Submission

QCA Review of Irrigation Prices 2013-17

Response to Draft Report

22 February 2013

1 Introduction

The QCA has been directed to recommend irrigation prices for the Queensland Bulk Water Supply Authority (Seqwater) water supply schemes for the period 1 July 2013 to 30 June 2017. The QCA released its Draft Report in December, 2012 and has called for submissions by 22 February 2013.

Seqwater has reviewed the Draft Report and accepts many of the QCA's recommendations. For those recommendations with which Seqwater does not agree, this submission sets out Seqwater's responses.

This response from Seqwater to the Draft Report is structured as follows:

- Section 2 sets out each recommendation and Seqwater's response in a tabular fashion;
- Section 3 responds to matters in Volume 1 of the Draft Report that are not included in recommendations; and
- Section 4 responds to matters in Volume 2 of the Draft Report.

2 Response to Recommendations

Reference	QCA Draft Recommendation	Seqwater Response
Volume 1, page 30	The Authority recommends that short term volume risk should be assigned to customers through a tariff structure that recovers fixed costs through fixed charges and any and all variable costs through volumetric charges.	Seqwater concurs with this recommendation. This is as per Seqwater's submission.
	Fixed costs should be allocated to customers on the basis of nominal volumes or in the case of Central Lockyer Valley WSS, the fixed charge in the Central Lockyer Valley WSS should be estimated on the basis of the number of ML allocated to the scheme and not be applied until permanently tradable water allocations are in place.	Seqwater concurs with this recommendation except for Central Lockyer Valley WSS where, in the absence of a fixed charge, Seqwater requires an assurance that the fixed charges not applied will be recoverable through a CSO agreement. According to Table 6.6 on page 130 of the Draft Report Volume 2 Central Lockyer Valley Water Supply Scheme, the medium priority irrigation share of fixed revenue requirement in 2013-14 is $952,000.
	The Authority also recommends that: (a) DNRM should ensure that permanently tradeable water allocations be in place for every Seqwater irrigation customer by 30 June 2015; (b) to facilitate (a), DNRM should finalise	Seqwater concurs with this recommendation. However, Seqwater questions whether this can be realistically achieved for Central Lockyer Valley WSS in this timeframe. Seqwater concurs with this

	relevant ROPs (or sections of ROPs); and (c) Seqwater should bear the costs of surrendered IWA and water licences (as proposed by Seqwater).	recommendation. Seqwater concurs with this recommendation.
Volume 1, page 34	The Authority recommends that Seqwater bear the risks, and benefits, from the revenues associated with reducing distribution system (and where relevant, bulk) losses, where WAE may be permanently traded. Other long term volume risks should not be the responsibility of Seqwater.	Seqwater concurs with this recommendation. Seqwater concurs with this recommendation.
Volume 1, page 34	The Authority recommends that Seqwater bear the risks, and benefits, from the revenues associated with reducing distribution system (and where relevant, bulk) losses, where WAE may be permanently traded. Other long term volume risks should not be the responsibility of Seqwater.	Seqwater concurs with this recommendation. Seqwater concurs with this recommendation.
Volume 1, page 43	The Authority recommends that: (a) end-of-period adjustments, price review triggers or cost pass-through mechanisms be used to manage risks due to market conditions for inputs and regulatory imposts; (b) prudent and efficient forecast electricity costs should be incorporated in recommended prices and any material variations to forecasts considered as part of an end of period adjustment; (c) in relation to off stream storage pumping costs incurred in a manner that does not relate to meeting customer demand (water use), Seqwater should apply for an end of period adjustment for any material variation to the nominated amount which has been incorporated in costs; and (d) to support any application for an end of period adjustment (for material variations in fixed electricity pumping costs associated with off-stream storages) Seqwater must retain records of actual pumped volumes and costs over the 2013-17 regulatory period.	 (a) Seqwater concurs with this recommendation. (b) Seqwater concurs with this recommendation. (c) Seqwater concurs with this recommendation. (d) Seqwater concurs with this recommendation.

Volume 1, page 66	(a) The tariff structure should consist of a volumetric charge which should recover all (and only) variable costs associated with the delivery of water services. The fixed charge should reflect the balance of revenues required to maintain Seqwater's revenue requirement. (b) Variable costs should reflect those costs which are expected to vary with water usage over the four-year regulatory period. (c) An unbundled tariff structure should apply to distribution systems (that is, Morton Vale Pipeline and Pie Creek tariff groups). (d) The appropriateness of current legislative and contractual arrangements, insofar as they relate to schemes where water deliveries fall below expectations for a sustained period due to a lack of supply, is a matter for Government.	Seqwater concurs with this recommendation. Seqwater concurs with this recommendation. Seqwater concurs with the thrust of this recommendation. However, Seqwater maintains its position that Pie Creek, being a ROP zone is more in the nature of a supplemented stream and not a distribution system. Seqwater concurs that this is a matter for Government policy.
Volume 1, page 74	(a) DNRM review and determine the efficient level of all bulk and distribution loss WAE to ensure that bulk and distribution system customers do not pay for loss WAEs held by Seqwater in excess of requirements (including for Pie Creek tariff group). The review should be completed by 30 June 2015. (b) Prudent and efficient bulk costs associated with necessary (efficient) bulk loss WAE be recovered from Seqwater's bulk customers according to their WAE. (c) Prudent and efficient bulk costs associated with necessary (efficient) distribution loss WAE be recovered from Seqwater's distribution system customers according to their WAE. (d) The costs of (any) inefficient loss WAE identified by DNRM, should not be borne by customers and should instead be borne by Seqwater. Depending on	Whilst Seqwater agrees in principle with this recommendation, this review should only occur for those schemes that are subject to a ROP. For the schemes currently subject to an IROL, the review should be carried out in conjunction with the development of a ROP or amendment to a ROP. This is needed so that Seqwater is able to trade any excess loss WAE. Seqwater concurs with this recommendation. Seqwater concurs with this recommendation. Seqwater concurs with this recommendation subject to ROP's being in place for schemes currently under an IROL.

	materiality, the impact of the identified inefficiencies may be considered by the Authority (from 1 July 2015) via a within or end of period adjustment to prices in bulk or distribution tariff groups.	
Volume 1, page 79	(a) Seqwater's termination fees should be calculated as a multiple of up to 11 times (including GST) the relevant (Part C) fixed cost-reflective tariff. Such an arrangement could also be negotiated for Morton Vale Pipeline customers. (b) A lower multiple could be applied at Seqwater's discretion should it be consistent with Seqwater's commercial interests (e.g. for example, in the interests of more efficient system management). (c) Seqwater should never recover the balance of any shortfall (in fixed cost revenue) from remaining customers, resulting from the exit of other customers (or from exit of Seqwater held WAE upon conversion from distribution loss WAE to other WAE).	Seqwater concurs with this recommendation, noting that in the case of the Morton Vale Pipeline this is a variation from the pre-existing contractual arrangements for breach of contract. Seqwater agrees that it should have some measure of discretion noting that the goal of cost recovery remains paramount. Seqwater agrees this should be an underlying principle.
Volume 1, page 100	The Authority recommends opening ARR balances for 2013-17 as per Table 5.9.	Seqwater concurs with this recommendation.
Volume 1, page 105	The Authority recommends that Seqwater implement the improvements to its renewals planning and processes as outlined in the SKM Final Report by 30 June 2015.	Seqwater expects to achieve its planning process objectives along similar lines to those recommended by SKM by 30 June 2015.
Volume 1, page 108	The Authority recommends that by 30 June 2015, Seqwater adopt modern equivalent replacement costs and/or more specific asset class indices, as appropriate, when preparing detailed options analysis of material items forecast for Years 1-5 of the next regulatory period, high-level options analysis for material items forecast for Year 6 onwards and for all other (non-material) forecast renewals expenditures.	While Seqwater accepts that opportunities for improvements should be explored however it should not be bound to a specific methodology without giving each item due consideration. No evidence whatsoever was provided by SKM to support their view that "the escalation indices developed by Cardno are likely to overstate replacement costs rather than understate them". Seqwater prefers to rely on sound empirical evidence rather than suppositions and undertakes to investigate all options in more detail. Seqwater submits that it should have the right to adopt the preferred outcome which may be the current approach.
	The Authority also recommends that in response to this Draft Report, Seqwater	Seqwater does not agree with this recommendation as it pre-supposes an

	submit a proposal to the Authority by 22 February 2013 on the assets to which it would be appropriate to apply a modern equivalent replacement costs versus specific asset class indices.	outcome. As stated above, Seqwater wishes to further investigate all options and should not be bound to adopt those recommendations unless they are proven beyond doubt to be beneficial or even necessary.
Volume 1, page 121	The Authority recommends that: (a) cost savings identified by the Authority (see Volume 2) be incorporated in cost-reflective prices; and (b) for unsampled forecast renewals expenditure items, a cost saving of 13% be applied to Seqwater's proposed costs.	The cost savings of 13% includes an amount of $0.344M for the refurbishment of observation bores in Lower Lockyer Valley WSS. The bores and the circumstances surrounding their inclusion in the renewals estimates are unique to Lower Lockyer. Therefore Seqwater submits that the savings should not be applied to unsampled forecast renewals expenditure as there is no real or implied application between the observation bores and the disclosed, albeit unsampled, renewals expenditure forecast items across all schemes. The application of the observation bores cost savings to the unsampled renewals items is therefore speculative. The result is a lower renewal annuity as otherwise nominally prudent and efficient expenditure has been reduced. This disadvantages customers because the ARR funding provided by the annuity is then less than optimal resulting in transference of costs to the next price path through diminished surplus or deficit ARR balances at the end of the regulatory period.
Volume 1, page 123	The Authority recommends that, in forecasting renewals expenditure, Seqwater undertake: (a) high-level options analysis for all material renewals expenditures expected to occur over the Authority's recommended planning period, with a material renewal expenditure being defined as one which accounts for 10% or more in present value terms of total forecast renewals expenditure; and (b) detailed options analysis (which also take into account trade-offs and impacts on operational expenditures) for all material renewals expenditures expected to occur within the subsequent five-year regulatory period, with a material renewal expenditure being defined as one which accounts	In response to these recommendations, Seqwater commissioned Cardno to provide an independent estimate of the costs of undertaking both the high-level options analysis and the detailed options analysis. Applying the QCA's threshold of 10% or more in present value terms of total forecast renewals expenditure, Cardno examined the renewals items that would need to be reviewed and estimated the annual cost of performing options analysis at $217,481. It is important to note that savings equal to the cost must be produced by carrying out

	for 10% or more in present value terms of total forecast renewals expenditure over that period.	high-level options analyses before customers benefit from incurring the additional costs. Seqwater notes that no evidence has been provided to show that carrying out high-level analyses over periods of up to 20 years will produce such savings and therefore be cost effective for customers. Seqwater also notes that if the cost estimates for the 20 year planning period outside of the price path were to be assessed as "reasonable" instead of "prudent and efficient", then the additional costs of undertaking high-level options analyses could potentially be avoided thus saving customers additional costs.
Volume 1, page 130	The Authority recommends that a 20-year planning period be adopted, as proposed by Seqwater.	Seqwater concurs with this recommendation.
	The Authority also recommends that the length of the planning period be revisited in subsequent price reviews (or as a result of a price trigger) should problems of intergenerational equity arise as a result of significant capital expenditure proposals.	Seqwater concurs with this recommendation.
Volume 1, page 135	The Authority recommends that Seqwater's Strategic and Operational Plans and relevant legislation be amended to require Seqwater to consult with customers in relation to, and publish annually on its website, updated NSPs commencing prior to 30 June 2014.	Seqwater notes that the *South East Queensland Water (Restructuring) Act 2007* provides, in section 51A, for the responsible Ministers to issue a "Statement of Obligations" to Seqwater. Section 51C provides for the inclusion of provisions about customer consultation. A Statement of Obligations, containing a requirement to consult with its customers, is in the process of being issued to Seqwater. It is expected that the Statement of Obligations will be made publicly available on Seqwater's website. Seqwater therefore submits that the outcomes of this recommendation are already substantially in place. Seqwater will update and publish the NSPs.
	The NSPs should be enhanced to present: (a) high level options analysis for all material renewals expenditures expected to occur over the Authority's recommended planning period; (b) detailed options analysis for all material renewals expenditures expected to occur within the subsequent five-year regulatory period; and	Seqwater will enhance the NSPs to present more fulsome renewals information as detailed in this recommendation. It is estimated this will cost in the order of $24,000 to undertake this task.

	(c) details of Seqwater's proposed renewals expenditure items and accounting for significant variances between previously forecast and actual material renewals expenditure items.	
	Customers' submissions in response to the NSPs and annual updates should also be published on Seqwater's website alongside Seqwater's responses and related decisions.	Seqwater will comply with this recommendation.
Volume 1, page 150	The Authority recommends that, consistent with Table 5.23, for the allocation of fixed bulk (non-metering) renewals costs: (a) Seqwater's HUF methodology be adopted for Logan, Mary Valley and Warrill Valley WSSs; (b) the Authority's estimate of adjusted nominal WAE, in Central Brisbane River WSS; and (c) nominal medium priority WAE be adopted in Cedar Pocket Dam, Central Lockyer Valley and Lower Lockyer Valley WSSs.	Seqwater concurs with these recommendations.
	The Authority also recommends that the prudent and efficient irrigation metering costs forecast for each tariff group (over the Authority's recommended renewals planning period) be recovered exclusively from irrigation customers in that tariff group via the renewals annuity. Such costs should be allocated on the basis of nominal irrigation customer WAE.	Seqwater concurs with this recommendation.
Volume 1, page 153	The Authority recommends that nominal WAEs be used for the allocation of fixed distribution system costs between priority groups. Fixed distribution system charges should remain with customers if they convert between priority groups.	Seqwater concurs with this recommendation.
	The Authority recommends that, at the conclusion of the review recommended by the Authority for SunWater, Seqwater should, for subsequent regulatory periods, adopt the relevant outcomes.	Seqwater will review the outcome of the SunWater review with a view to applying the findings to the extent that is relevant and practicable.
Volume 1, page 155	The Authority recommends that Seqwater calculates its renewals annuities indexed annually by the general rate of inflation.	Seqwater concurs with this recommendation.
	The Authority also recommends that for the purpose of calculating renewals annuities, prudent and efficient renewals expenditure be escalated by: (a) 4% per annum over the regulatory period (2013-17); and	Seqwater concurs with these recommendations.

	(b) 2.5% per annum thereafter for the recommended renewals planning period.	
Volume 1, page 156	The Authority recommends that Seqwater's annual rolling annuity calculation be applied.	Seqwater concurs with this recommendation.
	The Authority recommends the adoption of the proposed all sectors (including urban, industrial and irrigation) renewals annuities presented in Table 5.25.	Refer Vol 1 page 121 recommendation response above.
Volume 1, page 172	The Authority recommends that Seqwater: (a) upgrade its policies, procedures, and information systems for the budgeting, incurrence and management of operating costs in its irrigation sector. In particular, the gathering, recording, documentation and analysis of operating cost information relevant to Seqwater's irrigation sector needs to be improved;	Seqwater has commenced to make improvements in this area and will continue to upgrade its recording and reporting processes.
	(b) publish on its website annually updated NSPs containing operating (and renewals) information along with stakeholder submissions and Seqwater's responses. The NSPs should also be enhanced to present details of Seqwater's proposed operating expenditure for the next year, and to account for significant variances between previously forecast and actual operating expenditure; and	Seqwater will update and publish the NSPs each year including the additional disclosures as recommended. The cost of undertaking these tasks is included in the estimate of $24,000 provided above.
	(c) should submit its proposals, in relation to the above matters, for consideration by the Authority by 30 June 2014 and implement the agreed improvements by 30 June 2015.	This is considered to be sufficient time to develop and submit proposals to satisfy these recommendations. Seqwater notes however that the first recommendation on page 135 of the Volume 1 draft report requires NSPs to be updated and published before 30 June 2014 whereas this recommendation requires submission of a proposal by 30 June 2014 and publication by 30 June 2015. Seqwater requests clarification of the targets and dates.
	As for renewals costs, the Authority also recommends that Seqwater's Strategic and Operational Plans (and relevant legislation) be amended to require Seqwater to consult with customers in relation to forecast and actual operating expenditure.	As stated above, Seqwater notes that the *South East Queensland Water (Restructuring) Act 2007* provides, in section 51A, for the responsible Ministers to issue a "Statement of Obligations" to Seqwater. Section 51C provides for the inclusion of provisions about customer consultation. A Statement of Obligations, containing a requirement to consult with its customers, is in the process of being

		issued to Seqwater. It is expected that the Statement of Obligations will be made publicly available on Seqwater's website. The estimated cost of providing this consultation is included in the estimates for providing renewals consultation above.
Volume 1, page 183	The Authority recommends that: (a) Seqwater's prudent and efficient direct operating costs for 2012-13 should be reduced to $11.2 million; and (b) Seqwater's forecast direct operating costs for 2013-17 (excluding rates and fixed electricity) should be further reduced by a general productivity gain of 1.5% per annum, for each of the four years of the regulatory period, applied cumulatively.	Seqwater has submitted that a number of direct costs are understated and requests they be amended (see below). Seqwater disagrees with the concept of the productivity gain on the basis that no evidence of the need to impose the productivity gain was provided.
Volume 1, page 189	The Authority recommends that Seqwater's : (a) forecast prudent and efficient non-direct operating costs for 2012-13 should be reduced to $9.1 million; and (b) non-direct operating costs be reduced by 1.5% per annum for each year of the 2013-17 regulatory period, applied cumulatively.	As stated above, Seqwater has submitted that a number of direct costs are understated and requests they be amended. This may alter the allocation of non-direct operating costs. Seqwater disagrees with the concept of the productivity gain on the basis that no evidence of the need to impose the productivity gain was provided.
Volume 1, page 193	The Authority recommends that Seqwater should allocate non-direct operating costs (excluding insurance) to irrigation tariff groups on the basis of total direct costs (TDC).	Seqwater concurs with this recommendation. This is Seqwater's currently adopted process.
	Insurance costs should be allocated on the basis of the replacement value of the insured assets (as recommended by Seqwater).	Seqwater concurs with this recommendation. This is Seqwater's currently adopted process.
Volume 1, page 195	The Authority recommends, that for the Logan River, Mary Valley and Warrill Valley tariff groups: (a) fixed repairs and maintenance costs be allocated to medium and high priority customers using HUFs; and (b) all other fixed operating costs (including insurance premium costs) be allocated 50% using HUFs and 50% using current nominal WAEs.	Seqwater concurs with this recommendation. This is Seqwater's currently adopted process. Seqwater concurs with this recommendation. This is Seqwater's currently adopted process.
	The Authority also recommends that for Central Lockyer Valley, Lower Lockyer Valley,	Seqwater concurs with this recommendation. This is Seqwater's

	Morton Vale Pipeline, Pie Creek, and Cedar Pocket Dam tariff groups, fixed operating costs should be allocated on the basis of current nominal WAEs as recommended in Chapter 5: Renewals Annuity.	currently adopted process.
	The Authority further recommends adoption of the approach outlined for the Central Brisbane River WSS (outlined in its scheme specific report).	Seqwater concurs with this recommendation.
Volume 1, page 201	The Authority recommends that for the regulatory period 2013-17: (a) the costs of direct labour and contractors should be escalated by 3.6% per annum in nominal terms;	In its NSPs, Seqwater escalated it direct labour costs by 4% on the basis that the enterprise bargaining increase was unknown but expected to be small and there was an allowance for salary increments. Seqwater can now confirm that the enterprise bargaining increase for 2012-13 is 2.2% and the average salary and wages increment for operations staff and the recreation maintenance staff is 2.986%. This brings the total direct labour escalation for 2012-13 to 5.186%. As the salary and wages average increment trends downward over time when staffing turnover is low and as future enterprise bargaining increases are not known, Seqwater submits that the direct labour escalation factor for the regulatory period should be 4%.
	(b) the costs of materials should be escalated by 4% per annum in nominal terms;	Seqwater concurs with this recommendation.
	(c) other direct costs and non-direct costs should be escalated by 2.5% per annum in nominal terms; and	Seqwater concurs with this recommendation.
	(d) electricity should be escalated by 2.5% per annum in nominal terms. However, should Seqwater sustain material electricity cost changes above the escalated level, consideration should be given to an application by Seqwater to the Authority for an end-of-period adjustment.	Seqwater concurs with this recommendation.
Volume 1, page 204	The Authority recommends that a working capital allowance not be allowed for Seqwater's irrigation activities.	Seqwater accepts this recommendation.
Volume 1, page 217	The Authority recommends that Seqwater's (November) estimates of revenue offsets be accepted.	Seqwater concurs with this recommendation.

Volume 1, page 224	The Authority recommends the application of fixed and variable tariff structures as presented in Table 7.9.	Seqwater agrees with the concept of fixed and variable tariffs.
Volume 1, page 248	The Authority recommends that a single discount rate (WACC) determined for Seqwater's irrigation business (separately) be applied consistently to each of Seqwater's irrigation WSSs.	Seqwater concurs with this recommendation.
Volume 1, page 250	The Authority recommends that the risk-free rate be based on the four-year Commonwealth Government bond averaged over 20 trading days. An indicative estimate using the 20 days trading up to and including 2 October 2012 is 2.55% per annum.	Seqwater concurs with this recommendation.
Volume 1, page 251	The Authority recommends a market-risk premium of 6.0% per annum.	Seqwater concurs with this recommendation.
Volume 1, page 252	The Authority recommends a capital structure of 60% debt and 40% equity for Seqwater's irrigation activities.	Seqwater concurs with this recommendation.
Volume 1, page 254	The Authority recommends an asset beta of 0.3 corresponding to an equity beta of 0.55 at 60% debt-to-value ratio.	Seqwater concurs with this recommendation.
Volume 1, page 257	The Authority recommends that the cost of debt be based on the BBB+ margin above the risk-free rate for four-year corporate bonds. As at 2 October 2012, the indicative cost of debt is 5.861% per annum. This is comprised of a corporate spread of 2.78% on the four-year risk-free rate of 2.55% and transactions costs relating to credit default swaps of 0.25%, interest rate swaps of 0.15%, and debt issuing costs of 0.125%.	Seqwater concurs with this recommendation.
Volume 1, page 258	The Authority recommends a gamma value of 0.5.	Seqwater concurs with this recommendation.

3 Response to Volume 1 Matters

Cost of Consultation (Volume 1, page 134)

The QCA stated that Seqwater should submit cost estimates regarding the options identified by the QFF on page 131. The options identified by the QFF are:

(a) Seqwater's current approach to consultation which involves operational staff informing customers of issues as they arise and responding to requests, but not formal customer committees;

(b) annual reporting of costs to irrigators only if there are significant variations between (operating and renewals) actual expenditure and forecast expenditure; and

(c) establishing formal advisory committees (similar to SunWater's previous approach) with quarterly meetings.

Seqwater's response to these options is as follows:

(a) Option (a) is the base case and is currently delivered at no additional cost to irrigators. This is because the staff involved are either direct or indirect operational staff whose costs are already allocated to the water supply schemes and responding to customers is an integral part of their standard duties.
(b) Option (b) is interpreted by Seqwater to be the same as the QCA's recommendations in respect to the reporting of variations in renewals and operating costs. Seqwater's estimate of the combined cost of this reporting is $22,000.
(c) Option (c) involves the establishment, support and co-ordination of seven scheme advisory committees. Seqwater's estimate of costs is $25,000.

Fixed and Variable Costs (Volume 1, page 220-224)

Seqwater notes the QCA's comment on page 223 of Volume 1 of the Draft Report where it states:

> *In response to Seqwater's concerns about this application, the Authority considers that:*
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> *(a) an optimal business structure would allow for existing employees to modify their work program depending on customer demands. For example, when operations activities are reduced, operations staff should be able to undertake other activities such as mowing and general maintenance of recreation areas;*

Seqwater notes that "operations activities" are both fixed and variable in nature from a cost perspective and includes "activities such as mowing and general maintenance of recreation areas". Seqwater assumes that the statement means that when customer demands (variable cost activities) are reduced, employees should be able to undertake fixed cost activities. The management of work in Seqwater operates in the reverse. Operations staff spend the majority of their time engaged in operations work activities that, from a cost perspective, are fixed costs. Staff cease these activities to attend to customer demands and then return to take up fixed cost activities. The level of customer demands determines the backlog of work to be completed when the demand tapers off. With Seqwater's current staffing levels, operations staff are fully utilised undertaking work of a fixed cost nature. This holds both for times when full supply is available without releases and in drought conditions when no water is released. This is contrary to the initial findings of SKM (see "Supposed Underutilisation of Operations Staff" below).

Seqwater submits that the above statement be amended to take these factors into account.

4 Response to Volume 2 Matters

Supposed Underutilisation of Operations Staff

The Draft Report claims underutilisation of operations staff at Cedar Pocket, Logan River, Lower Lockyer Valley and Mary Valley Water Supply Schemes based on “anecdotal evidence” provided to the consultants, SKM. These claims resulted from a misunderstanding of questions asked and answers given and Seqwater responded to SKM to address these erroneous claims.

In its final report, SKM clearly showed a retreat from these claims as follows:

- SKM increased its estimate of operations staff required to operate Cedar Pocket from 0.35 FTE to 0.6 FTE and recommended that the QCA accepts Seqwater’s estimate of 0.65 FTE;
- On page 49 of the Volume 2 report for Cedar Pocket WSS, QCA stated that “SKM found labour costs to be prudent and efficient”;
- SKM made only minimal changes to Seqwater’s revised labour costs for operations staff in the Logan River scheme and the Lower Lockyer scheme;
- SKM accepted Seqwater’s revised labour cost estimates for the Mary Valley scheme.

Seqwater submits that:

- SKM accepted Seqwater’s explanations of the supposed underutilisation of operations staff;
- SKM accepted Seqwater’s revised labour cost estimates with minimal changes; and
- SKM’s final recommendations clearly leave no room for the supposed underutilisation of operations staff to exist.

Therefore Seqwater believes all references to the misunderstanding that operations staff were underutilised should be removed from the final report. This includes the reference on page 175 of Volume 1 and in the Volume 2 reports for Cedar Pocket WSS, Logan River WSS, Lower Lockyer WSS and Mary Valley WSS.

Cedar Pocket WSS

Page 49 - Seqwater has identified an arithmetic error on in the labour cost calculations in the SKM report. SKM’s revised calculations based on 0.6 FTE plus overtime and allowances were reported as $44,170 for 2012-13. Seqwater has calculated the total labour cost based on 0.6 FTE to be $54,176. Seqwater submits that the total labour costs for Cedar Pocket WSS for 2012-13 should be amended to $54,176.

Page 57 – Seqwater disagrees that the proposed efficiency reduction should be applied to insurance. This is because Seqwater has limited ability to influence the amount of the insurance premiums, particularly when Seqwater has made large claims due to flood damage in recent years. Insurance is negotiated on the portfolio of assets and not on a scheme by scheme basis. Consequently, there is no ability to achieve savings on an asset by asset basis. Therefore Seqwater submits that the efficiency reduction should not apply to insurance costs in any scheme.

Central Brisbane River WSS

Page 66 – The QCA stated the following:

> *This excess may thus be utilised in non-core activity like mowing and minor maintenance work when such peak events are not present. However, the current operating model does not take advantage of this capacity but rather incurs extra maintenance contracting costs, in SKM's view, unnecessarily and thus inefficiently.*

The premise that Seqwater's current operating model at Wivenhoe Dam and Somerset Dam incurs extra maintenance costs is incorrect. In its response to the SKM draft report, Seqwater advised SKM on 5 September 2012 that the rangers do undertake mowing, slashing, controlled burns and similar tasks which are not outsourced to contractors. Although other similar references were deleted from the SKM final report in response to Seqwater's advice, it appears that this one reference remained in the SKM report and has been repeated in the QCA's Draft Report. Seqwater therefore submits that the above statement, being incorrect, should be deleted from the QCA's final report.

Central Lockyer Valley WSS

Page 12 – The QCA stated the following:

> *The Authority considers that Seqwater should establish service standards for the scheme in consultation with customers.*

Seqwater agrees that service standards should be established for the scheme despite the failure of SunWater and irrigators to reach agreement in 2001. Seqwater will work cooperatively with irrigators and stakeholders such as the Queensland Farmers Federation to develop and agree workable and acceptable service standards by 30 June 2014.

Page 108 – The QCA reduced Seqwater's revised labour cost estimate for the Central Lockyer Valley tariff group by 5% with the reason being that the labour cost estimate was unsampled. Seqwater submits that this is untenable for the following reasons:

- Labour costs are set by the Seqwater EBA which is legally enforceable. Consequently, Seqwater is bound to pay its employees for wages, salaries and allowances and for overtime when work is legitimately performed, These costs are not discretionary;
- Seqwater is required by the Dam Safety Regulator to undertake dam safety surveillance which includes weekends. Employee entitlements arising from the performance of this work are payable by Seqwater;
- Planned maintenance is required. Consequently, labour costs associated with planned maintenance are not discretionary; and
- Reactive or unplanned maintenance is required to meet emerging incidents and maintain service delivery. Consequently, labour costs associated with reactive maintenance are not discretionary.

This means that Seqwater does not have the capacity to find labour cost savings of 5%.

Seqwater further submits that the process undertaken to arrive at the revised labour cost estimates for the tariff group, which were some $38,000 less than the original forecasts, was identical to the process used to prepare revised labour cost estimates for the Morton Vale tariff group and the Lower Lockyer Valley WSS which was accepted by SKM with a small reduction of 1% relating to SKM's view regarding the overtime calculation.

Seqwater therefore submits that the 5% savings reduction be removed noting in addition that if Seqwater had not volunteered the revised estimates, the 5% savings reduction would have been applied to the original estimate of $166,000 resulting in a QCA recommended labour cost estimate of $158,000.

Page 108 – The QCA, based on SKM advice, reduced Seqwater's revised labour cost estimates for Morton Vale Pipeline from $43,000 to $36,000. The reduction relates to SKM's view of the overtime and allowances allocation for Morton Vale. On page 249 of the SKM final report, it was stated:

> *As a result, SKM is of the opinion that the overtime and allowances assigned to the Morton Vale System is over estimated. Assuming three events requiring overtime occurs at the scheme, SKM estimates that an allocation of approximately $1,500 per year is sufficient. While SKM acknowledges that as the pipeline gets older, such overtime events are likely to increase, For the next two years, we do not see this increase occurring to an extent beyond the 3 events allowed for. Accordingly, SKM recommends the revised 2012-13 budget of $36,000 for the Morton Vale Distribution System labour cost shown in Table 178.*

It is apparent that SKM overlooked that fact that the employee allowances are conditions of employment relating to location and being available for call-out. Allowances are costed to Morton Vale in proportion to the employee's time spent there. Seqwater's estimate of allowances was $3,700. Seqwater submits that the 2012-13 QCA recommended budget of $36,000 be increased by $3,700 to $39,700 to include allowances.

Logan River WSS

Page 54 – The QCA, based on SKM advice, reduced Seqwater's revised labour costs for 2012-13 by $15,375. The reduction appears to be based on misleading anecdotal evidence of "*a systemic underutilisation of operational staff, due to changes in working practices*" (refer above). Seqwater subsequently provided evidence that there was no such underutilisation of operational staff. The SKM final report, on pages 214, 215, accepts Seqwater's evidence. Seqwater submits therefore that the 2012-13 revised labour cost estimates of $321,507 be accepted.

Lower Lockyer Valley WSS

Page 11 – In regards to system losses, the QCA states that:

In the Lower Lockyer Valley there are significant in stream and storage losses which Seqwater excludes in the base WAE for calculation of prices for the scheme, resulting in higher prices for the scheme customers.

The statement that the exclusion of losses results "*in higher prices for the scheme customers*" is considered unnecessary and potentially inflammatory and Seqwater requests that it is deleted from the final report. It was well documented in the SunWater Irrigation Price Review 2005-06 that the Tier 1 group accepted the principle that losses do not form part of the water allocations base for determining tariffs (see Statewide Irrigation Pricing Working Group Tier 1 Report April 2006).

Mary Valley WSS

Page 10 – The QCA holds the view that Pie Creek is a distribution system. The Pie Creek water infrastructure was constructed to divert water from the Mary River to Pie Creek, McIntosh Creek and Calico Creek. Although the Pie Creek system has some of the visual characteristics of a distribution system, the Mary Basin ROP, which is the governing instrument for the scheme, has defined Pie Creek as a zone of the ROP thereby placing the water allocations in the Pie Creek system. The diversion of water from the Mary River therefore is a supplementation of the natural water courses. This is not consistent with the characteristics of a distribution system which typically transports water from the zone where allocations reside to customers' offtakes. It is noted that the eight distribution systems in SunWater are all channel and pipeline systems. By comparison, the Upper Condamine North Branch and the Upper Redgate Re-lift have the same ROP characteristics as Pie Creek. Consequently, Seqwater submits that Pie Creek should not be described as a distribution system but as a river system.

Seqwater is concerned that if Pie Creek is wrongly characterised as a distribution system, there is a risk that charges levied under the distribution contracts may not be enforceable if Seqwater is not actually performing a distribution service. Although Seqwater agrees with the concept of a four part tariff for Pie Creek which fairly reflects the cost of diverting water into the Pie Creek system, Seqwater submits that the Part C and Part D tariffs be described as "bulk" and not as distribution charges to remove all doubt.

Warrill Valley WSS

Page 59, 68, 69 – Seqwater notes that in Table 5.13 on page 59, the QCA recommends that a 5% saving is to apply to unsampled direct operating costs. This includes Seqwater's direct labour cost estimates which were not sampled for examination by SKM. Seqwater notes that in Table5.20 on page 69, the QCA's recommended estimate for labour costs for 2013-14 is $327,016 compared with Seqwater's estimate in Table 5.19 of $368,724. The reduction amounts to $41,708 which is an 11.3% reduction instead of the stated 5% reduction. Seqwater submits that the QCA's recommended labour costs estimate for 2013-14 should be $350,288 which equates to a 5% reduction. The recommended labour costs for the years 2014-15 to 2016-17 should also be amended accordingly.