

# Central Highland Cotton Growers and Irrigators Association Submission to the QCA Water Pricing Review

## **Caveat:**

*We are aware that QCA holds concerns about the content of some submissions received under the review process. These concerns relate to confusion over whether certain issues raised in the submissions are relevant to the QCA review process. For the purposes of this submission, we have made every effort to limit our discussion to price-relevant issues. However, should QCA subsequently determine that non-price relevant issues are included in this paper, we would appreciate being notified of that verdict as soon as possible, and the specific issues identified. That would allow us the ability to re-direct the non-price issues to the appropriate forums.*

## **Introduction:**

This paper follows an earlier submission from the Central Highland Cotton Growers and Irrigators Association (CHCG&IA), and includes additional details of importance for the current QCA water pricing review process. The issues raised herein relate specifically to those that we feel will be important and relevant to QCA in preparation for its water pricing review process.

## **Capital cost allocation & Rate of return:**

### **QCA papers addressed:**

Review of Issues-  
Capital Cost Allocation

Review of Issues-  
Rate of Return

At present, QCA and water users are searching for documentation that will confirm/deny the fact that purchasers of water paid for a share of the relevant infrastructure when they invested in their allocation. We believe that the onus should be placed upon SunWater and/or the state government to provide this detail, in order to show where they notified water purchasers of their responsibility to pay a rate of return at some future point. If it should eventuate that there is no documentation to support the claim that purchasers would be charged a rate of return in the future, then the current conditions should prevail, that is, zero or very little rate of return should be charged to water users.

The fact remains that most of SunWater's customers are operating under unsigned deemed contracts. These contracts clearly state that SunWater is under no obligation to guarantee supply to the water users, so it is difficult to determine what risk or uncertainty affects SunWater. Under the contracts issued to water users, SunWater negates all of its responsibility and ensures that water users pay for services provided (or not provided, as the case may be), effectively minimising all of their risk in regard to the timing, volume, quality and reliability of water supply.

As a consequence, we feel it is important that QCA examine these deemed contracts to determine the actual risk or uncertainty that SunWater claims it is operating under. Only via such an analysis can the complete range and scope of transaction costs involved in a rate of return be established.

**QCA paper addressed:**

Review of Issues-  
Capacity to Pay being  
prepared by ABARE

**Capacity to pay:**

In examining capacity to pay, it is very important that water is valued onto the farm. A general capacity to pay must be set on the cost of water to the property, not adjacent to property. This must include, for example, the extraction costs from the river.

Capacity to pay must also take into account the capital value of the water asset, as this is a significant cost associated with owning and using water. If the yearly price of water goes up, the capital value of water must effectively come down. This reality severely diminishes the water user's capacity to pay through reduced equity. For example, most businesses operate on financing, underwritten by the capital value of the inherent assets. If the value of those assets is reduced, then the ability to continue to finance the business is also reduced, in turn lowering that business' capacity to pay.

Capacity to pay must also consider the reliability of the water supply as well as the variability of commodity prices and returns. These issues dictate the water users' capacity to earn from the water right. We do not intend expanding upon commodity return variability in this submission; the individual commodity groups will be addressing this issue specifically. We do, however, want to emphasize our support for their commodity variability concerns herein.

Reliability figures derived over the last 15 years provide a good principle for establishing water users' capacity to pay. We agree with this principle being applied and support its use in the capacity to pay setting process. However, depending upon the system reliability during individual seasons, the Part A charges represent an important potential problem. For example, if we have an average reliability over that 15 year period of 50%, in assuming that water users would be paying the full efficient operational costs within the Part A fixed costs then the water users:

- Would only be receiving 50% of their water, and
- Incurring the capital cost of owning allocation while not receiving it, and
- Incurring the costs of owning irrigation infrastructure while not being able to irrigate with them.

To summarise, QCA must take into consideration the cost of the capital investment made by water users when developing capacity to pay through the water pricing review process.

**QCA paper addressed:**

Review of Issues-  
Pricing Principles for Dam  
Safety Upgrades prepared  
by  
PriceWaterhouseCoopers

**Spillway upgrades:**

The major concern for CHCG&IA revolves around who is the user of the current infrastructure, and on that basis who is responsible for the cost of spillway and/or dam safety upgrades. Equally, we are concerned whether water users should be paying for the total cost of providing the benefits to all beneficiaries, including those derived from flood mitigation. For these issues then, we believe that QCA needs to pay attention to the following points:

- The resultant damage from the 2008 floods would have been at least double that experienced in the absence of the Fairbairn Dam infrastructure delivering substantial flood mitigation benefits. These include millions in state mining royalties saved, the protection of at least \$1 billion worth of coal mining and community infrastructure, and the saving of considerable state revenues.
- The stated reason for spillway upgrading is the protection of human life and property below the relevant dam infrastructure. For that reason, why should these costs be apportioned to water users?
- The spillway upgrade is only brought about by the fact that the infrastructure exists in the first place to provide water to water users. If the infrastructure structure were removed, it would also remove the need for a spillway upgrade. But, who then would meet the cost of flood mitigation? Importantly if flood mitigation is required, someone has to pay for it, and that should be derived from ALL of the beneficiaries. This includes the state government who benefits from the community, agricultural and mining revenues generated under the operational protection afforded by access to water and flood mitigation.
- Flood mitigation must also be included as part of cost allocation of infrastructure, as highlighted in the section below.

#### ***Headworks utilisation***

**QCA papers addressed:**

Review of Issues-  
Capital Cost Allocation

Irrigators who are reliant on high priority water supply in the Nogo-Mackenzie irrigation scheme have some real concerns about the current arrangements for high priority charges within the Weemah Channel.

In the past high priority charges were set on the basis of a utilisation factor. This factor was established by calculating the infrastructure requirements for capturing both medium and high priority water. Throughout the last price path this factor was set at a rate of 2.5:1. For example, the scheme requires 2.5 times the infrastructure headworks to capture and store a megalitre of high priority water, as compared with the infrastructure requirements to capture and store one megalitre of medium priority water.

This utilisation factor has since been used to set the bulk water cost sharing arrangements between the two priority groups. This is evident in the charges that are now applied to the Nogo-Mackenzie scheme. In the 2009/10 season, for instance, Part A River charges with medium priority equalled \$5.72/ML, while Part A River charges with high priority equalled \$14.24/ML. As further evidence, in the same season Part A Channel charges with medium priority were set at \$19.64/ML, and the Part A Channel charges with high priority equated to \$49.12/ML.

As you would be aware, channel systems are used to deliver water, not for its capture and storage. As such, applying the factor of 2.5:1 to the channel systems is at odds with the original intent of the infrastructure headworks utilisation

factor. It is obvious the \$5.72/ML Part A medium priority river price is a bulk water charge, and as such the utilisation factor applied is correct. One would assume, though, that only \$5.72 of the \$19.64/ML Part A medium priority channel charge should incur a utilisation factor. Subtracting the bulk water charge (\$5.72/ML) from the current Part A medium priority channel charge (\$19.64/ML) leaves us with \$13.92/ML for medium priority channel infrastructure utilisation charges. Then, multiplying the original medium priority channel bulk water charge by the storage infrastructure utilisation factor ( $\$5.72/\text{ML} \times 2.5 = \$14.30/\text{ML}$ ). Adding that to the general channel utilisation charge (\$13.92/ML) provides us with a new figure \$28.22/ML. We recognise this charge as the correct price to be applied for high priority channel utilisation and request that QCA deal with this issue as a matter of urgency.

### ***Case study – Rate of return issues***

**QCA papers addressed:**

Review of Issues-  
Capital Cost Allocation

Review of Issues-  
Rate of Return

The following case study offers a useful point of reference for the QCA in regards to rate of return issues in the Nogoia-Mackenzie irrigation system.

When purchasing their allocations, one group of water users contributed a return of 200% of the value of the infrastructure built to entrap the allocation that they purchased. That entrapment is now rendered redundant due to failure. Other water users in the Nogoia-Mackenzie system are now having their reliability impacted upon so that the water users supplied by the failed infrastructure can have their water delivered.

Now it has been implied that all water users in the Nogoia-Mackenzie will be called on to fund rebuilding of the failed infrastructure. If that occurs, Nogoia-Mackenzie water users will effectively have paid for the infrastructure three times over. In addition, since the initial construction of the failed infrastructure, water users have been paying a rate of return on that infrastructure through their annual water charges.

Nogoia-Mackenzie water users took the risk of creating industry to build the capital value of water allocations, in turn increasing local water prices to above \$2,000/ML and enabling infrastructure to be built and paid for through the sale of allocation. This has created a significant return on equity for the state government. This large value has also enabled channel lining projects to be instigated and paid for through the sale of recovered allocation derived from the saved water.

Therefore, is QCA going to investigate who among the Nogoia-Mackenzie water users invested in the infrastructure through their purchase of allocation? Or do we rightly assume that the current capital value of water is the major contributing amount towards the cost of our scheme infrastructure? It was the Nogoia-Mackenzie water users who built the capital value of water to where it is today. Therefore, if water users' investment in water allocation exceeds the total value of the infrastructure, why are Nogoia-Mackenzie water users being asked to pay a rate of return?

**QCA paper addressed:**

Review of Issues-  
Capacity to Pay being  
prepared by ABARE

Review of Issues-  
Rate of Return

***Water planning process***

The original concept was that the capital value of water would drive the best end use of the resource. If there is a transfer of the capital value of water ownership this will undermine the water market that has taken 10 years to establish. If the water market is affected, this will also undermine SunWater's ability to invest in capital to fix problem infrastructure that is presently causing some of the biggest water losses and rising water table problems in the state.

SunWater, through their losses and distribution allocation, is one of the biggest single allocation holders in the state, which includes any comparison with Cubbie Station. However, in contrast to Cubbie Station, most of SunWater's water is unproductive and will stay so if the QCA price review process continues to undermine the capital value of water.

***Public benefit issues***

Water infrastructure was built throughout the state to capitalise on the state's wealth. Most of this infrastructure has achieved that purpose very well. For example, the Fairbairn Dam sits within the middle of the state and has derived massive diversity of industry, and delivered hundreds of millions of dollars worth of revenue for the state from royalties and taxes each year.

Throughout time, the water users have covered the cost of operation and maintenance for these infrastructure projects, as well as contributing to the cost of its construction. They have also paid a dividend on these infrastructure projects over the years. If government elects to impose a full rate of return through the instrument of capacity to pay it will destroy the diversity of the region and dramatically increase the risk and uncertainty for government and taxpayers into the future. This would occur, for example, because the irrigation industry could no longer afford to exist having been priced out of operational certainty.

We could further compare the proposed water pricing capacity to pay/rate of return arrangements to other infrastructure projects such as public transport in urban areas. In this case, should government elect to similarly charge a full rate of return plus the full cost of operation to the end beneficiaries of those projects we would find our city centres ceasing to operate in a very short period. Therefore, recognising the fact that public transport is a highly valuable component of our urban existence, and that charging the full rate of return and operational cost for such services is unachievable, surely we can argue that water infrastructure across the state fits equally into the same category.

***Strategic cropping land***

The Queensland government policy in regard to strategic cropping lands has now been tabled. To quote the Minister from one of his statements on the issue, "Agricultural land resources are important to Queensland - they support the economic growth in regional areas, strong regional communities and provide a resource base for growing food. They are a key state resource as Queensland

grows. The Queensland government is committed to protecting the best of Queensland's cropping land resources. This land, strategic cropping land, is a finite resource that must be conserved and managed for the longer term".

This statement must be put into the appropriate context. This statement would see prime strategic agricultural land, including irrigation land that provides much of the state's food production, protected from mining incursion at a cost to the state of hundreds of millions dollars in lost potential annual royalty revenues. However, the same state government seems determined to subject the irrigation industry to rate of return and capacity to pay water pricing arrangements that would, in contrast, net only a few million dollars annually and place the majority of future food production for the state at risk.

***Future submissions***

We eagerly await the release of future QCA issue papers relevant to the water pricing process, and reserve the right to submit further on the issue outlined within those papers as and when they are made available.

We are also contactable should QCA require further reference data in regard to this submission or have any queries relating to the information and views expressed herein.

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on behalf of:

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30<sup>th</sup> August 2010.