losses WAE be Distribution WAE, presently distribution customers are paying the cost of having this WAE delivered through the channel as total cost of distribution, its use is clearly determined for distribution and yet it is classed as a bulk WAE. If this WAE is removed from the channel there is more channel capacity available with a smaller spread of the costs. If it was determined as a distribution WAE an exit fee would have to be paid to ensure no impact on other users.

RECOMMENDATIONS:

- 1. There should be a greatly reduced termination fee ensuring SunWater reduces cost in line with demand, promotes its schemes to build demand and stop any risk of profiting by water being transferred to the river.**
- 2. All losses WAE to be treated as distribution WAE with a spread of distribution costs across the total of distribution allocation including losses allocation.**

(Prices impact per ML/year) 50% of distribution losses sold with exit fees applied = - \$5.00

Revenue Offsets.

- To ensure all revenue offsets are being increased with CPI.
- A more detailed review of the pricing model is required to establish whether all revenue offsets have flowed through to recommended prices.
- Minimum charges need to include as revenue offsets.
- The transfer adjustment fee was a new product created by SunWater during the last price path and was only available by the trading of irrigation water to industrial use without any allocation of revenue offset or water use being recorded.
- Revenue from the water treatment plant and sewage plant must be identified.
- The revenue from the seasonal trading of WAE brought about by channel lining must be recorded as revenue offset.
- The sale value of WAE sold from channel lining paid for by the scheme must be declared a revenue offset.
- The revenue gained from the selling water seasonally out of the channel and river to spot purchasers including Main Roads and Land Developers must be offset against costs.
- Revenue from drainage charges applied to urban Councils needs to be offset against drainage costs.

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RECOMMENDATIONS:

1. All revenues need to be allocated correctly and be increased by CPI each year.
2. Detailed reviews of the model to ensure all revenues are offset against costs.
3. The revenue from new products like transfer adjustment fees must be a budgeted revenue off set at the dollars recovered during this price path moving forward or the over recovery carried forward into the next price path and offset against increased costs like renewals.
4. All revenue offsets recovered above budget during the current price path must be offset against over budgeted costs that are carried forward into the next.

(Prices impact per ML per year) All revenue offsets gained above budget during this price path offset against the next (\$3 000 000) = \$3.00

Distribution Losses

- The current distribution losses allocations are MP 22490ML HP 6840ML. This represents over 33.6% of the WAE on the channel. QCA is recommending that prices reflect the cost of 100% of the losses allocation when less than 49% of them are being used.
- The allocation of losses WAE bulk costs to distribution has added to the fixed costs for losses above actual use by \$130 000 per year or \$1.50/ML/year.
- This is in direct contrast to Losses in the river/bulk system which is called TOL (transmission and operating losses) not incurring any bulk costs.
- If distribution WAE holders are going to be charged for the total of the losses WAE then they demand the right to use the total losses WAE.
- The use of HP losses to fill channels has to be questioned. The channels will only be filled with MP WAE to supply MP WAE. The only time the channels would be filled with HP losses WAE is if the announced allocation for MP WAE was 0. That being the case all HP losses WAE should only be paid by HP WAE holders for the sections of channels that are supplied with HP allocation.
- It may have been the regulator that allocated losses allocations but it was SunWater that summited the amounts required and it is SunWater who is trying to impose a charge on the submitted volume not the used volume. Is this the intent of the regulator?

RECOMMENDATIONS:

1. The original intent of the losses WAE to be upheld. The intent being they are treated the same as the TOL for the river. If this is not to be upheld then the person paying the cost must be the only beneficiary. **The unused proportion of the losses WAE must be made available for usage to those who have paid the cost.**
2. **The average losses WAE used over the last 8 years has been only 14381 ML.** SunWater should only be allowed to charge the bulk cost of losses WAE for the average yearly recorded amount of the WAE used in the past 8 years. This would be an interim measure until accurate bulk metering is carried out. If carryover of allocation is allowed within the scheme, carryover of losses WAE should also be allowed, limited by the total amount required within one water year, that being the largest recorded amount over the last 8 years or limited by the scheme rules for carryover.
3. SunWater must demonstrate the requirement for HP and MP losses WAE before any cost can be allocated. **This should be done through historical use data.**

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4. The bulk cost of HP losses WAE must only be passed onto HP customers at a modelled requirement.
5. All losses WAE to be treated as distribution WAE with a spread of distribution costs across the total of distribution allocation including losses allocation.

(Prices impact per ML/ year) Used distribution losses only - \$1.50

Return on Working Capital

- The requirement for working capital has been added into the costs for this scheme with no mention of all fixed costs being charged out 3 months in advance.

RECOMMENDATION: There is no need for a return on working capital charge as there is over \$10 000 000 paid to SunWater in fixed costs in advance, per quarter.

(Prices impact per ML per year) \$0.01 recommended now, dollars in the future.

Indirect and overheads

- There are large differences in the indirect and overhead data presented in the documents used in developing the draft prices.
- The Nogoia Mackenzie bulk has an indirect and overhead cost of over 55% and the distribution is over 42%. Both of these are well above any of the data presented in the Deloitte report.
- By using all the data from the Deloitte and QCA reports you are able to establish;
 - SunWaters total indirect and overheads percentage of total costs is 34%.
 - Irrigation service contracts indirect and overheads percentage of total costs are 49%.
 - Other service contracts excluding irrigation service contracts indirect and overheads percentage of total costs are 24%.
- The data presented in the Deloitte's benchmarking of administration costs to compare SunWaters costs with PV water is vastly different to the data in QCA volume 1 draft prices table 7.3.

RECOMMENDATION: Accept Deloitte report and comment when benchmarking SunWater as a whole for indirect and overheads of 34% (SunWater generally benchmarks well against a peer of global utilities.) The cost of indirect and overheads to all service contracts to be set at 34% of total costs.

(Prices impact per ML/year) 34% indirect and overheads compared to 55% = - \$2.50

Market Risks Costs and Renewals Annuity Costs

- Both these costs items pose a large risk of costs blow outs to this scheme if left without a strong consultation process in place with customers who have to pay the cost.

RECOMMENDATION: QCA to recommend that any new cost item that has not been identified and costed as part of this review will require consultation with customers before the item is costed against the scheme.

(Prices impact per ML/year) \$2 500 000 over budget spend in renewals= - \$5.75

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Forecast Costs

SunWater's forecast total costs are well above the targets costs set for the current price path. The QCA draft report identifies the following significant differences between forecast and actual costs for all bulk and distribution schemes from 2007 to 2011 in 2010/11 dollars:

- Operations \$11.4 million or 16% less than forecast.
- Electricity \$15 million or 36.7% less than forecast.
- Preventive/Corrective Maintenance \$8.8 million or 17% over spend.
- Revenue offsets \$10.5 million or 250% over recovery.
- Indirect and overheads \$17 million or 19% over spend.
- Renewals annuity \$30.9 million or 80% over spend.

The end result sees the total of operations, preventive maintenance, corrective maintenance, indirect and overheads costs for 2011 (the last year) being \$12 million or 33.5% above the budget forecast agreed to by SunWater. QCA proposes that SunWater should improve its information systems but unless detailed reasons can be provided for these significant variations it is hard to have any confidence in moving forward into another price path relying on information provided by SunWater.

Emerald has forecast expenditure for the next 5 years 23.3% above the efficient costs set and agreed to by SunWater in 2005/6.

RECOMMENDATION: QCA assess SunWater's total costs on the forecast costs from the last price path until SunWater presents detailed data to explain the cost variations.

(Prices impact per ML per year) 23.3% less costs = - \$9.00

Renewals Annuity

- There has been a large over budget spend on renewals items without any consultation with customers and regard for the service requirement.
- This has led to a large increase in the yearly cost of the renewals Annuity.
- SunWater's large overspend on renewals over the last 5 years has been passed directly onto irrigators with the recommended prices, but the \$15 000 000 over budgeted requirement for electricity and the above budget recovery for revenue offsets of \$10 500 000 has not. QCA cannot allow cost blow outs above budget to be brought forward without allowing above budget revenue to be brought forward as well.
- It needs to be established how a pricing process can allow a scheme paying above lower bound during this price path to have a greatly reduced renewals annuity in the next. The bulk section of the scheme has a renewals account balance of negative \$1 279 000 when it paid over lower bound during this price path of over \$2 000 000 (irrigation use only).
- The renewals for distribution in the recommended costs is 26.5% above the submitted renewals cost from SunWater with QCA saying they reduced the renewals costs submitted by SunWater by 10% across non sampled items and with large sampled items removed all together.
- Sampled item in table 4.3 for the Nogoia Mackenzie has the cost comparison between SunWater and a contractor presented by a SKM the consultant. The consultant has failed to get the job location correct by calling it the right bank.

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- The consultant then goes on to apply a 10% surcharge on all the contractors' costs and then allocates SunWater an indirect cost of 45% of the contractors total costs including the 10% surcharge. The contractors cost still comes in under 8.5% of the cost SunWater has costed to the scheme. After reviewing the data presented in this table we have no choice but to question all the projects reviewed by the consultants.

RECOMMENDATIONS:

1. Review the pricing model to ensure all efficiencies identified flow onto prices.
2. If QCA is going to allow over spends on cost items in the last price path to be transferred through to new price path then all revenue above budget also needs to be brought forward.
3. A more optimised approach to future renewals spends is required to ensure the renewal doesn't exceed the requirement and therefore exceed the customers' ability to pay for the service.
4. The above lower bound margin recovered during this price path must be offset against overspend in renewals.
5. QCA revisit the requirement for post winter flows and the infrastructure costs attributed to achieving this discharge.

**(Prices impact per ML/year) Negative renewals balance when paying above lower bound
= - \$1.20**

Minimum Charges

- Minimum charges are becoming more important as schemes become affected by urban encroachment. It is important that QCA ensures the current fee covers the cost of servicing these users without passing extra costs onto other users.
- Minimum charges should be established by identifying the costs of metering, billing and customer communications.
- The cost items above should only be charged once as they are only incurred once. QCA has not delivered a process that ensures the doubling up of these costs for distribution customers.

RECOMMENDATIONS:

1. QCA recommend that SunWater produce the data for cost of metering, billing and customer communications to establish the minimum cost of servicing a customer.
2. The cost of metering, billing and customer communication only to be charged once to distribution customers not twice as is the case in the current QCA recommendation with the splitting of bulk and distribution.
3. The minimum charge to only be applied to bulk ensuring no doubling up.
4. Minimum charges that are greater than per ML charge need to be added as revenue offset. Estimated total of over \$20 000.
5. The minimum cost of servicing a customer should be removed from distribution costs.

(Prices impact per ML/ year) Minimum charges not being applied as revenue offsets as well as distribution customers paying for metering and billing twice = - \$1.25

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New Water

- The QCA report states under 2.3 Survive delivery Frame work. (However existing customers do not bear the costs of increased or surplus Headworks capacity if SunWater undertakes investment to increase water storage. Rather the owner of any new WAE derived benefit from new assets.) Do issues like channel lining and the bags on the weirs fall with in this recommendation?
- The above quote from the report is in direct contrast to other sections of recommended prices allowing SunWater to charge for the costs of establishing, repairs and renewals of channel lining and Weir augmentation projects across all users when SunWater is the one who gained ownership of the WAE brought about by the projects.

RECOMMENDATIONS:

1. **Any works that is costed to the scheme that brings about new WAE must have the value of the WAE offset against the cost and can only be costed to the scheme with full consultation with customers before starting the works.**
2. **All WAE value or revenue brought about by past expenditure which has created new WAE must be returned to the scheme as revenue before any renewals costs can be attributed to these projects.**
3. **Projects like channel lining cannot be covered by renewals annuity without the value of the WAE gained being offset against the cost, repair and renewal of it.**

(Prices impact per ML/ year) Channel lining projects returns = -\$2.50

Recreational Facilities

- The recreational facilities of this scheme have a very high usage and are an important draw card to this area. The cost of maintaining these facilities is recommended to be covered by water users adding a cost of up to \$400 000 per year or as much as \$2.00 per ML. No accurate data has been provided on revenue gained by providing other services from this cost item including: water and sewage to education facilities, private houses and Caravan Park. The cost of delivering these services needs to be identified and returned to scheme as revenue offsets.
- The current Government has declared that recreational facilities are to be included into the cost of having water storages. The question is, has this dam become a dam for recreational purposes with water use a secondary benefit? At some point someone has to decide if this recreational facility is being utilised beyond its design and capacity therefore exceeding Government policy intent with irrigators carrying the cost.

RECOMMENDATIONS:

1. **QCA to review the intent of Government policy.**
2. **The cost of recreation facility to be allocated on a more user pays approach. This could be achieved by allocating costs based on use between irrigation users and urban and industrial users.**
3. **A detailed review of the service requirement of the recreation facility on its own, with a cost established for that requirement only.**

(Prices impact per ML/ year) All facilities revenue to be offsets against cost = - \$1.00

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Prices cannot come down policy

- If prices are above lower bound for this price path because of Government policy and costs have exceeded the budget, why is the over budget cost being carried forward into the next price path instead of coming of the above lower bound component of this price path.
- HP distribution irrigators under the current price path are being charged to have their water delivered 2.5 times per year in the channel when that is clearly not the case. The HP WAE was transferred into the channel at a time when the channel was already operating above design capacity and therefore had no peak flow entitlement. This has all been identified in the draft report from QCA, but because of the policy from Government the mistakes from the past are being carried forward. This issue was brought to SunWaters attention 12 months ago with SunWater responding by saying it would be addressed in the next price path. The QCA draft report is not dealing with the issue in recommended prices for HP distribution WAE.

RECOMMENDATIONS:

1. All identified above lower bound schemes in this price path are not to have a reduced renewals annuity from budgets set in 2005/6 moving into the next price path.
2. Exceptions have to be made in regards to Government policy for HP distribution WAE. The intent of the policy was surely not to have mistakes made in pricing continually carried forward.

(Prices impact per ML/ year) The difference between cost reflective and recommended
= - \$2.90

Largest impacts on increased costs to Irrigators

1. Bulk costs for Losses WAE.
2. Low water use and no operational changes to reflect usage.
3. Incorrect water use numbers for distribution.
4. Model used to establish prices incorrect.
5. Large indirect and overhead charges of up to 55% of total costs.
6. Large over spends on renewals making renewals annuity costs one of the biggest cost items for this scheme.
7. No flow on in reduced costs from the efficiencies set at last pricing process. Total costs for irrigation service contracts are 25% above the efficiencies set and agreed to at the last pricing process.
8. Lack of transparency and consultation by SunWater throughout the current price path and throughout this pricing review process.
9. Government policy on the price of water cannot go down.
10. No offset to costs from other revenue streams.