Cotton Australia

QCA Draft Report

St George Bulk and Distribution Scheme Submission

Thank you for the opportunity in allowing Cotton Australia to Submit on behalf of the irrigators with in the St George 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.

The lack of consultation between consultants and irrigators has led to no understanding of the scheme and comments in the report from GHD that quote (GHD further advised that as the scheme is a continuous share scheme, daily variation of flows and releases are required to fulfil customer orders.)   Daily variations of flows are required regardless of this being a continuous sharing scheme.

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.**

Fixed and Variable costs

- Electricity costs were over forecasted well in excess of use in the last price path leaving irrigators questioning any data produced by SunWater on electricity costs.
- Distribution fixed and variable total costs for 2012/13:
  - 84% fixed $1 244 880 /WAE MP 50788 = $24.51 not $27.51 Cost reflective in report.
  - 16% variable $237 120 /water use (93.4%x 50788ML) 47436ML = $5.00 not $5.33Cost reflective in report.
- Bulk fixed and variable total costs for 2012/13
  - 95% fixed $1 530 450 / WAE 84575ML= $18.10 not $18.20 cost reflective in report.
  - 5% variable $80 550 / water use (94.2% x 84575ML) 79669ML = $1.01 not $1.06 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 detail review of the model used to establish prices.**
2. **Electricity costs must be based on actual costs paid in arrears not forecasts.**

(Prices impact per ML/year) Modelled cost reflective price compared to calculated = $3.50

Termination Fees

- The fall out of the comments above is the termination fees. The recommended fees are up to $400.00 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.

- This means if all distribution customers were to exit the total termination fees would exceed $24 000 000 and at 5% interest SunWater would recover more than the yearly fixed cost without providing any service. With those numbers there is no incentive for SunWater to look after the customers it services.

- 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.

- QCA is recommending termination fees for this price path only, at this stage SunWater can still collect the termination fees and for the next price path allocate the costs over a smaller customer base, profiting from the termination fees paid and leaving irrigators with the extra cost.

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.**
3. **The customer base used to set this price path must be the base carried forward beyond this price path unless all termination fees are declared as revenue offsets.**

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 revenue from the water harvesting fee must be recorded as 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.

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. **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.**

Distribution Losses

- The allocation of losses WAE bulk costs to distribution has added to the fixed costs for losses above actual use by $196 000 per year or $3.85/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.

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. **All losses WAE to be treated as distribution WAE with a spread of distribution costs across the total of distribution allocation including losses allocation.**

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.

<u>RECOMMENDATION</u>: 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 St George bulk has an indirect and overhead cost of over 55% and the distribution is over 49%. 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.

<u>RECOMMENDATION</u>: 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% = - $3.80

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.

<u>RECOMMENDATION</u>: 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.

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 19.2% above the efficient controllable 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) 19.2% less costs = - $8.64

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.
- SunWaters 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 distribution section of the scheme has a renewals account balance of negative $1 308 000 when it paid over lower bound during this price path.

.

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**.

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 off 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 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 $10 000.**
5. **The minimum cost of servicing a customer should be removed from distribution costs.**

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.**

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 $100 000 per year or as much as $1.20 per ML.
- The current Government has declared that recreational facilities are to be included into the cost of having water storages. The question is has this storage become a storage 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.

<u>**RECOMMENDATIONS**</u>:

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 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.

<u>**RECOMMENDATION**</u>: **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.**

Largest impacts on increased costs to Irrigators

1. **Bulk costs for Losses WAE.**
2. **Model used to establish prices incorrect.**
3. **Electricity cost escalation in pricing model.**
4. **Large indirect and overhead charges of up to 55% of total costs.**
5. **Large over spends on renewals making renewals annuity costs one of the biggest cost items for this scheme.**
6. **No flow on in reduced costs from the efficiencies set at last pricing process. Total costs for irrigation service contracts are 33% above the efficiencies set and agreed to at the last pricing process.**
7. **Lack of transparency and consultation by SunWater throughout the current price path and throughout this pricing review process.**
8. **No offset to costs from other revenue streams.**
9. **Large costs attributed to the cost of continuous accounting without details of where the costs are.**

Efficiencies

Overall irrigation customers do not consider that the costs of servicing the distribution scheme have been justified by SunWater. They particularly question the abnormally high indirect/overhead costs and operating costs. Going forward they believe that efficiencies in this scheme will only be achieved through more local involvement in management.