29th November 2010

Water Submissions (SunWater)
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear QCA

RE: The Maryborough Sugar Factory Limited's submission to QCA – Irrigation Prices for SunWater Schemes 2011-2016

The Maryborough Sugar Factory Limited (MSF) is an integrated sugar sector agricultural company with a history stretching back to 1886. The majority of our cane growing is conducted in the Maryborough Region where MSF currently owns 5,418 hectares of land complemented by 7,504 ML of medium priority water allocation in the Lower Mary water supply scheme. In addition, MSF owns 69 hectares of land in the Isis district supported by 146 ML of medium priority water allocation in the Bundaberg water supply scheme.

MSF understands the requirement for adequate revenue for the ongoing viability of SunWater and provision of water supply schemes (WSS). However, it appears there is a difference in opinion of adequate revenue for ongoing viability between irrigation customers and the government. Not only does SunWater need to be viable into the future but irrigation customers also need to be viable into the future, it is a symbiotic relationship. This obviously varies in different water supply schemes depending on the customer structure and competition for water. The majority of customers in the Lower Mary WSS are irrigation customers and there will be increased urban and industrial demand in the future, however, it is considered that irrigation customers will continue to play an important role in the Lower Mary WSS.

The Minister's Referral Notice requires that bulk water supply and channel prices/tariff structures are set to provide a revenue stream that allows SunWater to recover:

- Its efficient operational, maintenance and administrative costs
- Its expenditure on renewing and rehabilitating existing assets, whether through a renewals annuity or a regulatory depreciation allowance
- A rate of return on assets valued at 1 July 2011 (the initial regulated asset base – RAB)
- After 1 July 2011, a return of and on prudent capital expenditure to augment existing assets or construct new assets.

MSF does not support the government seeking a rate of return on assets valued at 1 July 2011 (the initial regulated asset base – RAB) and the movement of pricing from lower bound towards upper bound pricing.

Is there adequate cost information available on SunWater schemes to determine the efficient operational, maintenance and administrative costs? The Issue Paper from Synergies on Rural Water Pricing Business & Scheme – Overview (Jan 10) stated for the Lower Mary:

> *Cost structure*
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> There is no discrete information available on the cost structure of the Lower Mary WSS from the various documents prepared for the price paths, as this scheme's costs were reported inclusive of the Upper Mary, which has since been transferred to Seqwater.

Scope of issues paper - Form of regulation:

- From the issue paper it does not appear that the choice between a revenue or price cap is that great and that the most important thing is to know the costs to align tariffs. This is where transparency is required for the irrigation customer to understand the cost of the water supply scheme. We understand that forecasting irrigation water demand is extremely difficult and variable and that is why it is essential, as with any business, to understand the fixed and variable costs in different scenarios and to price irrigation water accordingly.
- As mentioned previously MSF understands the requirement for SunWater to have some certainty of revenue it is just the level of revenue and level of certainty that is under debate at this point in time and the level of risk that SunWater and the customer should share. If SunWater is to have revenue certainty by increasing fixed charges or applying a revenue cap this should be reflected in lower water pricing to customers to reduce the risk to the customer.

Scope of issues paper – Tariff Structure
Currently 70% Part A fixed charge and 30% Part B variable charge.

- Clearly MSF would prefer greater consumption based pricing (as per NWI 2004 directive). As an irrigator we would prefer prices being low most of the time and high when capacity constraints apply. Consumption based pricing also provides incentive for water use efficiency (i.e. increased investment in more efficient irrigation systems) and water conservation by the irrigation customer. However, as mentioned previously we understand the requirement for cost recovery and a certain level of revenue stability for SunWater for the Lower Mary WSS to continue to supply the water requirements of the Fraser Coast Region and that is why we feel it is extremely important to identify relevant costs to establish the appropriate tariff structure and level (pricing) of tariffs.
- MSF support the continued application of postage stamp pricing to irrigation water – no differentiation within tariff groups. Maintain the same for each user irrespective of nominal allocation, water use or demand distribution and agrees this is more consistent with capacity-to-pay of all users within the scheme. MSF does support the differentiation between river and channel/pipeline tariffs (locational tariffs).
- 2006-11 used CPI as escalation factor but they did consider using a composite index that was weighted to account for SunWater's actual cost structure. MSF supports the continued use of CPI to apply indexation.
- MSF supports the use of the previous 7 years water usage patterns to compare with water use forecasts for pricing decisions.

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- Recreational costs – 2006-11 price review determined average irrigation customers' share included in lower bound costs for calculation of the new irrigation price path was 37 cents per mega litre. MSF does not support the inclusion of recreational facilities costs in the SunWater cost base to be recovered from irrigators. This cost should be passed onto State or Local Government or be user pays as it benefits more than irrigation customers. The Lower Mary WSS also has minimal recreational facilities, so is this cost determined on a WSS level if it is to be included in the cost base (i.e. different for each individual WSS)?
- It is mentioned in the Tariff structure issues paper that future pricing structure should aid users decisions as to whether to consume water. MSF takes irrigation water consumption decisions very seriously as the pricing of irrigation water is only part of our cost and the labour, pumping costs (electricity), and capital invested in plant and equipment to irrigate ensure water use is efficient. Currently a 30% variable charge (Part B) does not influence our decision whether to apply irrigation water or not.
- MSF considers the tariff structure does not need to be consistent across the various water supply schemes within Queensland as they are all different and can be treated differently.

Scope of issues paper – Capital Cost Allocation

- High priority water is less than 10% in the Lower Mary WSS. MSF supports that high priority entitlement holders are apportioned a higher share of capital costs per ML of entitlement.
- MSF understands HUFs are to allocate capital costs only and not operating costs. MSF was interested to see the HUF that was being proposed to replace the water pricing conversion factor for the Lower Mary WSS. However, even though the SunWater Headworks Utilisation Factors – Technical Paper (3/9/10) was referred to in the issue paper it could not be obtained from SunWater or QCA to view. It was adequately explained by QCA why we could not view the technical paper, due to government related policy issues. Having none or only high level information that is difficult to understand on an irrigation customer level makes it exceptionally difficult to comment on the issues paper. It would have been courteous to provide some lower level explanation and worked examples to demonstrate the impact of some of the proposed pricing tools/regulation in order for us to present a well understood and informed opinion on the issues papers.

Scope of issues paper – Rate of Return

- As mentioned previously MSF does not support the government seeking a rate of return on assets valued at 1 July 2011 (the initial regulated asset base – RAB).
- MSF understands the issue paper concludes that a single weighted average cost of capital (WACC) should be established for all SunWater assets.
- MSF was interested to know for the Lower Mary WSS what particular channel distribution systems assets would be valued at zero and what assets would be given a value, however, MSF was unable to obtain this information. Knowledge of the capital value would again assist in forming an opinion.
- The Lower Mary WSS does not have large headworks as it only has ponded storage with the Mary Barrage and Tinana Barrage and this should be considered when determining initial RAB. Historical capital investment by SunWater was not necessarily consulted with customers and it is felt some of the Lower Mary WSS is overdesigned (for example, Owanyilla pumping station). This should also be taken

into consideration when determining the initial RAB for irrigation supply assets in the Lower Mary WSS.

Scope if issues paper – Asset Consumption

- As far as MSF is aware the Lower Mary WSS has reached lower bound pricing in the current price path.
- It is understood SunWater want to continue the renewals annuity regime. If SunWater wants to achieve a commercial return on assets then they should adopt a regulatory depreciation approach and fund capital requirements through debt or equity and then recover over time. If SunWater were to continue the renewals annuity regime they could not also get return on this capital as it would be double dipping as the capital would have been funded by the irrigation customers to begin with.
- If SunWater wants to continue with a renewals annuity regime then the asset management plan (AMP) needs to be available for customer scrutiny so that there is consultation on renewals expenditure. The AMP should have transparency for economic efficiency and investment decisions. Currently MSF has not seen an AMP for the Lower Mary WSS for at least the last five years. The network service plan (NSP) should also be consulted with customers so that the quality of service and the standard of upgrades customers are prepared to fund are agreed upon.
- As mentioned in the Rate of Return response historical investment decisions have not necessarily been in consultation with irrigation customers. The balance of the Lower Mary sinking fund as presented in graph format on page 79 on the SunWater 2009/10 annual report was approximately -$830,000. MSF, a large irrigation customer of the Lower Mary WSS, was not even aware this was the case. MSF and other irrigation customers need to be consulted with the long term forecasts or renewals expenditure that are critical to annuity calculation.
- If SunWater does proceed with seeking a return on capital then it will have to be ensured that the initial RAB only has "original" capital included and no expenditure financed by renewals annuity included.
- If there is a transition to a depreciation based RAB pricing approach then SunWater or the government should top up sinking funds (i.e. -$830,000 Lower Mary WSS sinking fund) rather than a one off or recovery over time with increased price from irrigation customers due to the nature of historical investment decisions and lack of consultation. MSF would not want to capitalise this $830k into RAB for future recovery through depreciation and pay return on this capital.
- MSF is also not aware if SunWater is proposing a change in cost structure in the network service plan for the Lower Mary WSS. A change in cost structure would impact on irrigation water pricing.

MSF has not provided any response to the Funding of Spillway Upgrades issue paper as this is not relevant to the Lower Mary WSS at this point in time.

MSF has also not provided any response on the Capacity to Pay Issue Paper as it has not been released for comment on the QCA website. MSF would like to respond to this issue paper when it is released for comment. Even though MSF does not necessarily support the concept of capacity to pay, MSF would be willing to provide access to our cost of production figures to assist with assessment of capacity to pay.

In conclusion, it is exceptionally difficult to comment on the issues papers when we are not aware of:

- SunWater's efficient operational, maintenance and administrative costs in relation to the Lower Mary WSS,
- Capital to be valued in the Lower Mary WSS for a rate of return on assets,
- Expected rate of return on assets,
- The network service plan - planned expenditure on renewing and rehabilitating existing assets (maintenance and investment program)

Evidently we can comment on the concepts that we understand, however, it is very difficult to form an opinion when one does not know the impact the above points will have on irrigation water pricing in the Lower Mary WSS.

MSF requires SunWater to be viable to continue the provision of the Lower Mary WSS as MSF has significant investment that relies upon the availability and utilisation of irrigation water.

MSF would appreciate continued consultation in relation to the pricing of irrigation water for 2011-2016.

If you would like to discuss any of the responses please do not hesitate to contact myself on 4121 1153 or 0427 017 508.

Yours sincerely

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The Maryborough Sugar Factory Limited