Queensland Competition Authority

Irrigation price review 2025-29

Stakeholder workshops

Jan/Feb 2024

Today’s session

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Purpose of this workshop

- **At today's session, we want to:**
  - understand the issues of importance to stakeholders
  - provide an opportunity for stakeholders to share their views and ask questions
  - provide information to help stakeholders with their submissions.

QCA's role

- The QCA is the independent economic regulator for Queensland.
- The Queensland Government can direct the QCA to review and make recommendations about irrigation prices.
- The QCA does not:
  - make water policy
  - determine irrigation prices.
- This review is separate to other reviews undertaken by the QCA (e.g. setting retail electricity prices under the Electricity Act).

Burning issues or questions?

- Please tell us your burning issues or questions that you would like us to cover in this session:
  - Can be general / high level.
  - Can be specific / detailed.

Indicative timeline for the review

Initial stage

Businesses' proposals
30 November 2023

Workshops
January/February 2024

Submissions
due 29 February 2024

Mid stage

Draft report to govt
due 30 June 2024

Workshops
July/August 2024

Submissions
due September 2024

Final stage

Final report to govt
due 31 January 2025

Irrigation prices apply
1 July 2025

Referral notice

- The QCA has been asked to make recommendations on:
  - prices from 1 July 2025 to 30 June 2029 (including drainage prices, drain diversion prices, water harvesting prices and termination fees) that are consistent with the government's pricing principles
  - mechanisms to manage material cost risks.
- Key changes to government's pricing principles since 2020 review:
  - Different approach to transitioning fixed prices above the fixed price target.
  - Prescriptive approach to transitioning volumetric prices below associated target.
  - Special cases—flexibility in applying the pricing principles where improved service levels, augmentations/new assets or new tariff groups/components.
- Price recommendations could consider new tariff groups, subject to constraints about shifting costs and customer agreement.

Matters we must consider in our review

- In conducting the review, the QCA must also consider:
  - the matters in section 26 of the QCA Act, including:
    - economic efficiency—efficient costs, efficient resource allocation
    - business/industry specific matters—actual cost of providing services, effect of inflation
    - customer/social impact matters—social welfare and equity considerations, economic and regional development issues
    - environmental obligations—the impact on the environment of prices charged.
  - the stated matters in the referral (s. 24(1)(b) of the QCA Act):
    - balancing legitimate commercial interests of businesses with interests of their customers
    - where possible, transparent and simple revenue and pricing outcomes
    - having regard to customer agreements in line with requirements in referral
    - having regard to fixed and variable nature of costs.
- Judgement will be used to weigh up and take the various matters into account, but economic efficiency will be prioritised.

How we will assess pricing proposals

- We will assess the following aspects of the Sunwater's proposal:
  - the operating context within which the business operates
  - whether proposals are informed by meaningful engagement with customers
  - the business's justification for the prudency and efficiency of proposed costs with reference to the views of customers and our expectations
  - the business's explanation of price targets and associated prices with reference to our expectations and for consistency with the government's pricing principles.
- Key steps to reach our price recommendations will be informed by assessment of the Sunwater's proposals and stakeholder submissions:
  - Determine the prudency and efficiency of costs in each scheme.
  - Decide how the scheme costs are to be allocated to tariffs and smoothed over the price path period to reach the price target for each tariff group.
  - Derive prices that will transition to the price target.

Customer engagement

- Our assessment of the businesses' customer engagement will be based on the engagement principles outlined in our guidelines.
- We outlined the QCA's expectations with respect to engagement on service levels, cost inputs and prices.
- We consider that, to be effective, engagement should:
  - promote an understanding of customer needs by ensuring a broad representation of customer views
  - be cost-effective and targeted to what customers value and can influence
  - be ongoing and occur within timeframes necessary to inform decision-making
  - clearly inform the planning and decision-making of the business.
- We welcome feedback from stakeholders on how effectively the businesses have engaged.

RAB approach to irrigation pricing - background

- In previous irrigation price reviews, we used a renewals annuity approach to determine an allowance for asset renewal costs when developing price targets (i.e. cost-reflective or lower bound prices).
- In the 2020 review, we recommended that the businesses work with customers and the government to develop a proposal on transitioning from an annuity approach to a regulated asset base (RAB) approach.
- Sunwater engaged with customers on transitioning to a RAB approach for funding renewals expenditure. The prices in Sunwater's proposal reflect a RAB approach.

Renewals annuity vs RAB approach

- Key difference is the time profile of cash flows received by the business:
  - Under annuity approach, renewals smoothed over set period (e.g. 30 years)
  - Under RAB approach, renewals **capex** smoothed over life of the renewal.
- In theory, a renewals annuity should be calculated over a term equivalent to the longest life asset. A shorter term could lead to under-/over-estimate of true capital costs (e.g. under-estimate by excluding large replacement).
- Growing number of larger rural water businesses have transitioned from renewals annuity to RAB-based approaches, due to potential issues including:
  - uncertainty with long-term renewals forecasts—difficulty in forecasting long-term renewals and in determining prudency and efficiency of long-term renewals
  - effective engagement of customers—near-term expenditures in SPPs generally have minimal pricing impacts. Limited information on replacements later in planning period.

Assessment of transitioning to a RAB approach

- We will assess Sunwater's justification and supporting information for the proposed change, including:
  - reasons for transitioning to the proposed RAB-based approach, with reference to associated benefits/costs of change
  - explanations of the proposed approach, including treatment of existing annuity balances, opex/capex treatments of forecast renewals and any capitalisation of expenditure previously treated as opex
  - the immediate and long-term financial impacts on Sunwater and the immediate and long-term billing impacts at scheme level
  - Sunwater's customer engagement on the proposed transition.

Assessment of proposed opex

- Our approach to assessing opex over the price path generally involves:
  - reviewing policies and procedures to assess robustness of opex decision making
  - analysing Sunwater's performance over the previous price path period, **relative to our recommended allowance from the 2020 review**
  - considering whether the proposed base year represents a typical year for the price path period and, if necessary, adjusting for one-off or non-recurrent items
  - assessing the reasons for baseline opex (2022-23 actuals) being higher than our recommended allowance from the 2020 review
  - assessing the prudency and efficiency of any proposed step changes in baseline opex over the price path period
  - reviewing input cost escalation factors and assessing the potential for efficiency gains over the price path period.

Assessment of proposed renewals and other capex

- For Sunwater's proposed capex, we propose a focused assessment on:
  - incremental changes to Sunwater's governance arrangements, with a particular focus on the areas the QCA identified for improvement in the 2020 review
  - reviewing the prudency and efficiency of renewals and other capex first at the portfolio level, then at the project level based on a sample of representative and material projects
  - identifying any systemic issues from the project reviews and drawing on the assessment of governance, capital planning and asset management frameworks
  - reviewing the modelling approach for forecasting replacement and refurbishment costs beyond the price path period, including unit rates adopted and the determination of renewals timing.

Approaches to managing risk

- The referral requires us to recommend appropriate price review triggers and other mechanisms to manage risks associated with material changes in allowable costs outside the control of the businesses.
- We have typically provided regulated businesses with the ability to use review events or cost pass-through provisions to recover material changes in costs when there is significant uncertainty about whether an event will occur, or specific costs are unusually difficult to forecast.
- In the 2020 review, we said that the businesses should be able to recover unexpected changes in costs associated with:
  - opex risks associated with specified events outside the control of the businesses (Review Events)
  - renewals and other capex risks (e.g. major weather events) subject to an ex post prudency and efficiency assessment.

Making a submission

- Providing written submissions is the most effective way to provide feedback.
- Submissions can be made through our website or by post.
- We welcome joint or collaborative submissions.
- Submissions can be brief comments on specific issues.
- Providing evidence to support statements is helpful.
- We publish submissions on our website.

Next steps

- Submissions are due by **29 February 2024.**
- Information about how to make a submission is available on our website: www.qca.org.au/submissions.
- All submissions received by the due date will be considered in preparing the draft report.

Queensland Competition Authority

Questions?

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