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
- Approach to allocating shared scheme costs
- 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).

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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.

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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

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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

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Approach to allocating shared scheme costs

- Seqwater and MBRI joint submission:
  - modelled two scenarios – existing ‘with dams’ scenario vs alternative ‘without dams’ scenario
  - concluded that there is no significant change in hydrologic benefit when the two scenarios are compared
- The alternative ‘without dams’ scenario assumes:
  - No Wivenhoe or Somerset Dams
  - No high priority entitlements (urban water supply)
  - No system regulation

Approach to allocating shared scheme costs

- The QCA does not consider the alternative scenario to be a suitable comparator:
  - There is a long history of water for urban consumption being sourced from the Brisbane River.
  - Consistent with the regulatory framework, water in the system is managed to deliver certain environmental outcomes and to provide for the continued use of all water entitlements, including medium priority WAE. As such, the regulation is intended to balance the competing needs of urban, rural and environmental uses.
  - The total volume of allocations in the WSS has been determined on the yield of the system as a whole, including the relevant dam infrastructure.
  - Consistent with the regulatory framework, both WAE priority groups in the Central Brisbane WSS are supplemented by the Wivenhoe and Somerset dam infrastructure, and therefore benefit from the supplemented flows provided by that infrastructure.

Approach to allocating shared scheme costs

- We have been mindful that the joint submission represents a customer agreement but note this agreement:
  - Is based on findings that do not adequately represent the benefits that medium priority WAE holders obtain from the relevant dam infrastructure.
  - Given that medium priority WAE holders benefit from the relevant dam infrastructure, we consider that the proposed cost allocation of zero is not consistent with the requirements of the referral.
  - The proposal to allocate these costs to urban users may also introduce an implicit cross-subsidy from high priority urban users to medium priority irrigators. This would not be consistent with the requirements of the referral or the Government's commitments under the NWI.
  - Under clause C(1.5) of the referral, agreed costs/prices need to be consistent with the requirements of the referral.

Approach to allocating shared scheme costs

- We have therefore adopted an alternative cost allocation approach:
  - relies on a modified HUF methodology (calculated on the basis of the storage volume required to deliver 100% MP WAE per annum)
  - results in an allocation of 1% to MP WAE.

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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 during this pricing period. However dam safety upgrade projects are due to be commissioned in 2025-2026

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

Dam safety upgrade capex – Central Brisbane River WSS

- Dam safety upgrades due to be commissioned in 2025-2026
- On an 'as-commissioned' basis, capex is incorporated in the RAB in the year of commissioning. Therefore, the capex in this scheme will only impact costs in 2025-26
- We have estimated the impact in the year following commissioning (2026-27) to be an increase in the cost reflective fixed (Part A) price of $4.91/ML.

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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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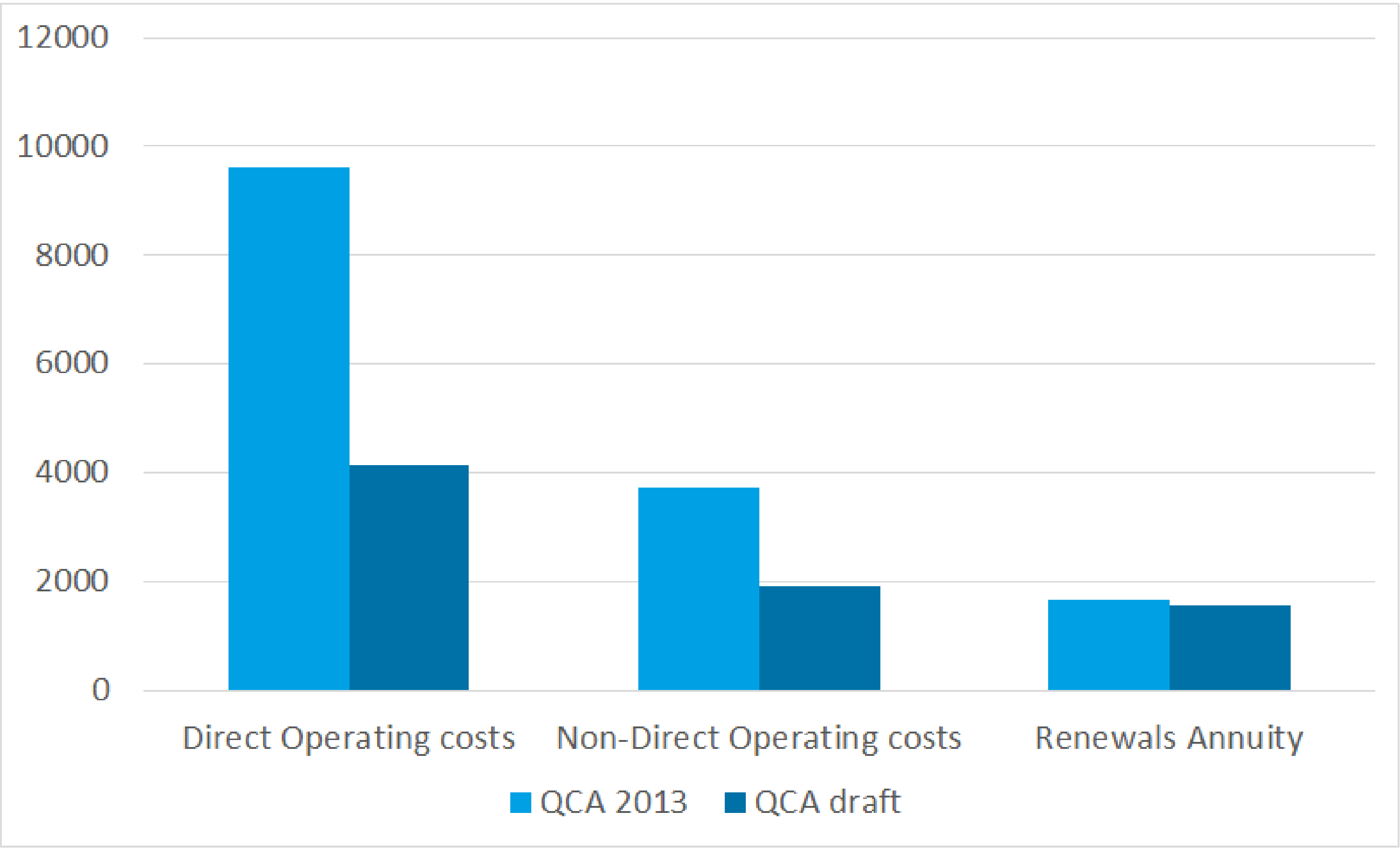
Allowable costs

Central Brisbane River WSS – base year costs ($'000, $2018-19)



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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
Labour, R&M and other	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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Cost allocation (medium/high priority)

- Generally, costs that are asset-related should be allocated using HUF, as this takes into account the differential in benefits received.
- For Central Brisbane River WSS, all fixed costs allocated using HUF.

Cost component	Bulk allocation
Operations (Labour & Other)	HUF
Electricity (fixed)	HUF*
Insurance	HUF*
Local government rates	HUF*
Dam inspection costs	HUF
Repairs & maintenance	HUF*
Renewals annuity	HUF*
Dam safety upgrade capex	HUF*
Variable costs	Usage (per ML)

* Only share of dam capacity used for supply (that is, 44%), as remaining share relates to flood mitigation services.

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

	Actual 2019-20	2020-21	2021-22	2022-23	2023-24
Central Brisbane River WSS – Medium priority					
Part A	**24.48**	5.81	5.95	6.09	6.23
Part B	**11.76**	2.81	2.87	2.94	3.01

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QCA recommended prices

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.

QCA recommended prices (Central Brisbane River)

- The exception to this approach is the Central Brisbane River WSS, for which the referral states that the 2020-21 fixed (Part A) price may be less than the prevailing 2019–20 fixed (Part A) price, where:
  - cost allocations are reapportioned as anticipated in the 2013 review
  - it is an outcome of wider cost allocation investigations with customers.
- We considered whether the results from Seqwater's cost allocation investigations with customers, or an alternative cost allocation approach, could provide an improved approach to assigning benefits attributable to each WAE priority group in the Central Brisbane River WSS.
- Given that our review process has developed an updated cost allocation approach that has resulted in the lower bound cost target being lower than the 2019-20 price, we have recommended the lower fixed (Part A) price for this scheme that is consistent with the lower bound target.

Recommended prices 2020-24 ($/ML)

	Actual 2019-20	2020-21	2021-22	2022-23	2023-24
Central Brisbane River WSS – Medium priority					
Part A	**24.48**	5.81	5.95	6.09	6.23
Part B	**11.76**	2.81	2.87	2.94	3.01

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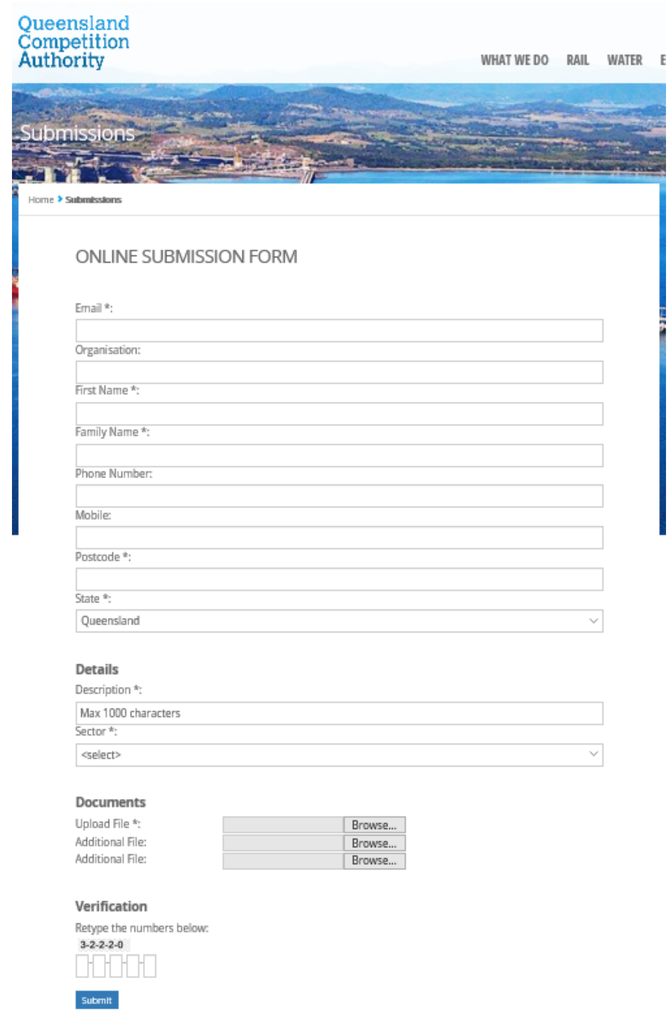
Next steps

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

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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