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3 March 2016

The Director
ACCC Water Branch
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Dear Sir/Madam

SunWater submission on ACCC's Draft Advice on the Water Charge Rules Review

Please find attached SunWater's submission to the ACCC's draft advice for the review of the Water Charge Rules (the Rules).

SunWater supports many of the proposed changes aimed at clarifying, streamlining and simplifying the Rules and their application. However, a number of proposed changes are of concern, in particular two matters:

- Price discrimination: irrigation water prices are currently subsidised by the Queensland Government, while prices to other users are set at, or transitioned to, upper bound cost recovery. These long-standing arrangements are consistent with the National Water Initiative and the Basin Water Charge Pricing Principles. The resulting price differences should not be prohibited through the application of non-discriminatory pricing. Furthermore, the Rules should exempt prices already set under pre-existing contracts.
- Price regulation: the ACCC should accept the current framework for the regulation of prices under the *Queensland Competition Authority Act 1997* as sufficient to devolve price regulation, reducing regulatory burden and cost. The costs of the alternative, which would see the ACCC determining prices for only around 1% the Basin, are considerable and there is no evidence that the current recommendatory regime is generating undesirable outcomes.

SunWater appreciates the ACCC's efforts in consulting with stakeholders and clarifying the intent of the draft advice. Indeed through this consultation we became aware of a number of issues that were not clear to us from a reading of the draft advice. We would greatly appreciate the opportunity to discuss this submission with the ACCC, prior to it finalising its advice.

I have asked Mr Peter McGahan [REDACTED] to contact the ACCC officers to seek to arrange this discussion.

Yours sincerely

A handwritten signature in dark ink, appearing to read "P. Boettcher", is written over a light blue circular stamp.

Peter Boettcher
Chief Executive
SunWater Limited

Att(s)
SunWater's submission on ACCC'S Draft Advice on the Water Charge Rules Review

SunWater's Submission on
The ACCC's Draft Advice on the Water Charge Rules Review
March 2016

SunWater's submission

This is a submission to the Australian Competition and Consumer Commission's (ACCC) draft advice for the review of water charge rules, published in November 2015.

SunWater is an infrastructure operator (IO) that owns both on-river and off river infrastructure in the Murray Darling Basin (MDB). Its assets comprise six discrete water supply schemes (on-river), and the St George Distribution System (off-river). Table 1 provides a summary of water supply schemes and water access entitlements (WAEs), which are only around 1% of all regulated WAE in the MDB.

Table 1. SunWater's MDB water supply schemes

Scheme	Water access entitlements (GL)	Uses of water include:
Chinchilla Weir	4.0	Irrigation, local government (urban water supply)
Cunnamulla	2.6	Irrigation
Macintyre Brook	24.9	Irrigation, local government (urban water supply)
Maranoa River	0.8	Irrigation
St George	84.5	Irrigation (including channel distribution system), local government (urban water supply), industrial
Upper Condamine	33.9	Irrigation, local government (urban water supply)

The St George Distribution System is currently owned by SunWater, however the Queensland Government has announced that the scheme is in the final stages for transfer to local user management (refer to: <https://www.dews.qld.gov.au/water/initiatives/lmas>).

More detail is provided in appendices to this submission.

This submission is largely concerned with three matters:

- the proposed prohibitions on discriminatory pricing (Section A);
- specific aspects of relating to price regulation and the application of Part 6 (Section B); and
- implementation arrangements and other matters of detail (Section C).

The following sections present our submission on these matters in detail. We have also provided three appendices with supporting background information.

A. DISCRIMINATORY PRICING – PURPOSE OF WATER USE

This section relates to the proposed prohibitions on price discrimination based on the purpose of water use, and relates to Rule Advices 5A, 5B and 5C and has implications for Rule Advice 5-E and 5-P.

As a matter of principle, price discrimination is not necessarily undesirable or inefficient. Prices for the same service can be different, provided they fall between the incremental and stand-alone cost of supply.

The 2006 COAG Competition and Infrastructure Reform Agreement provided for efficient price discrimination as part of simpler and consistent regulation of significant infrastructure. In particular, the Agreement required that regulated access prices should be set so as to allow multi-part pricing and price discrimination when it aids efficiency. The recent Harper competition policy review also recommended against re-introducing prohibitions on price discrimination into the *Competition and Consumer Act 2010*, and that discrimination with an anti-competitive effect could be dealt with in other legislation.¹

The ACCC's concerns appear to be focussed on IOs discriminating prices to benefit a sub-set of customers:²

... over the last five years ... the ACCC has identified several other forms of price discrimination that are of concern. The ACCC also considers that operators' governance arrangements can act to reinforce price discrimination, for example where voting rights are distributed within member-owned operators based on particular irrigator attributes such as the volume of water holdings.

The ACCC has identified additional cases where the interests of a sub-set of customers may not align with the interests of the infrastructure operator more generally, or the interests of customers with a controlling interest in a member-owned operator.

The draft advice goes on to state that:³

Specifically, operators may have incentives ... to discriminate against... customers based on the purpose for which water is used, for example via a tariff structure under which irrigators pay for costs incurred by the infrastructure operator as a result of environmental water users, or conversely charging an environmental water user a different (higher) charge for the same infrastructure provided to irrigators.

While not specifically stated, the ACCC seems concerned that an IO or certain interests within that IO will set higher prices for one type of water use, to reduce prices for others or discourage that form of water use (or non-use). The concern seems to be mostly related to equity for this type of price discrimination.⁴

However, the draft advice has not contemplated the situation where an IO applies different prices in response to a Government CSO or subsidy. Nor has the ACCC considered pre-existing contracts, or negotiated price paths to help specific customers transition to the upper bound level of cost recovery.

² Refer p62

³ Refer p63

⁴ Provided different prices lie within the bounds of incremental and stand-alone costs.

Background - subsidies and CSOs and pre-existing contracts

The National Water Initiative (NWI) requires that rural water prices are set to achieve full cost recovery, including continued movement towards upper bound pricing, with any CSOs reported publicly. This reform is reflected in the Basin Water Charging Objectives and Principles (BWCOP), which state that:

- Water charges are to be based on full cost recovery for water services to ensure business viability and avoid monopoly rents, including recovery of environmental externalities where feasible and practical;
- Water charges in the rural water sector are to continue to move towards upper bound pricing where practicable;
- If full cost recovery is unlikely to be achieved and a Community Service Obligation is deemed necessary:
 - the size of the subsidy is to be reported publicly; and
 - where practicable, subsidies or Community Service Obligations are to be reduced or eliminated.

In Queensland, Government policy requires that prices for irrigators are capped at the greater of lower bound or the current price. Where irrigation prices do not meet lower bound costs, Government directs SunWater to implement a specified price path, and provides a cash Community Service Obligation (CSO) payment for the difference between the price path revenue and lower bound costs. This policy only applies to irrigation users. Appendix 1 provides more detail about Queensland pricing policies.

The Queensland Government also requires that irrigation prices do not transition further to upper bound, or more specifically prices are not to increase to include a full return on the value of pre-existing assets. This is effectively a Government subsidy for irrigation that results in SunWater foregoing a full rate of return on the portion of its assets that supply the irrigation sector. Figure 1 provides an illustration.

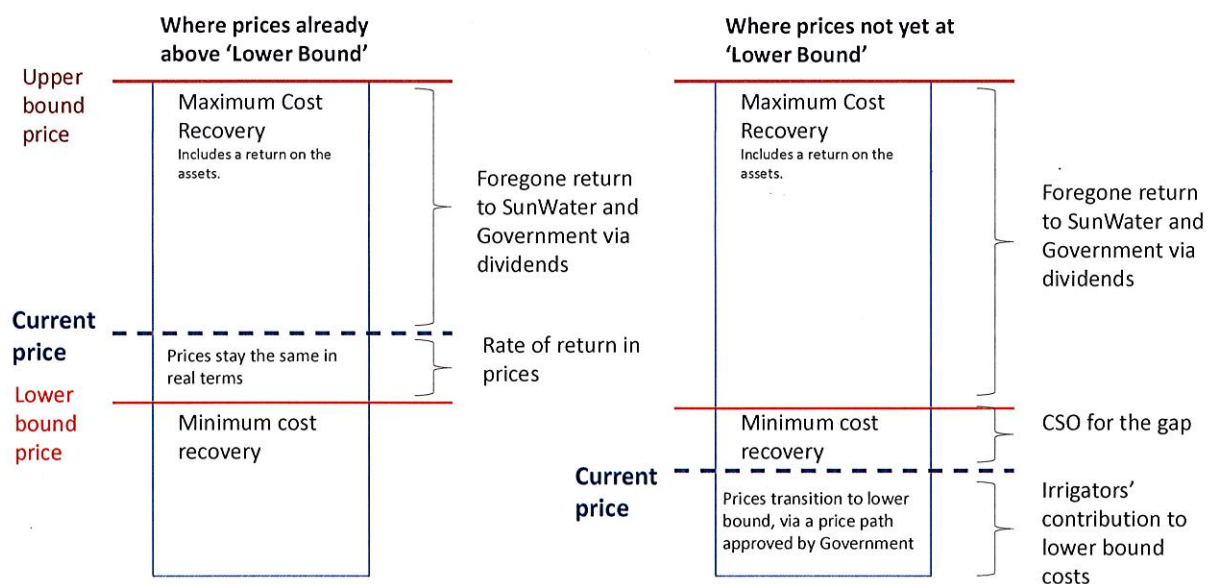


Figure 1: Irrigation Pricing arrangements in Queensland

The size of this subsidy per ML can be deduced from SunWater's published Fees and Charges schedule, which provides one table for charges payable by irrigators under the Government direction notice to SunWater, and another table showing charges payable by non-irrigators, including prices at the upper bound. Appendix 2 sets out the current subsidised irrigation price, and the non-subsidised (upper bound) price for each water supply scheme from these published fee schedules. It also shows that prices for WAE held by the Commonwealth Environmental Water Holder are set at the lower bound level of cost recovery.

Government does not provide the same subsidies to non-irrigation water users, such as industrial and local government users. Moreover, prices to non-irrigation users are not set through regulation, but through commercial negotiation. These negotiations often involve arrangements to transition non-irrigation customer prices towards upper bound, consistent with the NWI.

The result in many SunWater schemes is that different prices exist for the same service and priority WAE:

- between the irrigation sector and other sectors; and
- within the non-irrigation sector, depending on the outcomes of negotiated price paths.

Importantly, the pricing and subsidy arrangements are calculated on the basis of each sector meeting its own share of costs. That is, capital and operating costs are allocated based on methodologies and values set by the Queensland Competition Authority (QCA)⁵, which are indifferent to the 'purpose' of water use. The result is that price discrimination does not result in one sector paying more than its share of costs. Instead the subsidy and CSO from Queensland Governments makes up the difference between irrigation prices, and the share costs allocated to WAE's held by irrigators in each water supply scheme.

Finally, SunWater also has a number of pre-existing contracts with pre-determined prices. Some of these contracts and prices were set some time ago and will continue for many years.

SunWater's concerns and alternative proposals

SunWater is very concerned that the proposed amendments, without further exemptions, are inconsistent with the BWCOP. In particular, broad prohibition on price discrimination by purpose of water use would:

- frustrate the implementation of the Queensland Government's pricing policies, including its legitimate rights to provide CSOs and subsidies in accordance with the NWI; and
- mean SunWater would no longer be able to negotiate individual price paths with non-irrigation customers to smooth their transition to upper bound pricing.

The broad prohibition also puts SunWater in an impossible situation with pre-existing contracts.

SunWater submits that the Rules provide exemptions for the following categories of price discrimination:

- where different prices apply as a result of an IO complying with or passing through Government subsidies or CSO payments;
- where an IO has negotiated transitional prices towards upper bound cost recovery;
- price diversity arising from legacy contracts; and
- discounts offered by an IO under a 'prudent discount' framework.

⁵ Refer to the QCA's review of SunWater irrigation prices, which included approved cost allocation methodologies for capital and operating costs.

Each category is discussed below.

Price discrimination as result of Government CSO

SunWater submits that the Rules should exempt price discrimination that occurs as a result of an IO complying with or passing through Government subsidies or CSO payments, consistent with the BWCOP. In doing so, the Rules should distinguish between the function of Governments who provide CSOs, and IOs who are the recipients of CSO funds and perform certain actions in return. This distinction is important given the nature of the ACCC's concerns above, which were centred on the actions of IOs and not governments.

The BWCOP specifically require rural water prices to be transitioned to upper bound where practicable. Governments may decide that the practicable limit of price increases differs from sector to sector, or from user to user. The Rules should not prevent Governments making this judgement and transitioning prices accordingly through CSO / subsidy arrangements with an IO.

Also, from time to time Governments may decide to provide a CSO to reduce prices to irrigators in times of drought or low allocations. The Rules should not prevent Governments from applying this sort of targeted relief through CSO arrangements with IOs.

SunWater also notes the requirements under the BWCOP for CSOs to be made transparent.

SunWater accepts this might require:

- information on the 'upper bound' level of cost recovery to be published for each water supply scheme (refer Section B below);
- information revealing the Queensland Government's direction to SunWater to charge certain (lower) prices in accordance with its irrigation pricing policy; and
- information about the level of the subsidy, including CSO payments to SunWater and the gap to full cost (upper bound) prices that is foregone.

This approach would allow the current regime, illustrated in Figure 1, to continue.

SunWater's fees and charges schedules currently show irrigation and non-irrigation prices, as well as upper bound prices, to provide information to customers about cost recovery. This information is summarised in Appendix 2. SunWater accepts that the format and presentation of this information could be changed to better illustrate the amount of the effect of the Government's pricing policy and the amount of the subsidy. This could be implemented through amendments to Rule advice 5-E so that the schedule of charges includes information about CSOs and subsidies and how these have benefited customer prices.

The upper bound level of cost recovery would be based on SunWater's estimates (as is currently the case) or through a regulatory process. Section B below discusses the regulatory arrangements in more detail.

SunWater also notes the ACCC's proposed amendments to clarify the treatment of CSOs and, in Rule advice 5-P, which proposes to change Rule 29 as follows:

Rule 29(s) should be amended to more clearly take into account government subsidies and community service obligations, as well as revenue from sources other than regulated water charges. In particular, Rule 29(2) should require the regulator to be satisfied that the forecast revenue from infrastructure charges is reasonably likely to meet:

- *the prudent and efficient costs of providing infrastructure services; less*
- *any amount to be contributed by governments in relation to providing the infrastructure services.*

If SunWater were regulated under Part 6, then the proposed new Rule 29(2) would need to be modified to enable the above CSO reporting regime to be implemented. Specifically, the rule would need to require the regulator to be satisfied that revenues would not exceed, rather than be likely to meet, prudent and efficient costs, as it may be the IOs intention (or the IO may be directed) to not recover all its costs, including a full return on assets, from customers. A further amendment could be made to explicitly take account of any revenue that the IO intends to forego, along with government CSO contributions.

Price discrimination for pre-existing contracts

Rule Advice 5-X provides for an exemption for charges negotiated or arbitrated *under Part IIIA of the Competition and Consumer Act 2010* despite the non-discrimination provisions of the WCIR. The advice also suggests there should not be any general exemption for other 'commercially negotiated' infrastructure charges.

SunWater submits there should be an exemption for price diversity that occurs from pre-existing contracts, or other words these contracts should be 'grandfathered' into the new regime.

Without this exemption, IOs (including SunWater) will find themselves with an impossible choice between complying with either the WICR or their long-standing contracts when charging customers.

It would be highly irregular for the ACCC to apply regulation retrospectively and not honour the mutually agreed contractual arrangements already in place. For example, pre-existing contractual arrangements are effectively preserved under *Part IIIA of the Competition and Consumer Act 2010*.

SunWater suspects that the ACCC may simply not have included this exemption by way of oversight, as it is unconscionable that the ACCC deliberately intended to interfere with pre-existing, mutually agreed arrangements. If not, Appendix 3 has been provided to set out our concerns and arguments in more detail.

Price differences resulting from transitional price paths

SunWater submits that individually-negotiated transitional price paths towards upper bound cost recovery should be exempt. This is necessary to enable SunWater to transition non-irrigation customers to full cost (upper bound) recovery, consistent with the NWI and the BWCOP.

For example, some non-irrigation customers have contracted prices that are well below the upper bound target. As these contracts expire or allow for prices to be reviewed, SunWater usually negotiates a transition path with the customer rather than requiring an immediate increase to the upper bound price.

If the ACCC does not provide for this exemption, then customers would not get the opportunity to negotiate a transitional arrangement.

Discounts

The ACCC's proposed rules explicitly prohibit the IO from offering discounts. The ACCC's concerns appear to be that an IO will circumvent the price discrimination provisions through discounting.

SunWater does not agree that an IO should be prohibited from offering a discount where there are benefits to other customers from doing so. There are well-established regulatory frameworks for such 'prudent discounts' in the energy sector which provide for the business to provide discounts and recover the shortfall from other customers, provided all customers are better off. This helps the regulated business to manage bypass risk, and should give IOs the opportunity to pursue opportunities that would be lost if not for a discount.⁶

The ACCC will be familiar with the regulatory test for prudent discounts, and hence this is not examined in detail in this submission. However, the design of such a test under these Rules should be fit for purpose, and not overly-onerous for IOs to apply.

Summary – Price Discrimination

In relation to Rule Advice 5-A, 5-B and 5-C (as relevant), SunWater submits that:

1. The Rules should provide an exemption where prices are different as a result of implementing Government subsidy or CSO. Transparency can be provided through the schedule of charges (refer Rule advice 5-E).
2. The Rules should also exempt legacy contracts, negotiated transitional prices towards upper bound cost recovery, and discounts offered by an IO under a 'prudent discount' framework.

In relation to Rule advice 5-P, SunWater submits that the proposed Rule 29(2) is amended to require the regulator to be satisfied that the forecast revenue from infrastructure charges is reasonably likely to not exceed prudent and efficient costs, less any amount contributed by governments as a CSO payment or intended or required to be foregone by the IO, in relation to providing the infrastructure services.

⁶ Of course provided the discounted price was above incremental cost, thereby contributing to fixed costs.

B. APPLICATION OF PART 6

This section relates to Rule advice 5-M.

SunWater's schemes are currently regulated under Part 5 of the WCIR. The draft advice would see Part 5 removed, replaced by 'heavy handed' price regulation under existing state regulatory regimes. While not explicitly stated in the draft advice, SunWater understands that the QCA would not be eligible to regulate as it operates under recommendatory rather than deterministic powers for SunWater's charges. This would mean that Part 6 would apply by default.

SunWater is concerned this proposal will increase costs and regulatory burden for no apparent benefit, resulting in the ACCC being the regulator for around 1% of WAE in the MDB.

The proposed rules amendments also require that all infrastructure charges are determined by a state regulator in order for Part 6 to not apply. However, in Queensland only irrigation prices are determined through regulation, and prices to other sectors are negotiated with those customers with the aim of achieving upper bound cost recovery. If a dispute arises, then the QCA Ministers have the discretion to trigger a price investigation.

SunWater is concerned that the proposed Rules impose a change to the long-standing regulatory arrangements in Queensland, which allow for light-handed regulation of non-irrigation prices. The change would also constrain each state from implementing future regulatory reform towards more light-handed regulation, if a state chose to do so in the future.

These matters are set out below.

QCA as regulator

SunWater submits that the QCA should be eligible to undertake price regulation in accordance with the current regulatory arrangements that apply more broadly to SunWater under the *Queensland Competition Authority Act 1997* (the QCA Act).

Irrigation prices are currently regulated under the QCA Act throughout Queensland, including the MDB, as well as Part 5. This dual regulation has created complexity, duplication of effort and cost.

The ACCC quite rightly identified significant benefits transferring regulation to existing state-based regulators, in the draft advice:

The ACCC considers that it is appropriate that the Commonwealth's role be redirected away from determining an operator's overall revenue requirement (since this role can be performed just as effectively under state water management law) and toward providing consistent protections and promoting pricing transparency for customers....⁷

The ACCC considers that the gain in terms of decreased regulatory burden of these proposals would outweigh potential small increases in inconsistency in regulators' approaches to approvals and determinations.⁸

However, it appears ACCC has assessed that the additional costs from a recommendatory regime (compared to deterministic regime) outweigh the benefits from reducing regulatory burden. However, the ACCC has not set out the costs or the nature of the problem with a recommendatory regime in the draft advice.

⁷ ACCC (2015). p96

⁸ ACCC (2015). p98

There is no evidence that the existing recommendatory regime is dysfunctional or leading to improper outcomes. The QCA Ministers have largely accepted the QCA's recommendations for prices in past water reviews. For the last SunWater review, the QCA Ministers accepted all recommendations, including prices in MDB schemes (Appendix 4 provides more background).

The costs of the ACCC regulating under Part 6 will be significant, and the ACCC would need to retain resources and organisational capacity to carry out these reviews for only 1% of Basin WAE.⁹ The assets and services are very small, and currently involve less than \$10M in revenue per annum.

By taking over the regulatory function, the ACCC would duplicate the resources and capacity already held at the QCA, which has had the task of reviewing irrigation prices throughout Queensland. Hence the ACCC would create significant diseconomies of scale in regulation, taking away the scale economies from the QCA.

SunWater submits the WCIR should be amended to allow for prices to be set under the existing QCA Act, including approval of prices by the QCA Ministers following recommendations by the QCA.

Determination of all infrastructure charges

The current light-handed regulation of non-irrigation prices in Queensland has proven to be workable, enabling SunWater and commercial and local government customers to bi-laterally negotiate transition paths to upper bound cost recovery. Each transition path is different, depending on the individual circumstances and impacts

The ACCC should not seek to impose heavy handed regulation through the WCIR, when light handed regulation has been effective and remains the Queensland Government's preferred approach. This is not to say that light-handed regulation would continue for ever. Indeed the Queensland Government has chosen to regulate prices to non-irrigators for other bulk water businesses, such as Seqwater and the Gladstone Area Water Board. However a decision to move to a heavy-handed regime for some or all of SunWater's non-irrigation prices should continue to be at the discretion of the Queensland Government.

More broadly, the proposed rule amendment effectively locks-in heavy handed regulation across the Basin, and prevents all state governments from moving to more light handed regulation of any prices into the future. The WCIR should instead allow for regulatory arrangement to evolve and provide for innovation and change in how regulation is applied in each state. For example, the Essential Services Commission has already started a process to review price regulation of water authorities in Victoria. The WCIR should not create barriers to these processes.

Instead, the Rules should only provide for Part 6 to apply as a true stop-gap, where there are no mechanisms in place (either heavy or light handed) for price regulation. For SunWater, the declaration of its schemes as government monopoly business activities under the QCA Act, which enables the QCA Ministers to apply price regulation if needed, should be acceptable grounds for Part 6 not needing to apply.

There may be some merit in upper bound prices being established at the next regulatory review¹⁰ to inform negotiations with non-irrigation users, and enhance transparency about the amount of subsidy applicable to irrigation prices.

⁹ Under this proposal, it appears Queensland is likely to be the only Basin State that would be regulated by the ACCC.

¹⁰ That is, at the next review of irrigation prices – see Section C below.

However, state governments should have discretion about how to calculate these subsidies, particularly given the amount of CSO and subsidy is usually negotiated between government and service provider. A regulatory determination of the upper bound or maximum price/revenue simply to value the subsidy would create additional regulatory effort and cost, for little practical benefit for irrigators as they will continue to pay the subsidised prices regardless.

Exemption of pre-existing prices

The draft Rule 23 broadly refers to all infrastructure charges, but does not seem to consider prices that are already set in contracts. Therefore a strict interpretation is that Part 6 regulation would apply if prices continued as per pre-existing contracts, rather than a regulatory determination. As set out above, the Rules should honour and preserve prices under pre-existing contracts.

For clarity, prices in pre-existing contracts should be exempt. Appendix 3 provides further arguments.

Summary – Part 6 Regulation

In relation to Rule Advice 5-M SunWater submits that the current state-based regulation should be allowed to continue, rather than Part 6. Specifically:

1. The QCA should be eligible to undertake price regulation in accordance with the current regulatory arrangements that apply more broadly to SunWater under the *Queensland Competition Authority Act 1997*. There is no evidence that the current arrangements are dysfunctional or leading to improper outcomes. The cost and regulatory burden ACCC regulation under Part 6 for only 1% of the MDB is disproportionate to the concern about recommendatory powers.
2. The WCIR should not operate to impose heavy handed regulation (as exists under Part 6) when a State Government prefers lighter-handed regulation where regulators do not determine prices. Instead, the proposed Rule 23 should be redrafted so that an IO is only a Part 6 operator if it operates outside an existing State-based regulatory regime, without specifying the form or style of that regime.
3. Part 6 should not be triggered because some or all of an IOs prices already exist under pre-existing contracts, and would therefore not be subject to price determinations. Furthermore, if Part 6 did apply, then there should be specific carve outs that allow prices in pre-existing contracts to continue.

C. TRANSITIONAL ARRANGEMENTS AND OTHER ISSUES

This section sets out issues for the ACCC to consider in transitioning to the proposed arrangements under the revised WCIR.

Existing Queensland Government Price Paths

The transitional arrangements should preserve prices that have already been set for an IO and defer any regulatory process until such time as those prices are scheduled to be reviewed.

Schedule 2, Section 1 – Determination of regulatory asset base

Schedule 2 of the proposed WCIR provides for the regulatory asset base (RAB) to be either preserved, if already set, or if not a new RAB be determined according to a recognised valuation methodology.

Despite the above submission that the QCA regulates prices rather than the ACCC under Part 6, SunWater is concerned that this schedule needs to be stated in more precise terms.

Schedule 2 states that if an operator's charges were previously determined by an agency of a State under State law, then the RAB is to be set at the value of the operator's assets at the beginning of the preceding period. For SunWater, prices have arguably already been set by a State agency (e.g. the QCA Ministers) in the form of the current irrigation price paths. However, the QCA did not determine a RAB, and in fact was directed to not calculate a RAB (see Appendix 4). This should not be interpreted to mean that a RAB of \$0 applies, or should be applied in any initial regulation of SunWater's prices under Part 6. Rather, SunWater's RAB should be determined in accordance with item (b) of Schedule 2, which requires a new RAB be set using a recognised valuation methodology.

Consequently, SunWater submits that Schedule 2, item (a) should be amended to read:

- a) *In the case of an operator whose ~~fees and charges~~ regulatory asset base was determined by an agency of a State under a law of the State in respect of the period immediately before the first Part 6 period (preceding period), is to be determined in accordance with the following formula ...*

Summary – Transitional Arrangements and other issues

SunWater submits that:

1. Transitional arrangements should preserve prices that have already been set for an IO, until such time as those prices are scheduled to be reviewed.
2. Schedule 2, Section 1 should be amended to clarify the intent for a RAB to be preserved and carried forward where the RAB value had been previously determined, rather than where prices had been previously determined.

APPENDIX 1. Queensland Government irrigation pricing policy

The Queensland Government has set a long-standing pricing policy for the irrigation sector, which can be summarised as follows:

- Prices should recover, as a minimum, the lower bound costs of supply.
- If prices are below this level, then they are to be transitioned to lower bound cost recovery under a price path. Government provides SunWater with a Community Service Obligation (CSO) payment for the shortfall to lower bound costs.
- Where prices are above that required for lower bound cost recovery, prices are to remain in real terms and not transition further towards upper bound. Government does not provide a cash CSO to SunWater for the difference between these prices and those that SunWater would otherwise be able to charge (i.e. up to the 'upper bound' level of cost recovery including a return on pre-existing assets).

An illustration is provided below.

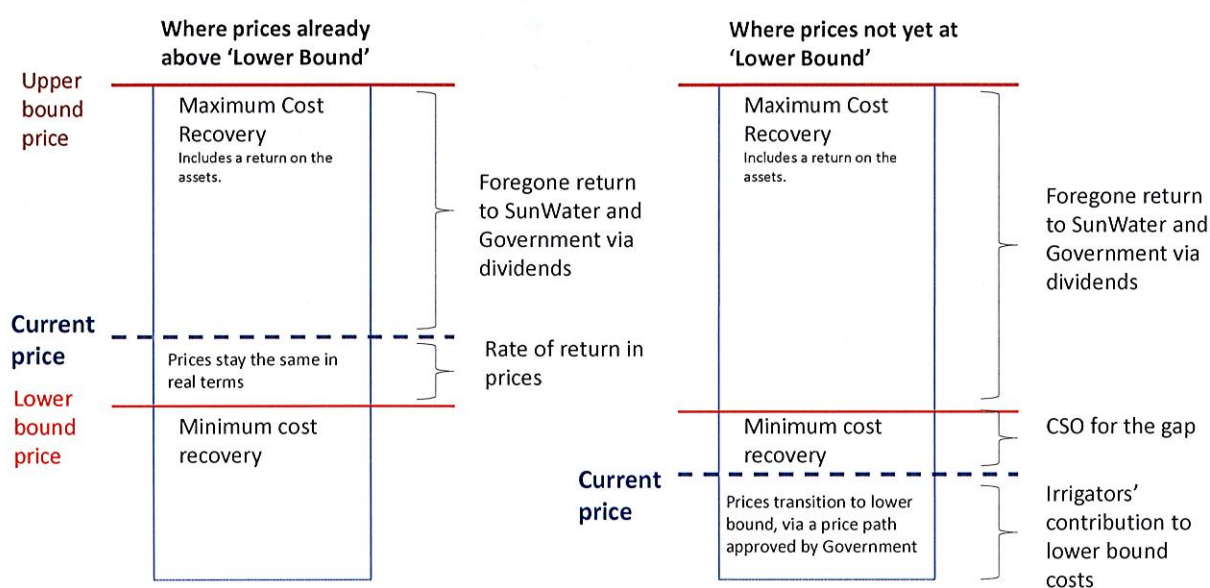


Figure A1 -1: Irrigation pricing arrangement in Queensland

There are no Government policy restrictions on SunWater's charges outside the irrigation sector. Consequently, SunWater has sought to transition non-irrigation prices towards the upper bound level of cost recovery where contractual terms allow. In doing so, SunWater often negotiates transitional arrangements with customers to avoid price shocks and allow time for customers to adjust.

Appendix 2. Current prices

The table below shows the upper bound prices and irrigation prices as published in SunWater's fees and charges schedules for 2015/16.

The Government's subsidy for irrigation prices is represented between the difference between the upper bound medium priority charge and the irrigation medium priority charge set by Government. For completeness, high priority charges are also published.

The upper bound prices are SunWater's calculations.

Table A2-1. Published tariffs – on-river services.

Scheme	High Priority Upper bound price \$/ML		Medium Priority Upper bound price \$/ML		Medium Priority Irrigation price \$/ML	
	Fixed	Consumption	Fixed	Consumption	Fixed	Consumption
Chinchilla Weir	793.01	3.11	54.49	3.11	27.32	3.13
Cunnamulla	NA	NA	194.65	3.22	28.77	3.24
Macintyre Brook	505.78	4.09	252.59	4.09	40.69	4.11
Maranoa River	NA	NA	1,405.73	58.42	48.16	58.89
St George	NA	NA	103.88	1.24	19.85	1.25
Upper Condamine	448.77	9.12	150.60	9.12	43.16	13.77

Notes: in some schemes no high priority WAE exists. Where there are multiple tariff groups, such as for Upper Condamine, only the main tariff has been shown for illustrative purposes.

SunWater also publishes prices for specific customers or types of customers in each scheme. The table below provides a summary explanation of specific prices that apply in each scheme, and shows that most non-irrigation prices are still be transitioned to upper bound cost recovery. In some cases this might involve a very long transitional period.

Table A2 -2. Non-irrigation prices.

Scheme	Non-irrigation customer type and price (\$/ML)	Explanation
Chinchilla Weir	Commercial (high priority) Fixed: 165.18 Consumption: 17.88	Negotiated charge under contract, transition to upper bound.
	Local government (high priority) Fixed: 66.61 Consumption: 3.12	Negotiated charge under contract, transition to upper bound.
Cunnamulla	Nil	NA
Macintyre Brook	Commonwealth Environmental Water Holder (medium priority) Fixed \$44.04 Consumption: \$4.11	Charges are set to recover the QCA's recommended lower bound costs for medium priority. This is slightly (\$4) above that paid by irrigators, who are still transitioning to lower bound cost recovery.
	Commercial (high priority) Fixed: \$246.48 Consumption: \$9.46	Negotiated charge under contract, transition to upper bound.
	Local Government (high priority) Fixed: \$271.75 Consumption: \$18.75	Negotiated charge under contract, transition to upper bound.
	Treated Reticulation Service: Fixed: 644.48	Charge was previously for customers receiving a treated water service. The service is no longer offered.
Maranoa River	No non-irrigation users.	NA
St George	Local Government (medium priority) Fixed: \$73.24 Consumption: \$1.25	Negotiated charge under contract, transition to upper bound.
Upper Condamine	Local Government (high priority) Fixed: 448.77 Variable: 9.12	Negotiated charge under contract, at upper bound.

Appendix 3. Detailed submission on grandfathering pre-existing contracts

Like all infrastructure operators, SunWater has a significant number of existing contracts. Those contracts were entered on the basis of a stable State based regulatory regime, and both SunWater and its customers will have made investment decisions on the basis of that understanding of how the contract would operate into the future. Neither SunWater or its customers could have anticipated the dramatic changes that are now being proposed.

It is conventional practice to honour or grandfather pre-existing contracts when implementing new regulation. For example:

1. the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth) allows parties to contracts that may be affected by the operation of the new regime to continue under their existing contracts, and will only apply to contracts that exist at the date of commencement if the terms are varied or the contracts are renewed after the date of commencement; and
2. the ACCC is not empowered to make an access determination under Part IIIA of the *Competition and Consumer Act 2010* (Cth) which has the effect of depriving any person of a protected contractual right (s 44W(1)(c)) – being a right under a contract that was in force at the beginning of 30 March 1995.

In light of that past precedent in relation to how other statutory intrusions on contract law have been introduced, it would be more appropriate to allow contracts that are presently on foot to continue until their reasonable conclusion, at which point new contracts could be drafted that incorporate terms consistent with the requirements of the Amended Act.

In particular, SunWater considers that excluding existing contracts from the scope of the non-discrimination provisions (and Part 6, to the extent applicable) would be appropriate given the circumstances, as it would prevent legislative change from disrupting the commercial and financial planning of SunWater's water infrastructure users. G

Transitional provisions

The inclusion of some transitional periods in the drafting of the Water Charge Rules also recognises the inherent difficulty in regulating contracts entered into by infrastructure operators and users of infrastructure service where those contracts are already on foot, and specific prices have been agreed by the parties.

The transitional provisions in Part 6 of the *Water Charges Rules 2010* (Cth) (the **Act**) contemplated the need for temporary continuation of existing charges with respect to infrastructure operators who became Part 6 Operators upon the commencement of the Act. The proposed amendments to the Act (the **Amended Act**) similarly contain some limited transitional provisions for operators who will become Part 6 Operators for the purpose of the Water Charge Rules. Part 3 of the Act provided that the prohibitions against price-discrimination did not come into effect until the end of the transitional period.¹¹ However, contrary to that past practice, the Amended Act does not contain a transitional period for the implementation of the non-discrimination requirements.

While SunWater, considers that grandfathering of existing contracts is clearly a more appropriate result, a long transitional period in which to allow SunWater and customers to adjust to a new pricing regime is the very minimum that should be provided for.

¹¹ *Water Charge (Infrastructure) Rules 2010* (Cth), section 10.

Appendix 4. SunWater's existing price regulation

SunWater is currently subject to regulation under the *Water Act 2007*, and specifically Part 5 of the Water Charge (Infrastructure) Rules (WCIR). SunWater provides pricing and other information according to the Part 5 requirements.

SunWater's MDB water supply schemes and the St George Distribution System are also declared as government-owned monopoly business activities under Section 19 of the *Queensland Competition Authority Act 1997* (the QCA Act).

Irrigation prices

In 2011, the Queensland Competition Authority (QCA) was directed by the QCA Ministers under Section 23 of the QCA Act to review and recommend prices for irrigators in SunWater's water supply schemes and distribution systems, from 1 July 2012 to 30 June, 2017. In essence, the QCA was directed to:

- recommend efficient lower bound costs and prices;
- recommend price paths in schemes where irrigation prices needed to increase to meet the efficient lower bound cost base; and
- not consider the Regulatory Asset Base (RAB) for irrigation assets prior to 1 July, 2012, consistent with the Government's pricing policy for rural irrigation water (refer above).

The QCA Act involves recommendatory, rather than deterministic powers for the QCA. In the above review, the QCA Ministers accepted the QCA's recommendations, advising the QCA that:¹²

We have accepted, without qualification, the specific prices, fees and charges recommended by the Authority.

SunWater's shareholding ministers are then responsible for directing SunWater to adopt those prices. SunWater enters into a CSO Agreement with the Queensland Government to meet the shortfall between irrigation prices and lower bound costs, in relevant schemes. The QCA's recommended efficient lower bound costs are used as the benchmark for the CSO.

A small CSO applies in only one MDB scheme, Macintyre Brook. Irrigation prices in the other schemes have prices at or above the QCA's efficient lower bound costs. A CSO also applies in the St George Distribution System.

Non-irrigation prices

The QCA Ministers have the discretion to request the QCA to undertake pricing investigations for non-irrigation prices, where they believe there is a need to do so. In practical terms, this is most likely to occur in response to a pricing dispute between SunWater and its non-irrigation customers. Hence SunWater must negotiate prices with non-irrigation users under the threat of potential regulation.

¹² Letter from Responsible Ministers for Queensland Competition Authority to Professor Brian Parmenter, Chairman of the QCA (30 June, 2012). This letter can be found at: <http://www.qca.org.au/getattachment/e073257c-76c1-4e8d-b358-3b716669fed1/Ministers-Decision-SunWater-Irrigation-Prices.aspx>

