

## CANEGROWERS submission re QCA Sunwater water pricing review February 2011

### NSP's

Below are some specific comments to both the bulk and distribution NSP's (besides Pioneer and Proserpine which only have bulk NSP's) within each cane growing area. At a generic level across all NSP's I have a concern re the level of operations costs specified and the items listed for the renewals program. With regards to operations costs it is extremely difficult to make any informed comments since the headings used are generic and high level and consequently are not conducive to scrutiny. Detail at least one level down needs to be provided.

Re renewals there is more detail in the renewals program than operational costs but still only a very brief description is given for only some renewals expenditure. However it is difficult for me to judge the validity of activities listed, the timing of activities and the efficiency of works. All items should be itemised for the 25 year period and more detail needs to be provided for all items.

It would also be extremely helpful if Sunwater or QCA could explain the NSP's to customers. It is likely that in most regions little scrutiny will be placed over the NSP's and the costs within them because people do not have the ability to understand them and a briefing in all schemes would help this process.

It would appear that many activities are either not required at all or Sunwater has taken a risk averse approach and included many items within the 25 year period that may not occur. I suspect a more commercial and cost sensitive business would defer some of the items out further than 25 years. Boards of a local management or more scheme focussed commercial company would only renew items that had no choice but be renewed or the dollar benefits outweighed the costs but i am not convinced this is the approach being taken by Sunwater.

Re efficiency of the renewals items, I suspect that again Sunwater has taken a very risk averse approach and ensured that items listed are costed to reflected the upper end of expected costs rather than an average likely spend.

An inequity occurs in many of the channel NSP's between high and medium priority customers and sometimes between river and distribution customers. In many NSP's a section of channel has been segregated by Sunwater from the rest of the channel system and treated as part of the bulk system which is extremely inequitable. This occurs in the lower Mary, Eton, Burdekin and Bundaberg and perhaps other schemes. There is no comment about how the supplementary stream customers will be treated in Mareeba.

If high priority customers or any deemed bulk customers are using any part of the channel infrastructure they should be paying the same channel charge as growers within the channel system for the proportion of their allocation which is typically delivery through the distribution system.

For example consider a scheme where bulk water users in total use 1000ML on average and have a 2000ML allocation. In addition they receive 500ML typically via the distribution system and 500ML from natural flows or bulk water deliveries not via the distribution system. They should pay the same channel charge as all other users in that scheme for 1000ML of allocation and 500ML of use. For the

remaining 1000ML of allocation and 500ML they should either pay nothing or the bulk charge if it is delivered via the bulk system.

It is important to ensure if this is done that costs are not put back in the bulk NSP and then shared between bulk and channel customers. This is a cost that should only go back to bulk water customers not all bulk water since bulk water used by distribution customers already pay the channel charge for all the water they use.

They should not be able to cherry pick infrastructure within the channel system which they use and only pay a proportion of costs for this infrastructure only. In its December 2010 revised Sunwater pricing direction to QCA, government directed the QCA not to introduce further segmentation of tariffs. It appears that Sunwater has inadvertently done so in this case.

Historically in the Mareeba supplemented streams tariff and the Giru groundwater tariff in the Burdekin, only a proportion of water use by these tariff segments came from delivery via the channel system and others from natural flows. Consequently both segments only paid a distribution charge based on the proportion of water which they received via the channel system. For the water they received from the channel system, the price used was the same channel charge that other water in these schemes paid for their water.

This appears fair and reasonable and consistent with the ministerial direction to QCA. It is inconsistent then for so called bulk water users in Burdekin, Eton, Bundaberg and Maryborough who partially use distribution infrastructure to only pay a proportion of costs for the distribution infrastructure that they use.

Alternatively distribution assets used by bulk customers could be included in the bulk NSP. However this may not be consistent with the principle of separating bulk from channel.

Comparisons are made of actual operational spending over last 5 years to the estimates of future spending. However no comparisons are made to efficient costs determined by Indec in 2006 and this information should be included in each NSP. The important comparison is between the efficient costs determined by Indec for each scheme and Sunwater determined efficient costs now.

The Indec efficiency numbers are not separated between bulk and distribution for each scheme but still allow a comparison at the scheme level which is of value. The Indec numbers are in 2005/6 numbers but these can easily be converted to 2011/12 by adding the 18% Brisbane inflation from 2005/6 to 2010/11 and I have then added 3% inflation for 2010/11 to give an over inflation number of 21.5% over 6 years.

A comparison of irrigation costs for the 7 cane schemes is given in the table below. All numbers are in thousands of 2011/12 dollars. The \$ difference column are the Sunwater costs minus the Indec costs. The % difference column is the \$ difference divided by the Indec costs and multiplied by 100.

	Sunwater	Indec	\$ Difference	% Difference
Mareeba	6040	6325	-285	-4
Burdekin	17381	14552	2828	19
Proserpine	472	575	-103	-18
Pioneer	912	724	189	26
Eton	4445	3274	1171	36
Bundaberg	10187	9874	312	3
Maryborough	1588	783	805	103
Total cane	41025	36108	4917	14

In real 2011/12 dollar terms the efficient irrigation scheme costs present by Sunwater vary considerably from the efficient costs determined by Indec. Overall for cane schemes the costs presented by Sunwater are \$4.917m or 14% higher than those determined by Indec in 2006. Real costs are lower in Proserpine and Mareeba by 18 and 5 percent respectively which is good outcome. For Bundaberg a modest increase of 3 percent in real terms is suggested. For the Burdekin, Pioneer and Eton significant increases are suggested which are 19,26 and 36 percent respectively. For the Mary scheme efficient costs are estimated to have increased by a massive 103 percent in real terms.

There needs to be a thorough review of operating costs over the next 5 years compared to efficient costs used for the existing price path. We need to ensure that any costs increases above the efficient costs determined for the existing price path are clearly justified and if they are not then these costs should also be removed from efficient costs for this price path. It is not acceptable to just ignore the outcomes of the efficiency review last time since comparisons can still be made and there are many valuable lessons to be learnt for this price review.

Insurance costs are very high and the insurance program needs to be reviewed to ensure it is appropriate and efficient.

The starting very large negative renewals balance of over \$11m for irrigation schemes needs urgent review. if this cannot be adequately scrutinised it may be appropriate to zero any negative renewals balances.

Little thought has been given by Sunwater on how to improve the efficiency of schemes and reconfigure them to lower their costs. this is especially the case since many schemes are facing prices over the next 5 years that will severely test their ability to pay. In addition the large renewals items estimated for major refurbishments over the next 25 years makes irrigators ask the question whether items should be replaced like for like or whether there are more efficient ways to deliver water to make the schemes sustainable in the long term?

### **Lower Mary**

With an estimated price of \$210/ML in 2016 for the lower Mary channel compared to \$70/ML now this scheme is clearly unable to cope with a price increase anything like this. There needs to be an urgent assessment of this scheme both within this price setting process and beyond to see what can be done to make this scheme viable long term.

There is a renewals annuity balance of -\$1.454m in the distribution system which has a significant impact on price. It means that the annuity is \$545,000 compared to a spend of only \$198,000 and that renewals is 41% of all channel costs. There is also estimated to be a major renewals spend between 2023 and 2028 in the distribution system which has a major impact on costs.

Operations costs in the distribution system are estimated to increase by 28% over the next 5 years in real terms which is around 54% in nominal terms by 2016. Also 40% of operating costs are overheads. Electricity is a major component of costs at \$31/ML or \$142,000 in total. Also insurance is \$41,000 for the distribution system.

For the river system operations costs are estimated to increase by 22% over the next 5 years in real terms which is around 46% in nominal terms by 2016. Also a staggering 60% of operating costs are overheads but insurance is only \$7,000 for the river system.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$783,000 in 2011 dollars. The Sunwater estimates are around \$805,000 higher than this figure which is 103% higher. This is hard to fathom and needs urgent investigation.

Distribution loss allocations are 4900ML compared to historical losses of around 300ML on average and assumed average losses going forward of 2900ML. There is considerable variation between these numbers which is likely to be having a significant impact on prices.

It is extremely unclear which existing tariff groups are within the bulk and distribution NSP respectively. For example at the time of the last price review there was 8148ML of irrigator help MP water in the channel system, 5358ML in the lower Mary barrage and 8578ML in the Tinana barrage and Teddington weir systems. It is unclear where each of these allocations is designated within the NSP's between bulk and distribution. The Mary river is clearly only in the bulk NSP while the channel is clearly in the distribution NSP. The Tinana and Teddington tariff group appears to be partially in the distribution NSP but this may be an incorrect assumption. This issue needs to be clarified before any sensible analysis of the Mary scheme can occur.

In the lower Mary there is a pump station and channel which are used by high priority customers and some customers with a different tariff not in the distribution system. These customers are only asked to pay part of the costs of running these assets only within the channel system rather than all channel costs. For the proportion of water typically used by these water users via the distribution system these water users should pay the same channel price as all other customers.

### **Bundaberg**

Operations costs in the distribution system are estimated to increase by 14% over the next 5 years in real terms which is around 37% in nominal terms by 2016. Also 32% of operating costs are overheads. Electricity is a major component of costs at \$29/ML or \$2.3m in total. Also insurance is \$475,000 for the distribution system which is 5% of total costs.

For the river system operations costs are estimated to fall by 15% over the next 5 years in real terms which is a 2% increase in nominal terms by 2016. Also 53% of operating costs are overheads and insurance is \$90,000 for the river system.

There is a large renewals spend in the last 5 years of the 25 year renewals projections for the distribution system and the last 6 years for the bulk system. The opening balance for renewals for the distribution system is \$2.291m compared to a starting balance of -\$1.305m for the bulk system. The big negative starting balance for the bulk system means that the annuity is much greater than future spending and renewals annuity is 33% of total costs for the bulk system.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$9,874,000 in 2011 dollars. The Sunwater estimates are around \$312,000 higher than this figure which is 3% higher. Consequently the Sunwater estimates of efficient costs are roughly in line with what Indec determined 5 years ago. This is a sound result but the expectation in 2006 from Indec was that further efficiency gains would be possible in this price path and costs should decrease in real terms.

The uncosted refurbishment of Wongarra pump station is a concern given that is estimated at \$5-10m and would add \$0.5-0.6m to the renewals annuity. Major potential expenditures such as this highlight the need to make modifications to schemes rather than just continue to refurbish existing assets.

Distribution loss allocations are around 40,000ML compared to actual losses of around 10,000ML and assumed future losses of around 21,000ML. This will unfairly have a major impact on the distribution systems share of bulk costs.

Like several other schemes the use of channel infrastructure for the bulk system needs to be reviewed. In this case 8% of the costs of the Gin Gin main channel and associated pump station are attributed to the bulk system. This is not an appropriate methodology and needs to be changed as discussed previously.

The impact of the floods on renewals needs to be considered. A number of assets have been affected by floods and some will be covered under insurance. Will this cause a number of estimated renewals expenditure not to occur in the future?

## **Eton**

\$115 in 2016 is the price forecast for Eton based on the costs and allocation methodology in the 2 Eton NSP's compared to a current price of \$67/ML. At this price irrigating cane is unviable in the Eton scheme and the focus for growers turns to how can we sell our allocations in a market with little demand for water. Water is currently worth around \$150/ML but there is little to no trading and consequently a \$15/ML increase in water price will make water worthless assuming a 10 percent discount rate.

Operations costs in the distribution system are estimated to increase by 28% over the next 5 years in real terms which is around 54% in nominal terms by 2016. Also 37% of operating costs are overheads. Also insurance is \$119,000 for the distribution system.

For the river system operations costs are estimated to increase by 8% over the next 5 years in real terms which is a 30% increase in nominal terms by 2016. Also 42% of operating costs are overheads and insurance is \$113,000 for the river system. In total around 30% of all costs for Eton are overheads which is around double that of the Pioneer Valley Water board costs. Is the presence of a local business centre increasing overhead costs unfairly?

Electricity is a major component of costs at \$13/ML for the channel and \$8/ML for bulk to give a total of \$21/ML used. A number of options exist to reduce electricity costs including new pumps, off peak pumping, new balancing storages, new electricity tariffs and these should be investigated especially for the bulk system. Re electricity use for bulk system, it is unclear how natural flows have been considered or are all inflows in dam assumed to be pumped from the river?

There is a starting balance for renewals of -\$404,000 which has a significant impact on price and 4 out of 5 largest renewals spends are in last 6 years of 25 years of renewals estimates. The starting renewals balance for the bulk system is -\$1.282m which again means that spending is much lower than the annuity. The total renewals balance for Eton has gone from around 0 2 years ago to -\$1.686m now which is a real concern.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$3,274,000 in 2011 dollars. The Sunwater estimates are around \$1,171,000 higher than this figure which is 36% higher. This is a very worrying result and serious investigation needs to occur to scrutinise these increases.

It is unclear from the plans how much costs are allocated to high priority customers in the distribution system. High priority customers do use the bulk and distribution assets in the Eton scheme and should pay their fair share of all costs on all their water.

A particular concern for Eton is the large recreational costs of \$171,000 per year. This service has nothing to do with irrigation customers and should be funded separately.

When comparing to the Pioneer Valley Water Board the Eton scheme is archaic and extremely labour intensive while Pioneer has extremely low labour cost and is heavily automated leading to a reduction in costs. the costs for Eton and all schemes should be modelled on the most efficient and low cost method of water delivery not continuing what has happened historically.

### **Pioneer**

Renewals is a big problem for Pioneer with a starting balance of -\$5.16m compared to around -\$0.5m 2 years ago. A negative balance of \$5.16m for the Pioneer is 46% of the total negative renewals balance for all Sunwater schemes. Consequently renewals are 47% of total costs despite spending being on 11% of total costs.

Over the next 25 years average renewals spend is around \$250,000 compared to an annuity of \$817,000. If the starting balance for the Pioneer was 0 then the price in 2016 would be \$20/ML rather than \$28/ML in the current plan which is only slightly above the current price of \$18.21 with a 70/30 split between part A and B. Clearly very serious scrutiny needs to be placed on renewals spending in Pioneer especially over the past 2 years.

Indirect and overhead costs are 53% of total operational costs. This is a very high figure and needs to be reviewed. Operational costs are projected to increase by 8% in real terms over the next 5 years compared to the last 5 years. Insurance costs of \$90k seems excessive.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$724,000 in 2011 dollars. The Sunwater estimates are around \$189,000 higher than this figure which is 26% higher. This is a large increase and needs serious scrutiny.

Dam safety costs of \$5.25m are mentioned for 2015 and 2016. I didn't realise that dam safety upgrades were occurring in the Pioneer?

The \$231,000 dam safety review costs seems high and around double what it would cost a consultant to undertake. There are no details of the 2023 costs of \$377,000 to replace pipework at palmtree creek so it is hard to comment on the expenditures need, timing of efficiency of cost. The cost of 2023 electrical cabling of \$200,000 for Mirani weir is difficult to scrutinise without more details.

### **Proserpine**

The renewals balance for Proserpine has increased from a negative balance of \$30,000 2 years ago to a current balance of -\$119,000 in line with many other schemes. Replacing electrical cables at the dam in 2026 have a massive impact on the renewals program.

55% of operations costs are overheads which is very high and operations costs have gone up 15% in real terms or 38% in nominal terms. Insurance is \$81,000 which is 10% of total costs while recreation costs are \$78,000 which is also of concern. There is a flood mitigation revenue offset of \$167,000.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$575,000 in 2011 dollars. The Sunwater estimates are around \$103,000 lower than this figure which is 18% lower. This is a very good result and suggests that Sunwater has been able to absorb the majority of the inflation cost increases for Proserpine over the past 6 years. Consequently costs are only 3% higher in 2011/12 as 2005/6 in nominal terms which is a very good outcome.

### **Burdekin**

Operations costs in the distribution system are estimated to increase by 8% over the next 5 years in real terms which is around 30% in nominal terms by 2016. Also 31% of operating costs are overheads. Also insurance is \$344,000 for the distribution system. Electricity is \$15/ML which is a concern. Drainage and water harvesting charges need to be reviewed

For the river system operations costs are estimated to decrease by 15% over the next 5 years in real terms which is a 2% increase in nominal terms by 2016. Also 57% of operating costs are overheads and insurance is \$272,000 for the river system which is 7% of total costs. Recreation costs of \$400,000 or 10% of total bulk costs are extremely high and staggering since the dam is so remote. I suspect water treatment costs in Clare are included in this figure.

Re renewals there is a starting balance of \$709,000 for bulk and -\$3.123m for channel which has a large impact on the annuity. There is very little spending for bulk over the next 5 years and a big spend between 2023 and 2028 and there is a big renewals spend in the last 4 years of the 25 year period.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$14,552,000 in 2011 dollars. The Sunwater estimates are around \$2,828,000 higher than this figure which is 19% higher. This is a very bad result and needs close scrutiny.

It is unclear why dam safety costs of \$12m are included in the NSP as I thought there were no dam safety upgrades over the next 5 years.

There is a distribution loss allocation of 207,000ML compared to an average loss around 100,000ML in times of very high water use. This very high loss allocation has a large impact on bulk costs for channel customers.

High priority users north of the Burdekin use the Haughton main channel and balancing storage but do not pay the same channel charge as irrigation customers. This is clearly part of the distribution system and these customers should pay the same as all others in the distribution scheme. Presently there are irrigators who take water directly from Haughton main channel and balancing storage and they pay a higher cost than high priority customers which is not appropriate.

The treatment of free water is a big issue that needs to be resolved for this scheme.

### **Mareeba**

This is a very complicated scheme but the NSP gives little insight into these issues which will be treated in the future. It appears that supplemented streams are in the distribution system but there is no comment on how Sunwater suggests to treat them since they only partially get their water from the distribution system. The methodology discussed previously should be used for this scheme.

Operations costs in the distribution system are estimated to increase by 6% over the next 5 years in real terms which is around 27% in nominal terms by 2016. Also 50% of operating costs are overheads which is alarming especially for a distribution system. Also insurance is \$254,000 for the distribution system which is 5% of total costs. Electricity is \$50/ML for the relift area which is a major concern. Drainage charges need to be reviewed and growers are very keen to keep existing tariff groups.

For the river system operations costs are estimated to decrease by 10% over the next 5 years in real terms which is a 8% increase in nominal terms by 2016. Also 57% of operating costs are overheads and insurance is \$107,000 for the river system which is 11% of total costs.

The renewals balance is \$244,000 which is much lower than 2 years before. The estimated spend in last year of the renewals program of 2036 is extremely high at \$8m and seems unrealistic. For bulk the renewals balance is \$1.469m which is a big drop from 2 years before. The large positive starting balance means that the annuity is very low.

Scheme total lower bounds costs for the irrigation sector were set by Indec in 2006 to be \$6,325,000 in 2011 dollars. The Sunwater estimates are around \$285,000 lower than this figure which is 5% lower. Consequently the Sunwater estimates of efficient costs are roughly in line with what Indec determined 5 years ago. This is a sound result but the expectation in 2006 from Indec was that further efficiency gains would be possible in this price path and costs should decrease by more than this in real terms.

Distribution loss allocation is 45,000ML compared to a historical average of around 30,000ML. There is 20% allocation of bulk costs for hydro which needs to be scrutinised.

### **Other issues**

#### **Conversion factors**

Need conversion factors for all bulk and distribution costs to ensure that if MP allocations are converted to HP there is not an extra cost to remaining MP customers. This needs to apply to both operational and renewals costs. Sunwater states that all costs besides electricity costs are fixed which suggests they are linked to asset maintenance rather than water delivery. If this is the case then this justifies the use of the same conversion factor for both operational and renewals costs besides electricity.

HUF needs much more detailed explanation and review but a revised HUF's methodology seems appropriate for bulk systems. A trading conversion factor for channel systems could be used for renewals and operational costs.

#### **Form of regulation**

We support a price cap and all legitimate fixed costs recovered from part A and variable costs from part B. However if this occurs there needs to be strong drivers for Sunwater to be efficient from both the efficient costs determined for them and also an ongoing efficiency target as part of yearly indexation. If this is done, issues such as demand risk and water use forecasting become much less important

Also environmental drivers including Burdekin groundwater need to be considered when setting tariffs. This is especially the case for the Burdekin channel scheme which has a significant problem of rising groundwater. A lower part A would be appropriate for this scheme to encourage increased efficiency to benefit the groundwater system.

The issue of incentive mechanisms is a difficult one to come to terms with. It suggests that Sunwater only will find efficiency gains if it can keep them rather than continually strive to be efficient to be efficient for the long term interests of the viability of its business and customers. This to me highlights a stark difference between Sunwater and locally managed schemes whose whole focus is on scheme efficiency and customer viability.

It is a difficult concept to me that QCA sets costs above what it deems to be efficient so Sunwater can keep some efficiency gains from past changes. I thought the whole point of price setting and efficiency reviews was to set efficient costs and prices not inefficient ones?

The list of review triggers identified by Sunwater is very lengthy. Surely only in extreme cases where changes cannot wait until the next price setting process should a review be triggered. The majority of items listed by Sunwater do not appear to fall into this category and should be able to be managed by Sunwater within its business and the 5 year price path like any other business. The whole point of a 5 year price paths is to provide 5 years of certainty re prices not to review prices on a yearly basis.

#### **Head office costs**

The empire described on page 6 of the Sunwater submission on Centralised costs seems to bear little resemblance to what is required to efficiently deliver water to irrigation customers. From the surface it appears to a very centrally controlled and top heavy structure with significant overstaffing and duplication of roles. For example, it is efficient to separate scheme management from scheme development? Why are there 2 engineering managers? Why is there both a manager business development and manager project development?

Why are regional operations managers so far down the organisational structure and why do they need to report to a manager of service delivery in Brisbane and then a GM infrastructure management? This management seems excessive and leads to the regional managers becoming powerless when they are the key scheme operations people and key staff to deal with irrigation customers. This highlights the lack of importance placed on scheme management by Sunwater.

Why is there a manager asset management? Doesn't this duplicate role played by area operations managers and infrastructure development? It staggers me that the manager water accounts is more senior in Sunwater than area operations managers?? I would have thought that a small water accounts team would report to manager finance rather than have a separate team and manager? Why is there a HR manager? Surely 1 or at most 2 people are required rather than an empire with a manager. Why is there a legal services manager and team? This seems excessive especially when around 60% of the costs are being attributed to schemes.

The need for the health, safety, environment and quality team is unclear and it is a very strange mix of roles under the 1 team. The quality and systems team seems to be of little value. These values should be embedded within Sunwater rather than have a separate team to manage. It staggers me that an environment team of 10 is required. I would have thought 2 or 3 people would be sufficient as part of infrastructure management and development teams. It is unclear why there is a need for a manager WH&S and 4 staff? I would have thought a team of 2 probably as part of corporate would make more sense.

It is unclear why the strategy and stakeholder relations area exists? The media area would better sit under corporate but I am not sure a team of 5 is required especially given the low profile Sunwater takes on media issues. Strategy is also probably best under corporate but the role seems to be duplicated with other roles but this role doesn't appear to have any relevance for irrigation. Water planning probably best fits under infrastructure management.

The need to apply a 5% loading to non labour costs is unclear and the true marginal cost of overheads to purchases needs to be better justified. If there is no marginal cost then this overhead should not occur and given that Sunwater asserts that all costs are fixed besides electricity I cannot see where the marginal cost is.

The method of applying overhead costs by direct labour costs favours capital intensive activities and schemes over labour intensive ones. Is this appropriate and is it fair to penalise schemes that have been maintained in an outdated way rather than modernised and automated?

In total \$20.2m of centralised overheads are allocated to schemes which is around 31% of total scheme costs. This is a very high number especially when indirect costs are not included in this amount. The level of total costs for each area mentioned on table 2, p12 of Sunwater Centralised

costs submission is staggering and bordering on the unbelievable. The total cost items appear to be multiples of what efficient costs should be. It is hard to know which numbers to criticise most but \$4.9m for water accounts, \$5.5m for ICT, \$2m for service delivery, \$2.5m WH&S, \$2.4m HR, \$1.6m legal and \$2.9m finance must all be miss prints?

There seems to be arbitrary allocation of costs items between bulk, distribution and other. It is unclear how this is done between direct labour costs and those items which are all or largely for schemes or other? It seems unbelievable that more effort is placed by the board, CEO and audit on 8 distribution schemes than 22 bulk schemes. The same comment applies to the majority of cost items.

This highlights a significant floor in using direct labour costs to overheads. I would have thought on average there would be similar effort for each of the 30 schemes so around 75% of costs would be for bulk and 25% for distribution. However I would have thought the vast majority of the focus of the board and CEO was to make money. Consequently 80% or more of its attention was on non scheme and high priority within schemes and only the bare minimum of attention would be paid to irrigation issues.

The \$2.1m in costs for strategy and stakeholder relations needs special, attention. The majority of these functions are of little value and the majority of the ones remaining appear targeted at non scheme and high priority customers. Stakeholder relations for irrigation is a function that is provided by area operations managers not a separate Brisbane unit.

60% of legal costs for schemes seems unbelievable. This surely cannot reflect time and effort in this area. The concept that it costs over \$4m a year to manage water accounts for schemes is impossible to believe. I would have thought this was largely an automated service and would be done at a much lower cost?

The extremely high level of Sunwater overheads, the high percentage of costs to scheme versus other activities, the fact that too high a cost is apportioned to distribution vs bulk and the high proportion of costs being apportioned to big schemes has delivered some unbelievable and unrealistic overhead costs for many schemes as shown in figure 3 and 4 of Sunwaters Centralised cost paper.

For example, over \$2.1m in costs for Burdekin bulk seems hard to fathom. Eton at \$0.8m is even more difficult to believe especially when compared to the Pioneer Valley Water Board overheads. When the majority of overhead functions for the Pioneer scheme are performed by the Pioneer Valley Water Board not Sunwater it is hard to imagine why they \$0.4m in overheads?

Re the distribution schemes, an additional \$3.3m for Burdekin which makes an astonishing \$5.4m in total is difficult to believe. If the Burdekin was locally managed there is no way that this level of overheads would exist. Bundaberg at \$2.1m and Mareeba at \$1.4m are equally concerning and high. It seems unbelievable that \$6.8m or a third of total scheme overhead costs are borne by the 3 highest cost distribution schemes being Burdekin, Bundaberg and Mareeba. This surely cannot reflect reality of cost causality?

The lower many distribution system is staggering with around \$0.4m in overhead costs for a 10,000ML scheme which works out at around \$40/ML. This must be a misprint? It is issues such as

this that have turned this scheme from reaching lower bound in the last price path to causing to be \$140/ML below lower bound in theory now.

It appears that schemes with local business centres have higher overhead costs than remote locations. Is this the case and if so why are these schemes being penalised?

The comparison in costs to State Water Corporation is of no value. There is no point benchmarking against an inefficient government entity from another state. There is much more value in comparing to efficient businesses and the Pioneer valley water board would be a good comparison on a scheme by scheme basis. The comparison of corporate costs on page 18 is of no value. The total cost of these items is \$15.4m but the majority of these costs are allocated to other issues. If state water had the same opportunity to allocate costs to other activities its cost to schemes would also decrease markedly.

Costs being distributed based on direct labour costs does not seem to reflect actual overheads by scheme especially for distribution systems. Perhaps it could allocate to direct labour costs for bulk only,...???

Also, there has been an increase in Sunwaters non scheme business over the past decade. As I understand now around 80% of Sunwaters revenue and around half its costs are for non scheme issues and this is increasing by the year. Perhaps a cost allocation methodology based on revenue may better reflect effort, Sunwaters business expansion and overhead costs than direct costs.

Before too long the vast majority of costs and over 90% of revenue will come from non scheme issues. This will become even more pronounced if some sunwater schemes move to local management, are shut down or medium priority allocations are sold to high priority customers meaning that there are no irrigators left in schemes.

Consequently i think it would be valid to determine what overheads costs are required by Sunwater to manage its non scheme and high priority customers and apportion all those costs to those customers. Any marginal costs above this specifically to service irrigators would then be paid for by irrigators. This methodology would have made no sense historically but with the changing face of Sunwaters business seems to be a better fit for its business.

Another option would be to look at what overheads would exist if schemes were locally managed along the lines of the Pioneer Valley Water Board. If this existed for each of the 30 schemes, would their overhead costs be high or lower than determined under a centralised approach. They are lower and more efficient then these costs should be used. If a centralised structure gives lower costs then these should be used.

## **Tariffs**

Recreation costs are a major concern and these should not be paid by water users. It is unrealistic for direct users of recreational facilities to impose ever increasing costs on schemes and pay nothing for them. Unless these costs are essential for the running of schemes the expenditures should not occur or should be fully funded by the users of these services or by government.

Drainage and water harvesting charges need to be reviewed. Indexation is an issue and CPI minus X (an efficiency incentive) is the preferred approach.

Not sure why 8 years was used for water use forecasts. 10 years seems a more sensible number of years

### **Maximum price increases**

These need to be discussed and set as well as transitional issues. Clearly \$2/ML real plus indexation will be a major challenge for some schemes.

In addition, the fact that prices can't come down in real terms is a concern and raises a number of challenges with other decisions by the QCA. This is a major problem and inequity especially if part A tariffs reflect fixed costs which would mean that the total cost to growers will be increased even if growers are deemed to be at lower bound already. Another issue arises if prices were increased historically to reach lower bound but now are found to be above lower bound.

### **WACC**

The impact of a lower WACC to increase prices is strange and needs to be considered when setting a WACC in the absence of a rate of return.

### **Loss allocations and free water**

The approach to allocating extra bulk costs to channel customers for distribution losses needs to be reviewed. At the very least, the extra allocation of costs should reflect actual losses not allocations which do not match reality. However, I think it is more appropriate not to allocate costs for distribution losses since river losses are ignored. The distribution losses are for a range of items including seepage in channels, evaporation in channels, meter inaccuracies and channel overflows. In some schemes including the Burdekin and Mareeba there are large end of channel overflows which flow into waterways so end up being environmental flows. It is difficult to understand why growers in channels should pay extra for these environmental flows but bulk water users are not asked to pay for environmental losses in the river.

Free allocations are a concern and should be reviewed and should not be used to allocate extra costs to the other irrigators in a scheme

### **Renewals**

Move from 30 to 20 years appears to have condensed same spending over a shorter period. All speculative spending towards the end of the 25 year renewals period should be removed and only items that are likely to occur within the 25 year time horizon should be included. Also, since cash flows closer to year zero it has also increase NPV. Combined impact is greater spending over shorter years leading to significant increase in renewals annuity.

The opening balance for renewals is a concern. Spending needs to be justified over the last 5 years and benchmarked against efficient costs which were determined as part of the 2006 review. The opening balances for 2006 and estimated efficient costs and cost items should be provided and compared to actual items and dollars spent. The starting balance for all schemes then need to be

adjusted which could mean resetting at 0 for schemes in a negative balance if no justification for historical expenditure can be provided.

The unbundling of the starting renewals balance for bulk vs distribution is an interesting process. Given that there may or may not be a relationship between spending from 2007-2035 and spending from 2000-2006 it is difficult to see why this process was chosen. This is especially the case when the renewals spend appears to be quite variable for some schemes and historical and future spending patterns may be very different between bulk and distribution for some schemes. In schemes where historical and future spending is even this methodology may be ok. For other schemes with much more variable spending the chosen methodology will not suffice.

Surely a historical investigation of the main spending items in each of the 8 channel schemes can be undertaken to assist in the setting of the starting renewals balance? It may be more appropriate in the absence of better information to balance the price impacts of an agreed efficient renewals balance between bulk and distribution customers.

### **Cost forecasting assumptions**

It appears that labour costs have been increased by 4% until 2012 and 2.5% (in line with inflation) after this date and any increase above this offset through productivity improvements. If this offset from 2012 can occur I would question why the same has not occurred historically and up until 2012? Where is the incentive for Sunwater to restrain labour increases until 2012? The same logic applies to materials and contractor costs

Re electricity, the concept of electricity indexed by inflation and then adjusted on a yearly basis by actual electricity increases provides absolutely no incentive for Sunwater to decrease electricity costs. Rising electricity costs are a real concern especially for channel schemes and are only uncontrollable if Sunwater continues to do as it has done historically rather than innovate.

Sunwater should be focussed on trying to decrease electricity and total schemes costs by implementing economically feasible changes. This could include negotiating new prices with suppliers, using off peak tariffs, installing new more efficient pumps, building new balancing storages or modifying existing ones or diverting water from rivers at more energy efficient locations.

Unfortunately because Sunwater is increasingly focussed on commercial developments being innovative and modernising irrigation schemes is a low priority. This will be even more pronounced should an electricity price pass through be given.