

Seqwater's submission to QCA's Draft Reports
*"Rural irrigation price review 2020-24
Part A: Overview"*
and
*"Rural irrigation price review 2020-24
Part C: Seqwater"*



November 2019

Introduction

With reference to the Queensland Competition Authority's (QCA) draft reports titled "Rural irrigation price review 2020-24, Part A: Overview" and "Rural irrigation price review 2020-24, Part C: Seqwater", the following pages sets out Seqwater's response to the recommendations made in those reports and provides commentary on other relevant matters.

QCA Recommendation No 1:

QCA recommend that short-term revenue risk be addressed through the use of a two-part tariff structure that closely aligns with the businesses' cost structure.

Seqwater's Response:

Seqwater agrees in principle that short-term revenue risk be addressed by a two-part tariff structure that closely aligns with the business's cost structure. The correct determination of the business's cost structure is important due to the impacts on tariffs. Tariff structure aligned to costs also ensures Seqwater is able to recover its costs. Seqwater re-affirms its position that its costs are very nearly all fixed and has therefore put forward some costs be shared only 5% to the variable cost and therefore volumetric price. A position on this is set out below.

QCA Recommendation No 2:

QCA recommend:

- *the use of a within-period price review mechanism where:*
 - *The water businesses or their customers consider there has been a material change in costs triggered by an unpredictable change in input markets, which they are unable to manage.*
 - *The water businesses consider there has been a material change in costs triggered by a government impost or an unforeseen event, which they are unable to manage.*
- *That any affected party should be able to apply for a within-period price review without a predefined review trigger.*
- *The use of an end-of-period adjustment mechanism in cases where the change in costs is determined not to be material.*

Seqwater's Response:

Seqwater has previously not had exposure to significant cost changes for irrigation during price path periods warranting a within-period price review. However, the unexpected quantum of the recent rise in insurance premiums warrants attention. This is dealt with separately below. Seqwater notes the recommendations.

QCA Recommendation No 3:

QCA recommend that only prudent and efficient dam safety upgrade capex that is required to meet dam safety obligations should be included in the dam safety upgrade cost category.

Seqwater's Response:

Seqwater supports the inclusion of only prudent and efficient dam safety upgrade capex that is required to meet dam safety obligations should be included in the dam safety upgrade cost category.

QCA Recommendation No 4:

QCA recommend that dam safety upgrade capex:

- a) *Be treated as a normal cost of operation in supplying water services to users*
- b) *Be allocated to water users unless there is a clear and justifiable basis for allocating some of the costs to other parties.*

Seqwater's Response:

Seqwater notes the recommendations.

QCA Recommendation No 5:

QCA recommended that where a dam provides a formal flood mitigation service:

- a) *That service should be recognised in the allocation of costs, including dam safety upgrade costs*
- b) *The costs associated with that service should not be apportioned to irrigators and should instead be allocated to the beneficiaries of that service (where possible) or the broader community.*

Seqwater's Response:

Seqwater notes the recommendations.

QCA Recommendation No 6:

QCA recommended that while the primary purpose of dam safety upgrades is to reduce the risks of dam failure to tolerable levels (as determined by the relevant dam safety regulators), the informal flood moderation benefits for communities downstream of dams should be acknowledged in the allocation of dam safety upgrade capex.

Seqwater's Response:

Seqwater notes the recommendations.

QCA Recommendation No 7:

QCA propose that, for dams that do not provide a formal flood mitigation service and are within the scope of this pricing review, dam safety upgrade capex should be:

- a) *Allocated using a general allocation ratio, with dam-specific allocation ratios only used where there is sufficient evidence of a material difference between the general allocation and the appropriate allocation for a particular dam*
- b) *The general allocation ratio for dam safety upgrade capex should allocate 80 per cent of the irrigation share of these costs to irrigation water users. The remaining 20 per cent should not be included in the allowable cost base for irrigation pricing purposes.*

Seqwater's Response:

Seqwater notes the recommendations.

QCA Recommendation No 18:

QCA recommend that Seqwater should work with its customers and with the Government to move to a RAB-based approach for future price reviews.

Seqwater's Response:

Seqwater will work with its customers and with the Government to further investigate this recommendation.

QCA Recommendation No 19:

QCA recommend the tariff structure should be:

- A volumetric price that covers variable costs associated with the delivery of water services
- A fixed price that reflects the balance of the revenue requirement allocated to the particular tariff group

Seqwater's Response:

Seqwater agrees that a tariff structure consisting of a volumetric price and a fixed price as recommended is consistent with the government's pricing policies. The calculation of the variable share of the cost base is critical to the outcome.

QCA Recommendation No 20:

QCA recommend that:

- Prudent and efficient bulk costs associated with necessary distribution loss WAEs be recovered from distribution system customers
- The bulk holding (fixed) costs of distribution loss WAEs not required to service distribution system customers be borne by Seqwater

Seqwater's Response:

Seqwater agrees in-principle with this recommendation. However, Seqwater does not agree with the QCA's findings that the Pie Creek distribution losses are not efficient.

Seqwater notes the QCA referred to their recommendation in the 2013-17 review *that Department of Natural Resources, Mines and Energy (DNRME), as the natural resource regulator, should review distribution loss WAEs to establish the efficient level to be held by Seqwater in accordance to the time frames established for amending the ROPs*. Seqwater agrees that distribution loss policy is the jurisdiction of DNRME and notes that the loss allocations have remained unchanged in the relevant water planning instruments subsequent to the review.

In the case of Pie Creek, Seqwater notes that on page 17 of the "Final Report, Seqwater Irrigation Price Review 2013-17, Volume 2, Mary Valley Water Supply Scheme", the QCA stated:

The Authority considered that on the basis of this data, the total loss WAE of 486 ML are, from time to time, required. If the full 486 ML was not available when needed, the integrity of the distribution system could be significantly compromised.

In response to Seqwater's proposal for an efficiency average of 82%, the Authority considered that the full volume of losses may at times be required and therefore should be considered for pricing purposes.

Seqwater agrees with the QCA on this position.

In the current review, the QCA assessed losses on data extending back only to 2013-14 and found the losses to be 60% efficient in Pie Creek. However, this assessment is over a short period, and Seqwater has a permanent obligation to supply its customers across a range of climatic conditions. While over the past five years, the full amount of distribution losses was not required, since 2002-03, more than the full amount has been required three times being 2002-03, 2003-04 and 2005-06 (refer table 3.2 in the 2013-17 Volume 2 Mary Valley Report).

This supports Seqwater's view that the measurement of losses should be over the long-term and that by limiting consideration of loss efficiency to a five-year view does not allow for longer-term cyclical factors such as weather patterns. These impacts were acknowledged in the QCA's draft report.

In further support of Seqwater's position on the efficiency of losses, Seqwater refers to the *Interim Resource Operations Licence for Mary River Water Supply Scheme Issued to Sunwater November 2000* (IROL) which shows on page 19 that the original interim water allocations were issued to Sunwater for two different types of losses in Pie Creek. The high priority loss allocation of 60 ML was described as "Initial loss – Pie Creek scheme" meaning it was the volume of water required to refill the system after it has been dewatered. Seqwater understands an allowance of 5% for seepage was included in the original calculations. When a system such as Pie Creek is dewatered it must be refilled to operating capacity before normal operations can recommence. To do this, Seqwater must have sufficient water allocation available to refill the system. Recognition of this requirement is evident in the priority given the loss allocation being high priority.

The medium priority loss allocation of 426 ML was described in the IROL as "Continuing loss – Pie Creek scheme". This loss allocation is for transmission losses in the three natural water courses, Calico Creek, McIntosh Creek and Pie Creek. Included in this loss allocation is an allowance for riparian use by landholders whose properties adjoin the creeks but are not water allocation holders.

As stated above, the Pie Creek loss allocations have been required on three occasions since 2002-03. Seqwater submits that the full allocation is required over the long term. The loss allocations act as insurance for irrigation customers that Seqwater is able to provide water to them in accordance with its obligations under its Resource Operations Licence for the scheme.

QCA Recommendation No 21:

QCA recommend that:

- *Dam safety upgrade capex and IGEM review costs should be allocated to medium and high priority customers using headworks utilisation factors (HUFs) for bulk WSSs, and using nominal WAEs for distribution services*
- *Insurance costs should be allocated to medium and high priority customers using HUFs for bulk WSSs and using nominal WAEs for distribution schemes.*

Seqwater's Response:

Seqwater incurred minimal costs which were not capital in nature from the IGEM review. These were treated as normal operating costs.

Seqwater agrees that insurance costs should be allocated to medium and high priority customers using HUFs for bulk WSSs and using nominal WAEs for distribution schemes.

QCA Recommendation No 22:

QCA recommend that:

- *Prices for irrigation customers for each water supply scheme and distribution system should be set according to the prices set out in Tables 55 and 56*
- *Prices for the Central Lockyer Valley WSS be updated to take into account the Water Plan (Moreton) (Supply Scheme Arrangements) Amendment Plan 20129 as soon as practicable after it is finalised*

Seqwater's Response:

Seqwater supports working with customers in the Central Lockyer Valley Water Supply Scheme to review pricing arrangements as soon as practicable following finalisation of the water plan.

QCA Recommendation No 23:

QCA recommend that:

- *Termination fees applicable to customers in the Moreton Vale Pipeline Distribution system should be calculated as up to 11 times (including GST) the cost-reflective fixed (Part C) tariff*
- *Termination fees applicable to Pie Creek distribution system should be calculated as up to 11 times (including GST) the recommended fixed (Part C) tariff*
- *Seqwater can apply a lower multiple if it is in its commercial interest to do so*
- *Seqwater should never recover any revenue shortfall from remaining customers upon exit of the scheme by another customer*

Seqwater's Response:

Seqwater supports all these recommendations. However, it should be noted that Seqwater does not foresee any realistic scenarios where it is in our commercial interest to set lower termination fees.

QCA Recommendation No 24:

QCA recommend that:

- *Ensuring that customers are engaged on an ongoing basis to provide more focus on what is important to customers over the course of the price path period and to provide a better understanding of customer requirements prior to the next price review*
- *Ensuring that its consultation draws a clearer link between proposed expenditure and both prices and service level outcomes for customers*

Seqwater's Response:

Seqwater is committed to continued customer engagement. We engage with all customers through our public forums. The learnings from the customer forums is that there is a small, core group of interested customers who have demonstrated a willingness to engage with Seqwater and work with us on scheme issues. We have established small reference groups drawn from the core groups and invited any other interested customers to join the reference groups. We are actively working on improving our engagement strategies including having introduced a customer satisfaction survey in 2019 which will now be undertaken annually and inform further work; and, offering to establish formal customer advisory committees for those schemes where there is enough interest. Seqwater proposes that we will continue engaging with the reference groups and seek ways to draw greater participation from the wider customer base.

The objective of this second recommendation is not clear to Seqwater and we seek further guidance from the QCA on what would draw "a clearer link between proposed expenditure and both prices and service level outcomes for customers". At each forum, Seqwater presents a report on operations, renewals and the ARR as standing items. The results of asset condition assessments are presented and the links to service level outcomes are discussed. Generic references only are made to impacts on prices because prices are subject to government policy.

In the context of section 10.4.3 on page 105 of the Part C report, Seqwater maintains that the topics presented to customers at the forums, including the one-off presentation of water usage forecasts which informed customers of our price submission, meets customer information needs. It is Seqwater's experience that, anecdotally at least, customers' expectations are met by presenting cost review and forecast information as well as other topics of interest such as our recent initiative of providing water availability forecast scenarios under conditions of low rainfall as an input to irrigators' farm planning.

Other matters

1. Fixed and variable costs

Correlation between operating costs and water use

In its draft report, the QCA stated:

Direct operations and maintenance costs have reduced over the period 2013–14 to 2017–18, as total irrigation water usage has decreased over the same period. (page 68)

To support this conclusion, the QCA prepared a graph outlining water and direct operations and maintenance costs. Seqwater agrees that a historical review of the correlation between costs and water use is useful in understanding the relationship between costs and water use. However, there appear to be other factors driving the decrease in direct operations and maintenance costs other than water use. This is typified by the change from 2014-15 to 2015-16, when water use increased but costs decreased.

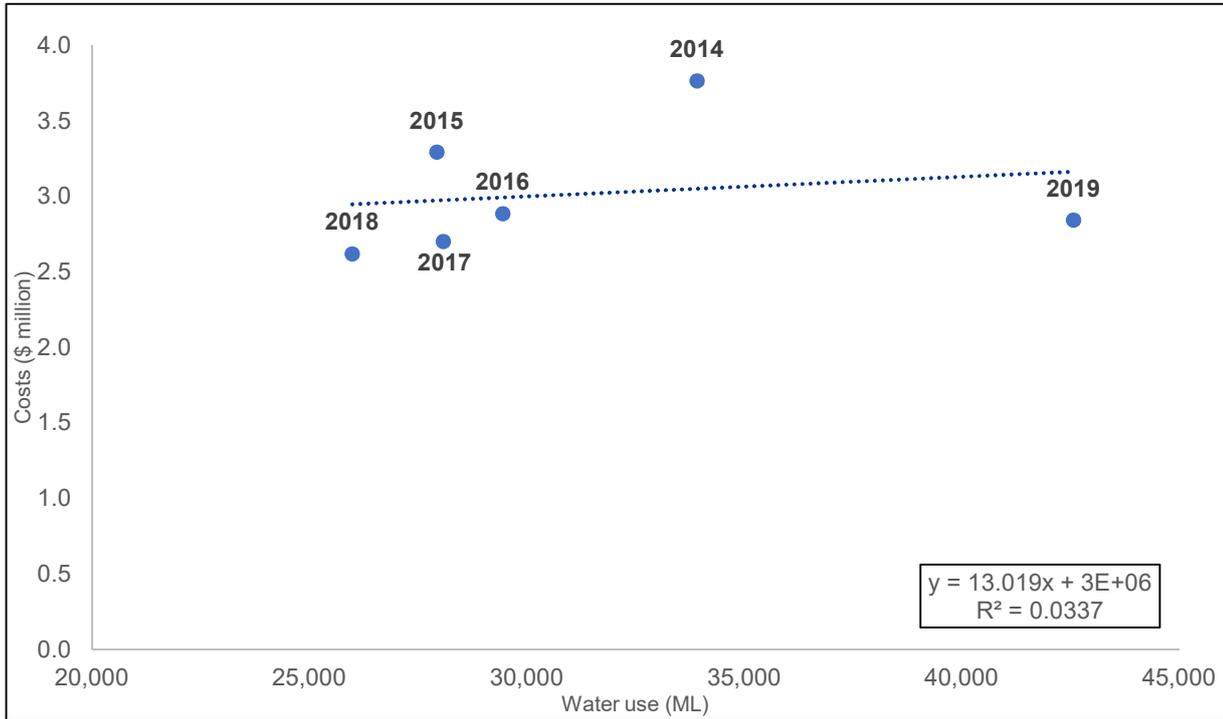
Seqwater has undertaken a more detailed assessment, for all schemes. Importantly, Seqwater has added a further year of information (2018-19). In 2018-19, water use was much higher than in previous years – however, costs were not materially different to previous year (Figure **Error! No text of specified style in document..1**). Seqwater submits that the inclusion of this additional data point, which was not available for the QCA's draft report, requires a re-consideration of the QCA's conclusions.

Seqwater has undertaken a statistical correlation of the data for the years since 2013-14 to determine whether there is a relationship between water use and costs, and the strength of any relationship. This assessment has included two components. The first is to measure the direction of the relationship.

Figure **Error! No text of specified style in document..1** shows the combined relationship between operating costs and water use across six schemes. There is a small positive relationship between water use and operating costs – this is consistent with Seqwater's submission.

Seqwater has calculated the R-squared value, which represents the proportion of the variance for a dependent variable that's explained by an independent variable. In this case, the R-squared shows the portion of the change in costs that is caused by a change in water use. Since 2013-14, 3.4 per cent of the change in costs can be explained by a change in water use.

Figure Error! No text of specified style in document..1 : All schemes – Direct Opex vs actual Water Use



Seqwater has also considered the labour and R&M components separately in figures 1.2 and 1.3 below.

Figure Error! No text of specified style in document..2 : All schemes - Labour vs actual Water Use

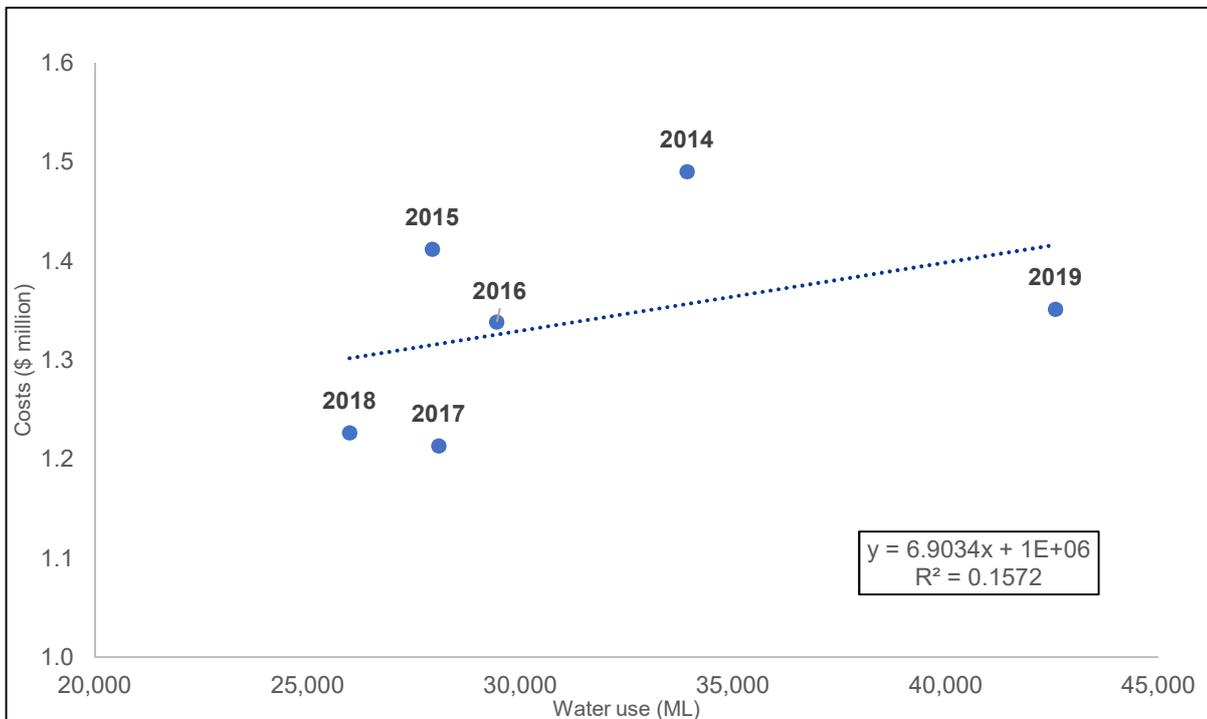
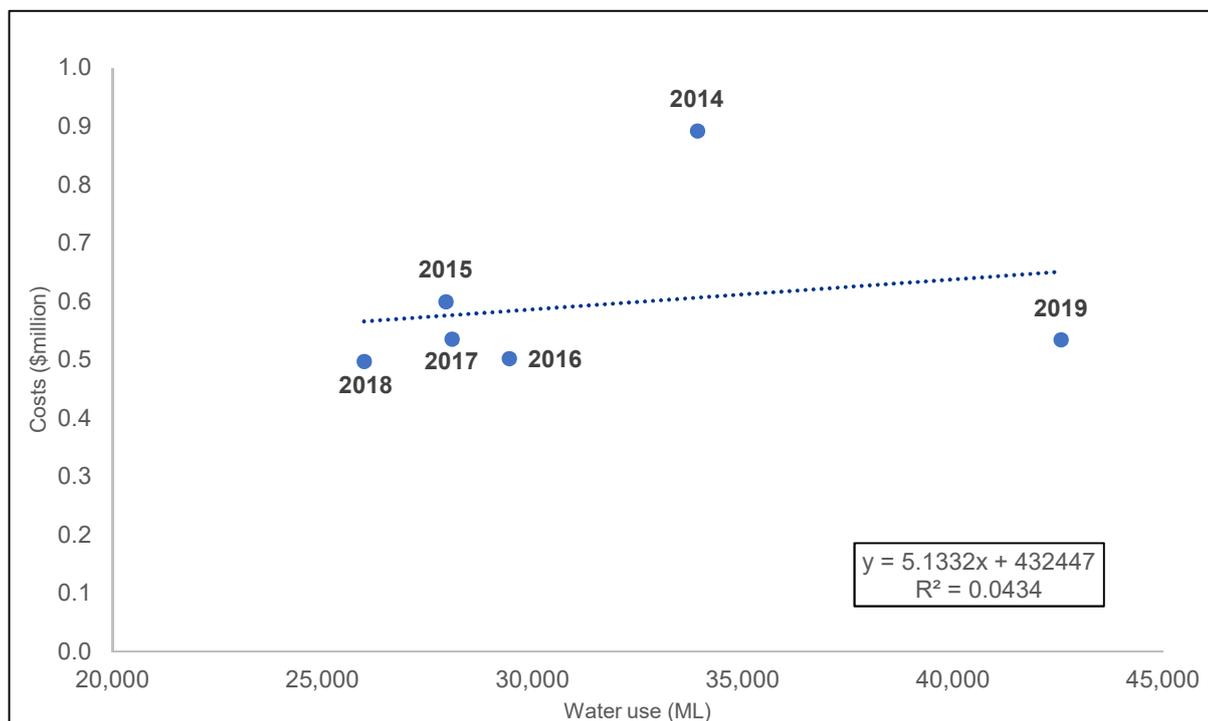


Figure Error! No text of specified style in document..3 : All schemes – R&M vs actual Water Use



This overall assessment shows that a change in water use explains 16 per cent of the change in labour costs and 4 per cent of the change in R&M costs.

On the basis of this assessment which includes the new data not previously available, Seqwater submits that the relationship between operating costs and water use is weak and only a very small portion of costs change due to a change in water use. Seqwater requests the QCA to review the fixed/variable apportionment in the light of this new evidence.

The following is a case study applying the above findings to Cedar Pocket Water Supply Scheme.

Case Study: Cedar Pocket Water Supply Scheme

Cedar Pocket Dam is a small storage that supplies 11 customers. The active water users are dairy farmers. The dam is a small storage that fills (and spills) frequently.

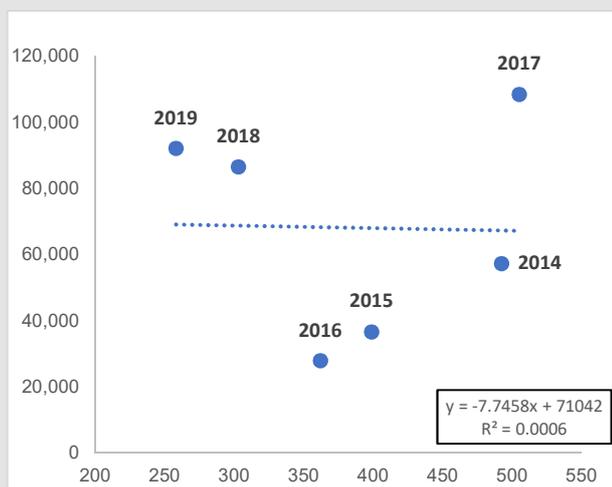
In practice, the operation of this scheme does not vary according to water use. The dairy farmers require water daily and submit standing water orders with occasional requests for short period increases. The scheme operator simply makes releases in order to maintain water in the creek through to the end of the scheme with the goal of not running water past the last customer. The amount of water released from the dam adds minimal additional operational effort. The operator is obliged to visit the dam three times a week to undertake a visual dam inspection. During these visits, the operators inspect the water level at the end of the scheme.

Cedar Pocket Dam is an uncontrolled structure where water above the maximum storage capacity flows over the dam's spillway. There are no gates that require operation during spill events. Whenever the dam is spilling, there is no need to make releases until the overflow begins to fall away. During the frequent spill events, no additional effort is required to deliver water. The dam is spilling 37% of the time measured over the past ten years.

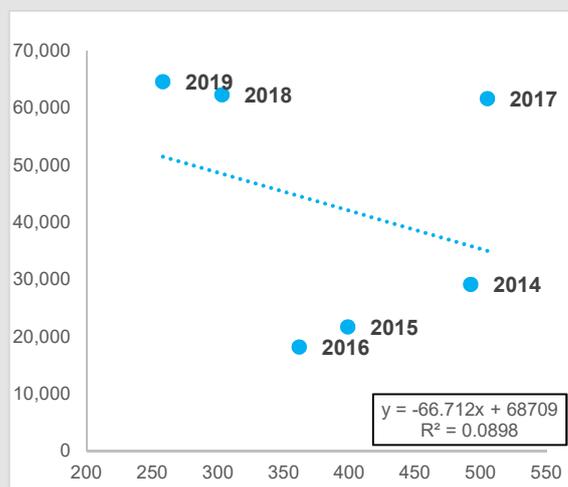
There are no recreational areas to be maintained during periods of low water use.

In practice, this small scheme does not allow for effort to be increased and decreased in a significant way during periods of varying water use. This is shown in the historical analysis, which shows a very mild inverse relationship between overall operating costs and water use. Water use explains 0.06 per cent of the variation in total operating costs.

Total Direct Opex (\$) vs Water use (ML)



Total Labour (\$) vs Water use (ML)



2. Insurance costs

Since making the initial submission in November 2018, Seqwater’s insurance renewals data for Seqwater’s insurance-year ended September 2020 has increased by 98% from \$3.2M to \$6.4M due to a hardening of the insurance markets. Seqwater submits that this increase is far above what was contemplated and reverses a previous trend of reducing insurance premiums and Seqwater submits that the QCA reviews these additional costs for possible inclusion in the price review.

3. Business case

In the Draft Report, Seqwater’s proposal regarding costs for system improvements for the water accounting and billing system for water allocations customers was not accepted as Seqwater had not completed the business case as we are awaiting advice from a potential supplier. This business case is being finalised shortly. Seqwater has strengthened the proposal with additional investigation into new suppliers finding a lower cost option. Seqwater intends to submit the completed business case subsequently to the QCA for further consideration.

4. Central Brisbane River Water Supply Scheme

Seqwater and the MBRI have submitted a joint submission under separate cover.