MARYBOROUGH SUGAR FACTORY
SUGAR MILLERS & GROWERS

21st December 2011

Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear QCA

RE: Submission from The Maryborough Sugar Factory on the Lower Mary River Water Supply Scheme and the Lower Mary Distribution System Draft Reports.

Transparent costs and the identification of fixed and variable costs

As per our previous submissions in November 2010 and April 2011- the most important thing to know is the costs to be able to align tariffs. This is where transparency is required for the irrigation customer to understand the cost of the water supply scheme. We understand that forecasting irrigation water demand is extremely difficult and variable and that is why it is essential, as with any business, to understand the fixed and variable costs in different scenarios and to price irrigation water accordingly. We do not feel the bulk and distribution NSPs and the draft reports demonstrate that fixed and variable operating costs are known and transparent for the Lower Mary Bulk and Distribution schemes. The Authority states on page 63 of the distribution draft report that they have:

- identified total prudent and efficient costs of the scheme
- identified the fixed and variable components of the total costs (if electricity is truly a variable cost why does historical electricity costs not correlate with water usage?)

We do not consider this has been achieved given the continued mention of insufficient information. For example, on page 52 the Authority notes that Aurecon was unable to validate the prudency and efficiency of SunWater's operations costs due to insufficient information. The draft reports still indicate a lack of data and large information gaps so again we are not sure how fixed and variable costs have been determined to be prudent and efficient.

No justification has been provided for costs increasing from $543k in 2006-07 to $764k in 2010-11 to a forecast $1.4 million in 2016-17 (Table 6.1 page 63 draft distribution report) when lower bound costs were achieved in 2008-09 for the Lower Mary Distribution System (A 258% increase in costs in 10 years). Does the Authority really consider these costs to be prudent and efficient? Indec set lower bound costs in 2006 for scheme of $783k in 2011 dollars.

Customers are more than willing to bear all the costs of water supply - Provided the costs are efficient and prudent (transparent). The importance of transparency and correct cost allocation to irrigation schemes is of greater importance if pricing is going to move towards

that of cost reflective (as recommended by the Authority in response to the risk of uncertain usage resulting from fluctuating customer demand and/or water supply – Table 2.1 draft distribution report).

Why has data presented to the Authority differed to that presented in the NSPs? Again this indicates that the business is not understood, especially on a scheme basis which is what we are being charged on. How can data provided as recently as September 2011 be subsequently altered.

Knowledge of business and data sufficiency in relation to the Lower Mary Scheme
How well does SunWater know its business? For example Table 3.1 page 7 distribution draft report and Table 3.1 page 8 Lower Mary River draft report state no permanent trading of water from 2002-03 to 2009-10.

MSF – Permanently traded 549ML from straight water purchases not associated with land purchases.
9/7/09 50ML to IWA 44532i
25/5/09 25ML to IWA 44532i
22/7/08 268ML to IWA38452i
20/5/08 70ML to IWA 44532i
17/12/07 14ML to IWA55300i
18/9/07 20ML to IWA0149105i
20/9/07 14ML to IWA 0149105i
3/7/07 88ML to IWA44532i

MSF has also received amendments to deemed water supply contract as a result of these permanent transfers.

We know this is not relevant to the pricing of irrigation water but it does demonstrate the lack of knowledge that is specific to schemes. Seen as irrigation pricing is on a scheme by scheme basis it seems only appropriate that information on individual schemes needs to be comprehensive and understood to establish this pricing.

Lower Mary River Water Supply Scheme (Bulk)
The draft report states no other stakeholders commented on preventative maintenance (Page 57), however in our April 2011 submission we stated:

Why is preventative maintenance significant from 2011 onwards (page 44 figure 5-3). We are struggling to understand the comment about preventative maintenance labour costs rising exponentially in 2011 (page 47) and that conversations with regional SunWater staff highlighted weed control costs were high in 2010/11 due to the extensive wet season experienced. This is the bulk system that is being commented on and in a big wet season floods tend to wash weeds down the river/creek so do not understand what weed control they would be doing in such wet conditions in the bulk system. Please clarify this justification. Also when you look at figure 5-14 on page 52 there is a significant increase in labour and this is not similar to that of 2007.

We do support the Authority reducing SunWater's estimates by $15,750. However, then in table 5.10 (page 63) we cannot see where these costs have been reduced. In the table SunWater has $26k and Authority has $25k, where is the $15,750 reduction? We request

the Authority to reinvestigate forecast preventative maintenance costs of the Lower Mary River.

We also still request the Authority to investigate why labour costs have doubled in the bulk system (Table 5.8 page 54). We do not feel this doubling of labour costs and then continuation of them has been adequately justified.

We are greatly concerned and request the Authority to explain that even though the Aurecon report says of concern is the substantial rise in operation costs from 2008 to 2010 (page 48). And the Authority has noted that Aurecon was unable to validate the prudency and efficiency of SunWater's operation costs due to insufficient information (page 56 draft report Lower Mary River). We supported this concern in our April 2011 submission. However, the Authority noted that the consultants engaged to review operations costs in other SunWater schemes did not recommend any adjustment to operations costs so therefore the Authority has not made any specific adjustments to operations costs. We request the Authority to reassess this decision and strongly consider making adjustments to the operations costs if the increases cannot be proven to be prudent and efficient.

We are concerned that Aurecon are saying from their desktop study they not able to identify any potential efficiency gains (page 55). Then there is a discussion in the report on restructuring, use of contractors, office locations etc but if this is the case why are costs increasing? Even though staff may not be solely allocated to a scheme and any employee who does work associated with the scheme would book their time/costs to it. Were these considered to be efficient? We ask are all of the costs being booked to the Lower Mary bulk scheme necessary for its operation?

Owanyilla Pump Station and Main Roads Channel bulk water function
Considering bulk water pricing is proposed to decrease. Could the authority not have held the bulk pricing as it was and used the additional revenue to offset the distribution scheme and maybe used the variation of the 27% allocation of Owanyilla pump station and main channel costs to the bulk as a means of doing this?

Operations costs – distribution scheme
Due to insufficient information, Aurecon was unable to validate fully the prudency and efficiency of operations costs. However, the Authority notes that Aurecon did not recommend any adjustment to forecast operations costs, and therefore not made any specific adjustments to SunWater's proposed operations costs.

The Authority not making any adjustments to operations costs just because Aurecon did not recommend any is considered unacceptable. We request that considering operations costs have increased from $19k in 2006-07 to $127k in 2011-12 ($108k, 668% increase) (Table 5.5 draft distribution report) they be investigated and adjusted. If they are not adjusted then the 668% increase is required to be explained and justified.

Preventative Maintenance Costs – distribution scheme
Preventative maintenance costs have increased from $64k in 2006-07 to $113k in 2011-12 ($49k, 176% increase) (Table 5.5 draft distribution report). The Authority has not made any specific adjustment to preventative maintenance costs. We acknowledge that SunWater did not agree with the use of labour costs at a sub activity level by Aurecon and that SunWater forecast the expense based on PBs review. However, given issues with historical data to identify this cost and SunWater suggesting to examine labour costs on a

scheme level, and assess whether total labour dedicated to that scheme is efficient for a given level of workload. As per operations costs we request the preventative maintenance costs be investigated and adjusted.

Corrective Maintenance Costs – distribution scheme
Corrective maintenance costs have increased from $35k in 2006-07 to $83k in 2011-12 ($48k, 237% increase) (Table 5.5 draft distribution report). Even though the actual average is $71k, there is still a 237% increase and combined with the preventative maintenance increase of 176% this is a total increase of 413%. We again do not feel it is appropriate to not adjust corrective maintenance or combination of corrective and preventative maintenance. We request SunWater to provide evidence supporting a 413% increase in these maintenance costs if no adjustments are made.

Electricity Costs – distribution scheme
Electricity maintenance costs have increased from $73k in 2006-07 to $141k in 2011-12 ($68k, 193% increase) (Table 5.5 draft distribution report). No explanation has been provided as to why electricity costs do not correlate to water use. We request this be addressed especially as this is being classed as a variable cost.

We accept the Authority's proposed escalation of electricity at 7.41% per annum. However, justification of a 193% increase from 2006-07 to 2011-12 is still required. As a starting point of $143k in 2012-13 has been adopted by the Authority.

Cost Reflective Pricing
$658k short 2012-13. As discussed elsewhere in the submission we express great concern at the shortfall of actual pricing in comparison to that of cost reflective pricing.

Labour Costs - distribution
Labour costs have increased 259% from 2006-07 $78k to $202k in 2011-12 (page 41 table 5.2 distribution). We request again that the justification for this increase be provided. Is it an increase in labour cost and/or an increase in FTEs? It is noted Aurecon is seeking additional information from SunWater regarding the drivers behind the labour cost increases but I still do not understand with a detailed ground-up budget process how this is not already detailed and analysed by SunWater. Surely a double in labour costs would have been investigated already if SunWater were operating a prudent and efficient business?

Extracted from April 2011 submission as do not feel Labour costs have been adequatey addressed in the draft report:
Labour costs - Figure 6-6 on page 64 shows the breakdown of operations labour costs. How can the scheme support the large amount of labour costs external to the region? –

- 8.1% Health and safety
- 10.8% strategy
- 9.5% corporate counsel
- 32.4% asset management – this is questionable as our renewals are not detailed and quite a few in the next 5 years on the tour with Aurecon and SunWater were identified as either being pushed back or downgraded to refurbishment. This is a massive cost for asset management and we would expect a higher standard of renewals planning with this level of asset management costs in labour. For example we have $30 to $40k per annum with condition monitoring costs – do we

require this level of service with our overdesigned system? We feel the assets are being over managed in terms of inspection and planning.

As for the bulk, we are concerned that Aurecon are saying from their desktop study they not able to identify any potential efficiency gains (page 73). If this was the outlook we took with MSF costs that were increasing we would be unviable in the future as we cannot just keep putting up the price of sugar to cover increased costs of production. We have to become more efficient. I feel it is unrealistic to state with all the increased forecast costs there are no potential efficiency gains.

Business management and strategy
If the long term viability of the Lower Mary River Water Supply Scheme was being considered and the efficient operating costs were known/budgeted then there should have been business decisions at SunWater management level along with increased consultation with irrigators to investigate the options available for reducing costs to keep the distribution scheme viable for both SunWater and Irrigators.

If the cost reflective prices are considered to be prudent and efficient then we would like to consider options and/or alternatives for levels of service for a new price path. The forecast expenses do not favour long term viability of the distribution system as the long term cost of water from the distribution system to the end user would be prohibitive.

Overdesign and renewals planning
We support the Authority's recommendations to improve asset planning methodology by conducting high-level options analysis and detailed options analysis (which take into account trade-offs and impacts on operational expenditures) for all material renewals expenditure to occur within the first five years of each planning period.

The implementation of options analysis is imperative to the long term viability of the Lower Mary Distribution scheme. As current asset planning methodology is not cost-effectively identifying assets requiring renewal or refurbishment.

Page 75 of the Aurecon report states 'A general observation regarding the Lower Mary, was that in many instances the facilities appeared way overdesigned compared to modern standards and were attracting additional maintenance and operating costs because of it.' We support this observation.

It appears as though SunWater is treating all schemes the same regardless of the customer requirements and size of the scheme.

Renewals – Negative balance
We request that the Authority ensures it reviews the actual renewals expenditure for 2000-06 for the Lower Mary Irrigation Scheme that Indec has uncovered in order to verify SunWater's opening renewals annuity balance of negative $973,000 on the 1 July 2006. We would like to request the Authority to investigate the impact of using an alternative method of determining the ARR balance (using actual 2000-06 renewals data). We also request that the QCA investigate the prudency of any items in this expenditure considered to be significant in nature.

Opening balance 1 July 2011 $1,298,000 SunWater ($1,290,000 Authority). Closing balance negative $1,178,000 30 June 2012.

We request the Authority to provide further explanation of their response to why negative ARR balances have not been set to zero. The explanation of - as to do so may result in insufficient funds for future expenditure required for service delivery (page 26 draft report lower mary distribution) is not considered to be sufficient. All that the negative balance is doing is creating a large payment of interest on top of trying to reduce the principle component of the negative balance. We fail to see how this impacts on the provision of insufficient funds for future expenditure if determination of renewals annuity is based on forecast expenditure. Setting the ARR to zero should not impact on the forecast renewals annuity.

If this large negative renewals balance is to be retained then we think that this level of capital investment in asset refurbishment should have resulted in efficiency gains, reduced operational and maintenance costs. This cannot be seen in the operational costs that have been forecast.

The large renewals overspend highlights the requirement for the distribution system to be reviewed to investigate optimisation of assets to supply demand.

Renewals – application of 10% saving

We understand that due to time constraints the Authority has not been able to review all past and forecast renewals expenditure items and is recommending that a 10% saving be applied to all non-sampled and sampled items for which there was insufficient information. However, we are questioning the methodology of this 10% saving. Our understanding is that this is based on a state average of savings findings. However, if you look at the 5 sampled renewal items (2 historical and 3 forecast) for the Lower Mary Distribution System the SunWater cost was $1,063,000 in comparison to the QCA accepted total of $445,000 (due to 3 forecast items being found not to be prudent) and this is 41.9% and therefore the overall reduction is 58.1%, thus indicating the application of a 10% saving for the Lower Mary Scheme renewals is inappropriate. If you only look at the forecast renewals then all 3 items were not accepted as being prudent, therefore this is a difference of 100%. We request the QCA to review the methodology of the determination of savings to be applied and request this to be done at a scheme level.

Determination of renewals annuity

We would like to request that the Authority check that when the renewals were removed from the forecast expenditure (3 sampled items and 10% saving or the saving applied once methodology is reviewed) was the model rerun to reset the scheme to remove overheads and reallocate to other schemes. Reduced OPEX should reduce overheads.

Table 4.6 on page 36 of the draft distribution report presents forecast renewals annuity. The 6 year average actual was $186,000 in comparison to the medium priority forecast 5 year average of $407,000 (this is a 219% increase). When $407,000 is divided by the 9,952ML of medium priority WAE this is $40.90/ML. This represents 43% of the 2012/13 forecast price (fixed + variable) and 27% of the cost reflective price ($152.55/ML fixed + variable, table 6.3). We discussed the large impact of the renewals annuity on the pricing of distribution irrigation water. It was suggested that there is a future renewals list presented in Appendix A page 84 of the draft lower mary distribution report and that we should identify and list any items we are concerned about. We find this a very difficult task with the one line of information provided and the lack of specifications. For example, how can a constructive opinion be formed based on:

Walker Point Distribution 2017-18 Replace fencing, gates and grids $257k

Therefore, we do not feel there is adequate information to comment on future forecast expenditure.

Renewals - Consultation with customers

We support the Authority's recommendation for a legislative requirement for SunWater to consult with its customers about any changes to its service standards and proposed renewals expenditure program. And that SunWater should also be required to submit the service standards and renewals expenditure program to irrigators for comment whenever they are amended and that irrigator's comments be documented and published on SunWater's website and provided to the Authority.

In our April submission we submitted – 'If SunWater wants to continue with a renewals annuity regime then the asset management plan (AMP) needs to be available for customer scrutiny so that there is consultation on renewals expenditure. The AMP should have transparency for economic efficiency and investment decisions. Currently MSF has not seen an AMP for the LMRWSS for at least the last five years.' Could you please explain the Authority's response to this that it notes that the timing of annual reports and reviews of SunWater's strategic asset management plans are determined by DERM (page 34 draft distribution report). We feel this is a poor response and still does not explain why the asset management plan and forecast renewals expenditure has not been seen by customers. We feel the reason why irrigation customers are expressing concerns about not seeing the asset management plans is the lack of options analysis and use of common sense (especially in the Lower Mary Distribution Scheme) with regards to asset renewal and refurbishment. If there was confidence in the management of assets in this distribution scheme then we do not feel this would be of such a concern to irrigation customers. However, when 3 renewals items forecast to occur in the next 3 to 4 years are dismissed by the Authority until further options are considered and the renewals balance is going to be in excess of negative $1 million this results in a lack of confidence of the management of the Lower Mary Distribution System assets and business management.

We do note that the Authority during the consultation on 21 November 2011 said options analysis would be published and detailed on the website and that discrepancies in forecast and actual renewals expenditure would also be published.

The network service plan (NSP) should be consulted with customers so that the quality of service and the standard of upgrades customers are prepared to fund are agreed upon. This should include the longer term forecasts of renewals expenditure that are critical to annuity calculation and that impact on water pricing.

Distribution Losses

As noted in the draft report there is a substantial variation between actual losses and loss WAE. The first factor used to justify this difference requires further explanation as for the Lower Mary scheme the historical announced allocations have basically been 100% year in year out or very close to. Therefore, the management of water releases is not a valid explanation of the variation between actual and loss WAE.

The second explanation of SunWater is holding excess WAE is the reason for the variation. And as stated in the draft report customers should not pay for distribution loss WAEs held by SunWater in excess of that needed to meet actual loss releases required.

Actual losses average 300ML per year and SunWater is holding 4,912ML. Therefore, at least 4,000ML is being held in excess of that required.

As there is evidence that there is a sustained difference between the loss WAE and the actual losses, the loss WAE needs to immediately reviewed by DERM. Has SunWater requested this review? We are not sure of the process of instigating this review. Therefore, in the event that SunWater has not requested this review is the Authority able to provide information on how we as irrigation customers request this review?

We do not agree with the Authority's position of - Pending any finding by DERM that current loss WAEs are excessive, the Authority accepts current loss WAE when it is very obvious that the current loss WAEs are excessive.

Recovery of costs for losses allocation in distribution systems has an impact on prices. For example, 2,294ML x $14.55/ML (Part A & B proposed 2012/13 Mary Barrage water charges) = $33,378 to be divided between water users in distribution system.

SunWater Maryborough Office

We apologise if this has been addressed in the draft reports (considering there are 87 pages draft bulk report, 87 pages draft distribution report and 405 pages in the volume 1 report we may have missed it)

Are the expenses of the SunWater office building in Maryborough being fully attributed to the LMRWSS and if so is the revenue from the lease of office space to National Parks and Wildlife being shown in the revenue in the NSP?

During the visit by Aurecon it was discussed how the office is not considered efficient and then were told by SunWater staff that this is not going to be the case in the future, and they will relocate from premises in town to on-site sheds/dongas (Page 55 Aurecon report). Has this been accounted for in the forecast costs in the ground up budget, i.e. reduced overheads?

Recreational Costs

Are there any recreational costs in the expenses in the NSPs, whether direct or from central cost allocations? As the LMRWSS does not have any recreational facilities we do not feel we should have any recreational costs.

Is there any evidence that the centralisation of customer services to Brisbane resulted in a decrease in costs to the LMRWSS or any other schemes? If there has not been a cost reduction what was the justification for this decision? This question was asked during consultation and an explanation was provided that savings were made on a state wide basis and do not necessarily see the benefit of centralisation locally.

Allocation methodology of non-direct costs

We note the Authority in the draft report has accepted SunWater's proposed direct labour cost (DLC) methodology to allocate centralised costs (non-direct costs). We do not consider this acceptable for the Lower Mary Distribution scheme as labour costs have more than doubled from 2006-07 $78k to $202k 2011-12 resulting in a 258% increase (page 41 table 5.2). The justification of this direct labour increase has not been addressed in the draft report and this was requested in our April submission.

The use of this methodology would be acceptable as long as direct labour costs are prudent and efficient (and very transparent). Any business experiencing a 258% increase in direct labour costs would have to have analysed this increase in an effort to understand it and reduce it. Is it an increase in labour cost and/or an increase in FTEs? Surely a double in labour costs would have been investigated already if SunWater were operating an efficient business? How can SunWater not provide historical labour cost disaggregation? (page 65 of NSP).

If the Authority is going to accept this methodology we request a thorough investigation into the direct labour costs of the Lower Mary Distribution Scheme.

In addition to this we request the Authority to address the variations is the percentage of indirect and overhead costs as that of the total operating cost. As the Deloitte benchmarking has the Lower Mary at 30% (Table 6.14 Volume one page 181) whereas the Lower Mary Bulk supply is at 63% and the distribution at 26% (Table 7.3 Volume one page 269). Even though the distribution is at 26% we feel this percentage is being lowered due to large renewals and direct costs that require reviewing. The average for SunWater WSSs is 29% (Table 6.14 Volume one) and the Lower Mary has the highest percentage of indirects and overheads in the state (Table 7.3 volume one). We request the Authority to explain the discrepancy between Table 6.14 and 7.3 figures in Volume 1. We feel the renewals annuities are impacting on this analysis as obviously systems that have not had large overspends and have positive balances have lower renewals annuities and results in the indirects and overheads being a larger proportion of the total efficient costs. This highlights the importance of costs being correctly allocated, transparent, prudent and efficient when pricing irrigation on a per scheme basis, and as stated earlier we do not feel this is the case with the Lower Mary.

Conclusion

MSF requires the Lower Mary River WSS to remain viable and sustainable as MSF has significant investment that relies upon the availability and utilisation of irrigation water. The LMRWSS needs to managed efficiently for both the short and long term. We believe the long term viability of the distribution irrigation system depends on:

1. the reduction of operating costs (movement towards the current forecast cost reflective prices would not be viable), and
2. establishing the opening balance of the distribution renewals annuity that is prudent and efficient (as the large negative balance has a major impact on pricing),
3. optimisation of the forecast renewals expenditure by considering options analysis and service standards.

We understand Tariff structure is to direct water use to its highest and best use from the overall community perspective. We question what other uses there are to direct to? The Sugar industry is the main water user of the Lower Mary Irrigation System and benefits the community with employment and the flow of money through the community (i.e. irrigation stores, auto electricians repairing tractors, quarry for gravel for farm roads, haulage cane to mill, haulage sugar to terminal and the list of community benefits goes on and on).

MSF would appreciate continued consultation in relation to the pricing of irrigation water for 2011-2016.

If you would like to discuss any of this submission please do not hesitate to contact myself on 4121 1153 or 0427 017 508 or email yolandelambert@marysug.com.au

Yours sincerely

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