2005-06 IRRIGATION PRICE REVIEW
BUNDABERG WATER SUPPLY SCHEME

Tier 2 Meeting 5 - 20th June 2006

Explanatory Notes associated with the channel tariff and CSO scenarios requested by the Bundaberg WSS Tier 2 group

- At the 4th Tier 2 Meeting held on 8th June 2006 the following data was requested:
    - Upper bound revenues for the river segment
    - The difference between current irrigation revenues and irrigation share of lower bound costs
    - Two further tariff scenarios:
        - Maintain the scheme CSO at $1.8 million over the 5 years, cap the increases in Abbotsford and Isis to $10 over the price path and increase the tariffs in Gin Gin/Bingerra, Gooburrum and Woongarra to recover the channel lower bound costs
        - Maintaining the scheme CSO at $1.8 million over the 5 years and permit the tariff increases in Abbotsford and Isis to exceed the $10 cap over the 5 years

- Upper bound revenues have not been determined by the 2005/06 Irrigation Price Review as the Tier 1 process was required to determine lower bound revenues only. Determining upper bound revenues requires regulatory asset values and a weighted average cost of capital (WACC) to be determined. Tier 1 has not considered regulatory asset values.

- The agreed data disclosure at the Tier 2 level was based on providing lower bound cost projections over the five year price path which is the basis for setting the new price path and not historical data. Disclosure of historical data occurred at the Tier 1 level to assist in determining efficient lower bound costs and was not intended to be disclosed at the Tier 2 level.

- The tariff scenario requested by Tier 2 which is based on maintaining the scheme CSO at $1.8 million over the 5 years, capping the increases in Abbotsford and Isis to $10 over the price path and increasing the tariffs in Gin Gin/Bingerra, Gooburrum and Woongarra cannot be provided as it is not consistent with government's policy objectives. Government has stated that 'scheme segments should not subsidise segments that have not yet reached lower bound' (letter dated 28 February 2006, page 4).

- The other tariff scenario requested by Tier 2 is attached and is labeled Scenario 4. This is based on maintaining the scheme CSO at $1.8 million over the 5 years and permitting the tariff increases in Abbotsford and Isis to exceed the $10 cap over the 5 years. This scenario involves the tariffs in Isis and Abbotsford achieving lower bound costs by the end of the price path, based on the following annual tariff increases:

	2006/07	2007/08	2008/09	2009/10	2010/11	TOTAL
Abbotsford	$0.25	$17.89	$0.20	$0.20	$0.20	$18.74
Isis	$0.25	$20.41	$0.20	$0.20	$0.21	$21.27

Background from Previous Meetings

- Some members on the Bundaberg WSS Tier 2 group have requested tariffs on a differential or nodal basis for the five channel segments of the scheme.

- It was outlined at previous meetings that electricity costs are the most significant and readily observable variable cost at the segment level. Attempting to identify other variable cost, other than electricity costs associated with pumping water, at the segment level is difficult as such cost are not as readily observable at the various segment level. To identify other variable costs at the detailed segment level would involve a more extensive cost collection exercise to provide greater confidence in the data. This is particularly important if prices are to be set on this basis.

- A number of tariff scenarios have been tabled to date which are summarised below:

  - Scenario 1 - Average channel tariffs based on 80% of revenues collected from Part A charges and 20% collected from Part B charges
  - Scenario 2 - Average channel tariffs based on 75% of revenues collected from Part A charges and 25% collected from Part B charges
  - Scenario 3 - Segment or nodal tariffs with the Part B charge based on each segment's variable or electricity cost and the Part A charge based on the average fixed costs in all channel segments. Each segment has a different mix of revenues recovered from Part A and B charges.

- Scenario 1 is not a preferred tariff arrangement for SunWater as the Part B charge is below the average electricity cost per ML of water delivered. It was agreed at the Tier 2 meeting held on 30th May 2006 that this scenario will not be pursued further.

- At the Tier 2 meeting on 30th May 2006, the Tier 2 group requested the price path tariffs be presented based on complying with government policy that tariffs cannot reduce and the annual maximum increases set by Tier 1. An analysis of the CSO implications for Scenarios 2 and 3 was also requested.

- Attached to this paper is a copy of a letter from the government dated 28 February 2006 which states that 'prices above lower bound should continue to move towards upper bound, those prices should not decline in real terms and those scheme segments should not subsidise segments that have not reached lower bound' (page 4, second dot point).

- The attached table shows the lower bound cost tariffs, the proposed price path tariffs and the CSO required for Scenarios 2 and 3 and the adjusted Tier 1 reference tariff.

Scenario 3

- The lower bound cost tariffs under Scenario 3 result in the Part B charge based on the variable electricity costs on a per ML basis in each segment with the Part A charge based on an average cost for all other costs in the channel segments on a per ML basis.

- Please note that the lower bound channel average Part A charge in Scenario 3 has been amended to $38.46/ML rather than $38.62/ML as presented at Meeting 3 on 30th May 2006. The average channel Part A of $38.62/ML was based on the Tier 1 reference tariff assumptions which split the revenue from Part A and B charges on a 70% and 30% basis respectively. The correct revenue split should be based on 75% of revenues collected from Part A charges and 25% of revenues collected from Part B revenues as the average electricity charges are 25% of total channel costs.

- Under Scenario 3, due to the Part A charge being set on an average basis the price path tariff for the Woongarra segment would not recover the lower bound costs associated with that segment. This has resulted in the price path Part A charge for the Woongarra segment being increased to recover the lower bound costs associated with that segment and a corresponding reduction in the Part B charge. This results in the price path Part A for the Woongarra segment being $43.16/ML which is higher than the average Part A of $38.46/ML. The Part B charge is $13.91/ML which is based on each segments cost of electricity and the above lower bound revenue component. The cost of electricity for Woongarra is $13.35/ML.

- Under Scenario 3, the Part A charge for Gin Gin/Bingerra and Gooburrum is based on the channel segment average of $38.46/ML and the Part B charge is $18.61/ML. The Part B charge is based on each segments cost of electricity and the above lower bound revenue component. The cost of electricity for Gin Gin/Bingerra is $16.40/ML and for Gooburrum is $8.46/ML.

- The price path tariffs for Abbotsford and Isis have been capped at a total increase of $10/ML over the five year price path. Abbotsford requires an increase of $18.75/ML and Isis requires an increase of $21.27/ML to achieve lower bound pricing.

- The Part B charges for Abbotsford and Isis have been based on the electricity costs for each segment which are $37.36/ML and $39.88/ML respectively. The Part A charge has been determined by the difference between Part B charge and total tariffs based on the annual price increases which are 25 cents per ML in the first year, $2.50 per ML in Years 2 to 4 and $2.25/ML in Year 5.

- The calculation of the CSO on a segment basis is based on the difference between each segment's lower bound costs and the revenues collected from customers based on the proposed price paths on an annual basis.

- The CSO required to transition towards lower bound pricing for this tariff arrangement totals $4.8 million over the five years which is $3 million above the CSO allocated to the scheme of $1.8 million.

Adjusted Tier 1 Reference Tariffs

- The Tier 1 Reference tariffs have been adjusted for the amendments agreed at Tier 2 relating to the treatment of the 4,500ML of allocations held by the Avondale Water Board (previously classified as 'Free Water' and not allocated lower bound costs are now treated as an irrigation customer allocation and receives a share of lower bound costs) and the removal of recreational costs at Fred Haigh Dam.

- The CSO required to transition towards lower bound pricing for this tariff arrangement totals $1.8 million over the five years.

Scenario 2

- This scenario is based on an average channel tariff based on a Part A charge that recovers 75% of lower bound costs and the Part B charge recovering 25% of lower bound costs. This scenario results in the fixed charges being recovered via the Part A tariff and the Part B tariff recovering the variable electricity costs.

- The CSO required to transition towards lower bound pricing for this tariff arrangement totals $1.4 million over the five years which is within the CSO allocated to the scheme.

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SunWater
- 6 MAR 2006
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6 MAR 2006

28 FEB 2006

Mr Peter Noonan
Chief Executive Officer
SunWater
PO Box 15536
City East Qld 4002

Dear Mr ~~Noonan~~ Peter,

Thank you for your letter of 29 November 2005 and the attached October Report, your previous letter of 6 October 2005 and the attached September Report, and your most recent letter of 21 December 2005. The reports provide a very informative account of progress to date in the irrigation price setting process and the primary issues to be resolved by SunWater and the Tier 1 committee.

You will no doubt be aware of the recent Government announcements on SunWater irrigation rural pricing and the water charges. Importantly, implicit within these announcements are Community Service Obligation (CSO) payments and subsidies for rural water users of approximately $34 million over the price path period. We trust this substantial package of assistance will enable SunWater and the Tier 1 committee to complete the irrigation pricing setting process.

While the announcements addressed many of the issues raised in the September and October Reports, we take this opportunity to formally inform SunWater of the recent decisions:

- Price Path Timing and Duration

The new price path period for rural irrigation prices will be from 1 July 2006 until 30 June 2011. Those three schemes whose price paths extend beyond 30 June 2006 can either continue to the conclusion of their current price path or alternatively, commence a new five year price path along with the majority of other schemes.

While the extension of the current price path provides several additional months for the new price setting process, we appreciate there is still a significant body of work before it can come to a successful conclusion. However we trust that the process can be completed to enable the new price path to commence on 1 July 2006.

During the five year period, the Government will, in conjunction with the National Water Commission's nationwide review, consider issues associated with implementation of a rate of return, to achieve upper bound pricing after 2011. While no additional rate of return will be charged from 1 July 2006 to 30 June 2011, relevant SunWater invoices are to include a statement that a rate of return is paid by other SunWater customers and that the National Water Initiative seeks movement towards full cost recovery, including an appropriate rate of return.

- Community Service Obligations

As previously decided by the Government, SunWater Category 3 schemes will continue to receive CSO payments pending a review during the price path period. The specific scope and timing of this review of scheme financial viability will be the subject of separate correspondence.

The Government has also decided to continue to provide CSO payments to subsidise the development of Resource Operations Plans (ROPs) and the development of SunWater's reporting systems, reducing the costs that would otherwise be passed on to irrigators (costing approximately $6.5M over five years).

The Government has further decided that CSO payments will be provided to assist non-Category 3 schemes to reach lower bound within a five year period (costing approximately $18M over five years inclusive of ROP development costs relating to those schemes). This is in recognition that, notwithstanding the State's commitment to full cost recovery under the National Water Initiative, it is likely that many irrigators would have difficulty in immediately moving to the new lower bound price in 2006.

However, it should be clear that these are 'transitional' CSO payments which will cease by 30 June 2011. It is the Government's expectation that all non-Category 3 schemes will meet lower bound without State subsidies from this point onwards. However, schemes that SunWater considers are demonstrably unable to reach this threshold by that time should be included within the scheme financial viability review.

In regard to the concern raised about schemes with an inherent low reliability of supply over the long term and the suggestion that a CSO payment be provided in times of low availability, Government policy is that issues of temporary low water availability should not be addressed within the context of water pricing. If it appears there have been permanent adverse changes to the hydrology of specific schemes, these should be identified by SunWater and advice provided to Government accordingly as part of the scheme financial viability review referred to above.
In accordance with Cabinet's decision, our officers will be in contact with you in the near future to confirm the level of CSO funding provided.

- Spillway upgrades

In regard to the Bjelke-Petersen, Borumba and Tinaroo Falls Dams, the Government has decided to provide a 40 percent subsidy to assist SunWater in financing the capital expenditure for these upgrades (costing approximately $7.5M over three years).

Financing options for the balance of the capital cost will be separately considered by SunWater's Shareholding Ministers. Water users in theses schemes will not have to contribute towards the capital cost of these upgrade works during the 2006 to 2011 price path. The Government will consider subsidies for other SunWater dam spillway upgrades on a case by case basis.

- Level of regulation

We acknowledge SunWater and the Tier 1 representatives' concerns regarding the cost of the development of ROPs. As outlined above the Government has decided to continue to provide CSO payments to contribute to these costs. However it is not clear whether there is any evidence to validate a claim why the regulatory requirements on SunWater would be more 'onerous' than for other water service providers, or indeed are more 'cumbersome or costly than necessary'.

- Standards of governance

We note your advice regarding the Indec Consulting Efficiency Review's findings. Specifically, that there would not be cost savings from decentralisation of management as there are economies of scale in providing centralised corporate support services.

The Government has no expectation that there will be any movement to local management of schemes before 2011. Any future consideration of decentralised or local management would need to ensure that it would not result in either an unacceptable diminishment in the quality of governance applicable to significant State assets or at a higher cost without any offsetting benefits.

- Standards of asset maintenance

The Government expects that all significant SunWater assets will be maintained so that they can continue to deliver water supply services, irrespective of the level of water in storages at any particular point in time. However, the Government recognises that in some circumstances irrigators in particular schemes may be experiencing hardship, due to continued lack of water availability. Under such circumstances it is expected that SunWater will continue to maintain its assets adequately, and that SunWater will manage hardship cases subject to the existing criteria.

This expectation of continued adequate maintenance is not limited to SunWater, but is the Government's expectation with regard to all water service providers and furthermore, is a key consideration for Government Owned Corporations charged with the stewardship of significant State assets. Regardless of any potential alternative management structure, it would not be an acceptable outcome to have important State water infrastructure being run down and its long term service capacity diminished for short term gains.

- Reserve water, free water and SunWater allocations

We note the concerns raised in relation to reserve and SunWater held allocations and believe that these issues should be resolved between SunWater and its customers and will not be open to funding support from Government through CSO payments.

In relation to the free allocation however it is clear that those allocations identified within SunWater's operating licences represent pre-existing entitlements and were a condition precedent to the establishment of the schemes in which they occur.

- Recreational costs

We note that the current SunWater practice, where possible, is for local governments to manage the recreational services associated with relevant schemes. However, in cases where this is not possible it is the expectation of Government that SunWater would continue to undertake these services as a part of its general good corporate citizenship within these communities. This is consistent with community expectations for other water service providers and as such these costs should be included within the lower bound cost base.

- Existing prices above lower bound

Under the National Water Initiative, Queensland is committed to continued movement toward upper bound pricing for rural systems, where practical. It is important that scheme segments which have previously negotiated prices above lower bound should continue to move towards upper bound, those prices should not decline in real terms and those scheme segments should not subsidise segments that have not yet reached lower bound.

- Cumulative impacts and Government water charges

The basis for the Government water charge is entirely separate and distinct from SunWater pricing. The two cannot be offset and the assertion that there is duplication between SunWater's commercial activities and the Department of Natural Resources, Mines and Water's regulatory activities is rejected. Supplemented customers are not being charged twice for the same service. In contrast, only a portion of the cost of water planning and management is being recovered via the water charge. The cost is being shared between the direct and indirect beneficiaries: namely the users (who directly consume water) and the broader community (who indirectly benefit from an effective and sustainable water management system). Hence the water charges levied on water users will only recover about \$25M out of the \$68M in water planning and management costs incurred annually by the State.

- Negotiation process

We would like to emphasise that Shareholding Ministers commend the work of SunWater and the Tier 1 Committee to date and are confident that an effective outcome will be achieved through the continuation of the current negotiation process. Any discussions necessary to finalise the details of the CSO payments should be progressed between SunWater, Queensland Treasury and the Department of Natural Resources, Mines and Water.

If you require any further information regarding these matters, please do not hesitate to contact either Mr Mark Askins, Acting Director, Water Industry Policy and Administration on telephone 3224 5614 or Ms Mary Chapman, Acting Director, Water Reform on telephone 3227 6692.

Yours sincerely

Henry Palaszczuk MP
Minister for Natural Resources, Mines and Water

Anna Bligh MP
Deputy Premier, Treasurer, and Minister for State Development, Trade and Innovation