Fairbairn Irrigation Network Submission to QCA – Assessment of Sunwater RAB and Annuity Models

From: Fairbairn Irrigation Network Ltd (FIN)

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Introduction

FIN acknowledges that Queensland Competition Authority (QCA) is responsible for independently assessing the pricing approaches proposed by Sunwater, including the Regulatory Asset Base (RAB) and Annuity models.

We understand QCA's role is to:

- Test the underlying assumptions
- Assess efficiency and prudency
- Ensure outcomes are fair, transparent, and in the long-term interests of customers

This submission highlights key issues that we believe warrant targeted scrutiny and challenge as part of that process.

1. Incentives Under a RAB Model (Overcapitalisation Risk)

Under a Regulatory Asset Base (RAB) framework, capital expenditure is added to the asset base and directly drives future revenue. New capital earns a return through the application of the Weighted Average Cost of Capital (WACC) and is also recovered over time through depreciation.

Accordingly, increases in capital expenditure result in a corresponding increase in allowable revenue.

As a result, the RAB model links revenue outcomes directly to the size of the asset base. While this provides a structured approach to cost recovery, it also introduces a potential structural incentive to increase capital investment, as higher capital expenditure leads to higher long-term revenue recovery.

This creates a risk that, unless appropriately constrained, the model may:

- Favour capital solutions over operational optimisation
- Encourage higher-cost or earlier-than-necessary asset replacement
- Reduce the imperative to demonstrate least-cost, whole-of-life outcomes

FIN considers that these risks are particularly relevant in irrigation schemes, where:

- Demand is variable
- Customer capacity to absorb price increases is limited
- Asset lives are often extended through effective operational management

FIN recommends that the Queensland Competition Authority explicitly tests:

- Whether proposed capital programs are:
    - Efficient

- Prudent
- Least-cost over the asset lifecycle

- Whether governance and assurance mechanisms are sufficient to:
  - Prevent overcapitalisation ("gold plating")
  - Ensure investment decisions are driven by customer outcomes rather than asset growth

2. Interpreting Stakeholder Engagement (Silence ≠ Acceptance)

The transition to a Regulatory Asset Base (RAB) framework represents a fundamental shift in pricing methodology, with long-term implications for customer pricing, risk allocation, and capital investment incentives. Given the technical complexity of the model and the significance of the change, it is critical that stakeholder engagement outcomes are interpreted with care.

FIN is concerned that the absence of detailed stakeholder submissions may not reflect support, but rather:

- The complexity of the RAB framework and supporting financial models
- Information asymmetry between the service provider and customers
- Limited time and resources available to scheme participants to fully assess long-term impacts

In this context, a lack of response should not be interpreted as acceptance or endorsement of the proposed approach.

FIN recommends that the Queensland Competition Authority:

- Treat stakeholder silence as neutral rather than supportive
- Apply independent and proactive scrutiny of the proposed models, particularly where:
  - Pricing impacts are material
  - Assumptions are complex or not readily observable
- Actively test whether:
  - Customers fully understand the implications of transitioning to a RAB framework
  - The resulting pricing outcomes align with customer capacity to pay
  - The model appropriately reflects the operational realities of irrigation schemes

3. The workshop identified that some schemes (e.g. Nogoa) may commence with a negative RAB position (e.g. -$10M).

The interpretation of stakeholder engagement is particularly important in the context of opening RAB positions, including scenarios where schemes commence with a negative asset balance (e.g. -$10M).

The opening RAB establishes the foundation for future pricing, and reflects:

- Historic capital investment decisions

- Asset condition and performance
- Past approaches to maintenance, renewal, and funding

- Where stakeholders have not actively responded to or challenged this position, there is a risk that:
- Legacy outcomes are embedded into the pricing framework without sufficient scrutiny
- Customers are exposed to the consequences of:
    - Inefficient or poorly scoped historic capital programs
    - Deferred investment or suboptimal asset management practices

FIN recommends that QCA:

- Does not rely on stakeholder silence as validation of the opening RAB position
- Undertakes independent testing of the underlying assumptions and historic drivers
- Assesses whether the opening RAB reflects:
    - Efficient and prudent investment
    - Appropriate allocation of costs between past and future customers
- Considers whether adjustments may be required where:
    - Historic expenditure outcomes do not meet expected standards of efficiency or prudency

4. Asset Life Assumptions and Replacement Funding Risk

The treatment of asset life assumptions under both the RAB and annuity models is a critical issue that directly impacts long-term pricing stability, intergenerational equity, and funding adequacy. FIN considers this an area requiring detailed and explicit scrutiny by the Queensland Competition Authority.

In irrigation schemes, it is common for assets to be operated well beyond their nominal or assumed useful life. This is not an anomaly, but rather reflects:

- Effective maintenance practices
- Operational optimisation
- A deliberate focus on maximising value from existing infrastructure

Under both RAB and annuity frameworks:

- Depreciation is typically based on standardised or assumed asset lives
- These assumptions may not reflect actual asset performance in the field

Where assets operate beyond their assumed life:

- Customers may have already funded the asset through depreciation
- However, replacement occurs:
    - Later than forecast
    - At a higher cost due to inflation, standards, and scope changes

Resulting Risk

This creates a structural mismatch between:

- When funding is collected, and

- When expenditure is required

Leading to:

- A funding shortfall at the point of replacement

Exposure to:

- Step changes in pricing
- Intergenerational inequity (future customers funding assets already “paid for”

FIN recommends that the Queensland Competition Authority explicitly tests:

- Whether depreciation profiles reflect actual asset performance and observed asset lives within irrigation schemes
- How each model:
    - Accounts for extended asset life beyond standard assumptions
    - Manages the resulting timing mismatch in cost recovery
    - Whether additional mechanisms are required to:
    - Smooth or “true-up” funding over time
    - Avoid price shocks at the point of asset replacement
    - Ensure equitable cost allocation across customer cohorts

5. Treatment of Un-forecast Capital Expenditure

Both the RAB and annuity models must be assessed against real-world operating conditions, where capital expenditure is not always predictable or evenly distributed over time.

In practice, irrigation schemes are exposed to a range of unforecast capital drivers, including:

- Natural disasters (e.g. flood damage)
- Latent defects or emerging asset condition issues
- Historical underinvestment or deferred maintenance

These events can trigger material, lumpy capital expenditure, which is not aligned with smooth long-term forecasts.

How does each model respond when significant unforecast capital expenditure occurs, and what are the implications for customers?

Under a RAB framework:

- Unforecast CAPEX is added to the asset base

This results in:

- Increased return on capital (via WACC)
- Increased depreciation

Leading to:

- A permanent increase in allowable revenue
- Costs being carried forward and recovered over future periods

This can:

- Transfer costs to future users
- Reduce price stability
- Embed the impact of discrete events into long-term pricing

Annuity models may:

- Provide greater price smoothing over time
- Allow costs to be spread more predictably across customers
- Reduce the immediate pricing impact of large capital events

However, the effectiveness of this approach depends on:

- How reforecasting is managed
- The interaction with regulatory reset periods

FIN recommends that QCA:

- Clearly compare how each model:
    - Manages price shocks arising from unforecast capital events
    - Maintains price stability over time
    - Allocates costs across generations of customers
- Demonstrates, with practical examples, why one approach delivers a superior outcome for customers, particularly in the context of:
    - Large, discrete capital projects
    - Irrigation scheme demand variability
    - Customer affordability constraints

FIN considers that any preferred pricing framework must be demonstrably robust under real-world conditions, including the occurrence of unforecast capital events, rather than relying solely on smooth, long-term assumptions."