Queensland Competition Authority

Irrigation price review 2020-24

Consultation on draft report

10 October 2019

Today's session

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Purpose of this workshop

- Role of the QCA
- Pricing framework
- Tariff structure
- Apportioning dam safety upgrade capex
- Costs
- Prices and bill analysis
- Next steps

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QCA’s role

- The Queensland Competition Authority (QCA) is the independent economic regulator for Queensland under the QCA Act 1997
- The QCA does not have a standing remit to investigate water issues in Queensland.
- The QCA investigates water issues in Queensland where we have been referred an investigation by the Treasurer under the QCA Act 1997.
- The QCA:
  - does not make policy
  - does not make the final decision.
- The Irrigation Price Review 2020-24 is a separate regulatory process to other activities undertaken by the QCA (e.g. setting regulated retail electricity prices under the Electricity Act).

Purpose of our draft report

- Sets out our draft recommendations and explains how we have arrived at them
- Provides stakeholders with an opportunity to review and comment on our proposed approach, prior to us finalising our report
- We take all submissions into account when we recommend final prices to the Government.

Who are we recommending prices for?

- Scope of our review is set by the referral notice
- Only recommending prices for **irrigation customers** in the schemes/systems listed in the referral notice
- Irrigation customers *use water for the irrigation of crops or pastures for commercial gain*
- Prices for non-irrigation customers in the specified schemes/systems are out of scope.

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The pricing framework

- We must conduct our investigation in accordance with the relevant legal framework
- For this investigation, the key components are the referral and the QCA Act
- The framework:
  - directs us to provide recommendations on particular issues
  - provides guidance on the matters we must consider
  - sets out the pricing principles we are to apply in calculating recommended prices.

The pricing framework

- Referral reflects the Government's water pricing policy, which aligns with its commitments under the National Water Initiative
- Policy applies different pricing frameworks and objectives to different customer groups, with:
  - prices for certain irrigation customers determined by the Government and expected to transition over time to prices that recover lower bound costs
  - prices for other customers negotiated by the relevant water business with their customers and expected, where practicable, to transition over time to full commercial prices.

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The pricing framework – lower bound

- 'Lower bound' prices recover the prudent and efficient costs of operating, maintaining, administering and renewing each scheme. These costs exclude certain costs, such as a return on and of existing assets (as at 1 July 2000).
- Full commercial or 'upper bound' prices include the same costs as lower bound prices as well as a provision for the costs of capital
- While lower bound prices are referred to as 'cost reflective', they still involve a subsidy from taxpayers, as the water businesses are neither earning a return on, nor recovering, the initial investment in the existing assets.

The pricing framework

We must have regard to the following when recommending prices:

- section 26 matters, including:
  - efficient resource allocation
  - social welfare and equity considerations
  - economic and regional development issues
- matters required by the Treasurer’s referral notice, including:
  - allowable costs and the government’s pricing principles
  - balancing legitimate commercial interests of businesses with interests of their customers
  - where possible, transparent and simple revenue and pricing outcomes

The pricing framework

- The matters we are required to consider are diverse and may at times require us to make judgements about the relative importance of matters in particular circumstances
- We have considered all issues raised in submissions in deciding the relative importance to attach to the relevant matters
- We have emphasised the pricing principles as these principles give effect to the Government's lower bound cost target
- The Government has indicated that, in setting the lower bound cost target for irrigation water prices and establishing a gradual transition path to that target, it has considered a range of matters including customers' capacity to pay and benefits of industry to the Queensland economy

Tariff structure (fixed and volumetric prices)

- The QCA acknowledges concerns raised by Lockyer Valley irrigators about the low reliability of scheme assets.
- We consider that any relief from fixed (Part A) prices during a drought is a matter more appropriately determined by the Queensland Government.
- Drought assistance provided by the Queensland and Australian governments generally encompasses a range of measures and any relief from Part A charges needs to be considered in that context.
- In addition, there are limits to the extent we can address this by rebalancing tariffs:
  - inconsistent with the Government's pricing principles in the referral (any relief is a matter more appropriately determined by the Government)
  - will not address the underlying reliability issues
- The QCA notes that the Government is currently working with irrigators in Central Lockyer Valley and Lower Lockyer Valley WSSs to investigate potential options to address reliability issues
- We encourage both parties to continue those investigations.

Tariff structure (fixed and volumetric prices)

- In determining the appropriate tariff structure, we need to have regard to fixed and variable nature of the underlying costs.
- Fixed/variable split from 2013 review is appropriate starting point.
- Propose to allocate 20 per cent of direct operations and maintenance costs to variable costs.

Cost component	Seqwater proposed	QCA draft
Operations & maintenance	5	20
Electricity costs	5	-
Insurance	5	-
Local government rates	-	-
Dam inspection costs	5	-
Non-direct costs	-	-
Renewals annuity	-	-
Dam safety upgrade capex	-	-

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Nodal pricing

- Some stakeholders submitted that nodal pricing should be considered to account for differing operations of Bill Gunn Dam (gravity-fed) and Lake Clarendon (pumped water).
- Under the terms of the referral, we have been directed to adopt the current tariff groups for all WSS, other than those tariff groups in schedule 3 of the referral.
- Consistent with these terms, we are required to adopt the existing tariff group for Central Lockyer Valley WSS, which provides for the same price for all customers.

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Dam safety upgrade capex

- Directed by Government to provide prices with and without an allowance for dam safety upgrade capex
- The Government will decide which set of prices will apply when it sets prices
- Consistent with the referral, our draft prices and proposed approach to apportioning dam safety upgrade capex only apply to irrigation customers in the specified WSSs and distribution systems
- There are no dam safety upgrade projects forecast to commence in Lockyer Valley schemes during this pricing period.

Dam safety upgrade capex – proposed approach

- Only prudent and efficient upgrade capex that is required to meet dam safety obligations
- Dam safety upgrade capex should generally be treated as a normal cost of operation in supplying water services
- Regulatory asset base (RAB) approach, as-commissioned basis
- Allocated to water users unless there is a clear justifiable basis for allocating some of the costs to other parties
- Two primary reasons for allocating costs to other parties:
  - Dam provides a formal flood mitigation service
  - For dams that do not provide a formal flood mitigation service, dam provides informal flood moderation / management benefits

Dam safety upgrade capex – proposed approach

- Where a dam provides a formal flood mitigation service, that service should be recognised in the allocation of costs, including dam safety upgrade costs
- The costs associated with that service should not be apportioned to irrigators
- The costs associated with that service should be allocated to the beneficiaries of that service (where possible) or the broader community

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Dam safety upgrade capex – proposed approach

- Some dams that do not have a formal flood mitigation role may still provide informal flood moderation and/or management benefits for downstream communities
- In light of those benefits, there is a case for sharing some of the costs of dam safety upgrades with the beneficiaries in the broader community where the upgrades will result in improved flood moderation or management
- For dams that do not provide a formal flood mitigation service, dam safety upgrade capex should be:
  - allocated using a general allocation ratio (dam-specific allocation ratios only used in certain circumstances) that allocates 80 per cent of the irrigation share of these costs to irrigation water users
  - the remaining 20 per cent should not be included in the allowable cost base for irrigation pricing purposes

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Lower bound costs

Cost-reflective prices that incorporate costs allowable under referral:

- prudent and efficient costs allowable under the referral:
  - operational, maintenance and administrative costs
  - appropriate allowance for expenditure on renewing existing assets
  - QCA fees (up to $2.5 million cap) – not included in Seqwater's costs/prices.
- includes costs required to meet regulatory obligations or deliver agreed service levels.
- costs recoverable from prices exclude:
  - the recovery of capex prior to 1 July 2000 used to build existing assets
  - subject to certain exceptions:
    - recreational costs incurred from 1 July 2020
    - costs associated with augmentation of existing assets, new assets, or any capex that is not like-for-like or does not reflect regulatory requirement.

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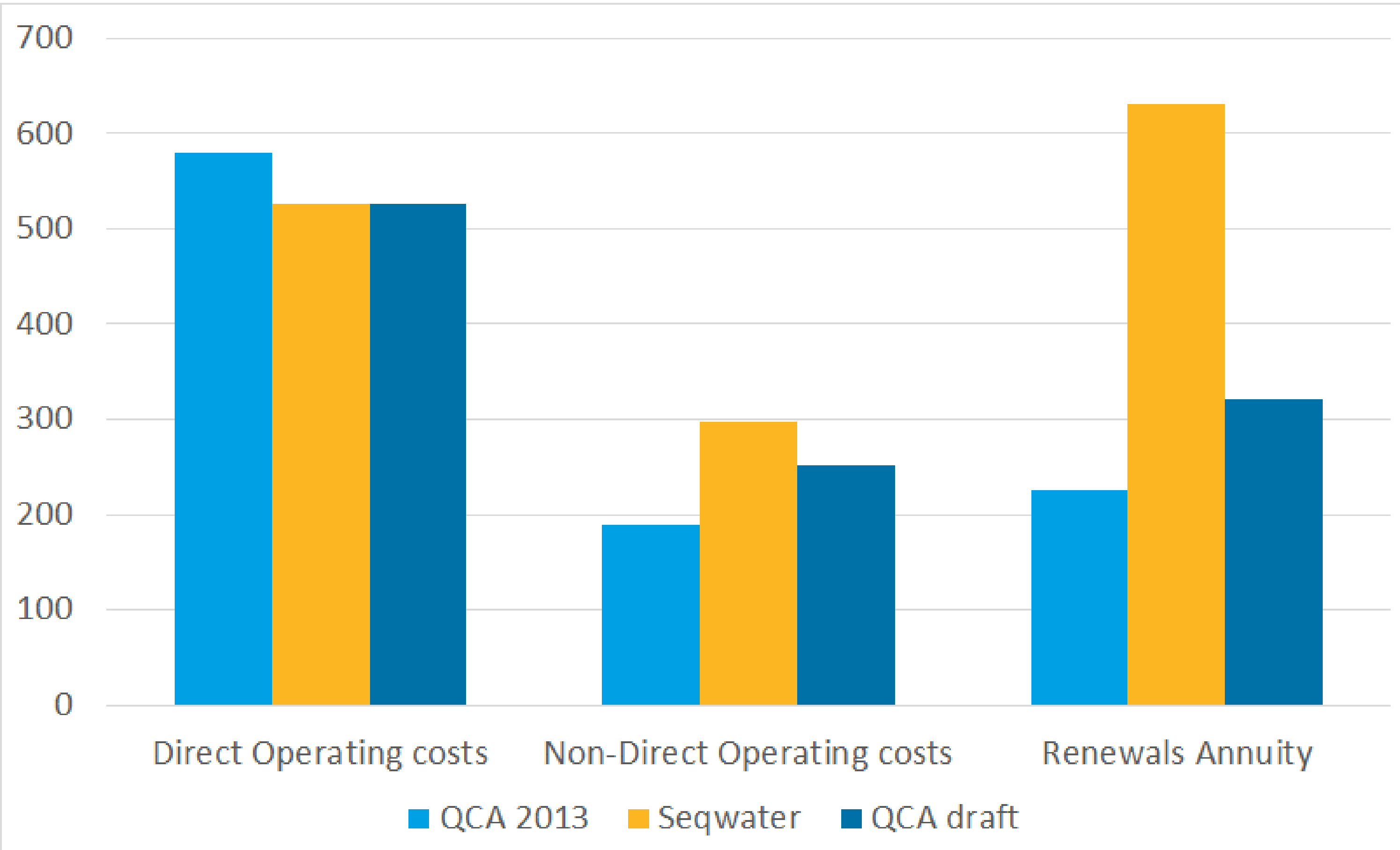
Allowable costs

Central Lockyer WSS – base year costs ($’000, $2018-19)



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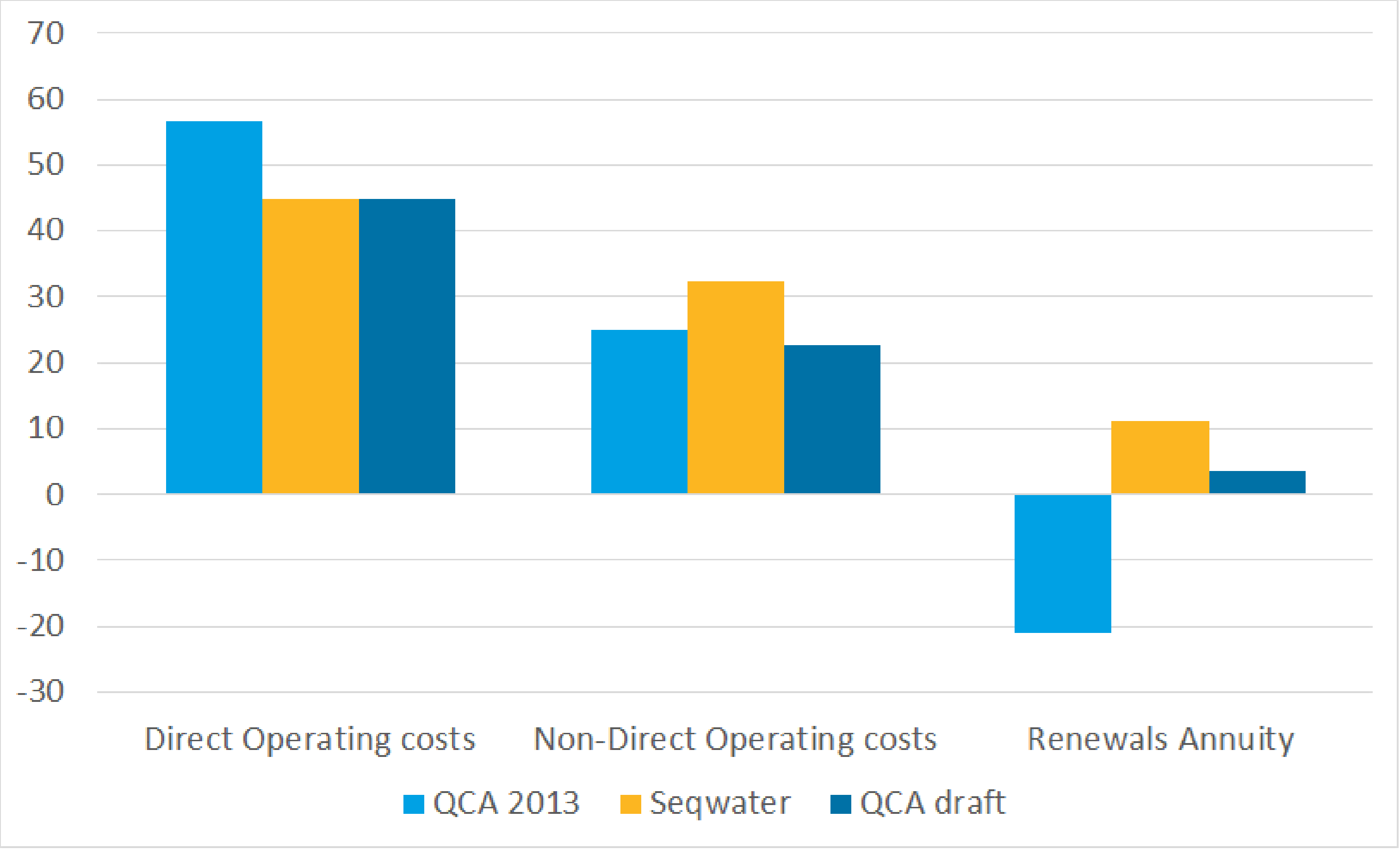
Allowable costs

Morton Vale Pipeline – base year costs ($'000, $2018-19)



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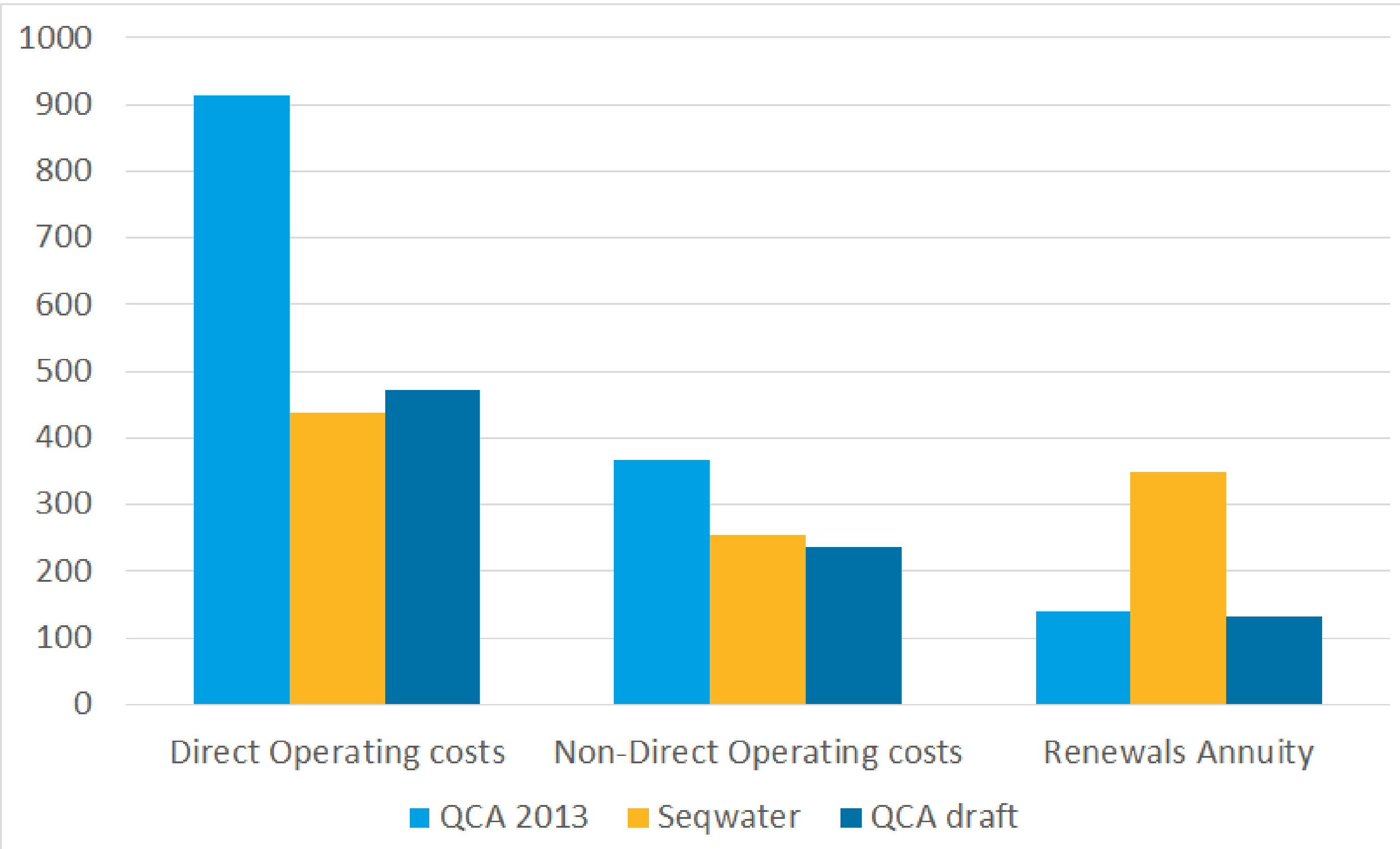
Allowable costs

Lower Lockyer WSS – base year costs ($'000, $2018-19)



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Distribution and bulk losses

- The overall volume of loss WAEs held by Seqwater is not material in comparison to Sunwater, but the appropriateness of the distribution loss WAEs does warrant consideration.
- Where we have assessed loss holdings to be excessive, we have allocated the bulk holding (fixed) costs of these to Seqwater.
- This is on the basis that customers should not pay for loss WAEs in excess of what is required to meet actual loss releases.
- Customers pay costs of remaining loss WAEs.
- To calculate the efficient level of loss WAEs, we have generally taken the maximum loss WAEs required over the past 15 years after adjusting for water usage.
- In the Lower Lockyer Valley WSS, the full allocation of bulk loss WAEs are consistently required.

Bulk losses - Lower Lockyer Valley

	2013-14	2014-15	2015-16	2016-17	2017-18
HP Loss WAE	0	0	0	0	0
MP Loss WAE	1,500	1,500	1,500	1,500	1,500
Actual Losses (HP + MP)	3,419	5,841	2,418	350	3,367
HP Loss WAE used	-	-	-	-	-
MP Loss WAE used (1)	3,419	5,841	2,418	350	3,367

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Distribution losses - Morton Vale Pipeline

- No data was available for the Morton Vale Pipeline, since the pipeline is gravity fed from the dam.
- Although no data was available for Morton Vale Pipeline, Seqwater has informed us that distribution loss IWAs are reserved to refill the pipeline, and distribution losses are caused by breaks or other failures in the pipeline.
- Given the lack of information on actual distribution losses associated with the Morton Vale Pipeline since our 2013 review, we propose to maintain the current approach and propose 50 per cent of distribution loss IWA is efficient.

Distribution and bulk losses

- We believe Seqwater is best placed to manage the risk of distribution loss WAEs in excess of the efficient level.
- Impact on Lower Lockyer cost-reflective prices:
  - Part A (fixed tariff) +$10.97/ML
- Impact on Morton Vale Pipeline cost-reflective prices:
  - Part C (fixed tariff) +$1.00/ML
- We recommend that Seqwater should review its loss WAEs and develop a strategy for their future treatment prior to the next price review
- For the next price review process, we would expect to be assessing the reasonableness of Seqwater's proposed strategy for its holdings of loss WAEs, including Seqwater's views on the efficient level of its loss WAE holdings.

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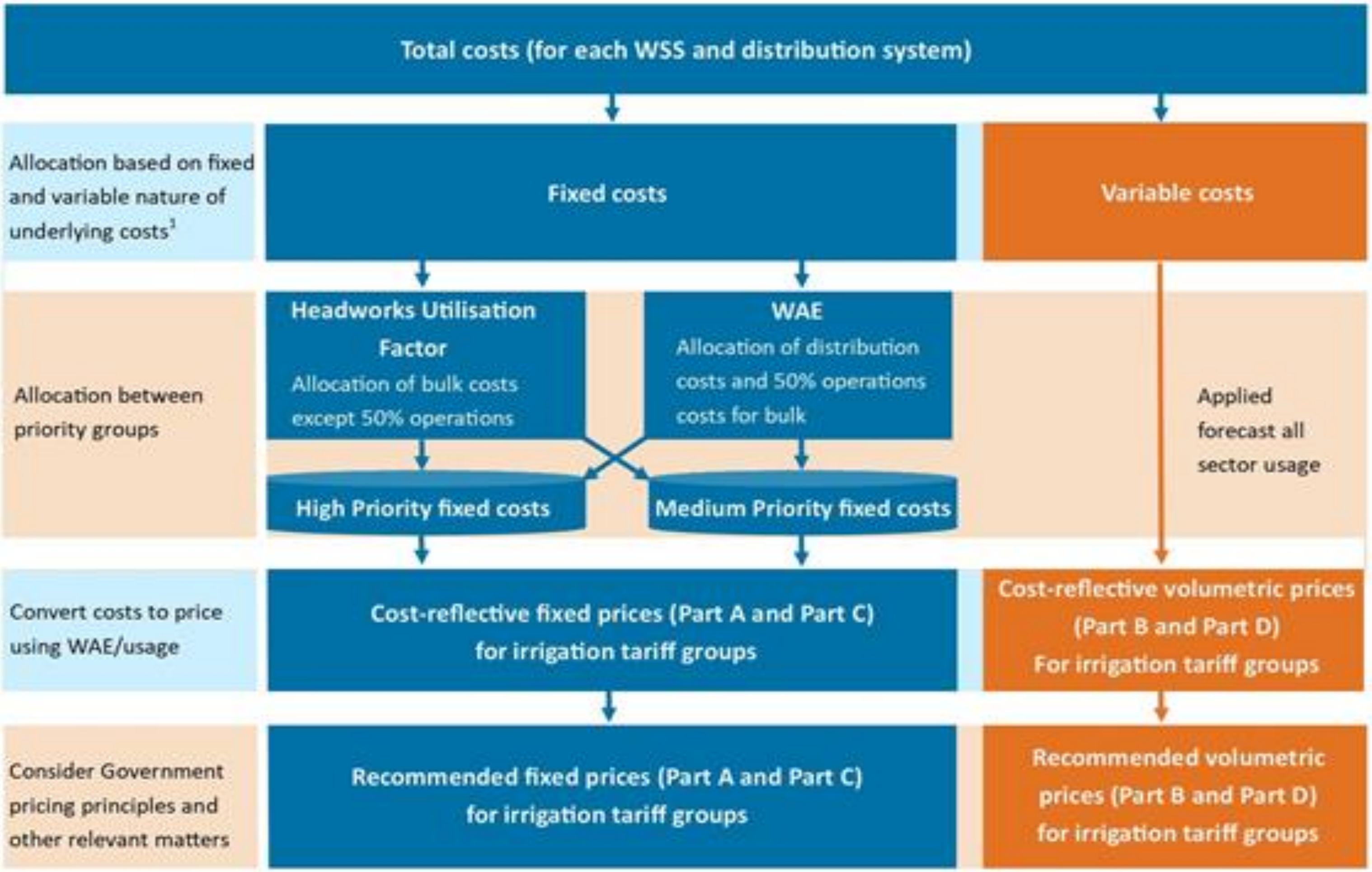
Approach to deriving recommended prices



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Moreton water plan amendment

- Over the past year, there has been public consultation on the Government's proposal to convert water entitlements in the Central Lockyer Valley WSS to tradeable WAEs.
- On 23 July 2019, the Minister asked for a new draft Moreton water plan amendment to be prepared, replacing the draft Moreton water plan amendment released in 2018.
- The draft prices derived for Central Lockyer Valley WSS are based on the priority groups and volumes in the current Interim Resource Operations Licence in place for this scheme.
- We recommend that prices for the Central Lockyer Valley WSS be updated to take into account the Water Plan (Moreton) (Supply Scheme Arrangements) Amendment Plan 2019 as soon as practicable after it is finalised.

Cost-reflective prices 2020-24 ($/ML)

	Actual 2019-20	2020-21	2021-22	2022-23	2023-24
Central Lockyer Valley WSS – Medium priority					
Part A	**35.42**	63.89	65.40	66.95	68.54
Part B	**11.46**	11.17	11.43	11.70	11.98
Morton Vale Pipeline – Medium priority					
Part A + C	**45.76**	77.36	79.20	81.07	83.00
Part B + D	**15.19**	21.93	22.45	22.98	23.53
Lower Lockyer Valley WSS – Medium priority					
Part A	**47.53**	92.70	94.90	97.15	99.45
Part B	**25.80**	30.40	31.12	31.85	32.61

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QCA recommended prices

The referral requires the QCA to adopt the current tariff groups for all WSS.

We have sought to recommend prices that transition gradually to lower bound costs, as this will give users sufficient time to adjust.

Above lower bound prices:

- Fixed price maintained in nominal terms until this cost base is reached.
- Existing volumetric price > cost-reflective → reduce to cost-reflective
- Existing volumetric price < cost-reflective → increase by inflation only.

Below lower bound prices:

- Fixed price transitioned to cost-reflective by $2.38/ML ($2020-21) of WAE (plus inflation).
- Existing volumetric price > cost-reflective → reduce to cost-reflective
- Existing volumetric price < cost-reflective → cost-reflective, except where this would lead to total (fixed + volumetric) price increase well above $2.38/ML of WAE plus inflation.

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Recommended prices 2020-24 ($/ML)

	Actual 2019-20	2020-21	2021-22	2022-23	2023-24
Central Lockyer Valley WSS – Medium priority					
Part A	**35.42**	38.64	41.93	45.31	48.76
Part B	**11.46**	11.17	11.43	11.70	11.98
Morton Vale Pipeline – Medium priority					
Part A + C	**45.76**	49.22	52.77	56.40	60.12
Part B + D	**15.19**	21.93	22.45	22.98	23.53
Lower Lockyer Valley WSS – Medium priority					
Part A	**47.53**	51.04	54.63	58.30	62.07
Part B	**25.80**	30.40	31.12	31.85	32.61

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Termination fees

- Since the 2012 review there has been no change to the ACCC Water Charge (Termination Fees) Rules 2009. The rules determined that termination fees in the Murray-Darling Basin should be calculated as up to 10 times the relevant cost reflective fixed tariff.
- As Seqwater is subject to GST payment on termination revenue it receives, the ACCC multiplier of up to 10 adjusted for GST results in a multiplier of up to 11.
- We consider that a termination fee applied as 11 times the cost-reflective distribution fixed (Part C) price balances the interests of Seqwater and customers with providing appropriate incentives for Seqwater to supply only those services required by their customers. Therefore, we propose no change to current arrangements.

Termination fees

- As remaining customers should not pay for any shortfall in revenue upon exit of the scheme by another customer, the termination fee for Morton Vale Pipeline should continue to be based on the cost-reflective fixed (Part C) price calculated using 5,051ML WAE—the agreed volume at the establishment of the scheme.
- We note that the termination fee multiplier is set to a level of up to 11 times the relevant cost reflective fixed tariff (including GST). A lower multiple could be applied at Seqwater's discretion, should it be consistent with Seqwater's commercial interests (e.g. in the interests of more efficient system management).
- We also note that customers do have the option of permanently trading their water entitlements to other distribution system users, which does not incur a termination fee. Alternatively, customers can choose to retain ownership of their distribution system WAE and engage in temporary trading.

Termination fees

Maximum termination fee per tariff group ($/ML WAE nominal):

Tariff group	2020-21	2021-22	2022-23	2023-24
Morton Vale Pipeline	148.22	151.73	155.33	159.01

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Next steps

Milestone	Date
Draft report released for consultation	9 September 2019
QCA community workshops	September and October 2019
Submissions due on draft report & issues paper	4 November 2019
Final report provided to the Government	31 January 2020
Final report released	Early February 2020

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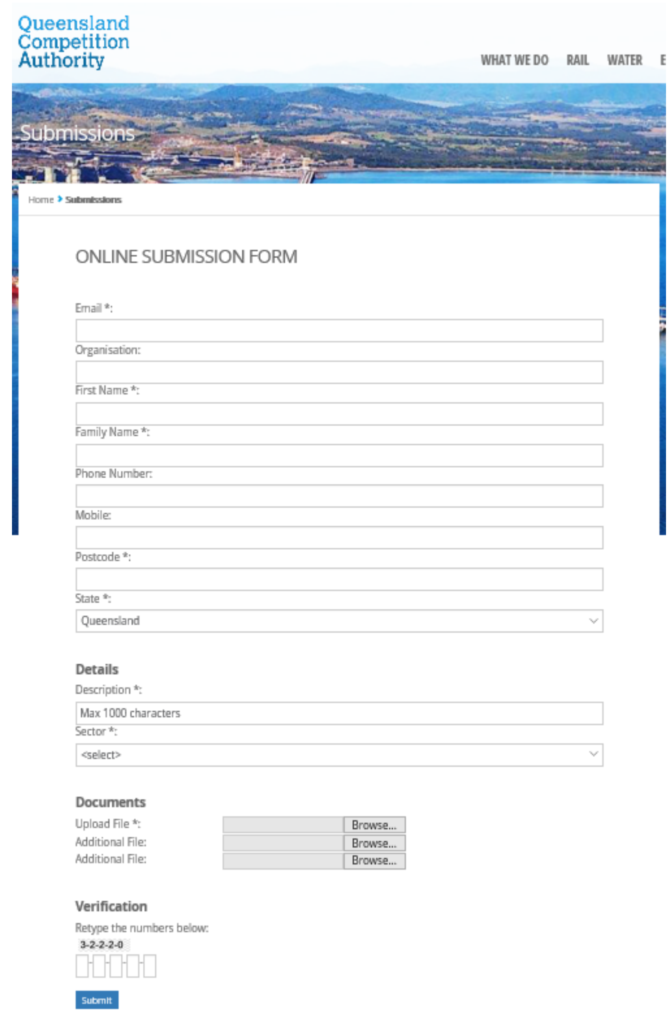
How to make a submission

- Online submission form at www.qca.org.au/submissions
- Or by post:
  QCA, GPO Box 2257, Brisbane Q 4001
- Submissions are encouraged, considered and addressed
- Transparency – submissions will be published



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Questions?

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