

Background paper
QCA review of irrigation prices

Contributed assets

Introduction

The Queensland Competition Authority (QCA) is to recommend prices for SunWater's irrigation customers. An important aspect of this process is determining the opening regulated asset base (RAB).

SunWater is currently updating and finalising its asset register to present values for bulk water assets. As part of this process, SunWater acknowledges the need to deal with capital contributions.

The QCA has previously considered capital contributions in an irrigation pricing context for the Burdekin-Haughton Water Supply Scheme:¹

While there is no generally accepted definition of capital contribution, the Authority has taken the view that capital contributions are capital payments made towards the capital cost of an asset by a third party with the intention of reducing the capital outlay by the owner of the asset and with the expectation that the payment will be recognized for pricing purposes. Capital contributions may be made by prospective users and/or government.

The purpose of this paper is to set out the categories of situations to consider and the issues relevant to an assessment of capital contributions.

This paper does not present SunWater's position. This will be developed once final, more detailed information is gathered. However, it is assumed that matters related to channel infrastructure are irrelevant given the opening RAB is to be set at \$0.

It is also assumed that government funding for bulk water assets does not need to be considered, having regard to the Authority's investigation into capital contributions and related issues in the Burdekin-Haughton. The QCA's findings in this case were clear and can be interpreted to have broad application across all schemes:²

Historical reasons for Government investments in other irrigation developments are considered relevant but not binding forever.

The Authority recognises that a more commercial approach to pricing has evolved over time although, in the case of the Burdekin, prices in real terms have not changed since the commencement of the Scheme, even though the structure of prices has been altered with the fixed charge being increased and the volumetric charge decreasing. The ability of Government to make and change policy is outlined in Chapter 7.

¹ Queensland Competition Authority. Burdekin Haughton Water Supply Scheme: Assessment of Certain Pricing Matters relating to the Burdekin River Irrigation Area (April 2003). p16.

² Ibid. p38.

The QCA went on to highlight that:³

... in the absence of any actual or implied contractual arrangements, the government has the power to alter existing pricing arrangements even though they may adversely impact on a particular individual or group of individuals. The Authority's legal advice is that, following a review of past and current water legislation and the representations made by the State during the relevant period, the relevant Ministers are not constrained in specifying water charges for BRIA irrigators and that they have a broad discretion in setting such charges. This broad discretion includes the ability to require that SunWater recover a rate of return in such charges.

As such, we do not expect that government funding for bulk water assets needs to be considered in establishing the opening RAB.

SunWater has identified the following categories of transactions or revenues that may need to be considered for bulk water assets:

- water allocation sales, prior to and after corporatisation and the passing of the *Water Act 2000*;
- meters funded by customers; and
- contributed assets from non-irrigators..

Sales of water allocations

In its Burdekin-Haughton investigation, the Authority examined revenues from the sale of nominal allocations either as part of, or separate to, farm auctions. These transactions occurred prior to 2000, when a number of other legislative and pricing reforms commenced which significantly altered the regime governing the sale of water allocations. For example, SunWater entered into these transactions through bilateral contracts with prices set on a commercial basis. This contrasts to the environment before 2000, where sales were typically dealt with via a license amendment process and prices were prescribed in regulation.

As such, revenues from the sale of water allocations are considered in two stages: before and after 2000.

Water allocation sales pre-2000

There are three categories to consider:

- sales of 'unallocated' water at prices set in regulation (nominal allocation charges);
- sales of 'unallocated' water from existing spare capacity, via auction; and

³ Ibid. p112.

- sales of water allocations generated from asset augmentation.

In assessing the above categories for capital contributions, SunWater expects the key issues to be:

- the contractual / licensing arrangements and the expectations of buyers;
- the extent to which these arrangements and expectations differ from the Burdekin-Haughton scheme as previously assessed by the QCA; and
- whether the water allocations purchased were an asset in their own right, and the current value of those allocations compared to the purchase price (as an indication of benefit).

Nominal allocation charges set in regulation

Prior to the establishment of SunWater and passing of the *Water Act 2000*, water allocations (nominal allocations) could be purchased by irrigators for the payment of a nominal allocation charge. These charges were approved by Governor in Council and prescribed in the *Water Resources (Rate and Charges) Regulation*. In other documentation, these charges were referred to as capital charges.

The QCA has previously considered whether the revenues from these charges should be considered as capital contributions in its Burdekin-Haughton investigation.⁴

SunWater intends to provide the QCA with its best estimate on the revenues from these nominal allocation charges for each scheme, sourced from annual reports and other documentation. Given the time that has elapsed, the nature of the transactions and various changes to information and billing systems, it is not possible to identify the individuals who purchased these entitlements. However, it will be possible to provide information about the current market value of those entitlements

The information in relation to the contributions for the Burdekin scheme should remain which was for a net contribution of \$30.7M (\$2003) comprising \$17.4M from the sale of allocations associated with land auctions (after accounting for favourable financing terms), and \$13.3M from nominal allocation sales outside of the auction process. However, the charges for these nominal allocations were higher in the channel network than for bulk water from the river, and it is likely that only a portion of this amount is attributable to bulk water assets. SunWater will make an estimate of the proportion attributable to bulk water assets from sales into the channel network, having regard to the price differential between water purchased 'ex river' (\$100/ML) and 'ex-channel' (\$250/ML).

⁴ Queensland Competition Authority. Burdekin Haughton Water Supply Scheme: Assessment of Certain Pricing Matters relating to the Burdekin River Irrigation Area (April 2003). pp 27-28

Water auctions – St George and Macintyre Brook

Two water auctions were held that were unrelated to any capacity augmentation, in the St George Irrigation Area and the Macintyre Brook Irrigation Project.

Accordingly, SunWater is gathering information in relation to:

- The revenues from these auctions;
- The terms of sale;
- Relevant statements made that go to the expectations and intentions of the parties in relation to the ongoing pricing treatment of those entitlements; and
- The current-day value of the allocations purchased (given those irrigators acquired what is now a tradable asset).

Given the time that has elapsed, it is unlikely that SunWater will be able to identify the individual buyers at these auctions nor track any changes over time.

Sale of water allocations from asset augmentation (pre 2000)

Prior to 2000, some asset augmentation projects were carried out which resulted in additional water allocations being available for sale. These allocations were sold at auction, and related to:

- raising of Bedford Weir and Bingeang Weir in the Nogo Mackenzie scheme; and
- improvements to channel distribution systems in the Mareeba Dimbulah scheme.

Information is being prepared in relation to the Bedford Weir auction, including the sale contracts and the revenues received, and the individuals who purchased water at this auction.

A separate tender was held for high priority water entitlements from Bingeang Weir raising, for urban and industrial users. This is not considered relevant for irrigation pricing.

The proceeds from the auctions in the Mareeba-Dimbulah scheme are unlikely to be relevant in setting the opening RAB for bulk water assets, as this related to investments made to the channel system to improve channel distribution efficiencies. SunWater will confirm this (or otherwise) with the Authority in the near future.

Water allocations sold since 2000

SunWater has traded water entitlements since corporatisation, including some limited sales (permanent transfers) under the *Water Act 2000*.

In its Burdekin-Haughton investigation, the QCA concluded that the sale of water entitlements (as upfront charges) does not, of itself, constitute a capital contribution:⁵

Should upfront charges be applied in the future, the nature and intent of the charge (including whether it forms a capital contribution or a net gain for SunWater) should be specified, as it will affect the expectations and therefore the investment decisions of irrigators. For example, where sales of water entitlements are not intended to constitute a capital contribution to scheme development costs, this would need to be clearly stated. In this event, the revenues from the sale of water entitlements would not be offset against water delivery charges.

Since 2000 and after corporatisation water trades were transacted through contracts, and occurred amidst a policy and legislative environment where water entitlements were traded as discrete assets, similar to land

SunWater can provide copies of its standard contracts upon request.

As such, SunWater does not propose to gather information in relation to the revenues from its water allocation sales since 2000.

Meters

Customers seeking a new or upgraded meter must meet the purchase and installation costs. The meter then becomes the property of SunWater, who is then responsible for its maintenance, repair and replacement.

Many of SunWater's meters are located in channel networks, and these meter installations tend to be far more expensive than those installed on river pumps. Hence only a small portion of donated meters will need to be considered in terms of the opening RAB, given the value of channel infrastructure is to be set at \$0.

Of those donated meters related to bulk water services (ie on river pumps or groundwater bores), many will have since been replaced or have been depreciated.⁶ SunWater does not believe the value of the meters for bulk water services will be material in terms of setting the opening RAB, and does not warrant the cost of investigating which donated meters remain and which have been consumed (and replaced).

SunWater therefore proposes to present to the QCA the aggregate value of all bulk water meters, and a methodology for approximating an adjustment to account for contributed meters.

Assets funded or donated from non-irrigation users

SunWater is aware of some assets that were donated or funded by non-irrigation users, particularly in the energy sector. For example, Stanwell Corporation and

⁵ Ibid. p41.

⁶ This will be relevant if a DORC valuation is to be applied.

Tarong Energy (via their predecessor entities) funded Eden Bann Weir in the Lower Fitzroy scheme (entirely) and Boondooma Dam in the Upper Burnett (partially).

The price arrangements associated with these contributions or contributed assets are set out in contracts with those customers who contributed.

In dealing with these contributions the QCA has typically preferred to include the asset in the RAB and allow price benefits to be reflected in contracts with individuals.⁷ As such, it is not proposed to research these transactions with non-irrigators further, nor to present information to the QCA on these matters.

Treatment of capital contributions identified

A number of issues arise for the treatment of capital contributions, once established.

As set out above, it is expected that such contributions will be reflected in price adjustments to those who made the contribution, rather than in the RAB itself.

The consumption of any capital contribution will need to be considered. This may be simple where a contribution related to a particular asset or augmentation, but less so where the contribution was towards a broader, more general suite of assets.

Contributed assets or capital contributions can attract a tax liability. The QCA has previously acknowledged the need to account for the taxation impacts of such contributions, for example in its earlier GAWB investigations.⁸

As a result, SunWater will identify the tax liability impacts from any contributions to be recognised, with the net cost to be recovered from customers.

⁷ The QCA's recent approach to capital contributions for SEQ retail/distribution businesses is an exception. However, the specific circumstances are very different to SunWater. For example, SunWater does not receive an ongoing stream of capital contributions.

⁸ Queensland Competition Authority (2005c), Gladstone Area Water Board: Investigation of Pricing Practices. p.70.