

Supplementary background paper
QCA review of irrigation prices

Customer involvement in renewals expenditure

February 2010

The Queensland Competition Authority (QCA) is currently investigating irrigation prices to apply in 22 bulk water schemes and 8 distribution systems owned by SunWater.

The QCA has asked SunWater to provide details of its corporate approach for involving customers in renewals expenditure decisions. The QCA has also asked SunWater to describe its approach for advising customers about the potential price implications of actual renewals expenditure, particularly where this varies from the forecast expenditure during the pricing period.

SunWater's response is set out below.

Decision making for renewals expenditure

The 2006 / 2011 price paths were developed under a negotiate-arbitrate model, whereby SunWater presented its costs to irrigator representatives for review. These representatives (the Tier 1 Working Group) engaged external consultants to review the proposed renewals expenditure program¹. Ultimately, irrigator representatives and SunWater jointly established renewals projections that feed into a cost recovery target for each bulk water scheme and distribution system.

Under the negotiate-arbitrate model, a third party² would arbitrate disputes if matters could not be resolved between the parties. This contrasts to the current review, where the QCA has been appointed to review SunWater's expenditure proposals and recommend tariffs. The QCA undertakes consultation and invites submissions with affected parties, including irrigators, as part of this process.

In preparing its renewals forecast (as set out in its Network Service Plans), SunWater has relied upon its asset management practices to determine its renewals program. SunWater has separately provided background information to the QCA about these practices and its decision-making processes.³ Importantly, these decisions are closely related to maintaining service to customers and considering the risk of failure against compliance and service delivery.

The QCA has appointed consultants to review these asset management practices and SunWater's expenditure proposals that result. The QCA will recommend prices for irrigators, based on its assessment (informed by its consultants) on the efficient costs to be recovered, including renewals expenditure. Under this regime, the regulator is

¹ Refer to Statewide Irrigation Pricing Working Group. Tier 1 Report (April 2006).

² In this case, the State Government indicated it would determine the prices to be charged if the parties could not agree.

³ Refer to SunWater's background paper, Asset Management Planning Methodology Paper (October 2010).

responsible for determining the costs that can be recovered. The regulator will also assess the actual expenditure, and review variations in terms of cost or program scope.

The decisions surrounding the proposed renewals program are risk-based and are the result of a rigorous technical asset management process. Renewals decisions are referenced to service standards, compliance requirements and other drivers.

Moreover, SunWater is accountable to its customers, including irrigators, miners, power stations, and local governments, for the performance of its assets. SunWater is also accountable for compliance with laws.

While there is clearly a case for transparency and information being provided to customers about renewals expenditure (refer below), SunWater remains accountable for asset performance and in turn the decisions about renewals, to its customers (through actual performance) and to the QCA (via ex ante and ex post reviews).

During the regulatory period, events will arise that require decisions about changes to the renewals program. SunWater should of course have the discretion to decide upon such changes as the situation dictates.

SunWater's customers can and do offer suggestions regarding planned asset maintenance and such suggestions are considered by SunWater within the context of its asset management decision making processes referred to above. In this manner customers and irrigator advisory committees can influence renewals expenditure during the course of a regulatory period. However, SunWater, as the owner of the assets retains control of the process.

It is also expected that at the end of the forthcoming regulatory period, the QCA will review the actual renewals expenditure for prudence and efficiency. SunWater will bear the risk of the outcomes of this review.

It might be argued that irrigator involvement in decisions to alter the scope of the program during the forthcoming regulatory period would increase scrutiny and may lead to more efficient outcomes. However, these are matters for the regulator to decide, through periodic price reviews. Moreover, acceptance by a group of irrigator representatives at one point in time does not mean, of itself, that the QCA would accept that expenditure as prudent. Indeed, irrigators or customers outside this representative group may argue separately that such expenditure was not prudent or efficient, despite any irrigator representative endorsement.

In short, SunWater submits that it must have control over decisions for the renewals program, and accepts that it is accountable for these decisions in terms of the service or compliance outcomes, and the efficiency of the expenditure through regulatory reviews of expenditure.

Finally, it is worthy to note that the ACCC recommended different requirements for customer involvement in irrigation price setting, depending on the strength of regulation applied. The ACCC established a three tiered approach, with certain service providers subject to a price monitoring regime, while other service providers

have prices determined by regulation. Importantly, the requirements upon service providers under each regime are very different.

Under the light-handed monitoring regime, service providers are required to publish a network consultation plan and seek and respond to customer feedback on that plan. The ACCC noted that this regime should ensure that “customers are able to provide input to an operator’s planning and price-setting processes”.⁴

Under the more heavy-handed regime where a regulator determines charges, there are no such requirements upon service providers to consult with customers prior to submitting expenditure proposals. Nor are there requirements to consult with customers during a regulatory period on expenditure (including capital or renewals expenditure). This is consistent with the role of the regulator, who is appointed to determine prices and consider the service provider’s proposals as well as stakeholder submissions on those proposals.

Information provision to customers

SunWater has existing irrigator representative groups to consult on various operational and other aspects of service provision, including the timing of shutdowns and managing supply interruptions generally.

SunWater provides information to these committees about renewals projects, particularly where those projects may cause a supply interruption, to minimise the customer impacts and ensure smooth delivery of the project. In the past, SunWater has provided more detailed, written information to these groups, and to irrigators individually, through scheme annual reports or newsletters mailed to customers.

This annual reporting to individual customers was discontinued in 2005, amidst informal feedback to SunWater that those reports were not of value.

SunWater is not averse to providing more information to customers about expenditure through the course of the next regulatory period. For example, an annual report could be prepared setting out the annuity restoration reserve balance and comparing renewals expenditure to the forecasts used for pricing purposes.

However, SunWater does not support estimating pricing impacts for customers or updating tariff estimates for the forthcoming regulatory period to take into account actual, historical expenditure. Nor does SunWater support any proposal requiring it to predict the pricing implications arising from the actual renewals expenditure varying from the forecast, as this would be misleading as renewals expenditure is only one aspect to the costs being recovered, and other factors may have equal or greater bearing on price in the next regulatory periods.

⁴ ACCC. Water Infrastructure Charge Rules. Advice to the Minister for Climate Change and Water (June 2009) pXVIII.

For example:

- the renewals annuity accounts for less than 25% of the lower bound cost recovery target in aggregate;
- in some cases an increase in renewals expenditure (compared to forecast) in regulatory period may be more than offset by operating cost reductions, changes to the renewals program in subsequent years, changes to approach to cost allocation or a range of other factors;
- in some schemes, the continuation of the Government policy for irrigation pricing may mean that while costs rise, there would be no corresponding change in prices;⁵ and
- in other schemes, transitional price paths may apply. Hence the impacts of any changes in renewals expenditure may not be experienced immediately.

Hence predictions about price implications from the delivery of the renewals program will be fraught, and will provide irrigators with very little (and possibly misleading) information.

In closing, SunWater submits that:

- it must have control over decisions for the renewals program, and accepts that it is accountable for these decisions in terms of the service or compliance outcomes, and the efficiency of the expenditure through regulatory reviews of expenditure; and
- while noting that customer research and past experience has found only a very small proportion of customers are interested in renewals information, SunWater is willing to provide further information on actual versus forecast renewals expenditure and reserve balances, through the course of the regulatory period. However, SunWater does not support any proposal to estimate the price impacts of such changes.

⁵ For example, where lower bound costs remained such that existing prices met or exceeded that level of recovery and were to remain in real terms.