sunwater

Irrigation Price Path 2025-26 to 2028-29

Response to QCA Draft Report

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1 Executive summary

Sunwater welcomes the opportunity to make this submission responding to the Queensland Competition Authority's (QCA) *Rural irrigation price review 2025-2029: Sunwater Draft Report* (Draft Report), released on 5 July 2024.

Sunwater's response is provided in the context of a collaborative and transparent process, which commenced in early 2023 and has been ongoing since. Following submission of its *Irrigation Pricing Proposal 2025* in November 2023, Sunwater has responded to more than 160 requests for additional information on a range of issues, either from QCA or its consultant, as well as holding numerous in-person interview sessions. Sunwater has also continued to engage with customers, customer advocacy groups and other stakeholders to obtain their views on a range of issues relevant to this submission.

Sunwater acknowledges that QCA have accepted many of the positions and forecasts set out in Sunwater's pricing proposal in its draft report. However, QCA has deviated from Sunwater's proposal in the material areas of the opex base year, customer and stakeholder project (CASPr) and renewals overheads, which represents a risk to Sunwater's commercial interests and the long-term interests of customers.

As such the focus of this submission is to provide a clear response to the positions outlined in the Draft Report, and to request amendment so the Final Report is more reflective of the costs Sunwater incurs in delivering water for its irrigation customers, as detailed in Sunwater's original proposal.

Sunwater is also of the view that, with the proposed revisions to its regulated asset base (RAB) proposal, it has adequately addressed the feedback provided by QCA. Further Sunwater reflects that, although a minority of customers hold strong views and are opposed to the change, more customers support the change than not.

1.1 Methodological concerns with the Draft Report

Sunwater's key concerns with the Draft Report centre around departures from QCA's published guidance, referral notice, and contemporary regulatory practice – particularly as this relates to the setting of an opex base-year, but also affecting decision-making in relation to the customer and stakeholder project (CASPr).

Sunwater's analysis argues for a Final Report that demonstrates:

- improved alignment with QCA's referral notice, guidance and contemporary regulatory practice
- reliance on well-evidenced positions where QCA seeks to depart from Sunwater's proposals
- provision of relevant context where QCA seeks to critique Sunwater's proposal or conduct
- appropriate balancing of Sunwater's legitimate commercial interests with the interests of its customers in the development of final positions and recommendations.

To assist QCA in its preparation of a Final Report, this response provides revised positions on specific matters, such as CASPr, electricity cost pass-through (ECPT) and RAB proposals, as well as detailed feedback on the draft recommendations set out in the Draft Report.

1.2 Sunwater's positions in response

1.2.1 Opex base-year

Sunwater's response to the Draft Report position on opex centres around the setting of the base-year allowance. Sunwater's view is that the revealed cost methodology contained in QCA's guidance is both consistent with good regulatory practice and the referral notice and is therefore more appropriate than the mixed approach of revealed cost and reference to past pricing reviews that has been applied.

Sunwater makes the case for the adoption of its proposed opex base-year (after adjustments for non-recurrent items) by presenting analysis and argument that:

- supports a top-down revealed cost method in setting an economically efficient base-year
- past regulatory forecasts (such as the allowances put forward by QCA at the 2020 irrigation pricing review) represent a point-in-time estimate that cannot be relied upon for setting the 2022-23 base year
- many of the base-year allowance changes proposed by QCA reflect a difference of opinion rather than superior analysis or data
- benchmarks compiled to support the review offered limited insights as a result of the quality and nature of the datasets assembled.

As a final opex consideration, Sunwater makes the case that any consideration of appropriate efficiency targets must use actual expenditure as its point of reference rather than an allowance.

Should QCA not accept its arguments relating to proposed cost adjustments, Sunwater is concerned that accepting the 0.5 per cent per annum efficiency proposal does not acknowledge the impact of proposed QCA adjustments on the actual savings this requires the business to find. That is, the actual opex efficiencies required are significantly higher than the 'headline' efficiency target of 0.5 per cent per annum, due to the adjustments to base-year expenditure made in the Draft Report.

- Sunwater estimates the cumulative efficiency factor is around 1.5 per cent per annum when its actual opex in the base year is taken into account, which translates to Sunwater having to realise opex savings of around $21 million in nominal terms in the next price path period.
- This significantly exceeds standard practice across the water sector nationally and does not advance Sunwater's commercial interests, which include recovering the true cost of providing an ongoing, reliable water supply to our customers.

A sound opex base-year is central to the revenue Sunwater can earn over the price path, but more importantly, has lasting implications for future periods under QCA's current assessment methodology. It is critical that this value reflect prudent and efficient cost levels.

Detailed arguments are presented in **Section 4**.

1.2.2 CASPr

In its Draft Report, QCA made both significant revisions to expenditure (capital and opex) and rejected Sunwater's preferred cost allocation approach for this significant project and spend.

Sunwater's response seeks to address each of these elements and includes commentary that seeks to correct apparent misconceptions about the scope of the project. CASPr is a multi-function system that will manage water allocations and accounting, the meter-to-cash process, customer relationship management, internal communications, management and reporting on critical functions.

The design, development and integration of the multifaceted, multi-function CASPr system is complicated and requires proper investment and planning; the solution is not available via an off-the-shelf generic product.

Each of these functions has been identified as necessary and each has costs. Sunwater has sought to break down CASPr costs across the three primary functions, although it is difficult to do so because:

- a significant portion of the cost is shared (project governance, quality management, data migration, solution architecture and others)
- there is a single contract that spans the three functions for clients, which are naturally integrated. All three functions are necessary and integrated for each client.

At this stage, Sunwater estimates the cost ratio of 20:40:40 across customer relationship management, billing and water accounting.

Sunwater issues approximately 21,500-22,500 water account statements and 20,000-21,000 invoices annually. All this documentation will be managed and produced by CASPr.

QCA draft position

QCA's draft position includes:

- reducing the allowed capital cost from $38.6 million to $18.5 million
- reducing the allowed opex step-change from $1.4 million to $0.7 million in 2022-23 dollars
- rejecting Sunwater's proposed recovery via the renewals recovery pathway and an opex step-change, in favour of recovery via the corporate overhead allowances.

Sunwater's response

Sunwater does not support these draft positions and puts forward counter-arguments for each.

The detailed business case value of $38.6 million remains appropriate for the project as scoped. Sunwater argues there is no basis for adoption of the recommended build cost of $18.5 million and both QCA and AtkinsRéalis found the detailed business case to be a sound decision-making document.

Sunwater acknowledges that some of the early works (and therefore costs incurred) in 2020-21 and 2021-22 were not demonstrably good practice. Sunwater therefore proposes that a reasonable outcome is for customers not to be required to fund the project development costs incurred in this period. This represents a total of $3.6 million.

On this basis, the cost apportionment across the three functions, based on Sunwater's revised recovery amount of $34.9 million, is:

Water accounting and management	$13,951,333 (40%)
Meter-to-cash	$13,951,333 (40%)
Customer relationship management	$6,975,666 (20%)

In relation to ongoing costs, which Sunwater proposed as opex step-changes, Sunwater has acknowledged (via its response to RFI 59) a further $0.2 million reduction in costs, meaning its position is that ongoing costs should be $1.2 million in 2022-23 dollars.

Sunwater argues that further recommended reductions require revision because they:

- incorrectly assert that a redeployment would result in an increase in costs of $0.2 million
- incorrectly identify a further $0.3 million in labour savings, and do not take into account AtkinsRéalis's statements regarding the ICT efficiencies already achieved by Sunwater.

Finally, Sunwater responds to QCA's proposed cost recovery approach, which is based on the recovery of CASPr costs (capital and operating) through the corporate overheads allowance.

Sunwater proposed that the capital costs of CASPr be distributed across regulated and non-regulated service contracts using customer numbers as the appropriate cost allocator and recovered in the same way as other renewals projects via either the annuity allowance or RAB. This approach is designed to properly reflect both the benefits and functions of the CASPr system, which will be shared equally among Sunwater's customers.

CASPr's functions are relevant and beneficial to all Sunwater's customers and are a necessary element of modern management and reporting on water distribution and organisational operations.

Sunwater notes QCA's stated desire for Sunwater to improve the causal alignment between costs and recoveries across its portfolio. The proposed capital cost recovery methodology for CASPr is overtly causal and aligns with QCA's approach. Sunwater acknowledges further work will be required in future across the full portfolio to increase causal recovery but contends this is not a valid reason to reject Sunwater's approach to apply a casual methodology where it is available, as it is here. This is a significant investment and will require Sunwater to utilise debt to fund this investment.

QCA's proposed treatment as a corporate overhead will lead directly to under-recovery of this critical project. This is not appropriate and runs counter to the regulatory principle of user pays – and precedent in the form of the Seqwater proposal.

1.2.3 Renewals overheads

QCA made a substantial adjustment to the indirect and overhead costs allocated to forecast renewal expenditure. Sunwater believes this adjustment is unjustified as it has reduced allowed indirect and overheads costs below prudent and efficient levels and relies on:

- a simple (unweighted) average of four years of actual renewals expenditure that QCA relied on to reduce the forecast direct labour portion of renewals from 26 per cent to 12 per cent
- the implicit assumption that this reduction does not require adjustment of the 'cost recovery rate' calculation.

This response presents analysis that demonstrates that both positions are unsupported by the available evidence.

Sunwater's response presents analysis that shows the weighted average historical level of direct labour is closer to 23.4 per cent. The 12.1 per cent value relied on by QCA for its Draft Report has been distorted by a handful of very large projects which were almost entirely (appropriately) outsourced.

Sunwater requests reassessment of the assumption that this reduction does not require adjustment of the 'cost recovery rate' calculation. Considering the reduced direct labour forecast implied by a renewals program with an average 23.4 per cent direct labour proportion, Sunwater recalculates the overhead recovery rate – demonstrating an uplift from the recommended 196 per cent in the Draft Report to 199 per cent. Note that this value is calculated independent of the positions set out above for opex.

Sunwater's revised position in relation to renewals overheads

To ensure Sunwater can recover the prudent and efficient amount of indirect and overhead costs, Sunwater proposes that:

- direct labour be forecast at 23.4 per cent of total direct renewals forecasts
- the cost recovery rate be amended to ensure overall recovery levels of indirect and overheads costs remain at prudent and efficient levels. The average rate should be recalculated to take into account a lower direct labour forecast.

1.2.4 Proposal to recover renewals via a RAB methodology

Sunwater's believes it is in the interests of its customers to introduce the RAB approach at the commencement of the next price path period. For this reason, Sunwater has sought to address QCA feedback on this proposal and worked with our customers and stakeholders to consider relevant transition matters. Specifically, our revised RAB position has been amended to include:

- a simplified capitalisation approach that results in greater capitalisation of activities that provide benefits over multiple periods
- shorter depreciation periods for opening RAB balances
- a suite of transition options for the QCA to consider for the three schemes projected to finish with positive closing annuity balances.

1.2.5 Proposal to introduce a permanent ECPT methodology

Sunwater has completed an additional assessment of electricity cost risk and shared this with relevant customers (i.e. Eton Irrigation) and customer representatives (Consultative Committee) to gauge feedback on whether there is customer support to proceed with a modified ECPT methodology.

Customers confirmed to Sunwater that, considering the apparent risks, they did not wish to continue with the development of a permanent ECPT methodology.

On the basis of this feedback, and in consideration of QCA's feedback in its Draft Report, Sunwater does not propose to introduce an ECPT mechanism for customers in any scheme in the next price path period.

2 Introduction

This document is Sunwater's response to QCA's *Rural irrigation price review 2025-29: Sunwater Draft Report*.

This is QCA's third review of Sunwater's rural irrigation prices; the first review was completed in 2012 and the second was completed in January 2020. As with previous pricing reviews, QCA is required to review Sunwater's regulated pricing for irrigation services in accordance with the referral notice[1] and Section 24(1)(b) and 26 of the *Queensland Competition Authority Act 1997*.[2]

The objective of the current review is to recommend prices to be charged by Sunwater to irrigation customers in the specified water supply schemes and distribution systems for the period 1 July 2025 to 30 June 2029. The Queensland Government will consider QCA's recommendations when it sets those prices.

Sunwater recognises that QCA is required to exercise its judgement to achieve multiple and potentially conflicting objectives, such as the need for efficient resource allocation, the protection of consumers from abuses of monopoly power, social welfare and equity considerations, balancing the interests of water businesses and their customers, and economic and regional development issues. Sunwater notes that QCA has said in its guidance for this pricing review that it will prioritise economic efficiency when using its judgement to weigh up and take these matters into account.[3]

Sunwater's response to the Draft Report has focused on whether QCA has exercised its discretion in accordance with the terms of the referral notice and sound regulatory practice when determining its draft positions.

The aim of this response is to provide clarity on Sunwater's key concerns with the Draft Report. Sunwater believes the arguments and analysis relied upon in the Draft Report have led QCA to propose allowances that fall well short of the level necessary to provide bulk water and distribution services at the standard our irrigation customers expect.

Sunwater considers that the insights its response provides will enable QCA to address concerns raised and provide Final Report recommendations that facilitate the continued safe and efficient provision of high-quality irrigation services and water security that customer rely on.

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1 *QCA Referral Notice*

2 *Queensland Competition Authority Act 1997*

3 *QCA 2023, Guidelines for pricing proposals, Rural irrigation pricing review 2025-29, 2023, p.3.*

2.1 Structure of this response

Sunwater appreciates that readers of this document will include regulatory experts and well-informed customers and stakeholders, as well as customers who may have limited knowledge of the pricing review process. Sunwater's response to the Draft Report has been structured to cater for this diverse readership by including:

- an executive summary that succinctly explains its key concerns
- a more detailed overview chapter on Sunwater's concerns with the methodology used to inform the draft decision
- specific critiques of QCA's draft positions on
  - opex
  - the customer and stakeholder project (CASPr)
  - forecast renewals expenditure.

An overview of the structure is provided in **Table 1**.

Table 1 The structure of Sunwater's response to the QCA Draft Report

Chapter	Section	Content
1	Executive summary	High-level summary of Sunwater's key concerns written in plain English to cater for a diverse range of readers.
2	Introduction	Provides context for the current pricing review as well as an outline of the structure of Sunwater's response.
3	Concerns with the draft decision	Discussion of Sunwater's methodological concerns with the assessment approach that underpins the Draft Report.
4	Opex allowance	Discussion of Sunwater's specific methodological concerns with QCA's draft opex position.
5	Treatment of the CASPr project	Response to the draft position to reduce the capital cost to $18.5 million and not approve the proposed cost recovery methodology.
6	Renewals expenditure	This chapter responds to the substantial cuts to the indirect and overhead costs allocated to forecast renewal expenditures. This chapter also looks at the application of cost recovery rates.
7	Engagement	Response to commentary on engagement around the pricing proposal, including engagement on the RAB and ECPT proposals.
8	Sunwater's proposals	Response to draft positions on the RAB and ECPT proposals, including updated information on these proposals. This chapter also covers QCA's draft position on an electricity review event.
9	Opportunities for improvement	Sunwater's response to QCA's draft recommendations relating to cost allocation and asset management and capital planning.
10	Conclusion	A brief concluding statement.

3 Concerns with the draft decision

QCA operates within a regulatory framework where it is required to review Sunwater's regulated pricing for irrigation services in accordance with the referral notice.[4] The key objective of the current review as set out in the referral notice is to recommend the prices Sunwater should charge to irrigation customers in the specified water supply schemes and distribution systems for the period 1 July 2025 to 30 June 2029. The Queensland Government will consider QCA's recommendations when it sets those prices. Importantly, while the referral notice gives QCA considerable discretion on how it assesses the prudency and efficiency of Sunwater's costs as part of this review, it also requires QCA to balance Sunwater's legitimate commercial interests with the interests of its customers.

The regulatory framework that applies to Sunwater is based on a building blocks model, where prices are set based on expenditure allowance forecasts. Sunwater is incentivised to outperform those benchmarks (and financially disincentivised to exceed them) and deliver customer service levels consistent with its obligations and customer needs.

Sunwater's response has been built around an assessment of whether QCA has exercised its discretion in accordance with contemporary regulatory practice and evidence-based decision-making when it established its draft position, and with reference to all relevant elements of the referral notice.

In this regard, Sunwater notes QCA exercises its judgement to achieve multiple and potentially conflicting objectives, such as the need for efficient resource allocation, the protection of consumers from abuses of monopoly power, social welfare and equity considerations, balancing the interests of water businesses and their customers, and economic and regional development issues. Importantly, QCA has stated in its guidance for this pricing review that it will prioritise economic efficiency when using its judgement to weigh up and take these various matters into account.[5]

Sunwater's response focuses on departures from QCA's guidance and its impact on the business's cost allowances. Sunwater also highlights elements of commentary that may be misinterpreted by its customers and requests QCA addresses this in its Final Report by providing suitable context where it seeks to critique Sunwater's pricing proposal, in particular its engagement with customers and the proactive corrections and updates it provided during the review process.

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4 *QCA Referral Notice*

5 *QCA, Guidelines for pricing proposals, Rural irrigation pricing review 2025-29, 2023, p.3.*

3.1 Alignment with guidance and contemporary practice

Some of Sunwater's concerns are as follows:

- A (top-down) revealed cost methodology is sound regulatory practice and should be applied to any cost category for which Sunwater has not prepared a detailed bottom-up forecast.
    - A bottom-up review approach is only reasonable for cost categories where the business's base-year proposal is based on a bottom-up approach; this only applies to electricity and insurance in Sunwater's proposal. A bottom-up review approach is incompatible with a revealed cost approach for all other cost categories.
    - In applying a bottom-up assessment approach, QCA has selectively considered category based overspends. This approach appears contrary to its guidance which states that "the opex allowance should be set at a broad level", which "provides flexibility for the business to redirect cost savings to new initiatives or to mitigate unexpected cost increases". Setting aside the cost savings achieved (particularly electricity) contradicts the fundamental basis of a top-down revealed cost methodology, is biased to achieving the lowest cost outcome, and removes Sunwater's ability to mitigate unexpected cost increases.
- Past QCA allowances are not a sound basis for setting a base year because:
    - Sunwater's operating environment is dynamic and not steady-state (before taking into account QCA recommendations for improvements in capability and practice)
    - they are estimates only, are fallible, and represent a point-in-time forecast under different (and undocumented) operating conditions.

      To use a past QCA forecast as a benchmark for future reviews, it would need to be demonstrably reasonable and accompanied by a comprehensive register of service standards and compliance obligations that apply at that time. This is necessary because every change would need to be documented/justified to appropriately benchmark against this prior forecast.
- There is no allowance for additional spend to deliver necessary/desirable improvements e.g. 2020 review expected better engagement, but funding allowance necessitates that this be self-funded.
- There are several instances where QCA and its advisors AtkinsRéalis appear to have drawn conclusions without robust justification or seem to have set aside other reasonable facts. This also contradicts an element of QCA's assessment approach, where it states it "would not generally adjust opex forecasts where ... the adjustment largely reflects a difference of opinion, rather than an identified error or invalid reasoning". Many of the proposed adjustments are based on assertions or opinions and the correlation of information, rather than demonstrated causation.
    - The AtkinsRéalis report which (p.125) says their opex review "includes providing opinion on the reasonableness of the baseline year and, if applicable, recommending an alternative baseline year". This appears to be in direct contradiction of QCA's guidance.

- AtkinsRéalis's rejection of "endogenous" change is a clear case in point. This approach has been relied upon by QCA and fails to recognise the complex operating environment that a modern utility operates within.

- Draft positions appear to have focused on minimising costs in the next regulatory period rather than considering whether actual opex incurred "represents the least-cost means, over the life of the associated assets, of providing the required level of service within the regulatory framework". QCA is focused on productive efficiency outcomes, to the detriment of dynamic efficiency, where shorter term uplifts in expenditure are expected to deliver longer term cost savings and value enhancement to customers (uplifts in capability in customer engagement and/or economic regulation are cases in point). This approach appears to leave little opportunity for Sunwater to respond to the evolving needs of its operating environment or its customers.
- QCA has threatened to impose an efficiency target on Sunwater's renewal expenditure programs in the Final Report, if it does not provide QCA with a workable and quantified plan to realising potential efficiencies.[6]
  - Sunwater sees this as a significant departure from propose-respond model of economic regulation, which requires the utility and regulator to be specific about their intentions in order for the other party to assess and respond. In the absence of specificity, Sunwater is not able to provide a detailed response.
  - Sunwater has, however, outlined a number of improvement projects it has underway to demonstrate its commitment to process maturity that will support future productivity improvements. This is discussed further in **Section 6.3**.

3.2 Requirement to consider other stated matters

3.2.1 The Referral Notice

The *QCA Act 1997* (section 24) allows the Minister to direct QCA to take certain actions and consider certain matters.

For the current (2024) review, Section C (1.1) (b) i of the Referral Notice requires: "the Authority to consider…the need to balance the legitimate commercial interests of the Business with the interests of their customers."

The 2024 direction is not subject to other matters, in the way the 2020 Referral Notice was.

3.2.2 QCA response to the direction

QCA outlined how it has directly responded to the specific matter that required consideration only in Appendix I, where it says: "In accordance with the referral, our draft price recommendations are consistent with the pricing principles, which constrain annual price increases, whether customers are transitioning to the price target or at the price target (Chapters 9 and 10).

[6] *QCA 2024, ibid, p.49.*

"We expect that Sunwater would recover sufficient revenue to recover its prudent and efficient allowable costs through a combination of irrigation prices and CSO payments." "However, as Sunwater does not earn a return on pre-2000 assets or dam safety upgrade capex, this provides an additional subsidy to customers."

Sunwater's observations of this approach include:

- With the exception of a short statement in Appendix I, QCA has not demonstrated how its decisions have balanced these often competing requirements.
- QCA's statement is materially the same as the statement made in the Seqwater report, indicating that QCA has not considered the specific commercial interests of Sunwater (as opposed to those of Seqwater). The commercial interests of Sunwater and Seqwater are neither identical nor interchangeable.
- To implement this requirement, QCA needs to understand the 'legitimate commercial interests' of the business. There is no analysis of this in the Draft Report. There is no definition of what constitutes a legitimate commercial interest, or any indication that QCA has turned its mind to Sunwater's commercial interests.
- There is no discussion of customers' interests.
- There is no discussion of how Sunwater's commercial interests and customer interests ought to be balanced, or what factors should be considered in applying this judgement.

A single, generic, statement in an appendix does not demonstrate compliance with the referral notice.

The establishment of cost-reflective prices only cannot reasonably demonstrate adequate consideration of the balancing of Sunwater's commercial interests and customer interests. The requirement to establish cost-reflective prices is specifically stated elsewhere within the Referral Notice. The direction to balance Sunwater's commercial interests and customer interests is a separate and specific requirement.

Sunwater requests this requirement be addressed in the Final Report.

3.2.3 How competing priorities might be considered

It is Sunwater's view that balancing the commercial interests of Sunwater with the interests of customers would require at least:

- a definition of Sunwater's legitimate commercial interests that considers the lower bound pricing environment that provides no 'buffer' for Sunwater to absorb costs not allowed by QCA
- a definition of customer interests, which includes not only prices, but also levels of service
- a consideration of regulatory incentives and how these should create benefits for both Sunwater and customers over time
- a review of how these interests can best be balanced and a discussion of how this impacts QCA's cost review. For example, where there is uncertainty in a cost forecast, how are the competing interests balanced?

In any forecast, there is a level of uncertainty requiring judgement by management to respond to changing circumstances. QCA decisions have tended to benefit customers by recommending lower prices without appropriate consideration of Sunwater's commercial interests. For example, for CASPr build costs, QCA reduced allowable costs considerably. QCA was not able to conclude that the lower cost was efficient, just that it was 'appropriate'.

It is Sunwater's view that in the areas this response is highlighting, the decisions taken by QCA have not considered Sunwater's commercial interests and operating environment. Sunwater requests that QCA should apply the full Referral Notice to its review and demonstrably consider Sunwater's commercial interests in its decision-making.

3.3 Commentary that requires appropriate context

The Draft Report contains several statements that are critical of Sunwater or its forecasts and lack balance and context.

This creates the risk of unnecessarily undermining customer and stakeholder confidence in Sunwater's competence and approach to service delivery and engagement in this important price setting process. **Table 2** contains a selection of examples of this conduct.

Sunwater has not sought to itemise every instance where these issues arise; these examples are highlighted to reinforce a request that QCA's Final Report is careful to provide appropriate context in its critique.

Table 2 Selected commentary examples in the QCA Draft Report

Location	Statement	Why this is inappropriate
Page 2	"actual renewals expenditure over the period 2019–20 to 2024–25 of $156.3 million, which is $14.6 million (or 8.6%) lower than Sunwater's proposed actual renewals expenditure"	Significantly overstates the proposed expenditure adjustment, counting an offset (insurance proceeds) in the value presented. QCA accepted 100 per cent of Sunwater's actual expenditure. Sunwater proposed an offsetting correction due to the previous omission of insurance proceeds which affects the annuity balance roll forward.
Page 46	"Our draft position is to adjust Sunwater's proposed review event adjustment for insurance costs"	This is a change that Sunwater proposed – we proactively provided an update to costs, as is appropriate under the framework. The Draft Report wording positions this as a QCA-led change, which is not accurate.

4 Opex allowance

The opex allowance is a critical element of the regulatory review as it is not subject to ex-post review and recovery. This feature means that it is critical that any regulatory position that reduces the opex funding available to Sunwater be cognisant of the risk this places on the business. Under QCA's base-step-trend methodology for setting an opex allowance, the opex base year is central to the overall allowance.

Sunwater is concerned with the approach adopted by QCA in its derivation of a prudent and efficient opex base-year. The following sections set out these concerns in detail.

4.1 QCA draft position and justification

4.1.1 Approach

In its guidance, QCA provided that it would adopt a revealed cost base-step-trend approach to assessing the efficiency and prudency of Sunwater's proposed opex for the next price path period. This is consistent with regulatory best practice.

QCA engaged AtkinsRéalis – a UK-based engineering and advisory consultancy – to assist in its assessment of Sunwater's pricing proposal by undertaking an expenditure review.[7] Sunwater notes that QCA has relied to a significant extent on AtkinsRéalis's advice in developing its draft position on Sunwater's prudent and efficient opex estimates.

4.1.2 Base-year opex

The first step in QCA's approach to developing an efficient and prudent base-year opex was to identify the adjustments to actual opex in the base year to remove non-recurrent costs and include costs that are recurrent in nature but were not included in the base year. The second step in QCA's approach sought to identify expenditure it perceived to be inefficient, and therefore warranted removal from the base.

Each of these adjustments is discussed in more detail below.

Base-year adjustments for recurrent and non-recurrent costs

The first step in QCA's assessment approach to developing an efficient and prudent baseline opex is to adjust the actual base-year costs to account for recurrent and non-recurrent costs. QCA has relied on the AtkinsRéalis advice to inform its draft position on these baseline adjustments, as discussed below.

Table 3 shows QCA's draft position on base-year opex and related adjustments to actual base-year opex to account for recurrent costs and what it terms 'efficiency' adjustments.

[7] *AtkinsRéalis, Review of Sunwater's Rural Irrigation Pricing Proposal 2025-29, June 2024.*

Table 3 QCA recommended base-year opex ($ million)

Category	Actual 2022-23	Non-recurrent adjustments	Efficiency adjustments	QCA draft recommendation
Labour	12.7	-0.6	-0.6	11.5
Contractor	5.4	-1.0	-	4.4
Materials	2.6	0.1	-	2.7
Other	8.2	-1.0	-	7.2
Insurance	9.0	-	-	9.0
Total direct costs	**37.9**	**-2.5**	**-0.6**	**34.8**
Total overhead and indirect costs	**26.5**	**0.8**	**-2.0**	**25.4**
Base-year opex excluding electricity	**64.4**	**-1.7**	**-2.6**	**60.2**
Electricity	9.3	1.2	-	10.5
Total base-year opex	**73.7**	**-0.5**	**-2.6**	**70.7**

(i) Electricity and insurance costs

QCA's draft position is to accept Sunwater's proposed upward adjustment to base-year electricity costs of $1.2 million due to lower electricity use from atypical wet weather. QCA noted in its draft report that Sunwater has effective procurement procedures and robust management practices in place to ensure efficient allocation of electricity expenditure.[8]

The draft position accepts Sunwater's proposed base-year insurance of $9 million as being prudent and efficient. In its draft report, QCA noted it considers that Sunwater has taken appropriate steps to manage costs and mitigate the increases in costs in the insurance market.[9]

(ii) Direct labour costs

QCA's draft position is not to accept Sunwater's proposed downward adjustment to direct labour costs of -$0.2 million, on the basis of AtkinsRéalis advice that Sunwater had incorrectly accounted for the backdated nominal 4.5 per cent uplift under the Enterprise Agreement (EA).[10]

QCA applied the backdated nominal 4.5 per cent uplift under the EA to the actual direct labour costs in 2022-23 and, on this basis, calculated the five-year historical average of real direct labour costs per annum. Under this approach, QCA derived a baseline adjustment of -$0.6 million to account for recurrent and non-recurrent direct opex costs.

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[8] *QCA 2024, Rural irrigation price review 2025–29: Sunwater, Draft decision, p.40, June.*

[9] *QCA 2024, ibid, p.29.*

[10] *AtkinsRéalis 2024, ibid, p.40.*

(iii) Contractors

QCA's draft position is not to accept Sunwater's proposed downward adjustment to contractor costs in base year of -$0.9 million, which was based on AtkinsRéalis's advice that base-year contractor spend be adjusted to reflect the 2018-19 to 2022-23 average for all schemes, resulting in an aggregate reduction of $1 million: "while Sunwater's proposed base-year contractor opex is relatively in line with average historical spend at $0.07m or 2% above it, the proposed base-year opex for a number of schemes varies in percentage terms. We therefore recommend that base-year contractor spend be adjusted to reflect the FY18-23 average for all schemes, resulting in an aggregate reduction of $1m."[11]

(iv) Other baseline adjustments to opex

QCA's draft position is to generally accept Sunwater's proposed baseline adjustments for the remaining direct opex categories, based on AtkinsRéalis's advice to:

- accept Sunwater's proposed adjustment of -$0.1 million for materials costs on the basis of the AtkinsRéalis advice that it appears to align with historical average expenditure and is below the adjusted QCA 2020 allowance for this cost category[12]
- accept Sunwater's proposed adjustment of -$0.3 million for one-off legal fees related to a settlement activity
- adopt a historical averaging approach to determine the baseline adjustment of -$0.7 million to rental and hire equipment costs, which is a slightly larger adjustment than Sunwater's proposed reduction of $0.6 million[13]
- not accept Sunwater's proposed adjustment of $0.1 million to other miscellaneous direct costs on the grounds that Sunwater's rationale for these adjustments was not clear.

Base-year 'efficiency' adjustments against QCA 2020 allowances

The second step in QCA's approach is to assess the efficiency of Sunwater's actual base-year costs, after adjustments have been made for recurrent and non-recurrent costs.

Sunwater notes that QCA relied to a significant extent on AtkinsRéalis's advice to inform its draft position on the base-year adjustments to be made for efficiency reasons.

(i) Direct labour costs

QCA's draft position is to apply a further adjustment of -$0.6 million to base-year direct labour costs on the advice of AtkinsRéalis.

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[11] *AtkinsRéalis 2024, ibid, p.131*

[12] *AtkinsRéalis 2024, ibid, p.131*

[13] *AtkinsRéalis 2024, ibid, p.131*

AtkinsRéalis identified that Sunwater's actual base-year direct labour costs were around $1.5 million above QCA's 2020 recommended allowance, adjusted for actual CPI. With the exception of a $0.3 million increase in direct labour costs associated with its increased safety-related activities,[14] AtkinsRéalis believed Sunwater had not justified the remaining increase in direct labour costs. In particular, Sunwater had not drawn a clear link between the increase in these costs and external (exogenously driven) changes in its obligations.

AtkinsRéalis concluded that QCA's 2020 recommended allowance for direct labour opex, plus $0.3 million in additional safety-related costs, remains the appropriate level for the base year.

The following table shows QCA's draft position on direct labour costs relative to the adjusted baseline direct labour cost.

Table 4 QCA draft position– direct labour opex ($ million, 2022-23)

Category	$ million, 2022-23
Actual direct labour costs	**12.7**
Adjustment for recurrent and non-recurrent costs	-0.6
Adjusted baseline – direct labour cost	**12.1**
Adjustment for efficiency	-0.6
QCA draft position	**11.5**
Add: justified safety-related direct labour costs	+0.3
2020 review (adjusted for actual CPI) – direct labour cost	**11.2**

QCA relied on AtkinsRéalis's advice for this aspect of its draft decision, particularly its advice relating to treatment of an increase in full-time equivalent (FTE) employees in operations and maintenance since the 2020 review as being driven by endogenous factors.

AtkinsRéalis noted that staff numbers have increased (in like-for-like terms), and that utilisation has reduced and is below its historical level. AtkinsRéalis noted that utilisation rates in 2020-21 and 2021-22 may have been impacted by COVID-19 but, in their view, this does not explain the continued lower levels in 2022-23.

(ii) Overhead and indirect costs

Despite Sunwater under-recovering its corporate, indirect and local overhead costs, the increase in non-direct costs allocated to regulated opex has exceeded QCA' s recommendation in the current price path period. QCA notes that Sunwater's adjusted baseline for overheads and indirect costs is $3 million higher than the recommended allowance (adjusted for actual CPI) from the 2020 review, which is driven mainly by a significant increase in corporate overheads and, to a lesser extent, local overheads.

Table 5 shows QCA's draft position, relative to the adjusted baseline, is a net decrease of $0.8 million in indirect costs and a net increase of $0.4 million in corporate overhead, due to the transfer of Orion/CASPr costs from indirect costs to corporate overheads. QCA's draft position is to reduce local overhead costs to a level consistent with the recommended allowance from the 2020 review.

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[14] *AtkinsRéalis did not provide compelling evidence to support its determination of the additional safety related costs.*

Table 5 QCA draft position – overhead and indirect costs ($ million, 2022-23)

	Corporate overheads	Local overheads	Indirect costs	Total
Adjusted baseline	12.1	8.2	7.0	**27.3**
Draft position	12.5	6.6	6.2	**25.4**
Difference	**0.4**	**-1.6**	**-0.8**	**-2.0**

QCA's draft position on overheads and indirect costs is based to a large extent on the advice of AtkinsRéalis, as follows:

- **Corporate overheads** - AtkinsRéalis considered that a large proportion of the increase in ICT costs appears to be driven by internal business decisions with no clear benefits (such as ongoing efficiency savings) discernible for regulated schemes. The exception relates to cyber risk and associated legislation, which appears to be driven by regulatory obligations and has required a material investment to enable Sunwater to self-insure in this area.
- **Local overheads** - AtkinsRéalis considered it reasonable to reduce local overheads to a level consistent with the recommended allowance from the 2020 review.
- **Indirect costs** - AtkinsRéalis considered it reasonable to make a transfer adjustment to move $2 million from indirect to corporate costs as the Orion system is being replaced by CASPr, the cost of which AtkinsRéalis included in corporate support costs. It also considered it reasonable to accept that Sunwater's safety responsibilities and focus have materially evolved since the 2020 review, with a corresponding increase of $0.9 million per annum. It also accepted an additional cost of $0.6 million per annum due to additional dam safety management activities attributed to new guidelines that came into effect in 2021.

AtkinsRéalis also undertook benchmarking analysis of corporate costs against other rural water businesses to supplementary its assessment of the prudency and efficiency of Sunwater's corporate costs. AtkinsRéalis used this analysis to suggest that Sunwater is not obviously more efficient than other rural water businesses.

4.1.3 Efficiency

QCA's draft position is to accept (unaffected in percentage terms by its other adjustments) Sunwater's proposed efficiency challenge of an ongoing opex efficiency target of 0.5 per cent per annum over the next price path period to commence from 1 July 2023.[15]

4.1.4 Cost escalation factors

In line with the regulatory framework, QCA applies forecast cost escalation factors across major opex categories to efficient and prudent base-year opex to determine a forecast opex allowance in each year of the next price path period. QCA's draft position on the inflation forecast and forecast cost escalation factors for each major opex category is summarised in **Table 6**.

[15] *QCA 2024, Rural irrigation price review 2025–29: Sunwater, Draft decision, p.45, June.*

Table 6 Summary of QCA's draft position on annual cost escalation factors by major opex category

Cost escalation factor	QCA draft position
Annual forecast inflation	QCA's draft position is to accept Sunwater's proposed forecast inflation, updated for the inflation forecast from the latest available RBA short-term forecasts.
Electricity	QCA's draft position is to accept Sunwater's proposed electricity cost escalation factors, which were recently updated for the actual 1 July 2024 price increase of electricity network and retail tariffs.
Insurance	QCA's draft position is to accept Sunwater's proposed insurance cost escalation factors, updated for recent insurance broker advice in 2023-24 and 2024-25. QCA updated the insurance cost escalation factors in the next price path period with the latest available annual CPI forecasts.
Direct labour costs	QCA's draft position is to accept Sunwater's proposed approach to direct labour cost escalation.
Contracted services, materials and other opex	QCA's draft position is to accept Sunwater's proposal to use annual CPI inflation forecasts as the escalation factor for contracted services, materials and other opex.
Overhead and indirect costs	QCA's draft position is to accept Sunwater's proposal to use a 50:50 weighting of labour and annual CPI inflation for escalating overhead and indirect costs.

4.1.5 Step-changes

QCA's draft position is not to accept Sunwater's proposed step-change to cover implementation of CASPr and the renewals opex under the RAB proposal. However, QCA proposed the recovery of its regulatory fee as a step-change.

4.2 Sunwater's response and final proposal

It is Sunwater's view that good practice regulation requires several important elements. Specifically, a regulatory framework and assessment (decision/recommendation) should:

- be robust, transparent and predictable
- provide appropriate incentives/disincentives for service delivery that are in the long-term interests of customers (and the regulated entity)
- allow for the recovery of prudent and efficient costs, so the service provider maintains ongoing financial sustainability
- acknowledge that – under an incentive-based revealed-cost framework – the onus for proof of a prudent and efficient level of spend lies with the regulator, not the regulated entity, where it proposes to remove actual base year expenditure
- be administered consistently and dispassionately, such that regulatory oversight and decisions are fact/evidence based, independently replicable and accountable.

These are fundamental to delivering the best long-term outcome for customers. Sunwater is concerned that QCA's derivation of a prudent and efficient opex base year does not address all these elements.

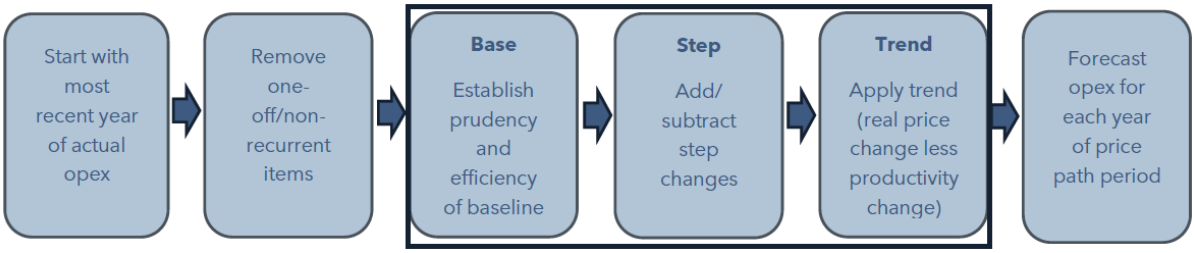
Sunwater's response to QCA's draft decision on opex is structured as follows:

- our methodological concerns with the approach adopted
- our response to the specific adjustments applied to base-year expenditure.

4.3 Methodological concerns

In section 4.1 of the Draft Report, QCA states that it adopts a base-step-trend approach to determining prudent and efficient operating expenditure (see **Figure 1**).

Figure 1 QCA's base-step-trend approach



In this same section, QCA states: "We generally consider that the opex allowance should be set at a broad level, allowing Sunwater to manage its assets, meet its regulatory obligations, prioritise expenditures and deliver bulk and distribution services within an aggregate, business-wide allowance. This provides flexibility for the business to redirect cost savings to new initiatives or to mitigate unexpected cost increases."

Within section 4.1 of the Draft Report, under baseline opex, QCA states that it prefers "to use actual (revealed) opex based on the most recently available data to establish baseline opex". QCA also states that a key step in its assessment of the prudency and efficiency of baseline opex is "comparing this with our recommended expenditure from the 2020 review".

In the 2020 price review, QCA and its advisors made similar statements emphasising their reliance on the outcomes of the 2012 review.[16] This approach has resulted in QCA's draft position on the efficient level of baseline opex for the current and forthcoming pricing reviews being similar in real terms to the opex allowance established in the 2012 review.

Constraining the opex allowance to this extent is not economically desirable as it undermines the efforts of Sunwater to move towards best practice, discourages innovation, and fails to recognise that Sunwater's regulatory obligations continue to grow and evolve while its customer base (as measured by volume per scheme) does not.

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[16] *QCA Draft Report, p.12 - "Where relevant we have leveraged off the findings from the 2012 review that developed efficient cost benchmarks and provided specific recommendations that seek to improve Sunwater's cost forecasting approach and its capture of labour cost information."*

AECOM expenditure report, p.3 - "Assessed the efficiency of these costs with reference to the QCA's 2012 recommendations (which were based on a comprehensive review of corporate and local overheads by the QCA's consultants at the time)."

The QCA approach does not adequately account for the significant changes that have occurred in Sunwater's operating environment since the previous review, including changes in customer needs, policy conditions, increasing environmental and First Nations obligations, safety laws, economic factors, ageing workforce, skill shortages and lingering post-COVID supply chain constraints.

As Sunwater's base-year opex is higher than QCA's recommended allowance, it sought to assess the justification for the uplift. On page 18 of the Draft Report the QCA states that: "where Sunwater has not provided sufficient justification, (it has) determined an appropriate baseline opex amount using available information. (QCA) also assessed the appropriateness of the allocation of the business-wide allowance to the scheme level."

Page 19 of the Draft Report, states that QCA "considers opex prudent if it is necessary to:

- operate or maintain the relevant service
- meet legal or regulatory obligations
- achieve an outcome that is explicitly endorsed or desired by customers (for example, agreed service levels)
- achieve broadly accepted changes in community expectations in relation to corporate responsibility (such as commitments to climate change mitigation)."

Further, the QCA "consider[s] that opex is efficient if it represents the least-cost means, over the life of the associated assets, of providing the required level of service within the regulatory framework."

Lastly, QCA also states that it "…would not generally adjust opex forecasts where:

- the adjustment is not an identified error and is small and/or has only a small impact on the price target at the tariff group level
- the adjustment largely reflects a difference of opinion, rather than an identified error or invalid reasoning
- the proposal represents a genuine attempt at estimating efficient costs, and the water business has been forthcoming with supporting justification and information
- there is evidence of proper consultation and agreement with customers."

The reliance on opex allowances from the 2020 review, which in turn was informed by the 2012 review,[17] is inappropriate. These historical point-in-time forecasts were developed under different operating conditions, with significantly different market, macroeconomic and regulatory conditions. This approach limits Sunwater's ability to continue to mature as a customer-centric organisation as QCA treats all endogenously driven overspends as inefficient and not recoverable from customers, even where it is reasonable to believe these expenditures will benefit customers in the longer term.

[17] *QCA, Rural Irrigation Price Review 2020-24 Part B: Sunwater, August 2020, p.12.*

Sunwater has several issues with the assessment approach, and has sought to separate these for clarity:

(i) Revealed costs/base-step-trend is a holistic top-down approach

QCA states that it adopts a revealed costs framework, meaning actual expenditure is relied on to demonstrate prudency and efficiency, as opex is largely recurrent. While this does not mean actual expenditure is automatically prudent and efficient just because it has been spent, the regulatory framework is designed to disincentivise overspending and there are protections in place to allow for the baseline to reset in the next period so the business is not disadvantaged longer than the pricing period for necessary overspends.

Sunwater has borne considerable unfunded costs this period. Sunwater is not funded (through its prices) to recover any overspends – irrigation prices are based on forecast annual opex with every dollar recovered during the regulatory period. In a situation where Sunwater spends more than its allowance during the regulatory period, all else being equal, it must seek alternative funding sources e.g. additional debt. As such, there is an incentive for Sunwater to minimise any overspends, and to seek savings (which Sunwater has done through its electricity cost work for example).

Base-step-trend is commonly applied to set the efficient opex forecast for several reasons:

- it is relatively simple to develop, and avoids costly and time-consuming bottom-up forecasts
- it allows for an expedited review process, given the relatively short timeframes regulators have to complete their reviews
- it captures scale and scope efficiencies that can be achieved across expenditure categories, that are commonly missed when applying a bottom-up forecasting technique
- it avoids the double counting commonly experienced across expenditure categories.

In setting Sunwater's last opex allowance, base-step-trend was used to forecast prudent and efficient opex. As it is a top-down forecast, the forecasts at the category level were estimates, as Sunwater avoided developing extensive bottom-up forecasts, except for the major opex categories of insurance and electricity.

Requiring Sunwater to demonstrate the prudency and efficiency of actual expenditure, against an estimate that was not the basis of the forecast, is unreasonable and conflates the forecasting method with a different assessment method.

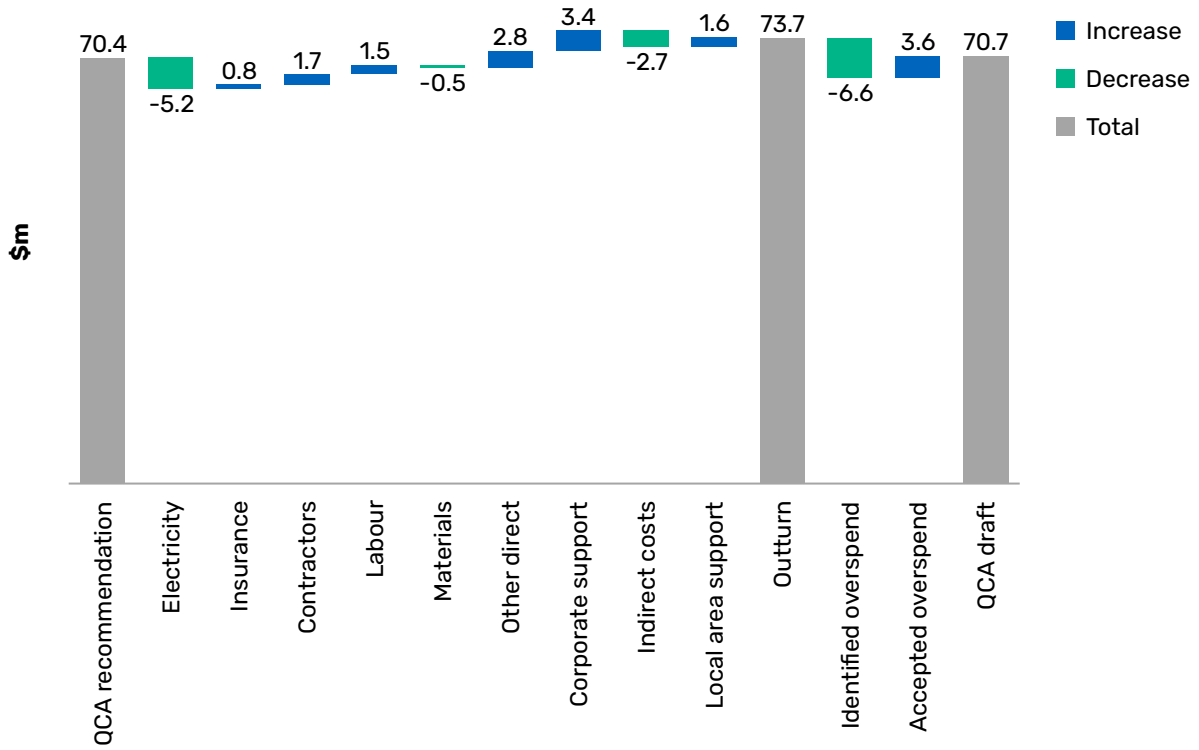
Further, QCA states that "the opex allowance should be set at a broad level", which "provides flexibility for the business to redirect cost savings to new initiatives or to mitigate unexpected cost increases."

In practice however, QCA has chosen to examine select categories where it believes Sunwater has overspent its allowance but has not considered offsetting savings achieved e.g. preventative maintenance, energy and indirect costs.

If QCA were to assess Sunwater's expenditure on a category basis, any adjustments should be net of savings delivered through the period. To do otherwise will penalise Sunwater for achieving the outcome that QCA's framework is designed to achieve i.e. "redirect cost savings to new initiatives or to mitigate unexpected cost increases".

As highlighted in **Figure 2**, Sunwater achieved baseline opex savings of $8.4 million in materials costs, indirect costs and electricity costs, which was confirmed in the AtkinsRéalis Report (p.135). In total, the spend above allowance was $3.3 million; when compared to the 2020 review, however, through the review of select categories of spend tied to 2020 values, QCA identified $6.6 million (Table 5 of the Draft Report) in overspends.

Figure 2 Comparison of base-year opex - actual vs allowance (adjusted 2020) by category ($ million, 2022-23)



(ii) Using the 2020 allowance as the efficient point of comparison

The analysis presented by QCA referred to the fact that there is no growth in regulated services, with the inference that changes in utilisation rates, ICT expenditure etc is driven by non-regulated services e.g. p. 35 of the Draft Report states: "general provision of ICT equipment and desktop support for an expanding organisation appears to relate to the non-regulated part of the organisation which is projected to experience some growth."

The implication is that these costs should not be recovered from regulated prices.

The lack of growth in regulated services is not evidence that the business is in a steady state.

Sunwater is not in a steady state. Since the 2020 QCA review, it has changed its vision and strategy, implemented significant changes in management and organisational structure, dealt with the COVID-19 pandemic and experienced changes to safety and cybersecurity expectations, among other things. Sunwater has addressed QCA feedback on customer engagement and capability gaps in regulatory pricing, ICT and other parts of the business as necessary. This transformation has started to deliver positive outcomes such as increased customer satisfaction, employee engagement, and improved cost management e.g. electricity and insurance. This demonstrates that Sunwater is responding appropriately to the incentives under the regulatory framework to pursue dynamic efficiencies.

The risk of QCA focusing on productive efficiency is that it may recommend a funding envelope that is too low and that discourages management from pursuing dynamic efficiencies that may require higher costs to be incurred in the short-term but are expected to deliver a longer term benefit to customers.

QCA has only focused on the uplift in cost, as opposed to whether any additional uplift results in the best outcome for customers in the longer term. A business should be able to act dynamically within the period to deliver programs that are in the long-term interests of customers.

A key aspect of Sunwater's corporate strategy is to invest in capability uplift to position the business to achieve best practice outcomes for its customers in the longer term and respond to changes in the broader regulatory environment. For example, Sunwater is investing in a range of technologies to secure its technology services and systems, assets, data and people by adapting and reinforcing our systems and controls. A technology-enabled workforce will increase safety, efficiency and effectiveness by ensuring employees have access to high quality and timely data to make decisions, manage performance, enhance sustainability and govern confidently.

The technology-enabled capability uplift across Sunwater will facilitate better service delivery and empower customers and stakeholders with information that is meaningful and adds value as well as supporting the business to meet their unique needs.

(iii) Avoiding adjustments that reflect a difference of opinion

Under good practice regulatory frameworks:

- *for forecast expenditure* – the onus of proof is on the regulated entity to demonstrate that forecast expenditure is prudent and efficient to justify the pass-through of expenditure through future prices to customers
- *for historical expenditure* – under a revealed cost framework and the incentives built into it during the period, when assessing revealed costs on an ex-post basis, the onus of proof is on the regulator to demonstrate that the expenditure was:
  - not prudent (hence excluding all expenditure)
  - prudent, but not efficient (hence requiring an adjustment to an efficient level)
  - prudent and efficient (confirming the efficiency of base-year expenditure).

Onus of proof under regulatory review requires the presentation of transparent, robust and fact-based analysis and evidence that is independently replicable. It should not be determined, or rejected, based on opinions or assertions. This would be inconsistent with regulatory best practice and open to legitimate challenge.

It is also consistent with QCA's regulatory guidance, which stated that QCA "would not generally adjust opex forecasts where… the adjustment largely reflects a difference of opinion, rather than an identified error or invalid reasoning".[18]

A thorough review of the Draft Report shows many positions put forward by AtkinsRéalis and adopted by the QCA are based on opinion and possibilities that are not supported by robust evidence. The AtkinsRéalis report (in the operating cost chapter) includes a statement to this effect: "Our review assesses the prudency and efficiency, per QCA's definitions, of Sunwater's opex. This includes providing opinion on the reasonableness of the baseline year."

This reference to providing opinion appears to conflict with QCA's regulatory guidance. Sunwater submits that QCA should only rely on AtkinsRéalis's advice where it is demonstrated to be based on robust evidence.

Where AtkinsRéalis does use evidence, it has identified correlation but does not appear to try to establish causation. Some examples that highlight this issue include:

- "we note that less than 25% of the O&M workforce is over 55, consistent with what would be expected if the workforce was evenly distributed by age and suggestive of a business-as-usual staff turnover challenge." (page 26)

  This is based on advice received by AtkinsRéalis.[19] AtkinsRéalis has not provided any evidence to demonstrate that an 'even' distribution, as opposed to a 'normal' distribution, is consistent with common practice. In a normal distribution, fewer employees would be expected in the youngest and oldest age brackets, with most employees being between 30 and 55. Nor has it presented any evidence that this reflects business as usual turnover. Indeed, QCA states it is "suggestive".

- "We note that Sunwater is forecasting utilisation rates to return to target levels from 2023–24. However, as there is no anticipated growth in regulated services, this may indicate that some of the 2022–23 increase in direct labour costs is relevant for the anticipated growth in activity in non-regulated service contracts." (p.26)

  This is speculative and does not explain why utilisation rates should remain constant when they can be impacted by the timing of activities, the cyclical nature of some activities or changes to workplace laws. Further, less utilisation does not mean an individual's available time can be redirected to other activities, especially where they do not have the requisite skills and expertise. New activities, driven by new policy and/or regulatory obligations, most commonly require new employees with those skills to support delivery.

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[18] *QCA, Rural Irrigation Price Review 2025-29, Guideline for pricing proposals, March 2023, p.16.*

[19] *AtkinsRéalis 2024, ibid, p.141.*

- "While it is conceivable that Sunwater has had to increase direct labour at the business-wide level, Sunwater has not justified why there should be an increase in direct labour for regulated schemes." (p.27)

  QCA acknowledges it is conceivable that Sunwater has had to increase direct labour, but has not explained why it should not have.

- "This analysis suggests that Sunwater is not obviously more efficient than other rural water businesses," (p.34) regarding corporate cost benchmarking analysis completed by AtkinsRéalis.

  This statement contradicts the justification for adjusting corporate expenditure to lower levels.

- "AtkinsRéalis considered that a large proportion of the increase in ICT costs appears to be driven by internal business decisions with no clear benefits (such as ongoing efficiency savings) discernible for regulated schemes…There has been a significant overspend in ICT projects over the current price path period," which AtkinsRéalis attributed to "inefficiencies in estimating costs and managing ICT project delivery." (p.35)

  These statements appear subjective and are not provided with any analysis of the presented evidence that would appear to justify them.

- "In the case of local overheads, we note that the key driver for the increase in the cost base is the reduction in utilisation rates for direct labour and that this reduction has occurred even as direct labour costs have increased. This may reflect a temporary reduction in productivity, in anticipation of a future increase in operations and maintenance work in non-regulated services. Given this, we do not propose recovering the increase in local overheads from regulated schemes." (p.36)

  The observation that this "may reflect a temporary reduction in productivity" acknowledges that there is no data proving this proposition. This statement therefore assumes that changes in utilisation are being driven by delivery of non-regulated services. The delivery of services does not have to change to mean that Sunwater is not in steady state. It is always responding to a raft of internal and external drivers for change. For example, a major driver of change is that Sunwater has been on a significant maturity journey since the 2020 review.

  A number of the activities that were recently completed or underway at that time have shaped the maturity journey Sunwater has been on, such as:

  - the significant cultural review and change to organisation size in 2017
  - the transfer of distribution services and assets to Local Management Authorities in 2018 and 2019
  - a significant uplift in the focus on dam safety, and safety in general
  - appointment of a new CEO in 2020 and a new Chair in 2021, setting a new strategic direction for Sunwater and resetting the business's focus on safe, capable people, as well as customers and compliance. This new strategic direction is reflected in Sunwater's corporate plan to invest in people, processes and technology to achieve industry best practice outcomes in culture, customer engagement and retention, and safety.

As outlined in the examples above, QCA has proposed adjustments on the basis of a difference of opinion; it has drawn possible correlations but has not been able to prove causation.

QCA has not recognised that in expecting Sunwater to find and deliver savings via technology, it is necessary to provide Sunwater with the necessary funding to make these investments. Benefits (such as efficiency gains) derived from self-funded activities are not typically available for consideration in cost reviews. To do otherwise runs counter to the user-pays principles and would see customers derive a benefit from an activity which they have not funded.

Use of benchmarking to inform an alternative forecast

There is a precedent in the electricity distribution and transmission sector, where if the Australian Energy Regulator (AER) determines that revealed costs are not prudent and efficient, then it may use benchmarking (among other techniques) to set an alternative.[20] As outlined in its annual benchmarking report,[21] the AER uses three 'top-down' quantitative benchmarking techniques to measure the annual productivity growth and efficiency of Australian distribution network service providers, individually and as an industry as a whole, in the National Electricity Market. That is, its benchmarks only include like-for-like peers who operate within a common framework.

There are two references to benchmarking in the Draft Report:

- **corporate costs** – AtkinsRéalis undertook corporate cost benchmarking of Sunwater with other rural water businesses (WaterNSW, Goulburn Murray Water, Grampians Wimmera Mallee Water and Southern Rural Water). AtkinsRéalis concluded that "Sunwater is not obviously more efficient than other rural water utilities."[22] The implication is that AtkinsRéalis could not prove that Sunwater's corporate costs were not consistent with other rural water service providers and, by implication, were comparatively efficient.
- **Information and Communications Technology (ICT)** – AtkinsRéalis's review of Sunwater's Irrigation Pricing Proposal 2025-26 to 2028-29 involved undertaking a benchmarking analysis of technology totex, compared to both revenue and cost.[23] The benchmarks include two international surveys (Gartner and Deloitte), SA Water, Sydney Water, Yarra Valley Water and four UK water companies. The analysis is used to determine an efficient range of ICT totex to revenue of 3.2-5.2 per cent. There are a number of flaws in this comparison:
  - AtkinsRéalis benchmarked Sunwater, an irrigation service provider, against large urban water service providers, some of which are vertically integrated, and some which are not. There appears to be no explanation as to why the same rural water businesses have not been used to benchmark both corporate costs and ICT costs.

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[20] *AER 2022, Better Regulation, Expenditure Forecast Assessment Guideline for Electricity Distribution, p.8.*

[21] *AER, Benchmarking Report: Electricity distribution network service providers, November 2023.*

[22] *AtkinsRéalis 2024, ibid, p.86.*

[23] *AtkinsRéalis 2024, ibid, Table 4-5, p.113.*

- Sunwater, an Australian service provider, was benchmarked against UK water companies that have different ownership structures, policy settings, regulatory arrangements, legal requirements and customer needs.
- AtkinsRéalis has used benchmarking data from the past nine years. In particular, the UK data includes 2015-20 business plans, where the data is almost 10 years old. Data this old is highly unlikely to account for the fast pace of changing technology, and the transition to cloud-based solutions.
- AtkinsRéalis benchmarked Sunwater, an organisation that it describes as "starting from a low base in terms of maturity and technology,"[24] against a set of sophisticated, and far more mature businesses with regards to digital enablement and transformation. These businesses do not need the capability uplift that Sunwater requires as part of its maturity journey, as that is an inherent part of their steady state.
- AtkinsRéalis has not considered the temporal nature of the benchmarking outcomes in its assessment. While Sunwater's totex to revenue ratio increases significantly between 2022 and 2024 (due to short-term investment requirements), in the next price path period it declines significantly to 2.5 per cent by the end of the period, which is below the efficient range of benchmarking outcomes identified by AtkinsRéalis. It is important to note that this efficiency benchmark range will always vary depending on where the business is on its maturity journey.
- AtkinsRéalis does not take into account that urban businesses have far larger revenue bases, due to the multiple services they deliver, and differing levels of cost recovery. For example, Sydney Water provides water, wastewater, recycled water and waterways/drainage services. As such, ICT totex to revenue is more likely to be higher for Sunwater, as its only focus is irrigation services.

Taking all of the above into account, the benchmarking analysis undertaken by AtkinsRéalis does not demonstrate that Sunwater's corporate costs are inconsistent with its peers. More importantly, the ICT benchmarking analysis undertaken should not be relied upon by QCA to draw any meaningful conclusions.

4.3.1 Sunwater's response to Draft Report opex adjustments

The commentary below relates solely to opex categories where QCA has proposed adjustments to Sunwater's original pricing proposal and Sunwater challenges the basis for the proposed changes.

4.3.1.1 Base-year adjustments for recurrent and non-recurrent expenditures

(i) Direct labour costs

Sunwater does not support QCA's draft position to apply a base-year reduction of $0.6 million to actual direct labour costs in 2022-23. Sunwater is concerned that QCA's draft decision results in base-year direct labour costs that are materially less than the costs it incurs to meet customer service, safety, and regulatory requirements in a typical year.

[24] *AtkinsRéalis 2024, ibid, p.109.*

QCA's reliance on a multi-year averaging approach does not consider that Sunwater has been operating in an environment of increasing direct labour costs due to increased compliance obligations and higher wage expectations. It also fails to consider the maturity journey that Sunwater has been on as a business during the current price path period, getting the right level of capability in place to deliver our services safely, efficiently and effectively now and into the future. This requires an uplift in short-term expenditure to deliver services more efficiently, over the life of its assets.

Sunwater requests that QCA reinstate Sunwater's proposed direct labour base-year.

(ii) Contractors

Sunwater does not support QCA's draft position to apply a baseline reduction of $1 million to actual contractor costs in 2022-23 on the grounds that this is based largely on a difference of opinion over the relative merits of using a pure historical averaging approach versus Sunwater's approach that allows for a deviation from the averaging approach where justified due to the local expertise of its operational team. This appears to be inconsistent with QCA's guidance, where it states that it "would not generally adjust opex forecasts where … the adjustment largely reflects a difference of opinion, rather than an identified error or invalid reasoning." QCA's draft position is not made on the basis of any evidence or analysis.

Sunwater requests that QCA reinstate Sunwater's proposed base-year reduction for contractor costs of $0.9 million in its final decision.

4.3.1.2 Base-year adjustments for higher than allowance expenditure

QCA has proposed a number of adjustments in its Draft Report, which are detailed below by opex category, including our response.

(i) Operations and maintenance (O&M) – direct labour

The Draft Report recommended adopting direct labour opex from the 2020 review, adjusted for an increase in safety obligations. This resulted in a $0.6 million downwards adjustment to $11.5 million.

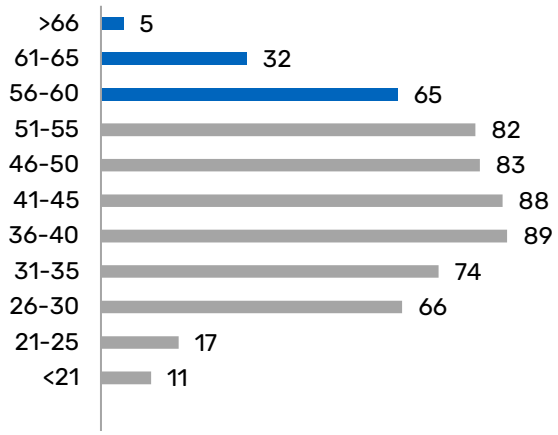
During the period, Sunwater saw a 19 per cent uplift in FTEs, compared to its initial estimate. This was driven by a need to address work safety concerns, roster coverage in line with modern expectations relating to the operation of a 24/7 water supply business, emerging regulatory (such as environmental, critical infrastructure security) and customer service expectations, and an ageing workforce.

In response to this uplift, there were three critical issues raised by QCA and AtkinsRéalis to justify the exclusion of actual opex from Sunwater's base.

Ageing workforce

Sunwater's demographic profile is reproduced here for context and follows a normal distribution. As stated in Sunwater's submission (**Figure 3**), 58 per cent of Sunwater's workforce is 41 years old or over, with 30 per cent over 50. Functionally, the majority of Sunwater's older workers (over 55 years of age) are found in Operations (60 individuals).

Figure 3 Workforce age profile (reproduced from Figure 11 of Irrigation Pricing Proposal)

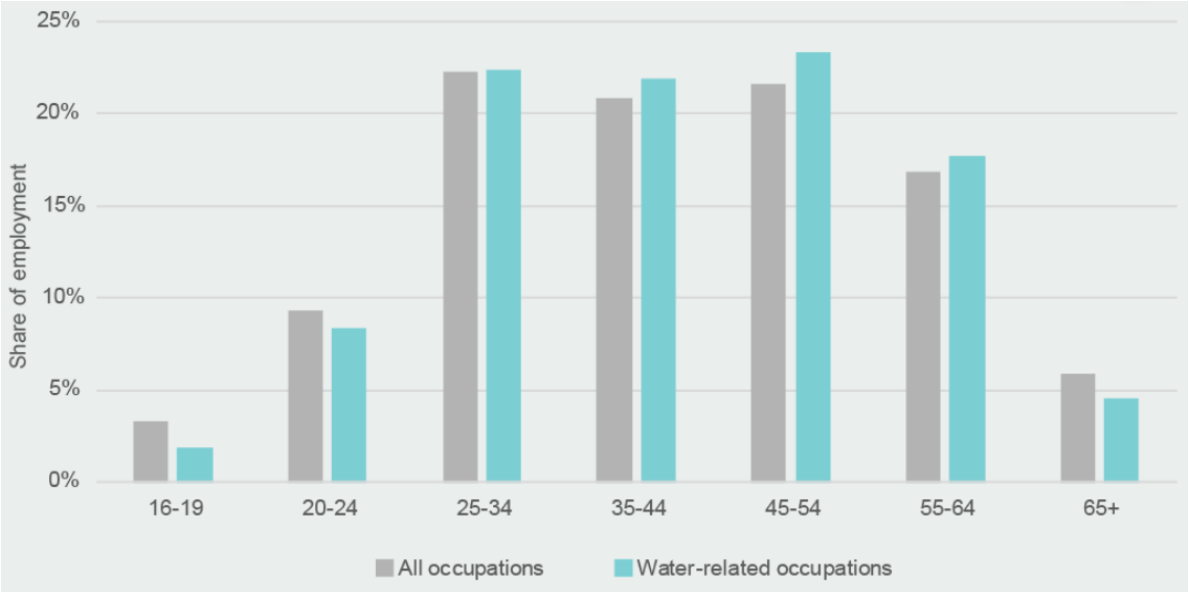


QCA states that less than 25 per cent of the O&M workforce is over 55, which is "consistent with what would be expected if the workforce was evenly distributed by age and suggestive of a business-as-usual staff turnover challenge." Neither QCA nor AtkinsRéalis has sought to evidence this as consistent with good/common practice.

The evidence outlined below suggests that the distribution of workforce by age commonly follows a 'normal distribution' (or a Bell curve), not an even distribution.

A study completed by Joseph W Kane and Adie Tomer[25] benchmarking 1.7 million water workers across the United States of America, provided the following age range of workers in water occupations vs all occupations:

Figure 4 Age range of workers in water occupations vs all occupations



[25] *Kane J and Tomer X, Renewing the water workforce - Improving water infrastructure and creating a pipeline to opportunity, 2018.*

Kane and Tomer go on to state on page 25 of their report that "water workers tended to be older and lack gender and racial diversity, in certain occupations, pointing to the need for younger, more diverse talent." Further, that "thousands of water workers are aging and expected to retire from their positions in coming years, leading to a huge gap to fill for utilities and other water employers."

In 2020, the Queensland Water Directorate released its urban water industry workforce composition snapshot report.[26] Section 3.2 states: "The age profile chart presented in past reports has been commonly cited in other reports as it not only presents a visual of a clearly 'aged' workforce, but also a progressing trend over capture periods towards growing 'ageing' (with the proportion of workers in the younger two age groups steadily declining while that of older workers continuing to grow). The ageing workforce trend continues with 35% of the workforce aged over 50 years in 2020 (34% in 2018) and 11% of the workforce aged under 30 years."

Figure 5 Age profile of water industry

An occasional paper released by the Water Services Association of Australia (WSAA) titled *An assessment of the skills shortage in the urban water industry*[27] noted on page 17 that the water utility workforce includes a relatively large proportion of workers over 55 years of age, 18.3 per cent compared with the all industry median of 12.2 per cent.

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[26] *Queensland Water Directorate, The 2020 Queensland Urban Water Industry Workforce Composition Snapshot Report, 2020.*

[27] *Water Services Association of Australia, An assessment of the skills shortage in the urban water industry, WSAA Occasional Paper No.1, March 2008.*

The evidence suggests workforce age is not evenly distributed as proposed by QCA and AtkinsRéalis and is more commonly normally distributed (as **Figure 4** and **Figure 5** show). Noting this, there is clear evidence of a trend in workforce ageing that needs to be addressed during the current price path period (as documented by the Queensland Water Directorate and WSAA) and justifies the uplift in investment in graduates, cadets and apprentices to ensure sufficient operational staff and knowledge as employees retire.

This older workforce profile has implications for impending retirements – a significant number can be expected over the next 10 years – and for attraction, retention, knowledge transfer and succession management. This profile also has occupational health and safety implications as those currently in manual roles may experience reduced capacity to perform in these roles as they mature.

Within its draft recommendations, AtkinsRéalis states that "Sunwater has not been able to draw a clear link between this increase and external changes in obligations."[28] However, what it fails to acknowledge is that drivers do not have to be exogenous to be prudent. Risk profile can change over the period, which provides an appropriate driver for action. Given the risk of Sunwater's ageing workforce, action needs to be taken within the period, justifying its workforce strategy.

It is also relevant to note that AtkinsRéalis assesses the efficiency of cost increases differently to cost decreases. AtkinsRéalis strictly applies the notion that all cost increases are inefficient if not explained by exogenous factors, even though it accepts the legitimacy of endogenous factors when assessing the efficiency of cost decreases such as Sunwater's reduced electricity costs, which were driven by management decisions to seek and enter a lower cost electricity supply contract.

Utilisation rates

QCA flags its concerns with Sunwater's continued lower (than pre-COVID) utilisation rates in 2022-23, and notes that forecast increases in utilisation rates from 2023-24 to return to target must be driven by growth in non-regulated activity as there is no anticipated growth in regulated services.

The assumption that utilisation rates should remain static year on year is not supported by evidence. Sunwater contends that utilisation rates in a low or zero growth business can and will flex according to factors including:

- changing business priorities and strategic objectives, leading to less direct charging activities
- required changes to field work delivery post-COVID
- increased training requirements (including safety related training)
- the balance between internal and external project/program delivery
- response to occupational health and safety reviews
- weather conditions

[28] *AtkinsRéalis 2024, ibid, p.141.*

- the cyclical nature of activities
- the ramp-up to an optimal level of utilisation consistent with new FTEs
- the impact of digital transformation across systems and processes, and on resource utilisation.

As Sunwater transforms and moves towards better practice, as expected by our customers, the skillsets it needs to meet changing customer service expectations and modern irrigation service delivery are evolving. Many of these skillsets do not currently sit within the business, requiring the acquisition of talent from the market. Sunwater's strategic workforce plan has identified key workforce segments, such as information/data business analytics, customer and stakeholder, and operations, that make a critical contribution to its strategic capabilities. Not only do roles in these groups typically possess highly developed skills and in-depth knowledge, but they are often in short supply. Sunwater is focused on recruitment and retention in these key workforce segments.

These factors do not appear to have been considered in the Draft Report.

Sunwater's response to the O&M – direct labour draft findings

QCA has not provided robust evidence and analysis to support its adjustments to Sunwater's uplift in direct labour. This is because:

- it has, without reference to analysis or data, assumed the workforce should demonstrate an 'even' age distribution, which is inconsistent with common practice i.e. a 'normal' age distribution
- it has determined that the percentage of Sunwater's workforce over 55 is consistent with industry practice, which is inconsistent with the workforce analysis presented above
- it has incorrectly assumed that lower utilisation rates, when coupled with higher costs and no growth in regulated services, indicate cost growth was driven by non-regulated services
- it has assumed, without evidence, that any backdated EA uplift in direct labour costs, compared to what was assumed in the 2020 review, is absorbed by the productivity offset. It should be noted that this approach results in a double count of the efficiency improvement as labour efficiency is also reflected in the efficiency improvement target
- QCA has not identified the new roles appointed during the period that are not prudent, how the activities these roles are delivering would be completed by pre-existing FTEs, and what Sunwater should do with those positions upon completion of the price review i.e. redundancies.

Sunwater has presented robust evidence that its workforce is ageing, requiring a proactive succession strategy during the period to appropriately manage business risks while maintaining a reliable water supply to its customers.

Further, Sunwater's utilisation rates are directly responding to changes in its operating environment, some endogenously driven in pursuit of becoming a mature service provider and appropriately managing risks, and some responding to challenges in service delivery and digital transformation.

Sunwater requests that the QCA reconsider its analysis and approve the labour costs put forward by Sunwater in its November 2023 proposal. Under a revealed cost methodology this represents the prudent and efficient costs required to provide Sunwater's services.

(ii) Overheads and indirect costs

In its draft findings, QCA has:

- transferred $0.8 million in billing system costs from indirect costs to corporate overheads, partially offset by a reduction in corporate overheads of $0.4 million
- reduced local overhead costs by $1.6 million.

The following addresses Sunwater's concerns, separating indirect costs and corporate overheads, and local overheads.

Indirect costs and corporate overheads

As noted earlier, AtkinsRéalis considered a large portion of the increase in ICT costs to be driven by internal business decisions with no clear benefits discernible for regulated schemes. QCA links the general provision of ICT equipment and desktop support for an expanding organisation to the growth in non-regulated services. QCA states that it expects ICT cost increases to deliver benefits that outweigh the costs, and that AtkinsRéalis attributed the overspend to inefficiencies in estimating costs and managing project delivery.

On this basis, QCA proposes to reject any uplift in corporate overheads that is not captured in Table 9 of the Draft Report.[29]

There are several issues with these findings:

- QCA refers to corporate cost benchmarking work undertaken by AtkinsRéalis, where Sunwater's corporate costs were compared with other rural water businesses. AtkinsRéalis could not form a view that Sunwater was less efficient than its counterparts. This provides evidence that existing expenditure is reasonable, and as such should not be adjusted.
- AtkinsRéalis and QCA were critical of Sunwater's historical approach to cost estimation and project delivery. As a business, Sunwater accepts that, historically, its maturity in ICT cost estimating and project management has been low. However, this does not demonstrate that the final cost of delivering those projects was not efficient, merely that Sunwater, in some instances, underestimated the cost of delivering those projects. This is an example of correlation being considered sufficient to justify a cost reduction, without consideration of causation. Overspending on the forecast allowances does not mean that outturn costs were not efficient. For example, in the case of the CASPr procurement process, the cost increased from the initial estimate due to a change in scope to achieve a better management of risks. QCA accepted this logic when it assessed the actual costs of Sunwater's renewal projects as prudent and efficient even while noting there was scope to improve its asset management and planning processes.[30]

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[29] *QCA 2024, ibid, p.37.*

[30] *QCA 2024, ibid, Section 5.3.1, p.57-58.*

- AtkinsRéalis has referenced an ICT benchmarking analysis[31], which it uses to suggest that "Sunwater's spend is a significant outlier, even taking into account the limitations of those type of analysis." The limitations of this analysis have been detailed in **Section 4.2**, and are partially recognised by AtkinsRéalis (see footnote 78). In light of the flaws Sunwater has highlighted, these benchmarks should not be used as part of decision-making for the Final Report.

Local overheads

QCA states on page 36 of the Draft Report that it does not propose to allow recovery of the increase in local overheads from regulatory schemes because "In the case of local overheads, we note that the key driver for the increase in the cost base is the reduction in utilisation rates for direct labour and that this reduction has occurred even as direct labour costs have increased. This may reflect a temporary reduction in productivity, in anticipation of a future increase in operations and maintenance work in non-regulated services."

Similar to earlier analysis, QCA/AtkinsRéalis have referenced the reduction in utilisation (which increases proportion of time booked to local overhead codes) and workforce decisions that were premised on workplace age. As demonstrated earlier, both these issues were incorrectly determined. Sunwater maintains it was justified in making workforce changes within the current price path period to address an identified retirement risk. Similarly, it is entirely plausible and, in fact, demonstrated, that utilisation rates can go down without there being a reduction in productivity.

QCA also fails to consider the impact of safety on these local overheads. Additional time and effort to ensure activities are planned and delivered safely affects the entire business, particularly the local overhead costs where senior operational leadership roles reside.

Sunwater's response to QCA's overhead and indirect cost draft finding

Indirect costs and corporate overheads

The reasoning presented by QCA and AtkinsRéalis does not justify the adjustments proposed. Consistent with AtkinsRéalis's own benchmarking, it could not be proven that Sunwater's corporate costs were not efficient. Nor was it proven that outturn costs were inefficient, despite shortcomings in cost estimation and project delivery. While there may have been findings on the strength of Sunwater's approvals process, customers were not disadvantaged during the period as these additional costs were not funded through irrigation prices.

As such, QCA is requested to reconsider its draft finding and reinstate adjustments made to corporate ICT costs, consistent with Sunwater's initial proposal.

Local overheads

Sunwater requests that the QCA reconsider the proposed adjustments and reinstate the local overheads expenditure. As discussed, QCA has not identified the FTEs that should not have been recruited, nor demonstrated those activities could be delivered by the existing workforce, nor explained how Sunwater should manage the impact of these adjustments on the workforce e.g. retrenchment of existing FTEs, reallocation of roles to other FTEs, etc.

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[31] *AtkinsRéalis 2024, ibid, p.112-113.*

4.3.2 An appropriate efficiency factor

QCA believes Sunwater has significant potential for opex efficiency and the proposed efficiency challenge is reasonable and achievable. Sunwater accepts that there is scope for efficiency gains to be made and proposed an efficiency factor of 0.5 per cent accordingly – relevant to its adjusted base-year.

Sunwater is now concerned that in accepting its 0.5 per cent per annum efficiency proposal QCA has not acknowledged the impact of their proposed adjustments on the actual savings this requires Sunwater to find. That is, the actual opex efficiencies required are significantly higher than the 'headline' efficiency target of 0.5 per cent per annum, due to the adjustments to base-year expenditure made in the Draft Report.

Sunwater estimates the cumulative efficiency factor is around 1.5 per cent per annum when its actual opex in the base year is taken into account, which translates to Sunwater having to realise opex savings of around $21 million in nominal terms in the next price path period.

This significantly exceeds standard practice across the water sector nationally, and is above even the highest commitments made under PREMO in Victoria for businesses where their submissions achieved the highest ratings ('Advanced') in the recent 2023 price review.

Sunwater is concerned that QCA and AtkinsRéalis have not properly considered that, unlike many urban water businesses, Sunwater cannot rely upon growth in customer numbers and usage (i.e. scale) to achieve efficiency improvements; it must achieve its desired efficiencies the 'hard way', through innovation and investments in people, systems and processes. These activities are endogenously determined and require Sunwater to incur costs now with the expectation of delivering customer value in the future.

With this context in mind, it is reasonable to conclude that QCA's efficiency factor approach will place significant constraints on Sunwater's operations in the next price path period, increasing the risk of adverse outcomes for Sunwater and its customers.

The efficiency factor (if any) must have regard to actual expenditure levels, not regulatory forecasts unless those two are aligned.

Efficiency related to renewals expenditure is addressed in **Section 6.3**.

4.4 Summary of Sunwater's opex base-year position in response

The proposed opex allowance under QCA's preferred base-step-trend approach is built on the basis of a prudent and efficient base year. QCA's draft position does not represent the prudent and efficient level of expenditure required to deliver services in 2022-23 after adjustments for reasonable non-recurrent items.

In responding to the issues outlined in the preceding sections, Sunwater requests that QCA review its approach for the Final Report and as a result reinstate the opex base year values presented in Sunwater's original proposal.

Addressing Sunwater's concerns would see a Final Report that:

- sets the baseline opex at a broad level by recognising that the actual overspends have been partially offset by opex savings realised
- rescinds recommendations made due to a difference of opinion, inferences drawn from correlations, or reliance on selective consideration of costs or cost drivers.

Each of these issues is explored in detail within Sunwater's response, with well documented and clear justification.

Should QCA decide not to accept or address Sunwater's base-year concerns in its Final Report, then it should reassess and revise downward any efficiency target. The adjustments proposed by QCA equate to a far higher efficiency target than any peer organisation in Australia. No further efficiency target should be imposed under these circumstances.

A summary of Sunwater's desired and justified position is presented in **Table 7**.

Table 7 Sunwater's response to QCA's draft opex decision by individual cost category

Category	Sunwater proposed	Draft Report	Sunwater revised	Rationale
Opex – direct labour	$12.5m	$11.5m	$12.5m	QCA has not proven that Sunwater's direct labour costs are inefficient.
Opex - contractor costs	$4.5m	$4.4m	$4.5	QCA's draft position is inconsistent with its guidance and based on a difference in opinion rather than evidence.
Opex - materials	$2.7m	$2.7m	$2.7m	QCA generally accepted Sunwater's proposal for materials and other opex category.
Opex - other	$7.2m	$7.2m	$7.2m	
Opex – support costs (overhead and indirect costs)	$26.5m	$25.4m	$26.5m	QCA has not proven that Sunwater's support costs are inefficient.
Opex- efficiency target factor	0.5% p.a.	0.5% p.a.	0% if QCA keeps base-year opex. 0.5% p.a. if QCA adopts Sunwater's proposed base-year opex.	An appropriate efficiency factor must consider revealed costs, not hypothetical costs. QCA is required to ensure that Sunwater has an opex allowance that provides for the safe, sustainable operation of the business, reflecting service standards desired by customers.

5 CASPr

This section responds to QCA's draft position on Sunwater's investment in the CASPr ICT system, including the decision to reduce the capital cost to $18.5 million and reject Sunwater's proposed causal recovery methodology.

Sunwater has responded to the arguments in the AtkinsRéalis analysis, and presented an alternate solution for determining the level of capital cost to be customer funded.

Sunwater has also responded to the recovery methodology and proposed a prudent solution that fairly and accurately reflects the nature of the investment and CASPr systems. Sunwater also rejects QCA's treatment of ongoing costs and offsets on the basis that the approach used by AtkinsRéalis is flawed and not supported by evidence.

CASPr is the most significant ICT project during the price path period and is the "only material controllable step-change in cost for the next price path."

There is agreement between QCA, AtkinsRéalis and Sunwater that CASPr is a necessary investment that will provide tangible benefits to customers. It is also agreed by QCA, AtkinsRéalis and Sunwater that the CASPr detailed business case is reasonable, as evident from AtkinsRéalis conclusion that the detailed business case is "a reasonable document in terms of setting out future activities, risks and the breakdown of costs."[32]

Despite agreement on the prudency of the CASPr investment and the reasonableness of the detailed business case, AtkinsRéalis has been critical of the CASPr investment and management process. AtkinsRéalis has used alleged deficiencies in Sunwater's initial investment decision-making process to justify imposing an arbitrary capital cost limit on CASPr for the purposes of this pricing review. The capital cost review is not supported by evidence and fails to acknowledge/accept the iterative nature of ICT investment and integrations in customer-focused organisations.

QCA has accepted the AtkinsRéalis review of the capital investment and imposed the superseded and out-of-date capital cost amount of $18.5 million on CASPr. This capital cost represents a scope of works that will not deliver the necessary, tangible benefits to Sunwater's customers. Sunwater cannot support this decision and it seeks a QCA final position that is aligned with the value contained in the detailed business case.

Sunwater aims to be constructive by proposing a reasonable and justifiable solution and not seeking to recover costs incurred until the middle of 2022, covering the period when its management of the project is alleged to have been inefficient. This results in Sunwater bearing $3,621,668 of costs. Sunwater therefore seeks to recover $34,878,332 from customers, ensuring they receive the necessary and prudent CASPr solution.

QCA has also adopted a recovery methodology position that rejects Sunwater's proposed causal methodology which seeks to apportion capital costs to schemes according to customer numbers. CASPr provides the same benefits to all Sunwater customers and customer number attribution is the most appropriate causal methodology. This aligns with QCA's stated requirement that Sunwater use causal methodologies.

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[32] *AtkinsRéalis, ibid, p.118.*

QCA's draft position also removes the potential for ex-post review – a position that is inappropriate for an investment of this scale and complexity, and places too high an investment risk on Sunwater. This position is advanced in the Draft Report with no reference to Sunwater's legitimate commercial interests.

These draft QCA positions are based on advice from AtkinsRéalis that is not supported by valid explanation or reasoning.

5.1 Context

CASPr is a complex system that is necessary for the proper management of a modern water organisation, its transactions and its customers. Sunwater has relied on the outdated and significantly limited Orion system, which will shortly become redundant and no longer externally supported. The CASPr system is necessary; QCA and AtkinsRéalis have acknowledged this, as evident from the following quote: "We concur with the need for replacing the billing system and implementing a CRM solution. The [existing] billing system was at the end of its useful life and was being withdrawn by the Vendor and Sunwater's CRM capability was very basic."[33]

There appears to have been some confusion regarding the breadth and functions of the CASPr system, which has led to inaccurate framing and benchmarking of the solution. Both QCA and AtkinsRéalis have repeatedly referred to CASPr as a 'billing system',[34] which dramatically understates its utility, functions and criticality to Sunwater's operations.

To address that misunderstanding, Sunwater has set out the elements of the CASPr system, the multiple functions it will perform and the integrations it will require. Understanding the function and detail of the CASPr system is critical because misframing has, in part, led to unjustifiable decisions regarding the acceptable capital cost and how recovery should be managed.

5.1.1 Elements and functions of the CASPr system

CASPr is a multi-function system that will manage water allocations and accounting, the meter-to-cash process, customer relationship management, internal communications, management and reporting on critical functions. **Table 8** sets out the primary functions and elements of CASPr.

The design, development and integration of the multifaceted, multi-function CASPr system is complicated and requires proper investment and planning – the solution is not available via an off-the-shelf generic product. **Figure 6** provides a simplified visual representation of the elements CASPr and how they interact.

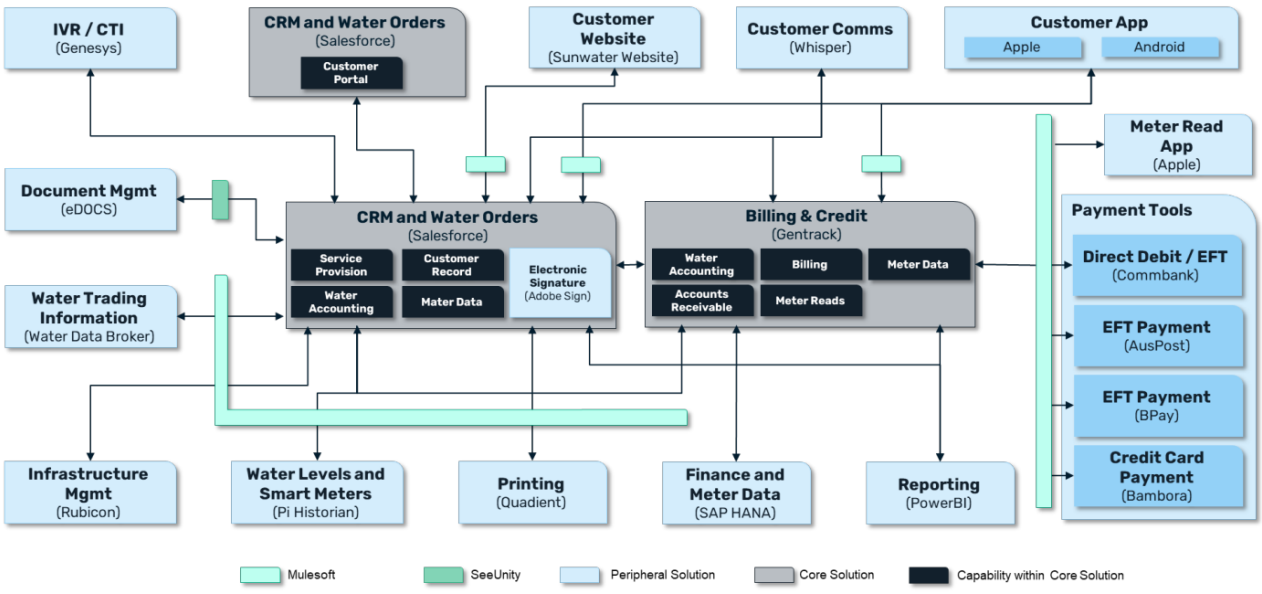
[33] *AtkinsRéalis 2024, ibid, p.115.*

[34] *Sunwater, p.41, AtkinsRéalis, section 3.6.*

Table 8 Primary functions and elements of CASPr

Function/element	Description
Water accounting and management	• Water allocation management and reporting • Temporary transfer management and reporting • Interactive water ordering and management across multiple platforms • Water fulfilment management and reporting • Real-time in-field communication for water fulfilment management
Meter-to-cash	• Account management • Meter information management • Automated meter and usage calculation • Development of customer invoices based on multiple data sets • Client billing distribution and management • Account receivable management and processing
Customer relationship management	• Centralised, integrated stakeholder management • Customer relationship management • Stakeholder management platform for community outreach • Customer communications management
Communications management	• Communication across Sunwater business on each of the primary functions: water accounting and management, meter-to-cash, customer relationship management
Reporting	• Business reporting across Sunwater business, including management and board reporting, on each of the primary functions: water accounting and management, meter-to-cash, customer relationship management
Integration	• The CASPr solution integrates across multiple internal, native and external software programs and platforms to manage and utilise data • External platforms include Salesforce, Gentrack and Mulesoft • Multiple third-party integrations are required

Figure 6 Proposed conceptual solution architecture for CASPr



5.1.2 Costs of CASPr system components

Sunwater understands that QCA has concerns about the capital cost of CASPr, although it appears those concerns relate, in part, to wrongly categorising CASPr as *only* a billing system. As outlined in **Section 5.1.1**, CASPr is a multi-function system that will manage water allocations and accounting, the meter-to-cash process and customer relationship management among other processes and functions. Each of these functions has been identified as necessary and has costs.

Sunwater has sought to break down CASPr costs across the three primary functions, although it is difficult to do so for the following reasons:

- a significant portion of the cost is shared (project governance, quality management, data migration, solution architecture and others)
- there is a single contract that spans the three functions for clients, which are naturally integrated. All three functions are necessary and integrated for each client.

To assist QCA, Sunwater has estimated the apportionment of the CASPr costs across the three functions. At this stage, Sunwater estimates the cost ratio of 20:40:40 across customer relationship management, billing and water accounting.

On this basis, the cost apportionment across the three functions is set out in **Table 9** based on Sunwater's revised recovery amount of $34,878,332.

Table 9 Estimated apportionment breakdown across functions

Function / element	Cost apportionment 2022-23 dollars (%)
Water accounting and management	$13,951,333 (40%)
Meter-to-cash	$13,951,333 (40%)
Customer relationship management	$6,975,666 (20%)

Sunwater issues approximately 21,500-22,500 water account statements and 20,000-21,000 invoices annually. All this documentation will be managed and produced by CASPr.

5.2 CASPr build costs

5.2.1 Analysis of QCA's draft position

QCA relied upon the analysis by AtkinsRéalis, to determine that:

- CASPr is a necessary and prudent investment to replace the existing billing system, provide a customer records management system and address technical, cyber risks and compliance risks set out in applicable legislation and regulations[35]
- the detailed business case for the CASPr investment is "a reasonable document in terms of setting out future activities, risks and the breakdown of costs"[36]

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[35] *Sunwater notes the Queensland Audit Office supported and endorsed the requirement, including identifying that the legacy solution was based on outdated technology and lacked the appropriate inherent controls to protect customer information, Detailed Business Case, p.16.*

[36] *AtkinsRéalis, ibid, p.118.*

- the capital cost estimate of $38.6 million is not efficient due to AtkinsRéalis's assessment that there were significant weaknesses in how this project was managed from an options assessment, budgetary, procurement and governance perspective"[37]
- The earlier cost estimate of $18.5 million (2022-23) is appropriate because it was the agreed value before Sunwater identified issues in the project development process, is at the upper end of the range of publicly available costs for similar implementations, and reflects a reasonable cost per customer for a project and organisation of this type[38]
- Sunwater appears to have significantly underestimated the required cost initially, due to a lack of relevant expertise.

5.2.2 Sunwater's response

As stated above, Sunwater notes that QCA has acknowledged that it relied on analysis and recommendations from AtkinsRéalis to make its determination of the appropriateness of the CASPr build costs. Sunwater submits that AtkinsRéalis's analysis, logic and understanding is problematic, and requests the QCA make a new decision that aligns with the analysis in this section.

AtkinsRéalis stated on page 124 of their report: "We are recommending that the regulated value for the build costs should be reduced to the January 2022 value of $18.5m (2022-23 dollars) across regulated and non-regulated customers. This represents:

- Sunwater's approved value at the timing of signing the vendor contract and before inefficiencies and omissions in its own management of the project were identified which led to the cost escalation
- a cost at the upper end of the range of publicly available costs for similar implementations
- a reasonable cost to implement a project for a water utility of the size and customer base of Sunwater when affordability on a cost per customer basis is taken into account."

The logic of this statement and recommendation is flawed and demonstrates a misunderstanding of the iterative nature of ICT developments. At the core of the arguments presented by AtkinsRéalis appears to be the position that if Sunwater had fully grasped its commercial and operational needs from the outset, it would ultimately have resulted in a project cost of $18.5 million. This is not credible or supported by evidence.

Indeed, QCA found that "Sunwater appears to have significantly underestimated the required cost initially, due to a lack of relevant expertise."[39] This statement indicates an appreciation that the initially estimated costs were less that what was ultimately 'required'.

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[37] *QCA 2024, ibid, p.42.*

[38] *AtkinsRéalis, ibid, p.124.*

[39] *QCA 2024, ibid, p.42.*

Sunwater has acknowledged in its submission, evidence and interviews that the early stages of the CASPr needs and project investigation were not perfect. However, there is no evidence to suggest these early challenges resulted in sub-standard outcomes or project selection. In fact, AtkinsRéalis acknowledged that the detailed business case – which it should be noted set the project cost at $38.6 million – is valid and reliable.[40]

There are multiple deficiencies in the arguments presented by AtkinsRéalis, and Sunwater has sought to respond to each of these deficiencies in this section. Sunwater notes that QCA acknowledged it relied on the commentary and findings of AtkinsRéalis in making its draft determination regarding the CASPr projects costs. It is Sunwater's position that the findings from AtkinsRéalis should not be relied on by QCA.

Sunwater's proposed solution

Sunwater submits that the detailed business case does set out a robust process for project selection, development and ultimate decision-making for Sunwater and its customers.

Sunwater submits that a reasonable outcome is that customers should not be required to fund the project development costs incurred in the period before Sunwater discovered (in AtkinsRéalis's words) "inefficiencies and omissions in its own management of the project".[41] This represents the actual costs for 2020-21 and 2021-22, a total of $3,621,668.

Sunwater proposes to remove this amount from the project cost to be recovered from customers. This is a practical solution that acknowledges the early project challenges, protects customers, and also relies on the estimates from the detailed business case which were found by AtkinsRéalis and QCA to be the most reasonable.

The CASPr project has been determined by QCA and AtkinsRéalis to be prudent, necessary and the detailed business case reasonable.[42] The evidence supports that the project development, implementation and operational costs from the commencement of 2022-23 are valid and should be supported by QCA. Each of these points is outlined in detail below.

Sunwater submits that QCA should determine the CASPr capital cost of $34,878,332 may be recovered by Sunwater as the prudent and valid project cost. This represents the detailed business case project cost forecast less actual costs for 2020-21 and 2021-22.

It is not reasonable to conclude that the older, less detailed cost is an appropriate estimate of prudent and efficient costs. To conclude this, QCA would need to be satisfied that the cost estimation process that derived this cost was sound and represented a project scope that is capable of delivering a prudent and efficient business and customer outcome. There is no evidence that QCA has formed this view.

Instead, QCA concluded, on the basis of AtkinsRéalis advice, that the $18.5 million estimate was prepared "before inefficiencies and omissions in Sunwater's management of the project were identified, leading to the escalation in cost."[43]

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[40] *AtkinsRéalis, ibid, p.118.*

[41] *AtkinsRéalis, ibid, p.124.*

[42] *AtkinsRéalis, p.114, QCA, p.41.*

[43] *QCA, p.42.*

It is difficult to conclude that a cost estimate prepared in ignorance of issues of suggested mismanagement is likely to be accurate. Further, QCA's reasoning depends on the difference between the $18.5 million estimate and the $38.6 million estimate being the result of 'inefficiencies and omissions'. Issues of this size should be easily apparent, yet QCA and AtkinsRéalis have not been able to specifically identify issues with the detailed business case, or anything that has arisen since.

Given the detailed business case has been found to reasonably set out the cost breakdown, Sunwater submits that it is not reasonable to adjust costs to a previous estimate that is known to be less accurate.

5.2.2.1 Iteration in ICT projects

The development of an organisationally transformative fully integrated billing, water accounting and customer relationship management system that interacts with every part of the Sunwater business is complex. Most importantly, the development of an ICT system of this nature is iterative. It requires a multistage discovery process that spans a significant time period.

During the discovery process, it is necessary to understand the nature of the organisational need, customer requirements, internal stakeholders and the many parts of the organisation that will be impacted and require integration. Sunwater undertook this discovery process and learnt more about organisational needs, market offerings and customer requirements. Sunwater acknowledges that management of the project development process was not perfect during its early stages (this is discussed further below). Despite this, the discovery process was still highly valuable and resulted in Sunwater building its understanding of needs, offerings and requirements.

AtkinsRéalis claimed that: "It is evident throughout the early development and procurement phases of this project that Sunwater did not have knowledge, experience and expertise to make effective and optimal decisions." (p.116)

This statement, and others by AtkinsRéalis, suggest that Sunwater should have been immediately positioned to understand its needs and ready to make informed decisions. This is not valid. Sunwater needed to undertake a process to build the project through multiple iterations and engagements with the market. This is what Sunwater did, which is evidenced by the progression in the build cost estimates as it developed and iterated the project from a simple billing system to a fully integrated billing, water accounting and customer relationship management system that can operate effectively for the next 20 years.

AtkinsRéalis further stated that: "Since the first business case, where the need and urgency were identified, it is fair to say that the timing of both the procurement and the project implementation has shifted backwards on multiple occasions and it is materially different from what was originally assumed to be required as a matter of urgency, and which we explain in more detail below does not reflect well on the management of this project." (p.115)

Far from reflecting poorly on management, the iteration of the project described by AtkinsRéalis, and expanded on its report, demonstrates that the project developed over time and management was sufficiently agile to manage the project as it developed.

Sunwater notes that Greater Western Water (GWW) experienced similar project iterations in the design and development of its 'Platypus' billing and collections system.[44] The Platypus billing and collections system is currently under development by GWW, and has been subject to multiple cost changes as the project was scoped and better understood.

The Platypus billing and collections system was originally proposed in City West Water's 2018 Pricing Submission at a capital cost of $15 million.[45] Further investigations, increased understanding and project iterations led to an increased cost of $62 million (+/- 20 per cent) in GWW's 2022 pricing submission. The Platypus project continued to iterate and evolve and, as a result, the price submitted by GWW in the 2024 pricing submission was $92.53 million (nominal).

The Essential Services Commission's consultants noted the significant increases in capital estimates for the Platypus project throughout the project discovery and development, and recognised that these differences were driven by factors relating to the evolving understanding of business requirements and the iterative nature of ICT investments. The following are some samples of the statements:[46]

- "The 2018 Pricing Submission estimate was developed before business requirements were documented or a market assessment completed."
- "Discovery during detailed design that changed scope and complexity of the project."
- "Replacement of the customer communications management (CCM) functionality was added to the scope of this program."
- "The estimate only included the technology solution cost, not the cost to implement."
- "Greater number and complexity of interfaces with external and internal systems than was not anticipated during the original design."

Each of these statements could be credibly made about Sunwater's early development of CASPr, and reflect that cost estimate increases, scope changes and evolving project understanding are expected in significant ICT investment projects. They are not, *prima facie*, evidence of poor management or decision-making.

Much of the criticism levelled against Sunwater management by AtkinsRéalis is not supported by evidence or fact. For example, AtkinsRéalis was highly critical of the Expression of Interest (EOI) process, length and market engagement. However, AtkinsRéalis also acknowledges that the EOI process produced 17 market submissions, which were then narrowed down to a shortlist of eight for further assessment. It is not realistic to suggest there are significantly more than 17 vendors that would be able to put forward a credible submission to deliver a multifaceted ICT system, and comply with the procurement, legal and financial requirements necessary to work with a government-owned corporation. This example attests to AtkinsRéalis's tendency to make unsubstantiated criticisms without understanding the limitations of the Australian and Queensland market.

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[44] *Essential Services Commission, Greater Western Water final decision: 2024 Water Price Review, June 2024.*

[45] *City West Water is the forerunner to Greater Western Water.*

[46] *ibid, p.61-63.*

This example also contradicts AtkinsRéalis's assertion that CASPr cost is at the upper end of the range of publicly available costs for similar implementations.

Sunwater also rejects the notion that affordability on a cost-per-customer basis is relevant to the selection of a solution designed to meet service and compliance obligations. This hurdle is not defined in the QCA's guidance and should have no bearing on the assessment of this project.

5.2.2.2 Detailed business case is reliable and credible

Both QCA and AtkinsRéalis acknowledged that the detailed business case is a valid document that effectively sets out the project activities, risks and breakdown of costs. The detailed business case sets out the build costs of $38.6 million and ongoing operation costs of $1.6 million.[47]

AtkinsRéalis has been critical of the level of transparency of the increase in the budget from $18.5 million in January 2022 to $38.6 million in March 2023.[48] Sunwater provided an explanation – in response to RFI 58 – that advised the primary driver behind the cost increase was the risk mitigation-based decision to move to integrations and interconnectivity of systems and works being centralised rather than being managed by smaller, higher risk providers. This is a valid decision in the context of an increasingly complex ICT investment, and is a clear example of the iterative nature of the project development outlined in **Section 5.2.2.1**.

The centralisation of the ICT integrations and functions resulted in the movement to a single prime contractor, which resulted in the need for a new project scope, provider-type and project complexity. Sunwater made this valid decision in the interests of managing the project risk and maximising the chances of a successful and effective project implementation.

Sunwater submits that the detailed business case sets out the project activities, risks and breakdown of costs. This has been agreed by QCA and AtkinsRéalis. That detailed business case set the project build costs of $38.6 million and ongoing operation costs of $1.6 million. The detailed business case is reasonable and the associated cost reliable and valid.

The concerns with project management in the initial phases do not impact or undermine the credibility and reliability of the build cost outlined in the detailed business case.

5.2.2.3 No evidence that early management decisions led to higher capital cost

AtkinsRéalis has claimed: "We consider the cost estimate of $18.5 million appropriate as it removes costs that could have been avoided with better scoping and reflects the costs of similar implementations for water businesses with the size and customer base of Sunwater.

"Inefficiencies and omissions in Sunwater's management of the project were identified, leading to the escalation in cost."[49]

There is no evidence presented to support $18.5 million as the appropriate cost estimate. In fact, the cost estimate of $18.5 million is found in the "Recommendation to Award CASPr

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[47] *AtkinsRéalis, p.114.*

[48] *AtkinsRéalis, p.115.*

[49] *AtkinsRéalis, p.115.*

Contracts", January 2022, which AtkinsRéalis has criticised by saying: "The project summary makes no reference to the previous budgets and no explanation why the forecast budget has increased again."[50]

Conversely, AtkinsRéalis consider the breakdown of costs in the detailed business case to be 'reasonable'. It says: "Overall, it is a reasonable document in terms of setting out future activities, risks and the breakdown of costs." [51]

It is hard to reconcile how AtkinsRéalis has selected the cost from January 2022 as valid, when it has rejected the cost outlined in the detailed business case, which it considers reasonable.

It appears AtkinsRéalis has formed the view that some of the project management processes in the project's early stages were the direct and proximate cause of the capital cost increases. That is, AtkinsRéalis has found the project costs increased by more than $20 million because of issues with project justifications, record keeping and reporting. This does not appear to be supported by the evidence. AtkinsRéalis has set aside the impact of increases in project scope, the complex nature of a multifaceted system and valid risk mitigation decisions that led to requiring a single prime contractor.

There is no established causal link between management's decisions and the higher capital cost. As identified by AtkinsRéalis, there is no evidence that "inefficiencies and omissions in Sunwater's management of the project" led to an escalation in cost.

The approach taken by AtkinsRéalis in reviewing CASPr also differs to that of historic renewals. For example, its assessment of the Coolmunda dam counterweights refurbishment project found Sunwater negotiated several variations with the lead contractors. AtkinsRéalis found this "highlights the need for Sunwater to improve its scoping process, project delivery of complex projects, budget approvals, and effective asset management approach." However, AtkinsRéalis ultimately concluded that "we do not recommend any adjustments as … there is no evidence that final outturn costs are inefficient."[52]

Likewise, for the Callide Dam Gates Vibration Study, AtkinsRéalis examined whether the project would have been more efficiently delivered if the initial project scoping was more comprehensive. Even though the budget increased substantially, AtkinsRéalis concluded that "procuring works in more comprehensive packages rather than using variations to manage scope is not always more efficient." [53] As a result, no savings were recommended.

Sunwater considers this logic applies equally to the assessment of CASPr costs. Changes in scope do not mean the ultimate solution is not prudent and efficient. To modify the proposed costs, QCA needs to be satisfied that the system could be delivered for less.

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[50] *AtkinsRéalis, p.118.*

[51] *AtkinsRéalis, p.118.*

[52] *AtkinsRéalis 2024, ibid, p.189.*

[53] *AtkinsRéalis 2024, ibid, p.194.*

Sunwater has acknowledged that some of the management processes and decisions in the first period of the project could have been better. The responsible officers were not sufficiently experienced in ICT project investments and this led to some inefficiencies in the project management process i.e. during 2020-21 and 2021-22 the project was not managed as efficiently as it could have been and this arguably led to project management costs during that period being less than full value for money.

On this basis, Sunwater has proposed a reasonable solution that the project costs incurred during that period be removed from the costs of the CASPr project, resulting in a revised CASPr project capital cost of $34,878,332. This revised cost is a fair reflection of the efficient project costs and represents value for money for Sunwater's customers.

5.3 Sunwater proposed cost allocation and recovery

5.3.1 Analysis of QCA's draft position

The Draft Report recommended that:

- treating the CASPr build cost as capex is consistent with standard regulatory practice on the basis that Sunwater is incurring high upfront costs to generate a product that provides a service over multiple years
- there is merit in treating the CASPr build cost as capex, and Sunwater should amortise these costs and recover them through corporate overheads.

5.3.2 Regulatory precedent

Customer meters are a critical component of customer billing and water accounting – the same as CASPr. The costs of meters for bulk customers are recovered through the annuity charge, which is allocated using the Headworks Utilisation Factor (HUF).

As part of the current irrigation pricing review period, Seqwater sought to recover the costs of its new water accounting system.[54] Seqwater proposed allocating these build costs in the annuity balance of each regulated scheme based on customer numbers. This seems very similar to the approach proposed by Sunwater.

QCA accepted Seqwater's proposal.[55]

5.3.3 Sunwater's response

Sunwater has proposed that the capital costs of CASPr be distributed across regulated and non-regulated service contracts using customer numbers as the appropriate cost allocator. This approach is designed to properly reflect both the benefits and functions of the CASPr system, which will be shared equally among Sunwater's customers.

CASPr's functions are relevant and beneficial to all Sunwater's customers and are a necessary element of modern management and reporting on water distribution and organisational operations.

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[54] *Seqwater, Submission to the QCA's 2025- 29 Irrigation Price Investigation, November 2023, p.28.*

[55] *QCA, Rural irrigation price review 2025–29: Seqwater, Draft Report, , June 2024, p.28.*

AtkinsRéalis states that, in its opinion, Sunwater's "proposed treatment of CASPr is not consistent with other ICT (or any other non-direct) costs. If amending the treatment of one corporate project, why not others?"

This question suggests that AtkinsRéalis has misunderstood the nature of the CASPr system, which is a tool that will provide multiple customer-specific benefits and directly interface with customers about allocations, purchases and stakeholder management issues. The CASPr system, subscriptions, interfaces and integrations all relate to customer requirements and are distinguishable from other, internally focused ICT systems.

On this basis, it is appropriate and reasonable that all customers share in the costs of the CASPr system.

Sunwater notes QCA's stated desire for Sunwater to improve the causal alignment between costs and recoveries across its portfolio. The proposed capital cost recovery methodology for CASPr is overtly causal and aligns with QCA's approach. Sunwater acknowledges further work will be required in future across the full portfolio to increase causal recovery, but that is not a valid reason to reject Sunwater's approach to apply a casual methodology where it is available, as it is here. This is a significant investment and will require Sunwater to utilise debt to fund this investment.

Given the scale, complexity and scope of the CASPr project, it is appropriate that it be treated as a capital project and subject to ex-post review. It is an unacceptable risk to Sunwater that a project of this scale cannot be subject to recovery of actual costs.

Allocation using the HUF is not inconsistent with the recovery of metering costs. Treatment as a corporate overhead will lead directly to under-recovery of this critical project. This is not appropriate and runs counter to the regulatory principle of user pays.

5.4 Depreciation offset and annuity calculation

5.4.1 Analysis of QCA's draft position

QCA's draft recommendations are that:

- CASPr build costs should be annuitised over 15 years at $1.7 million per annum based on a $18.5 million build cost
- decommissioning of the Orion billing system from 1 July 2025 will result in a $2 million saving due to the end of the asset life for depreciation
- removal of the Orion depreciation amount will offset the annuitised build costs of $1.7 million and result in a net saving of $0.3 million annually.

5.4.2 Sunwater's response

If Sunwater's revised cost recovery amount of $34,878,332 is accepted, the annuity will be $3.1 million annually (assuming a 15-year recovery period).

QCA stated that the Orion system (billing only) had an allowance of $2 million. If that was allowed, Sunwater submits that a modernised integrated billing, water management and customer relationship management system should be allowed at a greater cost i.e. a $3.1 million annuity is reasonable and prudent.

Depreciation was between $1.6 million and $1.7 million each year for the eight years ended 2021-22 for asset capitalisation of the Orion billing system. The amount was not $2 million annually and it ended in 2021-22.

An annual depreciation amount for the Orion billing system has not been included in the forward price period.

There is no available amount in the forward price period that can be used as an offset. If the annuity methodology is used (Sunwater opposes this, see **Section 5.3**), the full $3.1 million should be recoverable.

5.4.2.1 Annuity for billing system

As identified by AtkinsRéalis and QCA, the Orion billing system had an annual (depreciation only) allowance of $2 million, which was previously approved by QCA.

Orion was a billing system only and had significantly fewer functions than required from the new billing system in relation to information security, functionality and controls required to satisfy legislative and regulatory requirements. The billing system alone needed to be substantively improved.

As outlined multiple times in this document, CASPr is not only a billing system (see the detailed description at **Section 5.1.1**). Each of its functions, identified as necessary by the Queensland Audit Office, QCA and AtkinsRéalis, has costs associated with purchase, integration and development.

Sunwater's proposed revised cost recovery amount is $34,878,332 (see **Section 5.2**). Sunwater has calculated the allowance at that revised cost recovery amount to be $3.1 million annually (using a 15-year annuity period). To assist QCA's understanding, **Table 9** shows the annual allowance for each of CASPr's primary functions based on the apportionment outlined in **Section 5.1.2**.

5.4.2.2 RFI 138

Sunwater confirmed in RFI 138 that $1.6-$1.7 million was depreciated for the Orion billing system each year for the eight years ending in 2021-22. Sunwater stated that this: "item was fully depreciated by 2021-22 and therefore no further depreciation was charged to the income statement through cost centre 661."[56]

Table 13 of the Draft Report clearly shows QCA has offset the CASPr cost by $2 million annually for "reduction in savings for Orion end-of-life". However, this depreciation amount ended in 2021-22 and is not included in the forward price period. **It is not available to be used as an offset.**

Further, we note that the amount has been overstated as $2 million annually, which is not supported by the evidence.

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[56] *RFI 138.*

5.5 Ongoing CASPr costs

5.5.1 Analysis of QCA's draft position

The QCA's draft recommendation is based on advice from AtkinsRéalis that:

- ongoing costs should be reduced from Sunwater's proposed $1.4 million to $0.7 million in 2022-23 dollars
- the $0.7 million difference was made up of Orion-related efficiencies ($0.4 million) and labour savings ($0.3 million).

5.5.2 Sunwater's response

In its submissions (RFI 59), Sunwater acknowledged a further $0.2 million reduction in costs, meaning its position is that ongoing costs should be $1.2 million in 2022-23 dollars.

The further reductions recommended by AtkinsRéalis require revision because they:

- incorrectly assert that a redeployment would result in an increase in costs of $0.2 million
- incorrectly identify a further $0.3 million in labour savings, which was an amount that is unsubstantiated and ignores AtkinsRéalis's own statements regarding the ICT efficiencies already achieved by Sunwater.

5.5.2.1 Redeployment assumption

Sunwater identified in RFI 59 that $0.2 million of previous Orion-required labour resources were being used in the ICT program management. This is entirely appropriate and must be considered in the context that Sunwater has achieved highly significant ICT management efficiencies and reductions in ICT totex expenditure for the forward price period (see next section).

AtkinsRéalis incorrectly suggested that this labour utilisation was being used as the sole reason for an increase in expenditure. This is not supported by evidence. Sunwater had stated accurately that this resource was being utilised in ICT program management and there is no saving available.

5.5.2.2 Further labour savings

Sunwater identified labour savings from the new CASPr system of approximately two FTEs, which would be fully realised in the third year after the 'go live' date. This is a reasonable, identified saving on the basis that the CASPr system will be a multi-function system. As identified by AtkinsRéalis, many of these systemised functions will be new for Sunwater and will require resources to ensure their efficient and effective operation.

In Sunwater's view AtkinsRéalis has shown flawed logic by suggesting that, simply because a new ICT system is in operation, reasonable human resources will not be required to ensure its proper operation.[57] Sunwater had already examined the new system and identified a resource efficiency of two FTEs. AtkinsRéalis decided, without providing reasons or analysis, that this was too conservative and suggested that this saving should be five FTEs.[58]

AtkinsRéalis's additional reduction of $0.3 million per annum in ongoing costs is even more problematic in the context of Sunwater reducing its ICT totex as a percentage of total revenue to a low of 3.7 per cent for the future price period. It should be noted that this is well below Yarra Valley Water (5.2 per cent), Sydney Water (7.7 per cent) and the global mid-sized utilities survey (4.2 per cent).[59] Sunwater has already achieved significant ICT efficiencies for the future price period, and there is no valid argument or justification for requiring further reductions in ongoing costs for such a significant new ICT system.

5.6 Summary of Sunwater's CASPr position in response

Sunwater's position on CASPr is summarised in **Table 10**.

[57] *AtkinsRéalis, p.84.*

[58] *AtkinsRéalis stated they calculated the additional $0.3 million saving as a "Rough approximation assuming approximately 3 FTE saving and $100k per FTE p.a. taking account of non-labour cost uplifts (occupancy, etc.)." (AtkinsRéalis, p.84)*

[59] *It should be noted that AtkinsRéalis attempted to rely on four UK water organisations as benchmark comparisons. This is inappropriate because of the significant differences between the UK organisational maturity and because AtkinsRéalis had already provided a 2022 global survey result as a suitable benchmark comparison. The reasoning for including the UK water organisations may be an attempt to artificially reduce the benchmark comparison or because the consultant is more familiar with those UK organisations and is unfamiliar with the Australian water regime. Appropriately converting costs between the two jurisdictions is also inherently problematic. (AtkinsRéalis, p.108)*

Table 10 Summary of proposals and revisions

Topic	Sunwater proposed	QCA	Sunwater revised	Rationale
Build costs	Recovery of the full build costs at $38.6 million, including project development and assessment costs	Limiting recovery to $18.5 million being the cost identified in the previous 2022 cost estimate	Limiting recovery to $34,878,332	Allows proper, justifiable recovery and removes the cost to customers of any alleged management issues prior to mid-2022.
Allocation and cost recovery	Share costs across regulated and non-regulated customers using cost numbers as the cost allocator	Allocation methodology is not suitable for ICT capex	Share costs across regulated and non-regulated customers using cost numbers as the cost allocator	The benefits of the CASPr system are enjoyed equally by all regulated and non-regulated customers so customer number is the most suitable allocation methodology. Recovery of build and opex costs through overheads (via a method acknowledged to be flawed) is inappropriate and will lead to misalignment with the user pays principle. Sunwater, government or industrial customers will pay an inappropriate share of a customer specific activity.
Base-year adjustment for Orion	-	Decommissioning the Orion billion system from 1 July 2025 will result in $2 million in savings that will offset the annuitised build costs of $1.7 million and result in a net saving of $0.3 million annually	The annualisation methodology is not suitable for CASPr and there are no Orion costs available for offset	Orion costs have not been included after 1 July 2025, and so there is no offset available

Topic	Sunwater proposed	QCA	Sunwater revised	Rationale
Amortisation	Treat build cost as capex recovered under the proposed RAB approach with commissioning date of 1 July 2025 and an asset life of 20 years	Treat build costs as capex but amortise the costs and recover them through corporate overheads over a 15-year life span	Treat build costs as capex recovered under the RAB approach over a 15 year-life span	A 15-year lifespan is more in line with the Orion lifespan and allows for market changes relating to the SaaS model over time Includes an allowance for borrowing costs which the corporatised approach does not
Ongoing costs	Step-change of $1.4 million each year to account for ongoing costs	Net impact on ongoing opex of $0.7 million after reducing Orion system savings and labour efficiencies	Step-change of $1.2 million each year to account for ongoing costs	Proposed ongoing costs are already net of $0.5 million savings and there is no valid justification for reducing this further
Total annual adjustment	Recovery of build cost of $38.6 million over 20-year lifespan plus step-change of $1.4 million for ongoing costs	Recovery of $0.4 million as corporate overheads and $0.1 million recovered from regulated schemes	Recovery of build cost of $34,878,332 over 15-year lifespan plus step-change of $1.2 million for ongoing costs	Highly significant and impactful ICT investment that requires proper investment and will benefit all customers should be recovered appropriately

6 Renewals expenditure proposal

6.1 Allocation of indirect and overhead costs to renewal expenditure

QCA made a substantial adjustment to the indirect and overhead costs allocated to forecast renewal expenditure. Sunwater submits that this adjustment has reduced allowed indirect and overheads costs below prudent and efficient levels. Sunwater submits that this is the result of QCA:

- reducing forecast direct labour from 26 per cent to 12 per cent of direct renewal expenditure
- not altering the 'cost recovery rate' calculation.

QCA's draft decision proposes that direct labour costs should be 12.1 per cent of future renewal costs. This figure was calculated based on a simple average of direct labour costs from the four previous years (2019-20 to 2022-23). This reduced the indirect and overhead costs recovered through renewals expenditure by more than half.

Sunwater has undertaken a thorough investigation of the historical labour component of renewals and found that the low average determined by QCA is driven by a relatively small number of very large projects with small direct labour costs as a ratio of total renewals costs.

Approximately half of Sunwater projects are below $300,000 and the average portion of direct labour for these projects is 44 per cent. Application of a 12.1 per cent direct labour ratio will significantly under-resource the delivery of these renewal projects, which are typically delivered using only Sunwater labour.

Sunwater undertook this analysis for a range of project sizes, and applied these ranges to forecast projects. Analysis is based on a weighted average accounting for the number of projects in each size category, the average direct labour cost being 23.4 per cent of forecast renewals.

This lower direct labour forecast results in lower recovery of indirect and overhead costs. However, given the lack of a causal link between direct labour and indirect and overhead costs, it is not reasonable for a reduction in direct labour cost forecast to reduce overall indirect and overhead cost recovery below the prudent and efficient levels established by QCA.

To ensure Sunwater can recover the prudent and efficient amount of indirect and overhead costs, Sunwater proposes that:

- direct labour be forecast at 23.4 per cent of total direct renewals forecasts
- the cost recovery rate be amended to ensure overall recovery levels of indirect and overheads costs remain at prudent and efficient levels. The average rate should increase from 196 per cent in the Draft Report to 199 per cent.

These matters are set out below in greater detail.

6.1.1 Direct labour in renewals

QCA made a substantial adjustment to the indirect and overhead costs allocated to forecast renewal expenditure. Sunwater submits that this adjustment has reduced allowed indirect and overheads costs below the prudent and efficient levels set by QCA.

6.1.2 Sunwater original proposal

Sunwater's pricing submission forecast that direct labour made up 26 per cent of forecast renewal expenditure. This was based on a historical analysis that was not updated for this price review.

6.1.3 AtkinsRéalis/QCA

AtkinsRéalis reviewed the historical breakdown of renewal data and found the average of actual labour cost allocation over 2019-20 to 2022-23 was 12.1 per cent of the pre-overhead renewals. AtkinsRéalis considered the average of actual allocation provides a more representative forecast of labour cost allocation.

QCA accepted AtkinsRéalis's recommendation and calculated overhead recovery rates using a direct labour base of 12.1 per cent.

Table 11 Calculation of the QCA direct labour percentage (2020-23)

Cost	2020	2021	2022	2023	2020-23 total
Labour	2,653,637	2,992,139	3,341,108	2,733,249	11,720,133
Overhead	3,333,497	4,514,224	5,347,122	4,255,748	17,450,591
Indirect	1,574,382	2,144,123	1,717,264	1,161,140	6,596,909
Consultants and contractors	13,868,102	19,149,351	22,673,654	22,145,550	77,836,567
Materials	1,164,971	1,263,054	1,743,626	2,257,589	6,428,876
Other	396,493	631,620	1,045,574	1,259,602	3,333,462
Total	**22,991,084**	**30,694,510**	**35,868,347**	**33,812,877**	**123,366,818**
Direct labour as a percentage of direct costs	14.7%	12.4%	11.6%	9.6%	**12.1%** (simple average of values to left)

6.1.4 Sunwater response

Sunwater has further examined the historical data and has included an additional year (2023-24), which was not available to AtkinsRéalis at the time of its review. Replicating the QCA approach exactly, with the additional data point, results in a direct labour percentage of 12.85 per cent. This approach involves calculating the total direct labour forecast in a given year and dividing it by the direct costs recorded in that year. The five years of data are then averaged using a simple average.

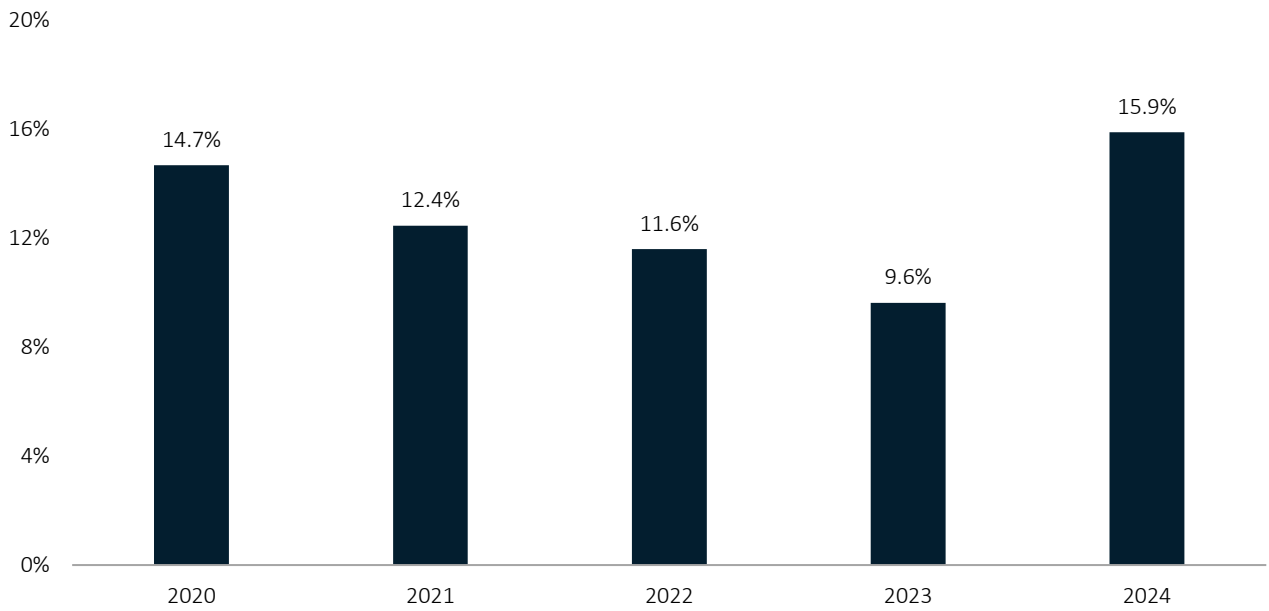
The data breakdown is shown below.

Table 12 Recalculation of the direct labour percentage (2020-24)

	2020	2021	2022	2023	2024
Labour	2,653,637	2,992,139	3,341,108	2,733,249	4,290,117
Overhead	3,333,497	4,514,224	5,347,122	4,255,748	6,564,327
Indirect	1,574,382	2,144,123	1,717,264	1,161,140	1,401,687
Consultants and contractors	13,868,102	19,149,351	22,673,654	22,145,550	18,225,647
Materials	1,164,971	1,263,054	1,743,626	2,257,589	2,759,719
Other	396,493	631,620	1,045,574	1,259,602	1,728,896
Total	**22,991,084**	**30,694,510**	**35,868,347**	**33,812,877**	**34,970,394**
Average (labour/direct costs)	**14.67%**	**12.45%**	**11.60%**	**9.63%**	**15.89%**

This data is shown graphically in **Figure 7**.

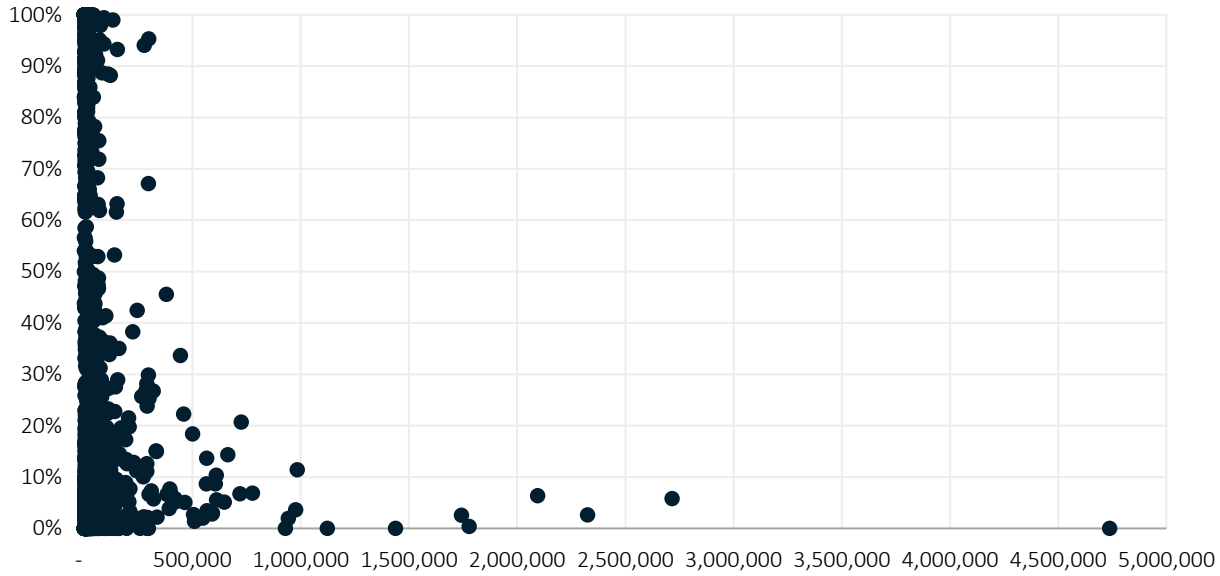
Figure 7 Historical average direct labour percentage



Sunwater has interrogated the data in response to the Draft Report. This interrogation shows that a small number of large projects influences the AtkinsRéalis/QCA averaging approach.

To examine the impact of large projects, Sunwater has identified the average direct labour component at a project level. The below figures show each of the historical projects. The x-axis is the direct cost of the project, while the y-axis shows the percentage of direct costs that relate to direct labour.

Figure 8 Historical renewals: Direct costs vs percentage of direct costs



This assessment shows that:

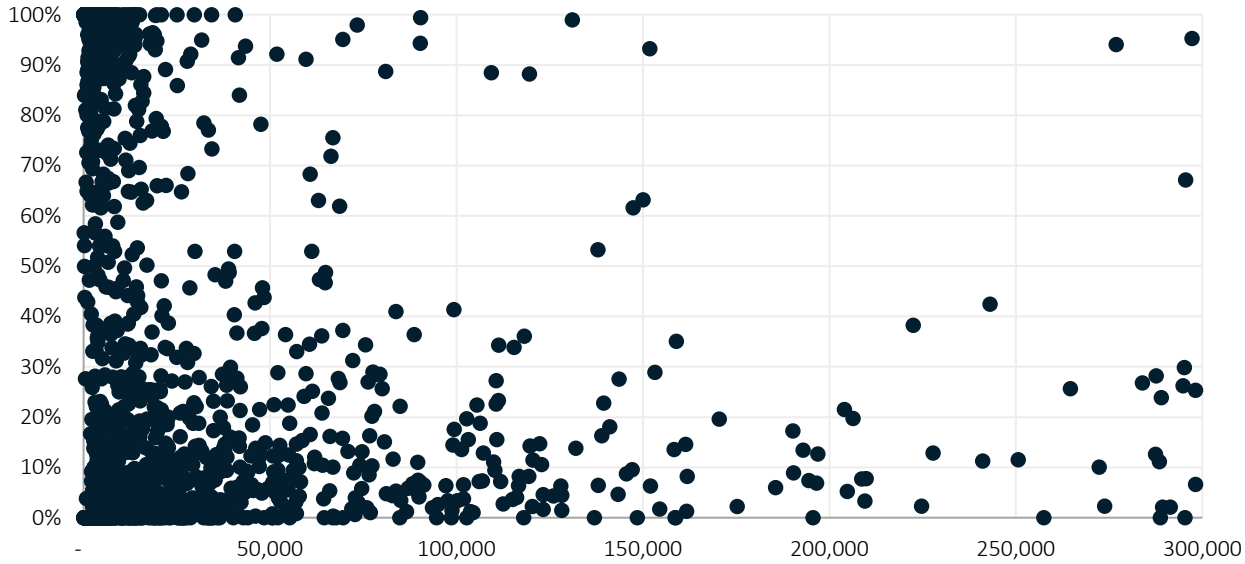
- there is a wide range of direct labour cost percentages between 0 and 100 per cent
- most projects are below $300,000
- as projects get larger, direct labour is a smaller percentage of direct labour costs. This reflects that smaller projects are more likely to be delivered in-house using Sunwater labour and larger projects are more likely to be outsourced.

To examine this issue more closely, Sunwater studied small, medium, large and very large projects defined as follows:

- small projects – less than $300,000
- medium projects – between $300,000 and $750,000
- large projects– $750,000 to $1,500,000
- very large projects– more than $1,500,000.

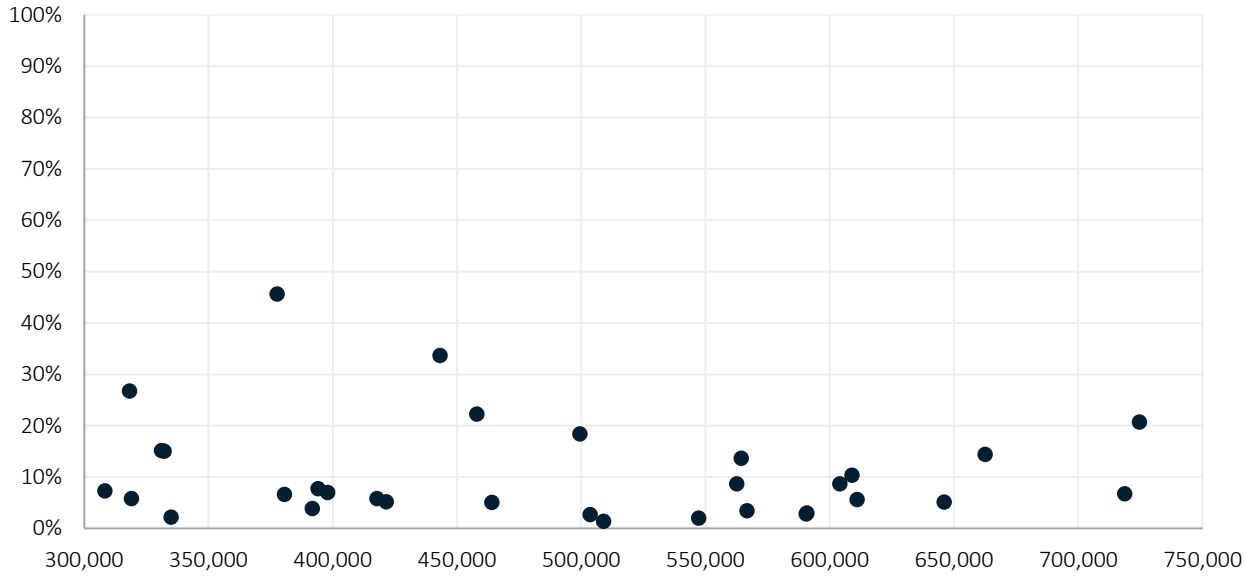
Using this breakdown, the following figures focus on each project size.

Figure 9 Historical renewals: Direct costs vs percentage of direct costs (projects up to $300,000)



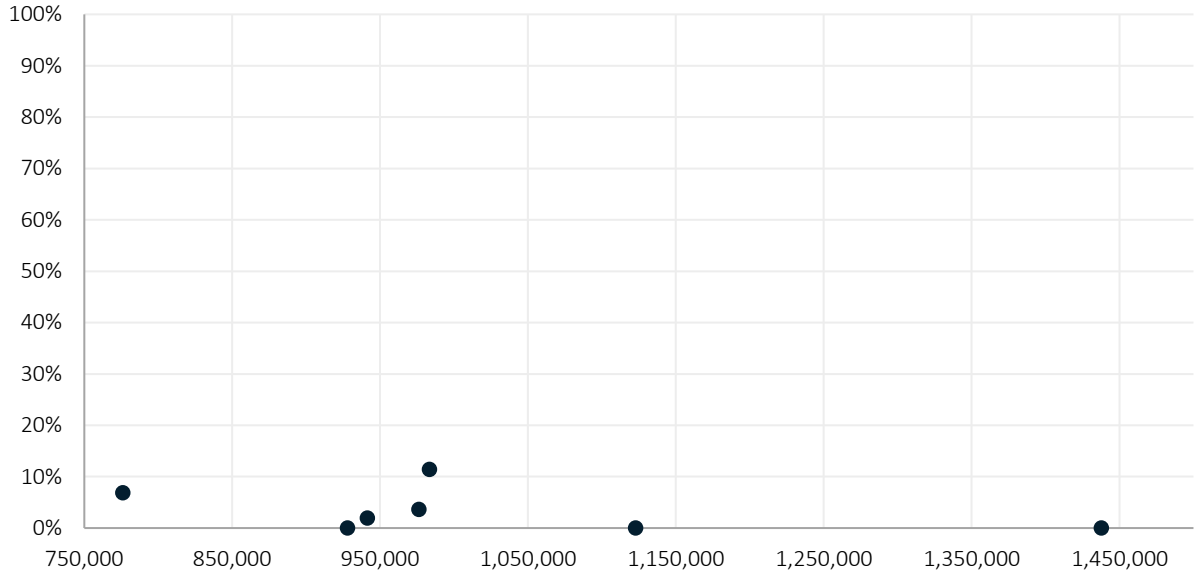
Projects of this size make up 52 per cent of project value and 98 per cent of project count. Within this project size, the average percentage of direct labour is 44 per cent.

Figure 10 Historical renewals: Direct costs vs percentage of direct costs (projects between $300,000 and $750,000)



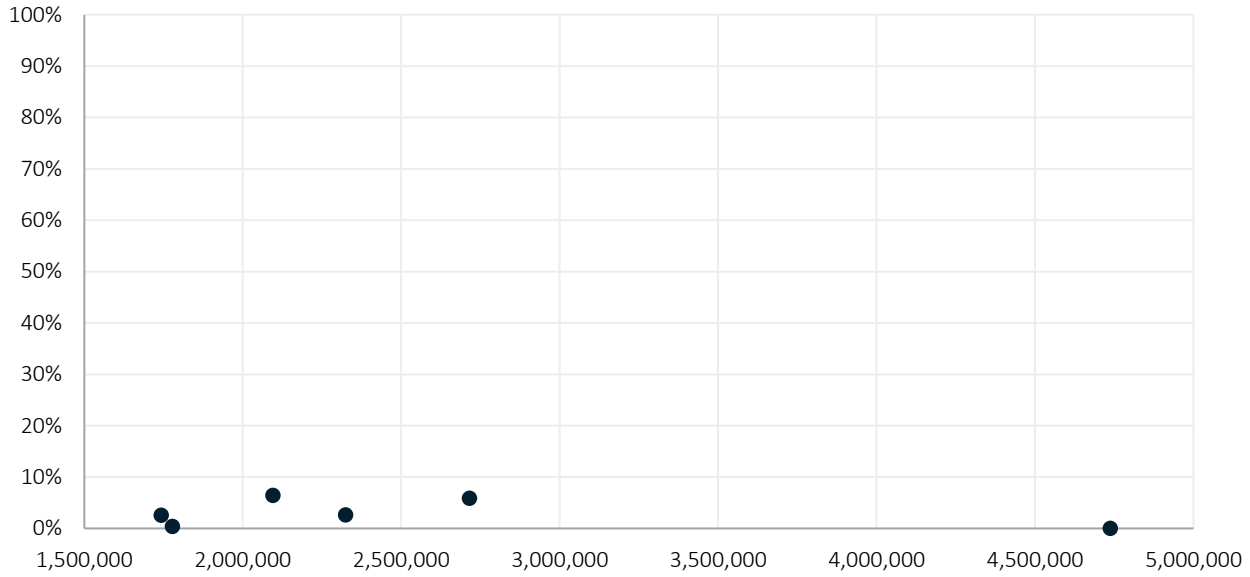
Projects of this size make up 19 per cent of project value and two per cent of project count. Within this project size, the average percentage of direct labour is 19 per cent.

Figure 11 Historical renewals: Direct costs vs percentage of direct costs (projects between $750,000 and $1,500,000)



Projects of this size make up nine per cent of project value and 0.4 per cent of project count. Within this project size, the average percentage of direct labour is three per cent.

Figure 12 Historical renewals: Direct costs vs percentage of direct costs (>$1,500,000)



Projects of this size make up 19 per cent of project value and 0.3 per cent of project count. Within this project size, the average percentage of direct labour is three per cent.

The summary of each project size is shown below.

Table 13 Summary of direct labour percentage by project size

	Small projects	Medium projects	Large projects	Very large projects
Minimum	$0	$300,000	$750,000	$1,500,000
Maximum	$300,000	$750,000	$1,500,000	$10,000,000
Percentage of direct labour	44.4%	10.7%	3.4%	3.0%
Percentage of total projects	97.5%	1.8%	0.4%	0.3%
Average of direct labour as a percentage of total value	52.4%	19.5%	8.9%	19.2%

It is clear that calculation of the direct labour percentage needs to take into account project size, and not be inappropriately influenced by a small number of large and very large projects with a small percentage of direct labour.

For 98 per cent of projects (those below $300,000), the direct labour percentage is more than three times higher than the QCA forecast. Given that most projects do not align with the QCA forecast, Sunwater considers that an alternative approach is required.

Sunwater has examined its forecast projects and has applied the above breakdown to project size. For example, for all forecast projects below $300,000, Sunwater assumed a 44 per cent direct labour component, based on historical findings.

When this is done for all project sizes, it results in an average direct labour portion of 23.4 per cent. The breakdown for all project sizes is show below.

Table 14 Applying historical rates to future projects

	Small projects	Medium projects	Large projects	Very large projects	Total
Percentage of direct labour	44%	11%	3%	3%	23.4%
Value of projects	$38,925,616	$23,111,545	$18,175,424	$7,676,304	$87,888,890
Value of direct labour	$17,284,594	$2,471,962	$617,716	$227,079	$20,601,350

This approach is superior to the simple averaging approach used by AtkinsRéalis because:

- there is a very wide range of project sizes and direct labour percentages and therefore stratified breakdown provides better outcomes for similar sized projects
- a very small number of very large projects is the reason the AtkinsRéalis calculation results in such a small overall average
- for many schemes, particularly those with predominantly small renewal projects delivered primarily by Sunwater labour, the application of a low average skewed by very large projects will result in an under-forecast which will need to be adjusted at the next price review.

Sunwater's aspiration is to apply the above percentages to each project based on its size. However, it considers that this is best done in conjunction with the overall assessment of indirect and overhead allocation.

6.2 Application of cost recovery rates

Cost recovery rates are the percentage uplift to apply to direct costs to allow for recovery of indirect and overhead costs, and are calculated as total indirect and overhead costs divided by total direct labour costs. Cost recovery rates are then applied at a service contract level to allocate indirect and overhead costs between service contracts.

QCA has found a small level of inefficiency (four per cent) in Sunwater's proposed indirect and overhead costs and has made an adjustment to the cost recovery rates – decreasing the average bulk water rate from 205 per cent to 196 per cent.

Sunwater supports an adjustment to the cost recovery rates if the inputs to calculation change. Accordingly, Sunwater supports, in principle, the change to the rate when QCA adjusted the indirect and overhead costs.

However, QCA also made an adjustment to the other parameter – direct labour. As set out in the previous section, QCA substantially reduced forecast direct labour. Sunwater asserts that if QCA wishes to alter the direct labour forecast, the updated cost needs to be re-inputted into the cost recovery rate calculation.

If this is not done, indirect and overhead cost reduction will be much greater than the four per cent inefficiency identified.

6.2.1 Previous review

In the two previous reviews, QCA has set out the total non-direct costs it has allowed. This is done in Table 6.20 of the 2012 review and Table 15 of the 2020 report.

6.2.1.1 QCA

In Table 2 of the Draft Report, QCA reduced proposed overhead and indirect costs from $26.5 million to $25.4 million – a reduction of $1.1 million (four per cent).

QCA then adjusted the cost recovery rates to account for this reduction, relative to Sunwater's proposal. This resulted in the cost recovery rates for bulk schemes dropping from 205 per cent to 196 per cent (approximately four per cent).

QCA then applied the adjusted cost recovery rates to a smaller direct labour base (due to QCA's view that 12 per cent of direct renewal expenditure was direct labour).

This resulted in a much larger decrease in overhead and indirect recovery. For example, despite reducing total prudent and efficient levels of indirect and overhead costs by only $1.1 million, QCA reduced indirect and overhead recovery from renewals in 2025-26 alone by $6.7 million.

6.2.1.2 Sunwater

This section examines the cumulative impact of QCA's decisions through a simple worked example which sets out:

1. the "Sunwater original proposal" column sets out the example direct costs for operations, maintenance and renewals – separated into labour and other. The indirect costs are then calculated using the originally proposed cost recovery rate of 205 per cent (the bulk scheme average)
2. the "QCA Draft Report" column then makes two adjustments:
   a. the renewals direct labour percentage decreases from 26 per cent to 12 per cent
   b. the cost recovery rates decrease from 205 per cent to 196 per cent.

Table 15 Worked example showing impact of QCA decision ($'000)

Activity	Sunwater original proposal	QCA Draft Report	Difference	Comment
Operations - direct labour	100	100	0	
Operations - other direct costs	125	125	0	
Operations – indirect costs	205	196	-9	Decrease caused by change in the cost recovery rates
Total operations	430	421	-9	
Maintenance - direct labour	150	150	0	
Maintenance - other direct costs	200	200	0	
Maintenance – indirect costs	307.5	294	-14	Decrease caused by change in the cost recovery rates
Total maintenance	658	644	-14	
Renewals –direct labour	52	24	-28	Decrease caused by change in direct labour from 26% to 12.1%
Renewals – other direct costs	148	176	28	Increase caused by change in other direct costs from 74% to 87.9%
Renewals – indirect costs	107	47	-59	This decrease is caused by change in the direct labour base to which a lower cost recovery rate is applied
Total renewals	307	247	-59	
Total	1,394	1,312	-82	

The results are further summarised below. The combination of changing the direct labour base and cost recovery rates has a cumulative impact of decreasing indirect costs by 13.2 per cent. This is a much larger reduction to total indirect and overhead costs than the four per cent reduction proposed by QCA based on its assessment of prudent and efficient costs.

Table 16 Summary of worked example ($'000)

Cost category	Sunwater original proposal	QCA Draft Report
Total direct costs	**775**	**775**
Total indirect costs	619	537
Total	**1394**	**1312**

Sunwater proposes that if QCA determines it to be appropriate to change the allocation approach of indirect and overhead costs, then it is appropriate that the modified approach results in collection of the prudent and efficient level of indirect and overhead costs.

Accordingly, Sunwater has recalculated the cost recovery rate that results in QCA's preferred reduction of 4.2 per cent. The approach for this is presented as a continuation of the worked example. The third column (**Table 17**) is added by:

1. retaining direct costs for operations and maintenance
2. setting renewals direct labour at 23.4 per cent (47 in the right-hand column)
3. recalculated cost recovery rates (199 per cent) and applied these to direct labour – across operations, maintenance and renewals.

Table 17 Worked example showing impact of QCA decision ($'000)

Activity	Sunwater's original proposal	QCA Draft Report	Sunwater's updated proposal
Operations - direct labour	100	100	100
Operations - other direct costs	125	125	125
Operations - indirects	205	196	199
Total operations	**430**	**421**	**424**
Maintenance - direct labour	150	150	150
Maintenance - other direct costs	200	200	200
Maintenance – indirect costs	308	294	299
Total maintenance	**658**	**644**	**649**
Renewals – direct labour	52	24	47
Renewals – other direct costs	148	176	153
Renewals – indirect costs	107	47	93
Total renewals	**307**	**247**	**293**
Total	**1,394**	**1,312**	**1,367**

The summarised results are shown below. Sunwater's updated proposal approach results in an indirect cost reduction of four per cent, relative to the original proposal.

Table 18 Summary of Sunwater updated proposal ($'000)

Cost category	Sunwater's original proposal	QCA Draft Report	Sunwater's updated proposal
Total direct costs	**775**	**775**	**775**
Total indirect costs	619	537	**592**
Total	**1,394**	**1,312**	**1,367**

While the above is a simplified worked example, this approach is easily applied to each service contract individually.

This is entirely consistent with QCA's draft findings and more appropriate than an approach that results in a much larger indirect cost reduction.

For QCA to continue with the approach outlined in the Draft Report, it would need to be satisfied that a much greater (than four per cent) reduction of indirect and overhead costs was an appropriate outcome. Given that QCA has already determined that a four per cent reduction in the indirect cost allowance is appropriate, it would need to form the view that a reduction in direct labour would directly cause a reduction in indirect costs.

Sunwater considers that QCA cannot reasonably form this view. In the Draft Report, QCA found that:

- the existing direct labour allocation approach results in an allocator that does not have a strong causal link with several cost centres
- there might be potential to improve causality in the choice of allocators
- Sunwater should investigate ways of improving the causality, transparency and simplicity of its cost allocation approach prior to the next review.

Given QCA's finding that direct labour does not have a causal link with indirect costs, it cannot also simultaneously find that a reduction in direct labour will result in a linear reduction in indirect and overhead costs. The approach in the Draft Report has this inconsistency, which Sunwater seeks to resolve by:

- forecasting direct labour at 23.4 per cent of total direct renewals forecasts
- amending the cost recovery rate to ensure overall recovery levels of indirect and overheads costs remain at prudent and efficient levels. The average rate should increase from 196 per cent in the Draft Report to 199 per cent.

As part of its review into cost allocation, Sunwater will further review these matters, and incorporate this into a fully integrated improved approach prior to commencement of the next price review.

6.2.2 Addendum to Dam Safety Management business case

Since the development and lodgement of the Irrigation Pricing Proposal in November 2023, Sunwater has continued to plan for and deliver the 'as low as reasonably practicable' (ALARP) assessments included in the Dam Safety Management business case. A recent change to the Australian Rainfall and Runoff guideline that these assessments must consider means that additional effort and cost must now be incurred.

Sunwater has prepared an addendum to the Dam Safety Management business case for an uplift in total cost of $1.7 million to be incurred in 2025-26. A copy of the addendum has been provided separately to QCA.

6.3 Renewals efficiency

6.3.1 QCA draft finding

QCA has expressed concerns about Sunwater's forecast renewal planning, particularly emphasising the need for an efficiency plan. It found that Sunwater's asset planning and management remains lacking in the areas of:

- project development and decision making — due to continuing deficiencies in information management and inadequate understanding of the condition and performance of assets, QCA found there are still issues relating to project development and decision-making. It considers that Sunwater can improve its understanding of its assets to make renewals planning (including timing) more specific to the condition and performance of assets
- information management — QCA notes that Sunwater was unable to provide a program-based view of its historical renewals program and that its consultant had to manually manipulate data in SAP to develop a program-based view of the forecast renewals program; it is suggested that Sunwater build on and embed the program-based view of the renewals program in SAP
- cost estimation — unit cost estimates in SAP remain outdated in many instances.

QCA considers there is room for efficiencies in the renewals program if Sunwater addresses these issues in the upcoming price path period. In the absence of such a plan, QCA said it may apply an efficiency target to the renewals program in the Final Report.

6.3.2 Sunwater response

Sunwater has carefully considered the matters raised by QCA and agrees with many of its findings regarding possible future improvement. Sunwater is committed to prudent and efficient planning and delivery of renewal projects.

On this basis, Sunwater does not consider that a renewals efficiency target is warranted, for the following reasons.

1. **QCA found actual and forecast expenditure to be prudent and efficient:** QCA has just reviewed a sample of specific historical and forecast renewal projects; it did not make any adjustments to Sunwater's historical spend, which indicates that project delivery is being undertaken efficiently. QCA allowed an increase of 70 per cent above what it approved (as a forecast) for the same period in the previous review. An increase of this magnitude does not provide price certainty or stability. The application of an efficiency target now will almost certainly result in a larger ex-post adjustment.

   Likewise, the forecast renewals expenditure was reviewed and found to be almost entirely prudent and efficient (which the exception of the application of overheads, which is responded to elsewhere.

2. **Planners drop:** Sunwater acknowledges that its renewal planning processes could be improved and that the issues of 'planners drop' identified by AtkinsRéalis are relevant.

   It is not reasonable to address planners drop by reducing forecasts. If anything, a recognition of planners drop would result in an increase to the forecast. While Sunwater does not seek this, it does expect actual costs to be higher than those proposed.

3. **Work is underway and ongoing:** In response to the challenges highlighted by QCA and in recognition of the need for enhanced asset management capability and processes, Sunwater has launched the Asset Performance Uplift Program (APUP). This initiative represents a significant, long-term investment in improving the accuracy and maturity of asset forecasts and delivery processes.

   This initiative commenced in very early 2024 with the appointment of an Integrated Planning Manager. As a result, Sunwater has commenced development of APUP, which has six components as shown in **Figure 13**.

Figure 13 Sunwater's Asset Management Uplift Program (APUP)

APUP is a strategic response to the very issues raised by QCA, demonstrating Sunwater's commitment to long-term improvement. However, this is a process that naturally takes time to fully develop and implement. The improvements that are being implemented will be evident in our next price submission.

Part of APUP will include an improved understanding of asset condition and resulting asset lives. Sunwater has already commenced the engagement of additional asset condition assessors, which will substantially improve the understanding of asset condition. Sunwater will also improve its processes to integrate the improved data into its medium and longer term forecasts.

Sunwater has recognised the substantial limitations in its cost forecasts and has begun to develop options to improve the cost data. Given the number of assets and cost estimates required, Sunwater will undertake this approach in multiple phases. For the next price review, Sunwater expects to have improved cost data for each forecast expenditure.

4. **Incentives:** Unlike operating costs, renewal costs will be subject to an ex-post review with prudent and efficient costs allowed, irrespective of the level of forecast allowances set by QCA as part of the pricing review. Given that QCA has allowed much higher renewal costs to be recouped on an ex-post basis in the past two pricing reviews than the allowance determined on an ex-ante basis as part of the pricing review, it is reasonable to believe that imposition of a renewal efficiency target will not achieve its intended outcome. This is because the most likely outcome is that the efficiency target will be unwound when actual renewal costs are found to exceed the forecast allowances and assessed to be prudent and efficient in an ex-post review context.
5. **Natural justice:** Sunwater has difficulty responding to this matter as QCA's view is largely unknown. While QCA has said if Sunwater does not provide a "workable and quantified plan" it may apply an efficiency target, it has not set out the level of application of an efficiency target. While it did refer to the recommendations made by AtkinsRéalis, QCA did not endorse its approach. Given this, it is difficult for us to properly respond to the undefined notion of an efficiency target.

   The propose-respond model of economic regulation requires both the utility and regulator to be specific about their intentions, so the other party can assess and respond. In the absence of specificity, Sunwater is not able to provide a detailed response. However, for clarity, Sunwater does not agree that a renewals efficiency target is in the long-term interests of customers and any introduction should be deferred until after Sunwater is able to properly consider, and respond to, a QCA proposal.

7 Engagement

QCA includes a range of commentary relating to Sunwater's approach to customer engagement on several topics in its Draft Report.

- QCA's general discussion of engagement is covered in detail in **Section 2.1**
- **Section 7.2.4** repeats specific commentary related to the RAB proposal
- **Section 12.2.1** provides specific commentary related to the ECPT proposal.

7.1 General engagement matters

7.1.1 QCA review of Sunwater's engagement

On page 12 of the Draft Report, QCA reasonably acknowledges that "while the referral, and therefore information on government policy positions and timing, for this price review was issued earlier than the 2020 review, the remaining time of less than 9 months for customer engagement on the pricing proposal was less than is the practice in other jurisdictions." In light of this timeframe, it is evident that Sunwater worked hard to inform and engage all customers.

Sunwater aims to be a stakeholder-centric organisation by:

- building relationships with stakeholders based on trust
- actively working with customers, communities, Traditional Owners, shareholders and industry groups
- minimising the impacts of its operations and projects
- creating opportunities for benefits beyond water delivery wherever possible.

7.1.2 Sunwater response

The Draft Report did not acknowledge Sunwater's efforts to engage with 100 per cent of its irrigation customer base – to treat every customer as an equal and provide the same access to information and opportunities to engage with Sunwater directly.

Sunwater expended considerable effort in engagement, demonstrating it has learnt from previous price path processes and earning acknowledgement from its customers and industry groups in this regard. These efforts have been recognised in the written submissions from representative customer groups.

7.2 RAB proposal engagement

This section responds to QCA's analysis of Sunwater's customer and stakeholder engagement as part of its RAB proposal. Discussion related to the design of the proposal is found in Section 8.

7.2.1 QCA review of Sunwater's RAB proposal engagement

Sunwater proposed this shift on the basis that:

- irrigation customers are either broadly supportive of, or agnostic to, the change, and they:
  - have been afforded ample opportunity to engage with the proposal and raise concerns
  - will be better (or no worse) off under the RAB-based approach (Eton high-B (medium) priority is the only tariff group with higher transition prices during the price path period).

QCA's critiques of Sunwater's customer engagement on the RAB proposal fall broadly into the categories shown in **Table 19.**

Table 19 QCA commentary on RAB proposal engagement

Theme	Examples drawn from QCA Draft Report
Customer input on (or support for) technical issues is unnecessary	"Typically, highly technical issues such as cost recovery mechanisms are not issues that businesses seek customer input on. … consultation about these issues should focus on the outcomes that customers value and how the proposed instruments impact on these outcomes."
A handful of written submissions holds far greater weight than other forms of engagement – or the choice not to engage	"We would generally be receptive to customer support in determining whether to recommend prices based on a RAB approach, but in this case we see some mixed messages. There is certainly no clear support from customers for the RAB approach."
Sunwater should have better identified and addressed customer concerns	"Several issues were raised by stakeholders on this committee, which Sunwater could have addressed more fulsomely if given sufficient time. We also note that stakeholders expressed concern about the limited timeframe for customer consultation regarding the proposed transition to a RAB approach." "… we have concerns regarding Sunwater's failure to explain how it has attempted to address feedback in instances where it has been unable to incorporate this feedback. For example, stakeholders raised concerns about various issues related to moving to a RAB, including transparency, potential additional tax costs, price variability and the suitability of a RAB approach for Sunwater's rural water assets."
Customer concerns are largely unfounded	"We note that customers have raised a series of concerns with the RAB approach, but we consider they are largely unfounded." "… we do not consider any of these issues to be material under an appropriately designed RAB approach. However, we consider that Sunwater should have addressed these issues as part of its customer engagement."

Each of these themes in addressed below.

7.2.2 RAB proposal engagement was appropriate and robust

Sunwater disagrees with the QCA's criticism of its RAB proposal engagement , specifically on two points:

1. customer input is important for a significant pricing reform such as this
2. at no stage did Sunwater suggest customer support was unequivocal.

Customer input *is* important

Sunwater is unclear why QCA thinks that customer opinions on the RAB proposal are not issues it should seek input on. Like its engagement on technical matters such as asset management, maintenance and appropriate engineering solutions – areas where the QCA have commented engagement should occur – Sunwater sees value in engaging on matters like the RAB proposal.

Sunwater engaged with customers on this topic because:

- trust is based on transparency – not engaging with customers on a topic such as this may be detrimental to Sunwater's relationship with its customers
- transparency applies to all aspects of a pricing submission, not just costs
- customer input on the treatment of annuity balances (particularly positive ones) was appropriate
- testing customer support for such a proposal is sound practice in a price setting process with multiple review and approval steps
- it has real implications for cost reflective and recommended prices.

For these reasons, Sunwater elected to make this a proposal that customers could influence, both as to the treatment of some design elements and whether to include this in its final proposal to QCA.

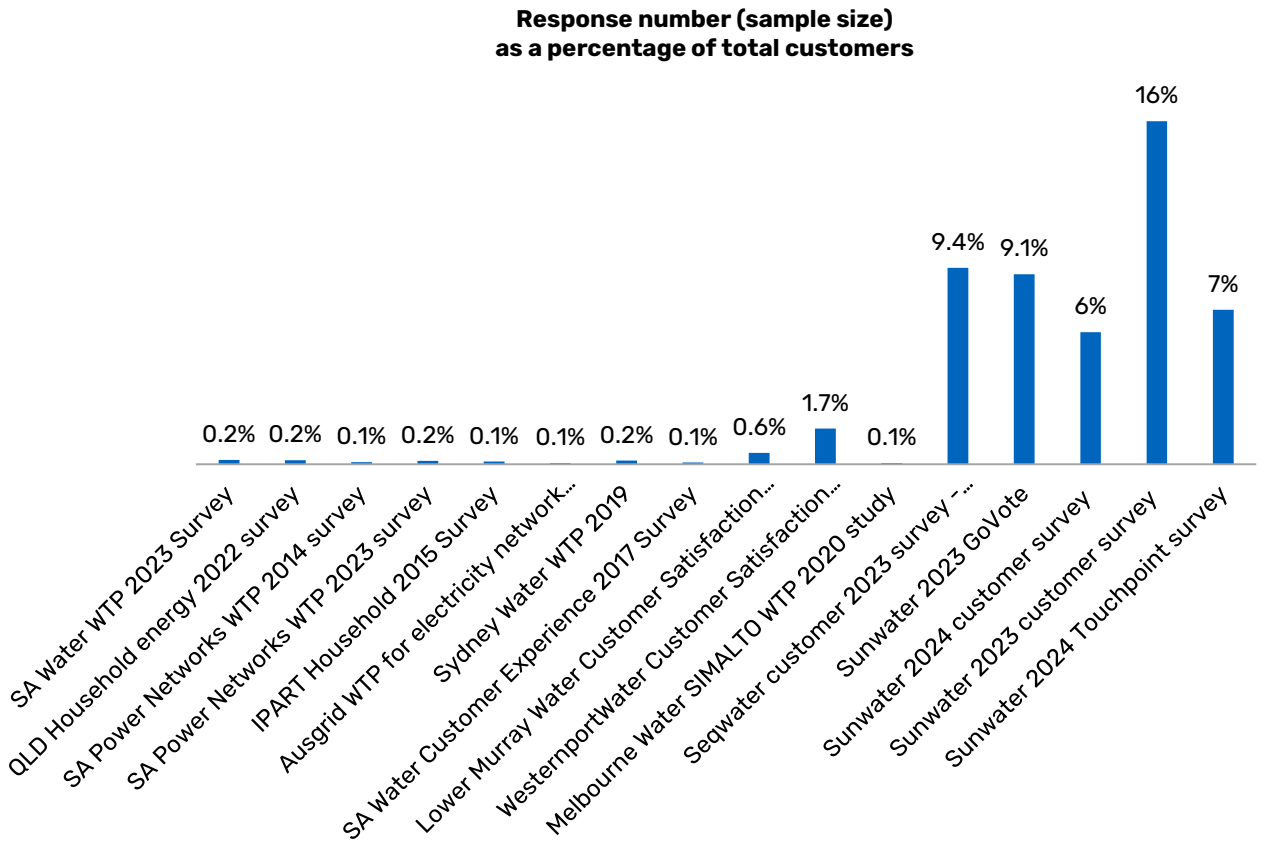
QCA's criticism of this approach appears to be predominantly derived from the written submissions it received directly from a handful of organisations *after* Sunwater developed and lodged its pricing proposal.

Sunwater notes that one of the key engagement principles in the QCA guidance is that "to be effective, engagement should promote an understanding of the customer needs by ensuring a broad representation of customer views."[60] Sunwater believes that QCA should recognise its efforts to obtain broad-based customer feedback to inform its pricing proposal and give this feedback greater consideration its Final Report, particularly given that a significant proportion of Sunwater's customers has made an effort to provide this feedback.

Figure 14 below shows the response rate for Sunwater's direct customer engagement is well above what is typically the case for customer surveys undertaken by other regulated businesses and jurisdictional regulators – feedback representing typically less than one per cent of the customer base for survey.

[60] *QCA, Guidelines for pricing proposals, Rural irrigation price review 2025–29, March 2023, p.9.*

Figure 14 Comparison of customer response rates across a selection of customer surveys



Source: Sunwater analysis

Customer support is important, but it need not be unequivocal

In Sunwater's view QCA's commentary appears to place significant weight on a small number of submissions received during the preliminary review period and doesn't appear to adequately consider the extensive engagement Sunwater undertook with its entire irrigation customer base.

It also appears to be looking for an unspecified level of support that is unlikely to be achievable for a proposal such as this. As QCA points out, this is a technical matter, and differing levels of understanding and support are unsurprising. What Sunwater was seeking to understand via its engagement - and the GoVote process in particular - was whether there was a level of *opposition* to this proposal that would make it unviable from the perspective of ongoing customer support and trust.

Our engagement process found that:

- most customers were not sufficiently motivated by the proposal to participate in the GoVote process
- of those who did participate, support for the proposal outweighed opposition.

On this basis, and taking into account the benefits of the shift, Sunwater was (and remains) comfortable progressing this proposal.

Sunwater's statements relating to customer support were clear in its pricing proposal. When taken across Sunwater's customer respondents nearly half (46 per cent) were supportive of the shift, 20 per cent were neutral, and the remainder against, with those against concentrated in two schemes.

Sunwater does not agree with the views presented in the Bundaberg and Burdekin submissions that volume held should be the metric by which support is gauged and decisions are made. This position, if applied, would lead to the complete disenfranchisement of most of Sunwater's schemes. By this logic, with 80 per cent of irrigation entitlements held in the six largest schemes, there would be no need to engage with the other 16 schemes on matters of this nature.

Some context that Sunwater believes should be in QCA's commentary includes:

- Sunwater engaged with 4,372 irrigation customers – providing opportunities for customers to attend workshops, download and review proposal materials, and contact Sunwater directly and indirectly with questions and concerns.
- Engagement with 100 per cent of the customer base is beyond leading practice engagement – most regulated water utilities do not even attempt to engage with their entire customer base in support of a pricing proposal.
- 369 customers provided direct feedback on Sunwater's RAB proposal via the GoVote process.
- The remaining 4,000 customers elected not to engage – while the reasons for this are likely to be many and varied, it is highly likely that one reason is that they were not sufficiently concerned about the RAB proposal to voice their opinion.
- Against this, QCA received a total of 21 submissions from stakeholders, of which eight referenced Sunwater's RAB proposal. Within those eight:
    - three (Burdekin River Irrigation Area (BRIA), Bundaberg Regional Irrigators Group (BRIG) and CANEGROWERS) were expressions of opposition towards the proposal (all within the Bundaberg and Burdekin schemes)
    - two (Cotton Australia and Wilmar Sugar) sought independent QCA endorsement of the benefits of a RAB approach
    - two highlighted some concerns, but did not express an overall view on the merits of the RAB proposal (Theodore Water expressed concern about the potential for price increases at the subsequent pricing review, and Central Highlands Cotton Growers & Irrigators Association expressed general concern about the consultation process and reform timing)
    - one (Central Downs) was generally supportive of the proposal.

The QCA review process has not solicited any new information in relation to support or otherwise for a RAB approach to renewals recovery. The opposition to the proposal from the BRIA, BRIG and Canegrowers groups is consistent with the opposition recorded in the GoVote process in the Bundaberg and Burdekin schemes. It is also consistent with the views of the Bundaberg and Burdekin representatives on Sunwater's Consultative Committee.

Sunwater should have better identified and addressed customer concerns

QCA made comment about Sunwater's efforts to address customer concerns regarding its RAB proposal. Sunwater outlines below the efforts it undertook, to respond in a measured and appropriate way.

The comments relate to either feedback received at QCA workshops or part of the eight submissions sent to the QCA *after* the submission of Sunwater's proposal.

QCA's critique of this aspect of Sunwater's proposal development approach is detailed in Section 2.1.3 of the Draft Report (p.12): "Several issues were raised by stakeholders on this committee, which Sunwater could have addressed more fulsomely if given sufficient time.

"We also note that stakeholders expressed concern about the limited timeframe for customer consultation regarding the proposed transition to a RAB approach."

Sunwater provides the following for clarification:

1. Issues raised by members of the Consultative Committee were addressed at the time they were raised, and they directly informed its engagement in scheme. Sunwater's Stage 2 engagement materials covered matters such as the taxation building block, price variability, and the relative merits of a RAB and an annuity for funding Sunwater's rural water assets. It should be noted that the QCA was invited by Sunwater to speak directly with members of the Consultative Committee and presented to the group on the topic of the taxation building block.

   More broadly, Sunwater conducted a robust and thorough engagement process. Issues identified by customers or customer groups were addressed. That some customers were not persuaded to change their preliminary position on the proposal is not surprising, but it is also not indicative of a flaw in Sunwater's approach. Sunwater does not believe that additional time to engage would be likely to yield a materially different outcome.

2. The statement that stakeholders expressed concern about the limited timeframe for customer consultation should also be placed in appropriate context. Of the three groups expressing outright opposition to the proposal, none mention limited time for customer consultation as an issue. This statement appears to be based on one submission from the Central Highlands Cotton Growers and Irrigators Association – a submission which is better characterised as having concerns around the consultation process Sunwater adopted to gauge support for the RAB proposal.

Customer concerns are largely unfounded

Sunwater agrees with QCA's view that customer concerns are unfounded.

The views presented in the BRIA, BRIG and Canegrowers submissions are consistent with the issues raised by the Bundaberg and Burdekin representatives in the Consultative Committee.

Additional time is highly unlikely to yield additional concerns or greater attendance at workshops or sessions. While the period of engagement was constrained, Sunwater asserts that its proposal was not rushed.

7.3 ECPT proposal engagement

Section 3.6.2 of Sunwater's Irrigation Pricing Proposal dealt with the topic of a potential change to the method of electricity cost recovery. Among other things, it states: "Sunwater proposes to introduce an ECPT mechanism in the next price path period in eligible schemes where there is sufficient evidence of broad and informed customer support for doing so."

7.3.1 QCA review of Sunwater's ECPT proposal engagement

This section responds to QCA's analysis of Sunwater's customer and stakeholder engagement as part of its ECPT proposal. Commentary related to the design of the proposal is found in Section 8.

On page 12 of its Draft Report, QCA reasonably acknowledges that "while the referral, and therefore information on government policy positions and timing, for this price review was issued earlier than the 2020 review, the remaining time of less than 9 months for customer engagement on the pricing proposal was less than is the practice in other jurisdictions."

QCA's critiques of Sunwater's customer engagement on the ECPT proposal are broad, and appear not to be evidence based.

Table 20 QCA commentary on ECPT proposal engagement

"Moreover, it remains unclear how Sunwater effectively incorporated feedback from stakeholders on its Consultative Committee into the design of its ECPT proposal, particularly given the ultimate lack of support of Sunwater's proposed design."
"Although Sunwater said that it would continue engaging with customers to understand and address their concerns regarding both issues, we expect that Sunwater should address these issues and explore options before lodging its pricing proposal to us."
"Sunwater said that it had engaged with its Consultative Committee to co-design and test the proposed mechanism, before consulting with customers. This followed a three-year ECPT trial conducted by Sunwater for each of the above tariff groups (except the Eton tariff groups), which ended on 30 June 2023. However, the mechanism that Sunwater developed and consulted on with customers differed from the mechanism that applied during the trial." "Sunwater advised that it adopted the proposal to set charges quarterly to address the concerns of Consultative Committee representatives about potential bill shocks associated with an annual billing approach."
"While Sunwater advised that there was initially strong customer support for its proposal, that support was withdrawn in all schemes, except the Eton scheme, by the end of the consultation period when final prices were presented."
"Given the lack of customer support, Sunwater proposed to introduce an ECPT mechanism for the Eton scheme only."
"We are concerned that Sunwater's consultation may not have been sufficient, because customers did not appear to understand how the proposed mechanism would work or what the potential bill impacts would be until late in the consultation process. The differences between the proposed mechanism and the trial mechanism may have contributed to this confusion, and it is not clear whether those differences were clearly communicated to customers."

7.3.2 ECPT proposal engagement was appropriate and robust

Sunwater does not agree with the QCA's criticism of its ECPT proposal engagement. The criticism does not give sufficient weight to the time Sunwater had to engage with external stakeholders. It also does not recognise that Sunwater has extensively engaged with customers on the ECPT for many years and, through this engagement, has developed a sound understanding of their willingness to accept exposure to electricity cost risks. Sunwater has genuinely tried to address these concerns in the design of the ECPT mechanism.

It fails to sufficiently acknowledge the hands-on role played by members of the Consultative Committee. The BRIA and BRIG representatives in particular were significant contributors throughout and were central to the decision to include a quarterly electricity cost review.

That Sunwater was willing and able to adapt its proposal to changing customer sentiment and continue to seek to provide new and more up-to-date information should be lauded as a commendable approach to engagement.

Sunwater appreciates that the uncertainty surrounding the proposal as put to QCA in November is not ideal and makes it challenging for QCA to assess. Given the acknowledged challenges with timing and the considerable customer interest in this topic, we do not see this as a failing of Sunwater's engagement.

Sunwater has always engaged in good faith with irrigators on the Consultative Committee and in scheme on this topic and has continued to do so since 30 November 2023.

The outcome of additional consultation conducted with the Consultative Committee and Eton Irrigation in 2024 is that Sunwater is withdrawing its proposal for the introduction of a permanent ECPT as part of this price path period.

Its rationale for doing so is set out in **Section 8.2**.

8 Sunwater's proposals

This section responds to QCA's analysis of the design of the RAB and ECPT proposals. Commentary related to Sunwater's engagement on these proposals is found in Section 7. The electricity review event is also discussed.

8.1 RAB proposal

A central element of Sunwater's submission was the proposal to change the way it recovers renewals expenditure via prices. Specifically, the submission proposed a shift in the recovery of renewals costs from an annuity-based approach to a RAB-based approach on the basis that:

- irrigation customers are either broadly supportive of, or agnostic to, the change, and they:
  - have been afforded ample opportunity to engage with the proposal and raise concerns
  - will be better (or no worse) off under the RAB-based approach (Eton high-B (medium) priority is the only tariff group with higher transition prices during the price path period)
- cost reflective prices in most schemes will be lower under the RAB-based approach, placing downward pressure on the community service obligation (CSO) payment provided by the Queensland Government to Sunwater
- the RAB-based approach is best regulatory practice and delivers improvements in efficiency, equity and transparency
- it has been designed appropriately, with key design features having been part of Sunwater's customer engagement.

8.1.1 QCA review of Sunwater's RAB proposal

QCA's thoughts and final position on the design elements of Sunwater's RAB proposal are covered in several locations in the Draft Report; however, its comprehensive assessment of the relative merits of Sunwater's proposal is set out in Section 7.2 of its Draft Report.

Sunwater has limited its analysis to matters relating to the central elements of QCA's critique which it assesses to be:

- the impact of **capitalisation** on price target variability
- appropriate treatment of annuity balances (and their possible interaction with capitalisation issues) and their implications for **transitional** impacts on Sunwater and customer prices
- multiple and sometimes contradictory lines of commentary on Sunwater's **engagement** approach:
  - Sunwater's engagement on this proposal is not clearly supported by customers
  - Sunwater should not have sought customer feedback on this issue
  - Sunwater should have responded to matters raised by stakeholders after its submission was lodged.

These matters are set out in detail in Draft Report[61] *Section 7.2.3 Practical considerations* and *Section 7.2.4 Customer engagement*. Each of these themes is addressed in turn below. Sunwater has not provided any response to the discussion of tax allowances on the basis that QCA's conclusions and approach are consistent with our original proposal.

8.1.1.1 Design matters

QCA considers that Sunwater's original proposal reduces the perceived economic benefits of a RAB methodology on the basis that Sunwater's existing capitalisation policy results in a large proportion of renewals being treated as opex, which in turn:

- reduces alignment with the user pays principle where that opex provides multi-year benefits
- leads to potential variability in the price target between price path periods due to some lumpy renewals projects.

Following its consideration of design matters, QCA concludes: "We consider that Sunwater should review the timeframes for recovering (or returning) the negative (or positive) annuity balances from (or to) customers in its revised RAB proposal that incorporates an amended capitalisation approach that is appropriate for regulatory purposes." (QCA, 2024, p.91)

Detailed consideration of issues raised and Sunwater's response is provided in **Table 21**.

Sunwater's final response to these issues is outlined in **Section 8.1.2**.

8.1.1.2 QCA's conclusion on proposal design

QCA stops short of supporting Sunwater's RAB proposal due to the need for the following work to be done:

1. a comprehensive review of the opex and capex treatment of renewals that considers the treatment of large irregular costs that deliver benefits to customers over multiple years
2. appropriate adjustments to address the resulting short-term transitional impacts on cash flows and price targets
3. consultation with customers on transitional issues, to ensure that its approach to managing the transitional impacts is informed by the outcomes sought by customers.

[61] *QCA, Rural irrigation price review 2025-29: Sunwater – Draft Report, 2024, p.86.*

Table 21 QCA commentary and Sunwater response

Issue	QCA commentary	Sunwater response to commentary
Alignment with user pays principle (Section 7.2.2, p.82 and Section 7.2.3, p.87)	"Sunwater's existing capitalisation policy results in a large proportion of renewals being treated as an opex step-change, … which reduces alignment with the user pays principle if this component includes renewals with multi-year benefits." "Our analysis shows that Sunwater is expensing many asset replacements that provide benefits over multiple periods, would lead to a material increase in assumed useful life, and meet the standard value threshold for capitalisation."	• Sunwater acknowledges that its existing capitalisation policy is likely to expense some items that provide multi-year benefits. • The Mirani Pump Station electrical switchboard replacement cited (p.88, Draft Report) is an example of this outcome.
Transparency (Section 7.2.2, p.85)	"Under either cost recovery approach, we expect Sunwater to provide us with long-term renewals plans that show its supporting methodology and assumptions. This long-term planning should be developed through ongoing engagement with customers to ensure that these plans deliver in the long-term interests of customers."	• Sunwater is committed to engaging in a meaningful way with both customers and QCA in relation to its approach to asset management and long-term renewals plans. • The RAB-based methodology supports this outcome.
Price target variability (Section 7.2.3, p.89)	"While Sunwater said that it would consider the implications of a RAB approach in its next review of its capitalisation policy, this makes it difficult for us to assess implications of a possible future change to this policy on future price target variability."	• Sunwater notes there is significant uncertainty associated with the pricing review process, including the actual time between reviews, policy settings, costs, and compliance obligations under which Sunwater operates. A future RAB-based proposal is not guaranteed. • Sunwater's proposal for the 2025-26 to 2028-29 period is suitable for endorsement by QCA on its merits, noting that all except two schemes (Eton and Macintyre Brook) have lower cost reflective prices under the RAB proposal. • Recommendation of the original RAB proposal could be provided with an expectation that, at the next review Sunwater identify and mitigate any residual challenges with ongoing price target variability.

Issue	QCA commentary	Sunwater response to commentary
Possible double counting of expenditure (Section 7.2.3, p.89 and section 5.2.2, p.54)	"In addition, changes to Sunwater's capitalisation policy during the next price path period could lead to the capitalisation of expenditure already incorporated within the opex allowance, and possible double counting of this expenditure." "Under the current regulatory framework where there is an ex post prudency and efficiency assessment for renewals expenditure, it is possible for expenditure that would generally be classified as opex for regulatory pricing purposes to be classified as non-routine in order to become eligible for ex post assessment."	• The first statement assumes any changes to Sunwater's capitalisation policy would be implemented mid-period. It also overlooks the fact that QCA would have the ability to identify, assess and reject any double count at its next review. • Sunwater is unclear what the second statement is alluding to as no evidence has been presented that points to a problem under the current approach. Ex-post reviews have applied for multiple regulatory periods. • Sunwater does not share the implied concern that QCA's ex-post assessments are inadequate to effectively assess expenditure. Under this process the risk of expenditure being disallowed remains with Sunwater. • Sunwater understands the regulatory framework and would not implement future changes to its capitalisation policy in a way that would lead to the recovery of expenditure twice.
Transparent, consistent capitalisation policy (Section 5.2.2, p.54)	"… consider that, regardless of whether the annuity approach is retained, it is important for Sunwater to establish a clear capitalisation guideline for regulatory pricing purposes. This guideline should be transparent and consistent across regulatory periods, and Sunwater should be required to provide details of any changes in its capitalisation approach for regulatory pricing purposes and any resulting reclassification of expenditure from opex to capex."	• Sunwater agrees it is important to have a clear capitalisation guideline and notes that it has a capitalisation policy and guideline in place. • Sunwater further acknowledges that changes to this policy should be transparently communicated as part of a regulatory pricing submission. • Sunwater notes that changes to capitalisation policy have no impact on pricing proposals under an annuity methodology. • QCA has not identified any issues or evidence that would require a change to Sunwater's capitalisation policy under a retained annuity approach.
Treatment of *existing* annuity balances	"We consider that Sunwater's proposed treatment of rolling the outstanding liability associated with negative annuity balances into the opening RAB is reasonable."	• No comment.

Issue	QCA commentary	Sunwater response to commentary
(Section 7.2.3, Page 89-91)	"Options for treating positive annuity balances include: • returning the positive balance to customers over time by gradually using this balance to reduce the revenue requirement over a set period • treating this balance as capital contributions and offsetting future capex spend."	• Sunwater acknowledges these are possible options. Under the original proposal positive balances are returned to customers in the next price path period. • Sunwater notes that at no time before or after the presentation of Stage 2 engagement materials did any customer or customer representative raise concerns with Sunwater about the suitability of this approach, or its impact on prices in the subsequent regulatory period.
RAB opening balance depreciation (Section 7.2.3, Page 89-91)	"We note … that the proposed asset life of 75 years appears high compared to the weighted average life of assets expected to be capitalised in the next 12 years (24.1 years) and over the price path and planning period (32.7 years)." "… a shorter asset life would result in higher capital revenues over the shorter life of asset, it will have a lower total amount collected over the life of the asset relative to a longer asset life. The higher cash flows associated with a shorter asset life could partly address the lower initial cash flows as renewals capex is added to the initial RAB."	• Sunwater acknowledges the QCA's commentary on this topic and agrees that a pragmatic approach to the adoption of final depreciation period for each scheme is reasonable to balance business and customer impacts. • This topic is covered further in Sunwater's final response outlined below.

8.1.2 Revised RAB proposal

The overarching conclusion QCA draws (Executive Summary, p.3) is that a RAB approach has "relative merits compared to the existing renewals annuity approach in terms of improved efficiency and transparency."

Sunwater agrees and this response amends Sunwater's original proposal to address the three items QCA highlighted as barriers to its endorsement of a RAB-based approach to renewals recovery.

While Sunwater considers that its original proposal remains suitable for endorsement by QCA, it believes that now is the right time to introduce this change, and does not see merit in revisiting this matter at the next irrigation pricing review. Uncertainty over the timing of the implementation shift to a RAB methodology does nothing to benefit irrigation customers and does not allow Sunwater to deliver the benefits that such a shift will bring.

To support this position Sunwater's revised proposal includes:

1. **Reduced variability in cost reflective prices, through:**
    a. a simplified capitalisation approach that removes material barriers to capitalisation – *Asset Capitalisation Guideline for Regulatory Pricing August 2024*
    b. greater capitalisation of activities that provide benefits over multiple periods.
2. **Shorter depreciation periods** for opening RAB balances:
    a. generally set at 25 years, consistent with QCA's analysis of the weighted average life of assets expected to be capitalised in the next 12 years (~24 years)
    b. bespoke periods for the Lower Mary (bulk only) and Cunnamulla schemes to manage impacts on recommended irrigation prices.
3. **A suite of transition options** for QCA to consider for three schemes projected to finish with positive closing annuity balances.

As set out in its November 2023 Pricing Proposal, Sunwater believes there is merit in a shift to the RAB methodology and that it will deliver real pricing benefits to most irrigation customers. Consistent with the engagement analysis presented above there is no evidence of strong or widespread customer dissatisfaction with this proposal.

8.1.2.1 Reduced variability in cost reflective prices

Extract from Section 7.2.5 Conclusion:

"While we are supportive of an appropriately designed RAB approach, we do not consider that a RAB approach should be adopted alongside Sunwater's current capitalisation policy because of the impact on price target variability…

"We consider that Sunwater should conduct a comprehensive review of the opex and capex treatment of renewals prior to transitioning to a RAB approach, including the treatment of large irregular costs that deliver benefits to customers over multiple years."

Sunwater proposes to adopt a regulatory pricing capitalisation policy based on simple revisions to its existing accounting capitalisation policy that remove barriers to capitalisation while retaining current financial thresholds. This policy change would apply from 1 July 2025.

Sunwater has reviewed its renewals program and has applied these principles to that review. The outcome of that review is presented in **Table 22**.

Table 22 shows that, across the four years of the price path, this has the effect of reducing the opex step-change from $62 million to $3 million, while increasing capex from $85 million to $144 million. For simplicity, this comparison is based on Sunwater's November 2023 proposal.

Table 22 Impact of proposed change to capitalisation policy over price path period (Nominal $'000s)

	Sunwater Nov 2023 proposal	Capitalisation revision	Change
Total renewals expenditure	$146,970	$146,970	$0
Opex (step-change)	$62,186	$2,974	-$59,212
Capex	$84,784	$143,996	$59,212

Reclassification risk

Given Sunwater now proposes to capitalise 98 per cent per cent of its total renewals program, the risk to customers of reclassification is significantly reduced. There is no incentive for Sunwater to reclassify activities from capex to opex.

As outlined above, Sunwater does not propose to introduce further changes to its capitalisation policy. Where future changes are contemplated, they would not be implemented partway through a price path period to avoid the potential for double counting of expenditure through the building block process.

Continuation of an annuity methodology

Sunwater notes that QCA has not made a compelling case for an adjustment to its current capitalisation policy under an annuity methodology. Additional administrative effort will flow from the need to capitalise a significantly greater portion of expenditure. As such we do not consider these changes provide benefits to Sunwater or customers should QCA's recommendation be to continue an annuity funding methodology.

8.1.2.2 Treatment of opening RAB balances

Extract from Section 7.2.5 Conclusion:

"We note that an appropriate capitalisation policy would involve capitalising a significant proportion of renewals and that this would require offsetting any short-term reduction in cash flows with a shorter recovery period for negative annuity balances (i.e. less than 75 years). Under this approach the net impact on prices across schemes could vary considerably, so there may need to be different recovery periods (or modifications to the depreciation profile) to manage transitional impacts of moving to a RAB approach. We would expect Sunwater to consult with customers on these transitional issues, to ensure that its approach to managing the transitional impacts is informed by the outcomes sought by customers."

Consistent with QCA's Draft Report, Sunwater also proposes to amend the depreciation period applied to RAB opening balances to offset the short-term reduction in cash flows that arises from greater capitalisation of renewals expenditure.

Taking into account QCA's commentary and its capitalisation position, Sunwater proposes to depreciate RAB opening balances set out in **Table 23**.

Table 23 Proposed changes to depreciation of opening RAB balance

Service contract	Original period	Revised period
Lower Mary bulk	75 years	40 years
Cunnamulla	75 years	30 years
All others	75 years	25 years

In arriving at this position Sunwater compared and/or considered:

- current (2024-25) *cost reflective* prices against the cost reflective prices derived from the Draft Report under:
  - an annuity methodology
  - a RAB methodology with Sunwater's revised capitalisation policy and different depreciation periods (in five-year increments)
- current *irrigation* prices (and the transition pathway) against recommended irrigation prices derived from the Draft Report under:
  - an annuity methodology
  - a RAB methodology with Sunwater's revised capitalisation policy and different depreciation periods (in five-year increments)
- the expected time for a tariff group to transition from current irrigation prices to cost reflective prices.

Sunwater's analysis of these changes shows:

- 26 (out of 47) tariff groups will have lower cost reflective prices under a RAB methodology, compared to 18 under an annuity methodology
- the RAB methodology delivers lower cost reflective prices than the annuity methodology in 39 tariff groups (out of 47)
- Six tariff groups have higher cost reflective prices under a RAB methodology (two others are price neutral as the renewals expenditure building block does not form part of their revenue requirement). Of these:
  - two (Callide Valley and Macintyre Brook) are on long-term transition pathways, meaning the change in methodology will have no impact on irrigation prices for multiple price path periods
  - one (Boyne River and Tarong) will see lower prices regardless of methodology
  - bespoke depreciation periods for Lower Mary (affecting the Mary Barrage, and Tinana and Teddington tariff groups) and Cunnamulla bulk water service contracts are proposed to reduce/eliminate the difference between RAB and annuity-based prices, without significantly adding to the cashflow impact that this change will have on Sunwater.

8.1.2.3 Management of transitional issues

Extract from Section 7.2.5 Conclusion:

"We would expect Sunwater to consult with customers on these transitional issues, to ensure that its approach to managing the transitional impacts is informed by the outcomes sought by customers."

Sunwater takes the view that engagement on transition issues is unnecessary outside the three schemes where the return of a positive annuity balance has the potential to create an apparent "step up" in prices between periods. Since this issue was not raised by any customer (or customer group) in the Burdekin or Mareeba schemes where this situation also arises, we have not sought to engage in those schemes.

Sunwater is open to alternative treatments of the positive annuity balance where it can be demonstrated there is material customer support for a particular option.

Sunwater notes it has engaged with its more than 4,000 irrigation customers on its RAB proposal and received very little direct feedback. QCA has only received a handful of relevant submissions, with only two making any mention of transition issues.

The Cotton Australia submission talks to the return of positive annuity balances in the Dawson Scheme; however, its suggestion that irrigation customers were unaware of the temporary nature of the return of a positive annuity balance on customer prices is contradicted by the engagement material published for that scheme by Sunwater in 2023. This material clearly outlines the impact of the return of the positive annuity balance by forecasting likely prices across multiple price paths.

Sunwater's initial proposal included the return of positive annuity balances to customers over the next four-year price path. The potential pricing impact of the conclusion of this period was shown in Sunwater's stage two engagement material – which is still available on its website. At each public session held in relevant schemes Sunwater communicated clearly that the return of funds had a temporary effect on prices. Alternative options are set out in **Table 24** and formed the basis for follow-up consultation with Theodore Water (Dawson scheme) undertaken in late July 2024.

Theodore Water's submission included the note that "we would be concerned that after the five-year price period there is potential for significant increases." Sunwater presented material to members of Theodore Water at its 27 July Board meeting, which presented Dawson Valley prices under a revised capitalisation policy and showed the impact of different options for the treatment of positive annuity balances. The group requested time to digest before responding that they prefer a return of positive annuity balance funds across the next four-year price path per Sunwater's original proposal. Theodore Water wrote to Sunwater in September to confirm that under a RAB approach their preference is for the return of any positive annuity balance over the four years price path period.

Table 24 Possible options for returning positive annuity balances to customers

Option	Commentary
Sunwater's preferred option remains the return of funds to customers over the next four-year price path period. There is no meaningful evidence of an issue that might warrant further engagement on this matter, with imposts on both Sunwater and customers (time, travel, materials) clearly outweighing any perceived benefits.	
Return to customers in **four years** as a positive step-change	Sunwater engaged with all customers in relevant schemes during both Stage 2 and Stage 3 engagement. Stage 2 engagement materials clearly showed the end of the return of funds and its impact on projected prices. Sunwater engaged directly with Theodore Water in August 2024 and Theodore Water has subsequently confirmed its members prefer this approach.
Return to customers in **eight years** as a positive step-change	Better for Sunwater's cashflow, but may diminish the link between customers who have contributed to the positive balance and those who receive the benefit of its return.
Return to customers **via the RAB** (as a negative starting balance)	This approach was discussed with the Consultative Committee and at in-scheme workshops. While this approach is the easiest to administer and has least impact on Sunwater's cash flows, it is not preferred by customers. At no stage during Sunwater's engagement on this topic did any customer or customer representative group express a desire to have funds returned over a long period of time. Further diminishes the link between customers who have contributed to the positive balance and those who receive the benefit of its return. Reduces the potential for perceived 'price shock' associated with the end of the return of funds period.
Hybrid return – half in the next four years, with half via the RAB	Completely untested with customers. Reduces the potential for perceived 'price shock' associated with the end of the return of funds period.
Ring fence positive balances initially, with Sunwater to attempt to engage with all customers within relevant schemes to determine preferred approach. Sunwater to account for returned funds at next pricing review.	High cost, high uncertainty approach. Completely untested with customers. Increases risks to both customers and Sunwater. Customer risk is increased due to uncertain timing and manner of return of funds, while Sunwater's risk is centred around an ex-post QCA review that second guesses the outcomes of consultation. This risk arises both in the context of the cost of engagement and also should Sunwater seek to return funds prior to the next QCA review.

Sunwater's view is that the cost of further engagement on transition issues outweighs any perceived benefits and comes with an extremely high level of uncertainty that additional customers would participate and that there would be a uniform preference.

8.2 ECPT proposal

As set out in the November 2023 Irrigation Pricing Proposal, Sunwater has been exploring the possibility of introducing an ECPT mechanism in selected schemes with affected irrigation customers.

“Sunwater proposes to introduce an ECPT mechanism in the next price path period in eligible schemes where there is sufficient evidence of broad and informed customer support for doing so.”

While initially customer support appeared strong, during Stage 3 engagement: “five of the six previously supportive schemes provided feedback to Sunwater which suggested customer support for the proposal had changed. This feedback has been reflected in the Scheme Summaries and informs our final position on this proposal.”

Sunwater’s ECPT proposal was summarised as: “Sunwater will continue to gather and respond to customer feedback and will keep the QCA informed of any further change to customer support for this proposal. Consistent with our position throughout our engagement with customers, Sunwater does not wish to pursue an ECPT mechanism in the absence of customer support.

“Based on feedback received from customers prior to 30 November 2023, Sunwater is:

- not proposing an ECPT mechanism for the Barker Barambah, Bundaberg, Burdekin Haughton, Lower Mary, Mareeba-Dimbulah and Upper Condamine schemes
- proposing an ECPT mechanism for the Eton scheme, noting that support in this scheme may be qualified or change during the review phase.

“Sunwater attempted to clarify the position Eton prior to finalising this submission, but as no further feedback was received, is progressing as stated.”

8.2.1 Proposal update

Sunwater has continued to engage with the Consultative Committee on this topic, with meetings in January, April and July 2024 including the ECPT proposal as an agenda item. Sunwater also facilitated a separate meeting with Eton Irrigation. (Eton Irrigation is a locally owned and operated company that delivers irrigation water to some 350 customers.)

At the July meeting of the Consultative Committee, Sunwater presented on cost risk, and QCA’s expectations on an acceptable proposal. The same material was presented to Eton Irrigation on 23 August.

Due to feedback provided at these meetings, Sunwater no longer believes there is sufficient customer support for an ECPT mechanism to be introduced in the next price path period. Therefore, Sunwater is no longer proposing an ECPT mechanism for the next price path period.

8.3 Electricity review event

Sunwater did not propose a review event for electricity costs because the savings in electricity costs had already been returned to customers through the ECPT trial. QCA did not accept this argument and have recommended in the Draft Report to make an end-of-period cost adjustment for three schemes where it believes electricity cost savings were material during the period — Bundaberg (distribution), Burdekin-Haughton (distribution) and Eton — after subtracting the amounts that were returned to irrigation customers through the ECPT trial.[62]

Sunwater acknowledges QCA's draft position and proposes to extend the ECPT trial to also cover the 2023-24 and 2024-25 periods. This revised proposal is made in good faith and on the basis that:

- the trial methodology accounts for 100 per cent of the difference between cost allowances and actual electricity costs, noting the Queensland Government pays a portion of the electricity costs incurred by Sunwater on the behalf of irrigation customers
- extending the trial:
    - removes all forecasting risk from the 2024-25 year which otherwise would apply under QCA's proposed electricity review event
    - better aligns the return of funds with the party that paid for the service.

On this basis, Sunwater expects that the electricity review event is no longer required in participating ECPT trial schemes i.e. the Bundaberg and Burdekin-Haughton schemes. Customers will have paid a price commensurate with the actual cost of electricity incurred by Sunwater recognising that the Queensland Government pays a portion of their bill on their behalf.

It should also be noted that there is some uncertainty over the need for a review event for the Eton scheme as it would appear to be dependent on actual electricity costs in 2023-24 and 2024-25 as to whether it will satisfy the materiality threshold for a review event of $500,000 in aggregate across the period. QCA should only determine an end-of-period cost adjustment for the Eton scheme in the Final Report to the extent that these costs remain material.

8.3.1 QCA does not appropriately deal with CSO payments

Critical to QCA's acceptance of Sunwater's revised proposal is the recognition that "the trial methodology accounts for 100 per cent of the difference between cost allowances and actual electricity costs."

QCA's analysis is presented in **Table 17** of the Draft Report and calculates the possible electricity review event cost adjustments for the Eton (bulk), and Bundaberg and Burdekin-Haughton distribution service contracts. The following commentary relates to QCA's treatment of the 2020-21 through to 2022-23 years for the Bundaberg and Burdekin-Haughton distribution service contracts only.

[62] QCA 2024, ibid, p.48.

QCA identifies:

- the difference between forecast and actual electricity costs (adjusted for actual usage)
- monies returned to irrigation customers during the ECPT trial.

QCA's analysis overstates the scale of the review event as it might apply to the next price path (via an adjustment) because it fails to recognise that:

- cost recovery (via prices) comes from both irrigation customers ***and*** the government[63]
- the entire difference between actual and expected electricity costs (adjusted for actual usage) was accounted for during the trial period, but only a portion of it is appropriate to return to irrigators
- the "net difference" which QCA proposed to include in the electricity review event allowance should not be returned to irrigators as it was paid for by the Queensland Government
- returning the "net difference" via an electricity review event will have the effect of giving irrigation customers an additional benefit that is not due to them.

To assist QCA to understand how it could correct its draft calculation of the end-of-period cost adjustment to account for the account for the contribution made by government to electricity costs when customers are on transitional prices rather than cost reflective prices, Sunwater has summarised the annual cashflows between Sunwater, irrigators and government under our ECPT trial for the Burdekin-Haughton distribution scheme in 2021-22.

Table 25 shows the annual 2021-22 outcome of this breakdown in cash flows between Sunwater, irrigators and government for Burdekin-Haughton distribution scheme.[64]

Table 25 Worked example – Burdekin ECPT outcome 2021-22

Source of revenue	Electricity rate ($/ML)		Electricity costs ($)		(Under)/over recovery ($)
	Fixed	Variable	Recovered	Actual	
Cost-reflective (QCA)	3.77	17.88	6.18m	2.98m	3.20m
Recovered from irrigators	3.07	14.87	5.15m	2.48m	2.67m
Recovered from others[1]	0.70	3.01	1.03m	0.50m	0.53m

Note 1: Revenue from "Other" includes under-recovery by Sunwater and any CSO payments received from the Queensland Government.

[63] *The Queensland Government provides Sunwater a CSO payment that covers the difference between gazetted irrigation prices and cost reflective prices.*

[64] *The workings for this delineation were provided to QCA via Sunwater's response to RFI 159.*

The table shows Sunwater's estimate of electricity cost savings realised for the Burdekin-Haughton distribution scheme in 2021-22 and how these savings are correctly apportioned between customers and the government. In our example of Burdekin-Haughton distribution, customers were on transitional prices. Consequently, these customers are not entitled to receive the full savings in electricity cost of $3.2 million as some of these savings relate to the component of forecast electricity costs that has been funded by the government. As shown in the table above, Sunwater estimates that Burdekin-Haughton distribution customers were entitled to around $2.67 million of the total electricity cost savings in 2021-22. The remaining $0.53 million of the annual cost saving is estimated to relate to the government contribution to funding the cost difference between cost reflective and transitional prices. On this basis, Sunwater believes the QCA draft position, which includes a cost adjustment for the Burdekin-Haughton and Bundaberg distribution systems in 2020-21, 2021-22 and 2022-23, is incorrect.

Sunwater notes that in response to a query on this matter, QCA has stated it is "unable to comment on the interaction between the review event mechanism and CSO payments under the ECPT trial" (email received 22 August 2024).

Sunwater is asking QCA to appropriately recognise the payments made by the Queensland Government on behalf of irrigation customers in its estimation of the end-of period cost adjustment under the electricity review event, and that it does not then seek to return these funds to irrigation customers via a review event or otherwise.

9 Opportunities for improvement

This section of Sunwater's response deals with QCA's recommendations about opportunities to improve the quality and effectiveness of future Sunwater pricing proposals.

QCA's recommendations relate to:

1. capitalisation policy
2. cost allocation methodology
3. asset management and capital planning.

Sunwater's response to the capitalisation policy recommendation is set out in **Section 8**.

9.1 Cost allocation methodology

QCA discusses Sunwater's proposed cost allocation methodology in Section 4.2.2 of its Draft Report: "However, given the potential for a significant increase in the cost base in future price path periods, we consider that Sunwater should investigate ways of improving the causality, transparency and simplicity of its cost allocation approach prior to the next review." (p.33)

Sunwater addresses concerns relating to its current cost allocation proposal as it relates to CASPr in **Section 4.4**.

Sunwater notes this concern and has commenced planning for a holistic review of its approach to cost allocation.

To support this review, Sunwater requests that QCA, in its Final Report, provide guidance on how it might assess a revised cost allocation proposal at the next irrigation pricing review.

9.2 Asset management and capital planning

QCA devotes considerable time to discussion of Sunwater's asset management and capital planning activities. This discussion contains various assertions and assumptions, which in Sunwater's view are not based on tangible evidence. QCA's recommendations in this regard are set out in Box 3 and 4 (reproduced below).

Sunwater's notes that QCA's discussions and recommendations contain no recognition or acknowledgement that the changes it is seeking will require additional effort (and cost) to deliver. This creates the impression for irrigation customers that Sunwater can improve maturity at no cost.

Despite this, and consistent with both our irrigation pricing proposal and subsequent responses to requests for information, Sunwater is committed to continuing its maturity journey and has already commenced several initiatives designed to uplift our asset management and capital planning capabilities.

Box 3: Draft Findings on Sunwater's asset planning and management

We consider Sunwater should implement the following actions this price path period:

- Efficiency plan:
  - Develop an efficiency plan that sets out a pathway to revealing efficient costs including an ongoing process to identify and implement spend to save investment initiatives and efficient working practice changes.
- Asset condition and risk understanding:
  - Develop an asset health reporting system to optimise maintenance and renewals activities. This system can be used to communicate asset health trends and underlying risks to senior management and stakeholders.
  - Improve understanding of the condition and associated risks of assets by undertaking more routine asset condition assessments and integrating these assessments into the asset health reporting system.
- Evidence-based asset lives:
  - Develop evidence-based asset lives to strengthen confidence in asset longevity.
  - Create specific asset plans, based on performance and condition, informed by historical renewals.
- Cost estimation and control:
  - Develop strong cost estimation tools and methods with a feedback mechanism to monitor performance of cost estimates, and find ways to improve them.
  - Conduct active and ongoing re-prioritisation of renewals works at a portfolio level to maximise the benefits within the available budget.
  - Develop an integrated dataset which brings together proposed renewals and asset lives in a consistent manner.

Box 4: Draft Findings on information required to support an ex post review

For future reviews, to support the ex post review of historical renewals expenditure Sunwater should:

- review its coding of renewals and other capex to allow clearer identification and understanding of drivers (e.g. maintenance, compliance and service standards) and types of investment (e.g. refurbishment, replacement and inspections) to better understand the drivers for variances between actual and allowed expenditure
- classify actual expenditure by program over the price path period, using the same program categories as for forecast renewals over this period
- clearly explain the drivers of any variance between actual and approved expenditure to stakeholders and in its pricing proposal
- clearly identify any projects that were deferred or brought forward during the price path period.

These initiatives will address a number of QCA's recommendations but we note that QCA's thinking appears designed for a business that does not run 26 discrete service contracts where trade-offs across schemes and customer groups are generally not possible.

Over the coming four years, Sunwater's focus will be on:

1. building and embedding a program-based approach to asset management and planning
2. improved cost estimation and control
3. evidence-based asset lives
4. asset condition and risk understanding.

Further discussion is provided in **Section 6.3.2**.

10 Conclusion

Sunwater has conducted a thorough and robust review of QCA's Draft Report.

The analysis presented supports the view held by Sunwater that its November 2023 proposal represented the prudent and efficient expenditure it needs to support the delivery of critical and reliable irrigation services over the coming price path period.

Sunwater requests that the following aspects are evident in QCA's Final Report:

- precedence be given to top-down revealed costs
- reversal of decisions that are based on opinions or do not consider all the facts
- recognition that prudent and efficient costs are neither static nor linear
- acknowledgement that revealed costs higher than QCA's pre-COVID forecasts are not, on their own, evidence of inefficiency.

The Draft Report does not provide Sunwater with an adequate revenue allowance to fund the prudent and efficient costs of supplying irrigation water in the next price path period. In Sunwater's view, QCA has not convincingly demonstrated in its Draft Report that forecast costs set out in Sunwater's pricing proposal are not prudent and efficient.

Sunwater has provided QCA with clear and well-reasoned arguments to support its positions. In summary, Sunwater requests that QCA:

- accepts Sunwater's original opex proposal given that QCA has not presented compelling evidence that our proposed base year opex costs are not prudent and efficient
- accepts that the efficient capital cost of CASPr project is $34.878 million given that:
  - the detailed business case was found by QCA and its consultant to be reasonable
  - it is reasonable to exclude the actual costs incurred in 2020-21 and 2021-22 because of the potential for inefficiencies to have arisen due to the early challenges with managing this project
- proposes to continue the ECPT trial for the remainder of the current price path period to ensure customers receive their appropriate share of the electricity cost savings and to minimise forecasting risks associated with an electricity review event
- accepts an increase in the direct labour portion of renewals to 23.4 per cent to more accurately reflect that the direct labour percentage varies across different sized projects
- ensures cost recovery rates are set to take account of a smaller direct labour cost base to ensure that an appropriate level of overhead and indirect costs is recovered
- ensures its opex efficiency factor takes account of the level of actual costs in the base year and refrains from imposing a renewals efficiency factor as it is not warranted.

Finally, Sunwater has included revised positions on its RAB and ECPT proposals in this response. With feedback from customers, Sunwater has carefully developed its revised position on the RAB to effectively address the key concerns raised in the QCA Draft Report. Sunwater has also decided to withdraw its support for the introduction of an ECPT mechanism in the next price path period on the basis of recent feedback from customers.

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