

SEQWATER'S 1 MARCH 2013 SUBMISSION / RESPONSE TO QCA REQUEST OF 25 FEBRUARY 2013

1 March 2013

From: Colin Nicolson
Sent: Friday, 1 March 2013 2:54 PM
To: Angus MacDonald
Cc: Damian Scholz
Subject: RE: QCA Information Request 25 February 2013 -- Clarifications and Omissions from Seqwater Submission

Hello Angus

Here is Seqwater's response to the above information request. Please note that responses are pending on A5 and E below. I expect to have these to you early next week.



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From: Angus MacDonald
Sent: Monday, 25 February 2013 10:47 PM
To: Colin Nicolson
Subject: RE: QCA Information Request 25 February 2013 -- Clarifications and Omissions from Seqwater Submission

Dear Colin

Thank you for your recent submission in response to the Authority's Draft Report – Seqwater Irrigation Pricing 2013-17.

I write requesting Seqwater to clarify a number of matters raised in that submission, as follows. Further below there is an additional request about the absence of Seqwater's proposed cost savings resulting from the 1 January 2013 merger.

CLARIFICATION

A. On Page 6, in relation to options analysis, can you please:

QCA Question A.1

Provide the Cardno report.

Seqwater Response to Item A.1

The draft Cardno report (Not to be published) has been provided as an interim measure. Final Cardno report will be provided as soon as it comes to hand.

QCA Question A.2

Advise whether the \$217,481 is an annual figure, or is this the cost to review all relevant renewal items within the planning period.

Seqwater Response to Item A.2

This is an annual number driven largely by the detailed options analyses component. Because of the cost impost, Seqwater proposes that the options analyses be undertaken once only for each regulatory period. This would be completed during the NSP preparation process for the review of the subsequent regulatory period and published on Seqwater's website. Consequently, this cost would be incurred once only per regulatory period. The analyses would be carried out in 2015-16 prior to the next review.

QCA Question A.3

If it represents a significant effort in the initial year, what would the annual (presumably considerably lower) figure be in years thereafter.

Seqwater Response to Item A.3

Whilst there is a significant effort in the initial year, the cost is expected to be the same each year because of the following three factors:

- 1. material projects moving into the rolling 5 year regulatory period from the 20 year planning period;*
- 2. new material projects appearing in the rolling 20 year period; and*
- 3. projects becoming material as their time horizon shortens.*

QCA Question A.4

Advise Seqwater's preferred approach to allocate the total suite of consultation costs (for example, include in non-directs and allocate to all sectors – that is high and medium priority users in each of the 9 tariff groups).

Seqwater Response to Item A.4

Seqwater proposes that the total suite of consultation costs should be treated as “Other” direct operating costs allocated in the following manner:

- *the options analyses costs of \$217,000 should be treated as 100% irrigation costs incurred once only each regulatory period and be allocated to tariff groups proportional to the number of material projects in each tariff group;*
- *the annual NSP reporting cost of \$24,000 should be treated as 100% irrigation cost and be allocated to each scheme on an equal share basis; and*
- *the annual cost of \$25,000 for the establishment, support and co-ordination of seven scheme advisory committees should be treated as 100% irrigation cost and be allocated to each scheme on an equal share basis.*

QCA Question A.5

Define ‘reasonable’ – SKM allowed a 30% margin to establish prudent and efficient costs – and specify your alternative approach to establish ‘reasonable’ costs and any high-option analysis costs savings.

Seqwater Response to Item A.5

Seqwater will respond on this point early next week.

B. On Page 7, in relation to NSP enhancement, can you please:

QCA Question B.1

Clarify whether the \$24,000 is an annual cost for all tariff groups.

Seqwater Response to Item B.1

This is an annual cost as stated in A4 above.

QCA Question B.2

Advise Seqwater’s preferred approach to the allocation of these costs (as above).

Seqwater Response to Item B.2

Seqwater’s preferred approach to the allocation of these costs is set out in A4 above.

QCA Question C

On Page 11, in relation to cost escalation, your submission specifically refers to 4% applying to labour costs only. We presume from this that you agree 3.6% should apply to contractor

costs, particularly as none of Seqwater's new arguments appear to pertain to contractor costs. Is this intentional? If not, please clarify.

Seqwater Response to Item C:

Seqwater agrees that 3.6% should apply as an appropriate escalation factor for contractor costs.

D. On Page 13, in relation to the cost of consultation, can you please:

QCA Question D.1

Clarify whether the \$22,000 cost (option (b)) is for the same activities as referred to on Page 7. If so, why are the costs different?

Seqwater Response to Item D.1

The amount of \$22,000 is an error and should be \$24,000 as it is for the same activities in the corresponding QCA draft recommendation.

QCA Question D.2

Whether the \$25,000 cost in option (c) is an additional cost to the \$22,000 in option (b). Please clarify that it is an annual cost for the nine irrigation tariff groups.

Seqwater Response to Item D.2

The cost of \$25,000 is separate to all other cost estimates as it relates only to the estimated costs to establish, support and co-ordinate seven scheme advisory committees. It is not intended to establish advisory committees at the tariff group level. The QFF submission referred to the establishment of formal advisory committees "similar to SunWater's previous approach" which was scheme advisory committees. Seqwater has submitted its cost estimate on that basis.

QCA Question D.3

Perhaps in your response you should prepare a table of total additional consultation costs and Seqwater's recommended approach and costs. Please provide this information in detail as it is one of the larger remaining items to be considered.

Seqwater Response to Item D.3

Table of Additional Consultation Costs With Seqwater’s Recommended Approach

Consultation Item	All Schemes Regulatory Period Cost Estimate	All Schemes Annual Cost Estimate	Tariff Group or Scheme Cost	Basis of Share	Irrigation Share	Direct Operating Cost Classification
Renewals options analysis	\$217,481	\$54,370	Tariff Group	Proportion of number of material projects	100%	Other Fixed Cost
Enhanced NSPs	\$96,000	\$24,000	Scheme	Equal share	100%	Other Fixed Cost
Scheme Advisory Committee	\$100,000	\$25,000	Scheme	Equal share	100%	Other Fixed Cost

Note: All cost estimates are in 2012-13 \$s

Table of Annual Share of Consultation Costs (\$2012-13)

Scheme/Tariff Group	Options Analysis Cost Share	Enhanced NSPs Cost Share	Scheme Advisory Cost Share
Cedar Pocket WSS	\$12,546	\$3,428	\$3,571
Central Brisbane River WSS	\$12,546	\$3,428	\$3,571
Central Lockyer Valley WSS	\$4,182	\$3,428	\$3,571
Logan River WSS	-	\$3,428	\$3,571
Lower Lockyer Valley WSS	-	\$3,428	\$3,571
Mary Valley WSS	\$4,182	\$3,428	\$3,571
Warrill Valley WSS	-	\$3,428	\$3,571
Pie Creek Tariff Group	\$4,182	-	-
Morton Vale Tariff Group	\$16,729	-	-
Total	\$54,367*	\$23,996*	\$24,997*

* Differences due to rounding.

E. On Page 14, in relation to insurance, we do not find the submission compelling, that is, we still believe that with its limited scope (and increased size since the merger, Seqwater should be able to achieve productivity gains in insurance – if not annually – then please clarify the type of cost savings that could be achieved periodically (and outline the dates and period). If Seqwater wished to build its case in this regard, suggested information could include:

QCA Question E.1

Reference to an independent benchmark indicating that insurance costs are forecast to rise (or fall); and/or

Seqwater Response to Item E.1

Seqwater will respond on this point early next week.

QCA Question E.2

Impact of climate change on future events that require insurance and reported (by insurance companies) impacts on future water infrastructure insurance premiums.

Seqwater Response to Item E.2

Seqwater will respond on this point early next week.

FURTHER INFORMATION

QCA Question F

Finally, I can see no evidence in this submission of decreased non-direct costs from the 1 January 2013 merger. This somewhat contradicts our expectations, raised with you and Peter in consultation meetings with us and irrigators. Please provide details of the non-direct cost savings arising from the merger. Alternatively, please provide a detailed set of reasons / explanations as to why the merger has not achieved (further) cost savings.

Seqwater Response to Item F

Seqwater has been working for some time to produce a merged budget estimate for 2012-13 and now has an indicative position on the change in indirect costs. Although savings were produced by merging the three previous entities into the new Seqwater, this has not resulted in savings in indirect costs to irrigators. While aggregate costs for the three entities has declined as a result of the merger, the new Seqwater business has a larger cost base than the previous Seqwater business upon which the NSPs were based. This is because it has taken on the additional functions previously conducted by LinkWater and the Water Grid Manager. As a result:

- Direct costs allocated to Seqwater have increased; however*
- Direct costs allocated to Seqwater irrigation schemes are unchanged.*

As a result, irrigation schemes represent a lower share of total direct costs than was previously the case. However, Seqwater's new non-direct costs base (i.e. the costs to be allocated between bulk and irrigation customers) have also increased, but at a higher rate than the increase in Seqwater's new direct costs base. Consequently, when the cost allocation methodology is applied to these initial numbers the result is, indicatively, an increase in irrigation scheme indirect costs of approximately \$200,000 compared to the indirect cost share recommended by the QCA. Given that the increase is not material, Seqwater submits that the currently recommended indirect costs be adopted.

URGENT DUE DATE

Seqwater's detailed responses would be appreciated by **4pm on Friday, 1 March 2013** at the latest if possible please.

We ask for this urgent response as we are consulting further with three schemes on 4 and 5 March 2013 (the following Monday and Tuesday).

I would be delighted to discuss this matter tomorrow by telephone or over coffee.

Kind regards

Angus MacDonald

Team Leader



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