Queensland Competition Authority

Information sheet

Rural irrigation price review 2020–24

February 2020

Nogoa-Mackenzie water supply scheme

Why are we recommending irrigation prices?

The Queensland Government directed us to recommend irrigation prices for Sunwater and Seqwater customers over the pricing period 1 July 2020 to 30 June 2024.

This includes recommending prices for irrigation customers in the **Nogoa-Mackenzie water supply scheme** (WSS). Prices for non-irrigation customers are outside the scope of our review.

After extensive consultation with irrigators, we have released our final report. The Government will make the final decision on irrigation prices, taking our recommendations into consideration.

How we have recommended prices

We recommended two-part tariffs for the tariff groups in this scheme. The first part (Part A) is a *fixed price* per megalitre (ML) of water access entitlement (WAE), and the second part (Part B) is a *volumetric price* per ML of water used.

The volumetric price recovers variable costs (e.g. a portion of labour costs) that change with water usage. The remaining costs are recovered by the fixed price. We assessed all expenditure to ensure that Sunwater only recovers prudent and efficient costs.

We applied the pricing principles in the referral, as these give effect to the Government's water pricing policy. Under that policy, prices are to gradually transition over time to the 'lower bound cost target'. This target recovers the irrigation share of the scheme's operating, maintenance and capital renewal costs but does not recover a return on, or of, the scheme's existing asset base (as at 1 July 2000). We also moderated bill impacts by capping total price increases to inflation plus $2.38/ML of WAE (from 2020–21, increasing by inflation). More details are in Part A (chapter 2) of our report.

Under our recommended prices, cost recovery for Sunwater's irrigation customers will improve from 90% in 2020–21 to 94% by 2023–24. The shortfall is currently funded by a subsidy, paid by the Queensland taxpayer, which will reduce over time as prices transition to the lower bound cost target.

What prices have we recommended?

For the Nogoa-Mackenzie (medium priority) tariff group, our recommendations result in the fixed price remaining constant over the pricing period, and the volumetric price decreasing to the cost-reflective level immediately. Prices fully recover costs.

For the high priority tariff groups, our recommendations result in the fixed price increasing by our estimate of inflation (2.24%) plus $2.38/ML (2020–21 dollars) over the price path period. Volumetric prices decrease to the cost-reflective level immediately. Prices will not recover costs by the end of the pricing period. Cost recovery will increase from 69% in 2020–21 to 84% by 2023–24.

For the Nogoa-Mackenzie (medium priority local management supply) tariff group, our recommendations result in the fixed and volumetric price decreasing to the cost-reflective level immediately.

Dam safety upgrades for this scheme are due to be commissioned in 2020–21. This only impacts on our recommended prices for the medium priority local management supply tariff group in this pricing period. We have estimated the impact in the year following commissioning (2021–22) to be an increase in the cost reflective fixed price of $1.12/ML for medium priority tariff groups and $11.56/ML for the high priority tariff groups.

Our recommended prices are shown in the table below.

Recommended prices for irrigation customers in Nogoa-Mackenzie WSS—$/ML nominal

Tariff group	2019–20 (Existing)	2020–21	2021–22	2022–23	2023–24
Nogoa–Mackenzie medium priority					
Fixed (Part A)	12.22	12.22	12.22	12.22	12.22
Volumetric (Part B)	1.32	0.84	0.86	0.88	0.90
Nogoa–Mackenzie high priority					
Fixed (Part A)	28.88	31.91	35.05	38.33	41.73
Volumetric (Part B)	1.32	0.84	0.86	0.88	0.90
Nogoa–Mackenzie medium priority local management supply (excluding dam safety)					
Fixed (Part A)	8.84	6.64	6.79	6.94	7.09
Volumetric (Part B)	1.32	0.84	0.86	0.88	0.90
Nogoa–Mackenzie medium priority local management supply (including dam safety)					
Fixed (Part A)	8.84	7.60	7.77	7.95	8.13
Volumetric (Part B)	1.32	0.84	0.86	0.88	0.90
Nogoa–Mackenzie high priority local management supply					
Fixed (Part A)	28.88	31.91	35.05	38.33	41.73
Volumetric (Part B)	1.32	0.84	0.86	0.88	0.90

How we have addressed stakeholder concerns

Access charge

Some irrigation stakeholders did not support the inclusion of an access charge.

We welcome the water businesses working with their customers to reach agreement on issues of concern. We are generally receptive to recognising such agreements when we recommend irrigation prices, subject to any agreement being consistent with the requirements set out in the referral.

Given the importance of the access charge and its impact on affordability, we have recommended that an access charge not be introduced until further consultation is undertaken with Sunwater's customers, particularly with small water users.

See Part B (section 6.3) of our report for further details.

Dam safety

Some irrigation stakeholders have raised concerns about the allocation of dam safety expenditure to irrigators.

The primary service provided by most dams that are within the scope of our review is the supply of water to users. In order to provide that service, the water business must comply with a range of regulatory obligations, including dam safety requirements. As a compliance cost, we consider that dam safety upgrade expenditure should be treated as a normal cost of operation in supplying water services to customers.

We reflected the incidental flood moderation benefits of dams by only allocating 80% of irrigators' share of dam safety upgrade expenditure to the allowable cost base.

Where a dam has a formal flood mitigation role, we consider that the costs of dam safety upgrades should be shared with beneficiaries in the broader community.

See Part A (Chapter 4) of our report for further details.

Electricity cost pass through mechanism

Some stakeholders provided in principle support for Sunwater's proposed electricity cost pass through mechanism.

Some stakeholders expressed concern for Sunwater's proposed electricity cost pass through mechanism.

We are concerned that the automatic pass through of electricity costs has the potential for large bill impacts and reduced incentives for the efficient use of electricity.

We have encouraged Sunwater to further refine the proposal and demonstrate clear customer support. The Government may wish to consider any such agreement were one to be reached subsequent to our report.

More details are in Part A (section 3.3) of our report.

Operating costs

Some irrigation stakeholders in this scheme have raised concerns with costs incurred to implement the 2015 recommendations made by the Inspector-General Emergency Management (IGEM costs), insurance costs (Part B, section 2.6) and electricity costs (Part B, section 2.5). In addition, electricity costs should be assessed for prudency and efficiency and recovered through a fixed and variable $/ML component.

We accepted Sunwater's revised (lower) IGEM costs provided to us in its June 2019 regulatory model. However, we allocated this between irrigation and non-irrigation customers using the headworks' utilisation factor. See Part B (section 2.9) of our report for further details.

We accepted the revised electricity costs for bulk schemes as they are not materially different from our alternative estimates. We recommended that electricity costs in bulk schemes should generally be recovered as a fixed cost as they do not vary with water use. See Part B (section 2.5) of our report for further details.

We accepted Sunwater's revised (higher) insurance costs as they are driven by recent changes in insurance market rates. We also recommended allocating this between irrigation and non-irrigation customers using the headworks' utilisation factor. See Part B (section 2.6) of our report for further details.

Some irrigation stakeholders were also concerned with Sunwater's cost allocation methodology used to allocate non–direct costs. We reviewed the cost allocation methodology and consider it appropriate. Non-direct costs are allocated based on the share of direct labour in a scheme because these costs mainly relate to staff time on head office and local support functions. See Part B (section 2.8) of our report for further details.

Renewals annuity

Some irrigation stakeholders raised concerns about Sunwater's asset management practices and the prudency and efficiency of some projects.

We identified improvements to Sunwater's asset planning and management to ensure assets are not replaced earlier or later than required. See Part B (section 3.2) of our report for further details.

We reduced Sunwater's forecast renewals expenditure by 35.2% (relative to the November 2018 submission) to reflect our assessment of the prudent and efficient level of expenditure. See Part B (sections 3.4 and 3.5) of our report for further details.

Recreation costs

Some irrigation stakeholders raised concerns over the recovery of renewals expenditure relating to recreation services from irrigators.

We reviewed Sunwater's forecast renewals expenditure to ensure that expenditure relating to recreational services have been excluded. See Part B (section 3.4) of our report for further details.

Headworks utilisation factor

Some irrigation stakeholders raised concerns with Sunwater's proposed headworks utilisation factor (HUF) methodology.

The HUF approach takes into account the water planning framework (including water sharing rules and other operational requirements) determined by DNRME in estimating the relative benefits of bulk water assets attributable to medium and high priority customers.

Our consultant, Water Solutions, reviewed the proposed HUF for this scheme and determined that it has been appropriately calculated.

See Part B (section 7.3) of our report for further details.

QCA fee

Some stakeholders did not support the recovery of QCA regulatory fees through irrigation prices.

Our review is limited to pricing for irrigation customers in Sunwater and Seqwater irrigation schemes. As such, we consider that irrigation customers are the key beneficiaries of our regulatory service, and should be allocated the associated costs. We allocated regulatory fees based on water entitlements (ML) held by irrigation customers in each of the water supply schemes specified in the referral.

More details are in Part B (section 2.9) of our report.

Termination fees

Some irrigation stakeholders were concerned about the level of the termination fee.

We note that a lower multiple could be applied at Sunwater's discretion, should it be consistent with Sunwater's commercial interests (e.g. in the interests of more efficient system management).

We also note that customers do have the option of permanently trading their water entitlements to other distribution system users, which does not incur a termination fee. Alternatively, customers can choose to retain ownership of their distribution system WAE and engage in temporary trading.

More details are in Part B (section 8.1) of our report.

Other matters raised by stakeholders

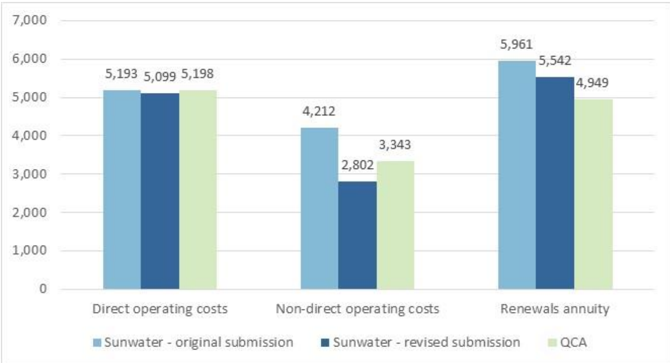
Some irrigation stakeholders in this scheme raised concerns about price levels, affordability and the impact of higher water prices on their businesses, regional economies and local communities.

We consider that recommending prices that are consistent with the Government's pricing principles takes into account social welfare, capacity to pay and regional development considerations. We also moderated bill impacts. More details are in Part A (chapter 2) of our report.

We have recommended a reduction in scheme costs for Nogoa–Mackenzie WSS

We reduced Sunwater's proposed scheme costs by 12% over the pricing period 1 July 2020 to 30 June 2024.

Total scheme costs over the price path period—Nogoa Mackenzie WSS (2018–19 dollars) ($'000)



Notes: 1. Revenue offsets are not included in the charts. 2. QCA Non-direct operating costs includes the QCA regulatory fees.

More details on recommended costs for Sunwater schemes are in Part B (chapters 2 to 4) of our report.

We have assessed local impacts

The table below presents an estimate of the change in water bills (compared to the bill based on existing prices), for various levels of water use.

More details on bill impacts are in Part B (chapters 7 and 9, and appendix C) of our report.

Change in water bill

Water use as portion of entitlement held (%)	Water bill change from 2019–20 to 2020–21 (%)	Water bill change from 2019–20 to 2023–24 (%)
Nogoa–Mackenzie medium priority		
0	–	–
25	(1)	(1)
50	(2)	(2)
75	(3)	(2)
100	(4)	(3)
Nogoa–Mackenzie high priority		
0	10	44
25	10	44
50	9	43
75	9	42
100	8	41
Nogoa–Mackenzie medium priority local management supply (excluding dam safety)		
0	(25)	(20)
25	(25)	(24)
50	(26)	(24)
75	(26)	(24)
100	(26)	(25)
Nogoa–Mackenzie medium priority local management supply (including dam safety)		
0	(14)	(8)
25	(15)	(9)
50	(16)	(10)
75	(16)	(10)
100	(17)	(11)
Nogoa–Mackenzie high priority local management supply		
0	10	44
25	10	44
50	9	43
75	9	42
100	8	41

Where you can find out more

The final report is on the QCA website in three parts:

- Part A—key regulatory and pricing framework issues that apply to both Sunwater and Seqwater
- Part B—Sunwater schemes
- Part C—Seqwater schemes.

What happens next?

The Government will consider our final report and make the final decision on irrigation water prices for Sunwater and Seqwater customers over the pricing period 1 July 2020 to 30 June 2024.

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