

# Theodore LMA Business Proposal Summary

## A critical need...

## An ambitious agenda for Theodore

**Our Vision: To develop Theodore's irrigation channel scheme so that customers realise the maximum possible value from the surrounding land and water through a simple system and efficient service that meets its delivery standards.**

### **A Critical Need...**

This business proposal from the Theodore LMA Interim Board for local management has been 81 years in the making. 1933 was the year of the first State-lead inquiry and resulting plan which recognised deficiencies of the Theodore Irrigation Scheme. Plans were devised again in 1949/50, 2001, 2004, 2010, and 2012. Eighty-one years and six plans later, little has been materially achieved to remedy the design constraints that are choking an area which boasts the low inter-annual variability of high quality irrigation water and productive black vertosol soils in Australia.

Proudly, Theodore is the oldest Scheme in Queensland but it is just making do with aged, outdated, and inefficient infrastructure.

Physical constraints on the infrastructure are amplified by Government ownership and centralised management of Queensland channel schemes. This state-wide approach cannot fully understand or foster Theodore's unique small scheme characteristics so it can realise its full potential. Under the current Government, the Community Service Obligation payment (CSO) paid annually to subsidise the Scheme's losses is approximately \$500,000. The Interim Board believes that under SunWater management this will continue to climb. We recognise that this level of subsidy is unsustainable; we also strongly believe that should the Government move towards full cost recovery with the existing Scheme inefficiencies, customers will become unviable.

Theodore already has the highest water cost per Megalitre of any distribution scheme in Australia supplying water for cotton. This is not sustainable for anyone – Government, customers, or our community.

### **...An Ambitious Agenda**

The Interim Board in consultation with scheme customers and the community has developed a clear way forward. Although this agenda is ambitious, it is achievable and absolutely necessary to secure a strong future for Theodore.

Modernisation is at the heart of the agenda. It is critical to the short-term and long-term viability of the Theodore Irrigation Scheme. Some critical assets are old – some approaching 80 years. The ageing pumps, pipeline and flume operational parameters have changed so significantly that assets are incapable of being operated efficiently. The pumps rely on staff with a highly specialised skill set to maintain their operations, and require very expensive custom repairs. All are

operating well beyond industry benchmarks for pumping best practice. All have significant and documented work place health and safety non-compliances.

**The modernisation proposed for this scheme is not a wish-list; it comprises only the essential investment required to ensure its critical assets are 'fit-for-purpose' for the cost-effective operation of the scheme.**

The Theodore Interim Board proposes the establishment of a not-for-profit, customer-owned and locally-managed entity (LME) and is requesting from Government funds to ensure:

- Upfront repair of assets identified as immediate priority by engineers SKM. This includes an amount for complete replacement of the most critical infrastructure assets in the Scheme (the Theodore Pump Station and rising main and the Gibber Gonyah pump station and bench flume);
- Contract employment of a specialized project manager during modernisation; working capital requirements; and net present value of financial operating losses until modernization is completed and cost-reflective pricing is instigated;
- Mitigation of any disadvantage to Theodore by zeroing positive renewals balance; and
- Entitlements of existing staff on transfer are covered.

Our proposal has been prepared on the basis of best available data and advice to date. Note that between the time of submission of the proposals and the final transaction, information will change.

## **What does this investment deliver to the Queensland Government, Scheme customers, and the Dawson Valley community?**

With sufficient separation payment from the Queensland Government and implementation of the planned modernisation program, a Theodore LME will be financially sustainable into the future. Under our business proposal:

- The business would operate in surplus, with no Government contribution required from 2020
- Modernisation of the critical assets of the Scheme conservatively reduces annual electricity costs from 2020 by 37%, and Scheme operating and administration, and corrective and preventive maintenance costs by 48%
- Accurate measurement of water delivery would continually drive system performance and business accountability
- The scheme would be a safe environment in which to operate
- The ability to deliver water on demand would potentially increase the Gross Value of Production (GVP) by more than 50% on current value, and allowing full use of Beneficial Water in the Dawson supplemented system
- A viable Theodore LME would underpin and secure cotton production and the Queensland Cotton processing facilities, servicing all irrigators in the Dawson and Callide Valleys
- A Scheme with capacity to meet future needs.

## **What does local management for Theodore look like?**

The Theodore LME needs the right strategy, underpinned by the right structure, run by the right people to get the job done.

It is proposed that the Theodore LME be established as a company limited by shares, owned by the local customers. This corporate structure places it on sound commercial footing with other modern, best-practice businesses. Each customer will be issued shares based on their water allocation. As owners, and shareholders they will have rights under the Corporations Act (2001) to have their say in the how the company is managed and as customers through participation in a stakeholder advisory group.

In developing the corporate structure, appropriate safeguards of shareholders' rights have been recommended. This will ensure the Theodore LME has strong representative ownership that can be retained into the future.

A skills-based Board will consist of two Scheme customers and up to three independent directors. Directors will be recommended by an independent selection committee and ratified by shareholders at the Annual General Meeting. This approach ensures leadership and governance of the business will be based on the skills needed, with the right balance of local knowledge and independent insight.

Bedding down the new business model and modernising the scheme will be critically important in the first five years of the Theodore LME. This will require staff with local knowledge of the scheme and the expertise to establish a new business in addition to managing the modernisation program. To that end, existing SunWater staff will be invited to join the Theodore LME, and an Executive Project Manager will be contracted to deliver the Theodore LME's modernisation plan.

## **Proposed Corporate Form and governance structure**

The Theodore Interim Board has recommended that the irrigation entity be established as a company limited by shares incorporated under the *Corporations Act (2001)*. It is to be not-for-profit organisation that retains surplus to fund a program of renewal and asset investment.

A summary of the Interim Board's consideration of its preferred corporate form, including the provisions in the Constitution that provide for protection of scheme assets and minority shareholders, are summarised in the attached table.

Following the Interim Board's extensive consultation on corporate form, a legal review has raised concerns about the impact of tax as it applies to the transfer of shares to irrigators. We are awaiting further detailed tax advice and may need to adjust the share allocation process or opt for a company limited by guarantee, to ensure the corporate form achieves the desired purpose and provides the most tax effective option for irrigators.

## **Assets and equipment**

It is proposed that if Government agrees to Theodore's proposal for local management that the assets of the channel irrigation scheme will be transferred at zero cost, together with a separation payment which will set up the Theodore LME to provide for the ongoing financial sustainability of the Scheme.

The Theodore Distribution System core assets to be transferred include:

- Theodore pump station on the right bank of the Dawson River
- Gibber Gonyah Pump Station on the left bank of the Dawson River
- Channel and pipeline network and associated structures including road crossings, siphons, levee banks, inlet and outlet structures, channel overflows, air valves, scours and water meters
- Drains and associated structures including road crossings, siphons, inlet and outlet structures and levee banks
- 3 houses and the depot complex at 1 Second Avenue.

The distribution assets do not include headwork infrastructure items such as Theodore Weir, which as bulk water assets will continue to be owned and operated by SunWater.

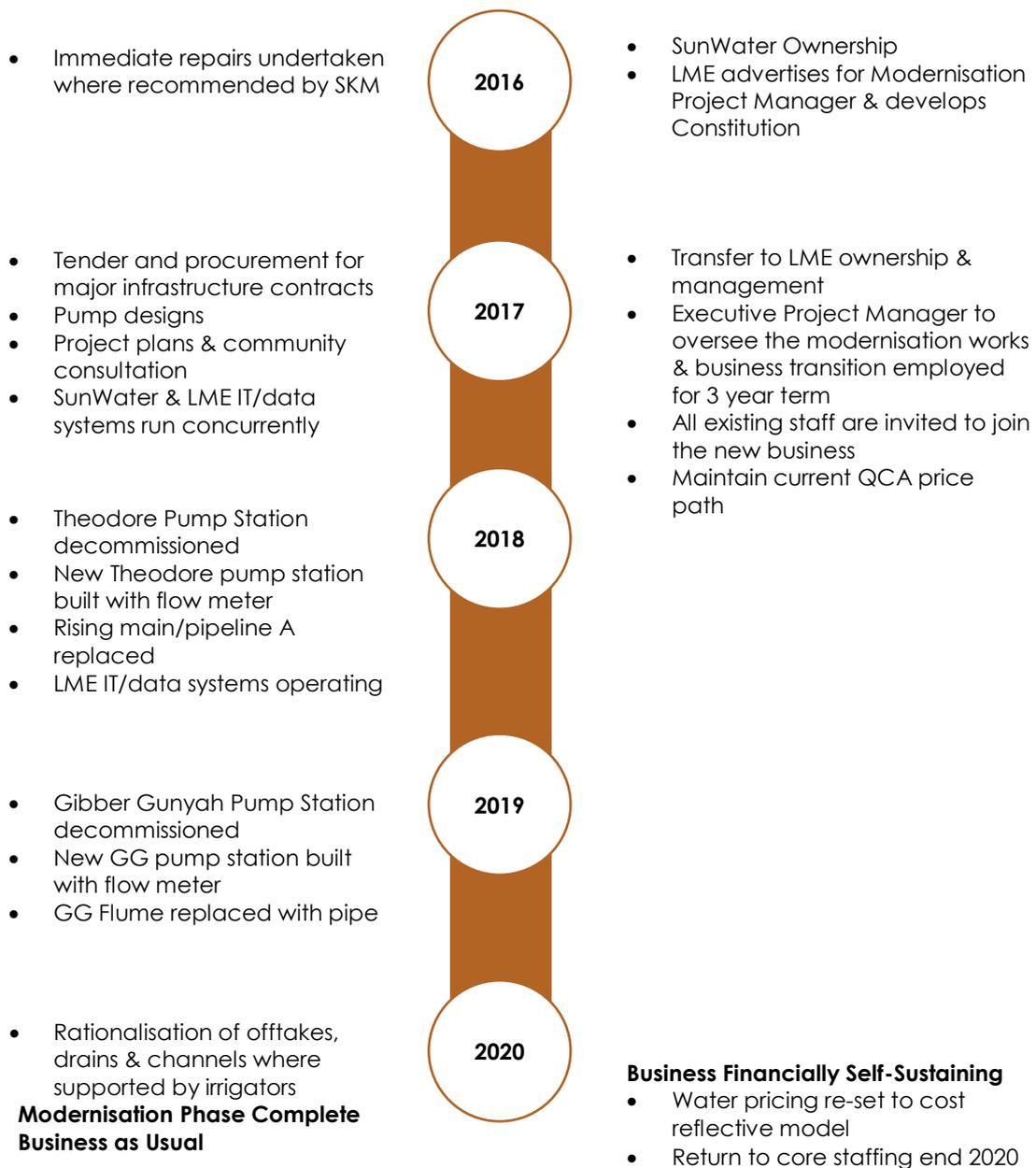
An independent engineering due diligence of the scheme has been conducted by consulting firm SKM. The due diligence confirmed that both pumps, the rising main and the Gibber Gonyah flume need immediate replacement, along with other repairs. SKM's estimate for capital expenditure requirements has been adopted by the Interim Board and included as an input in the financial modelling of the Scheme costs over the next 30 years.

## A plan for modernisation that won't sit on the shelf

The Theodore Channel System was originally designed and built in the 1920s with expansion of the area in the 1950s. Since its construction, changes to crop types, irrigation patterns, licencing conditions and planned infrastructure have resulted in the system being operated very differently from its original design criteria. Accordingly, much of the critical infrastructure's operational parameters have changed so significantly that they are incapable of being operated as required, or at their best efficiency point.

Modernisation is needed to bring current critical assets to a state where they are fit-for-purpose, safe, and to reduce rising costs in the Scheme.

The Theodore Interim Board has identified the following key milestones and timeframe for its modernisation plan as outlined in the diagram below:



Proposed increases in efficiency and value centre on three key strategies:

- Establishing a distribution system which is fit-for-purpose by immediately repairing assets as identified and replacing current infrastructure with assets, the design parameters of which meet current and projected demands
- Reducing operating and maintenance costs by rationalising channels, drains and offtakes where customers are supportive, and
- Increasing value for customers by removing Scheme constraints so that they can optimise on-farm production and grow wealth.

These strategies are interconnected and do not, in any way, stand-alone. For the Theodore LME, viability relies on adequate revenue, careful management of costs and ensuring capital investment in future asset replacement, refurbishment and maintenance.

## **What is the alternative to local management?**

The LMA Interim Board believes that the future will be more certain under local management.

Should local management not proceed our key concerns are:

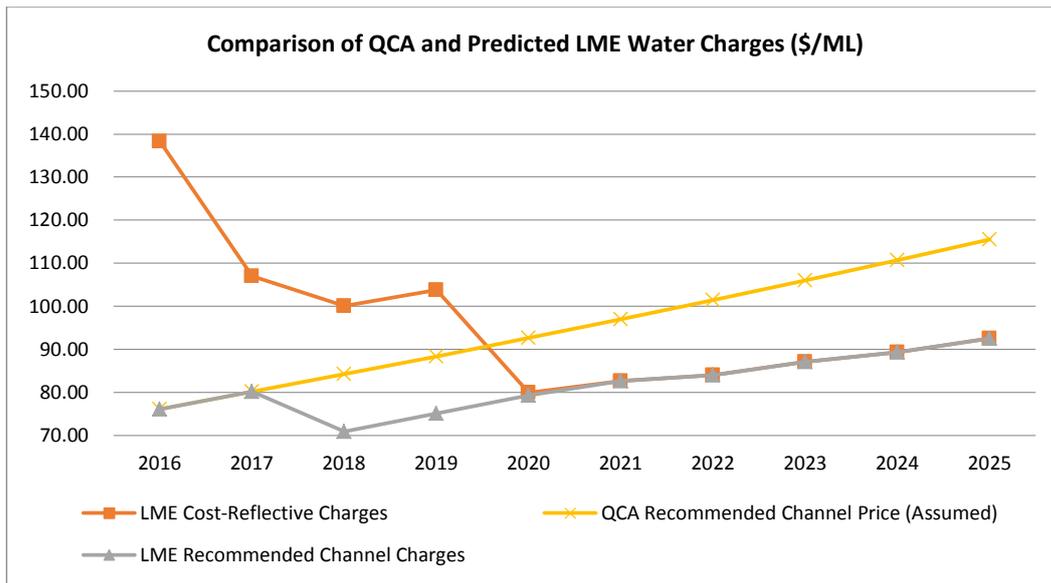
- Critical assets will fail – as happened last season – potentially causing interruption to water delivery that causes crop failure
- Aged equipment causes increasing delays in delivery of water; costly and unplanned repairs to equipment; increased leakages and losses in the system which in turn increase cost of supply
- Accident or injury to local staff

We think that modernisation under SunWater is unlikely to ever be achieved. Until the LMA process was instigated, the major works identified for the Scheme in the last financial year were comprised solely of safety fencing. Now that the LMA process has been instigated and third party scrutiny applied to the state of the Scheme assets, the 2015 Network Service Plan indicates that SunWater may replace components of the Gibber Gunyah Pump Station in 2015 and is considering refurbishing the Theodore Pump Station in the next decade. It also shows that SunWater's budgeting is above the QCA target for 2015. We leave it to your experience to judge whether modernisation and cost reductions under SunWater are likely.

Partial modernisation will not produce the significant cost reductions needed to ensure the Scheme can operate efficiently. This month the Queensland Competition Authority has been asked to review Queensland Government industry assistance measures – this includes the CSO paid to the Theodore Scheme. Should Government remove or reduce the CSO paid to the Scheme, SunWater will pass the additional cost of running the Scheme directly back to customers. Does a Brisbane based government-owned-corporation have the motivation or incentive to reduce costs and the price of water should local management not proceed? The result of Scheme customers becoming unviable will seriously impact the Theodore community, the wider cotton industry and the region.

## **Pricing strategy**

Part of the separation payment requested in the Theodore Business Proposal allows the new business to maintain the current QCA price path until 2020 and from that point move toward cost-reflective pricing. The significant investment in infrastructure assets will result in cost efficiencies that mean that the Theodore LME will no longer be financially dependent on the State and achieve cost-reflective pricing for irrigators in 2020 (as shown in the diagram).



### Proposed transition date

Business Proposals will be submitted to Government by the Independent Chair of the LMA project at the end of June 2014. If supported by Government, Stage 3 implementation of local management arrangements will proceed targeting 1 July 2015 as the establishment date of the new entity. SunWater will continue to operate scheme until such time that local management has been fully implemented.

### The time to act is now

The last thing irrigators want is another unrealised plan. The Scheme cannot sustain continuous, unchecked price increases matched with decreasing performance and reliability of supply.

The Theodore LMA Interim Board will make local management and modernisation happen. The irrigation and wider community have told us they want certainty for Theodore. Let us all revitalise Queensland's oldest scheme to turn it into something that pays it way and proudly generates wealth for Theodore and the State.

**This is the time and the opportunity for lasting change. Please vote to support local management on April 29<sup>th</sup>, 6.00pm at the Theodore Hotel.**

# Commonly Asked Questions

## **Q: If local management goes ahead, can the new organisation reduce or take away my water?**

A: No. Regardless of size, your water allocation is covered by a legal contract which is regulated by the Queensland Government Department of Natural Resources and Mines, and would be unchanged by any move to local management. All allocation holders also hold Supply Contracts which ensure that water is delivered to a written standard. This means that the channel system cannot be shut down for periods longer than specified in that contract. The Theodore Interim Board have requested to transfer these contracts over unchanged, should local management go ahead.

## **Q: Part A, B, C, D water charges – what does this all mean?**

A: A & C are what are considered the fixed costs of running the scheme. Sometimes these are referred to as just Part A tariffs. These costs include staff salaries, rates and vehicles. B & D water charges are considered variable costs – so they change. These include insurance, electricity pumping costs, and some maintenance.

## **Q: What is bulk water?**

A: For water users in the channel system, there are two components of the water costs to keep in mind. Bulk water is the water that SunWater supplies from the River that is delivered by the channel system. Allocation holders pay for bulk water plus the cost of delivery of that water through the channel infrastructure. A new entity will be able to manage the delivery costs but does not control the bulk cost and must pass this on. The cost of the bulk water component of the price is uncertain after the QCA price path ends in 2016-17. A new entity will not be able to control this cost but may have the ability to negotiate strongly should the price path not be reinstated after this time. Table 1 provides a breakdown of bulk and channel charges as a percentage of the Part A, B, C and D charges.

Water Charge	Based On:
Part A - Fixed Charge – Bulk	Based on fixed bulk costs e.g. 93% bulk revenue
Part B – Variable Charge - Bulk	Based on variable bulk costs e.g. 7% of bulk revenue
Part C - Fixed Charge – Channel	Fixed channel costs e.g. 65-85% channel revenue
Part D – Variable Charge – Channel	Variable channel costs e.g. 15-35% of channel revenue (electricity and some maintenance)

## **Q: If local management goes ahead, will the price of water go up?**

A: The Interim Board aims to maintain the price of water according to the current Queensland Competition Authority price path. When the business makes a profit that is over what is required to maintain the Scheme we intend to use that profit to keep delivery costs down. We have no crystal ball to predict things like insurance and electricity price rises and SunWater's bulk water costs in the future. A new entity will be committed to managing the Scheme as efficiently as possible because its success will be dependent on the financial viability of its customers. If local management does not go ahead, the Interim Board believes the risk is very high of substantial price hikes after the current price path ends in 2016-17.

**Q: I am worried that the new entity must be run as a business – will irrigator directors on the Board be able to over-service commercial irrigators?**

A: No. The Interim Board is proposing a skills-based board of 5 directors, including the Chair, to run the business. We had suggested a minimum of 2 allocation holders (shareholders) to ensure that there was some experience of the Scheme operations to inform strategic decision making. These could be allocation holders of any size. A new Board would require other independent directors with corporate governance, accounting and legal skills to bring to the business. While a constitution will not be drafted in Phase 2, the Board have discussed the use of an independent Selection Committee to review and recommend potential board nominees at AGMs, as is commonly done in other organisations to ensure the needed skills are present on a Board. It is also important to note that legally any director on a Board must make decisions in the best interest of the company not themselves. We will keep considering this one, mindful of all of your feedback.

**Q: There are lots of smaller allocation holders – can they vote in a way that undermines the financial survival of the commercial irrigators?**

**Q: The commercial irrigators hold most of the allocation – can they vote to unfairly disadvantage the smaller water holders?**

A: The answer to both questions is No. The Theodore scheme (like many other Schemes) is characterised by most of the total allocation being held by less than half the number of people. The Board have actively worked through a number of options to ensure that all allocation holders will have a say in a new entity.

- Firstly, it is just simple common sense that being a shareholder in the company that owns and manages the channel scheme, will provide all water allocation holders more opportunity to have a say in their local scheme than they do now with a Brisbane-based Government owned corporation.
- Secondly we have suggested that for matters of special consideration - over and above those required by law - such as major expenditure or sales of assets of a certain value, will be further protected constitutionally by requiring a vote and 75 per cent support from all shareholders.
- Other than these types of critical decisions above, the types of items that are generally voted on at meetings are the appointment of auditor, appointment of board members (who will be skill-based and likely nominated by an external committee), and the acceptance of financial statements. We do not believe that matters such as any future changes to the price of water should be voted on by shareholders.
- We suggest operational advice about the Scheme will be provided from a Shareholder Advisory Group which would include customers from each section of the scheme, including smaller water users.

The breakdown of amount of water held and the number of people with allocations is what it is. We do not believe that there is any one silver bullet that will solve all corporate form and voting concerns. We do believe that a company limited by shares, accompanied by constitutional safeguards, will protect the Scheme assets, is simple and effective, limits liability of its shareholders, and will provide the framework to run an efficient and sustainable business for all allocation holders.

**Q: When SunWater centralised much of their services in Brisbane we felt we lost some of the benefits locally – what is planned for services under local management?**

A: The Interim Board will be looking to partner with local businesses in Theodore and the region to undertake many of the services that had been moved elsewhere. These might include accounting, GIS systems and secretarial services among others. We hope that this will be part of the flow-on benefits for businesses in town.

**Q: Will a new entity be more transparent than SunWater in their reporting?**

A: Yes on two fronts. Firstly our books will be simpler, given they are for a single entity, and shareholders will be provided with full financial statements and an Annual Report, just like normal companies. The AGM would also provide shareholders the opportunity to ask detailed questions on the books and performance of the Scheme. Secondly, the Interim Board are working out what are the key performance measures that will drive the success of the Scheme and how we can build in ongoing monitoring that will provide the organisation and shareholders with this information. Some of this monitoring will cost money (for example gauges to measure individual pump efficiencies \$/ML) and may depend on the amount of the negotiated separation payment.

**Q: I'm a small allocation holder and receiving bills quarterly is annoying. Can I get single annual bill?**

A: Maybe! In this current Phase (2) we will not have the opportunity to make specific decisions on operational matters. However, customer service will be key for a new business to prosper and support allocation holders, so we will be seeking feedback and collecting your ideas to discuss when we get an idea of Government support or otherwise to continue.

## Theodore Channel System Local Management Arrangements: Proposed Corporate Form & Governance

<b>Corporate Form</b>	A company limited by shares incorporated under the Corporations Act (Cth).
<b>Profit/Not for Profit</b>	Not for profit purposes with all surplus funds to be retained in the business.
<b>Assumptions underpinning proposed approach</b>	<ul style="list-style-type: none"> <li>• Under this corporate structure depreciation is allowable.</li> <li>• A large amount of unused tax depreciation benefits will be available to the company on the existing assets.</li> </ul>
<b>Share Capital</b>	<ul style="list-style-type: none"> <li>• Shareholdings in the company will be based on rights to water from the Theodore Irrigation Scheme.</li> <li>• Shareholding will be restricted to those customers who hold a Medium A and/or High allocation as defined in the Fitzroy Resource Operations Plan;</li> <li>• Shares will be distributed on the basis of one share per ML of Medium A/or High water allocation.</li> <li>• Each share will entitle one vote.</li> <li>• Share transfers will be restricted. The permanent sale of Medium A and/or High allocation within the scheme triggers the transfer of the corresponding shareholding in the company.</li> <li>• Shareholding will be capped at a maximum of 49% of the total shares issued.</li> <li>• Irrigators who choose not take up shares will continue to receive water delivery by the local entity, without any change to service standards and contracts. Such irrigators will not be entitled to participate in the company or in the shareholder advisory group.</li> <li>• The shares that would otherwise be held by those irrigators who choose not to take up their share entitlement are to be classified as unallocated shares - issued by the company and held by the company without voting rights and remain unallocated until such time that the irrigator chooses to take up their shares or the irrigator permanently transfers their allocation to another customer who wishes to exercise their entitlement to the corresponding shareholding.</li> </ul>
<b>Transferability of Shares</b>	Shares in the company can only be transferred with a permanent sale of Medium A and/or High allocation within the scheme.
<b>Cancellation/Forfeit of Shares</b>	Shares in the company will be forfeited/surrendered where a shareholder makes a permanent transfer of a part or whole amount of their ML allocation out of the Theodore Irrigation Scheme.
<b>Issue of New Shares</b>	Where an allocation is permanently transferred into the Theodore Irrigation Scheme and converted into Medium A allocation, new shares corresponding to the ML amount will be issued to the customer.
<b>Voting Rights</b>	<ul style="list-style-type: none"> <li>• One vote for each share held in the company.</li> <li>• Resolutions of shareholders will be classified as "normal" or "special".</li> <li>• Normal resolutions require a simple majority of votes (over 50%).</li> <li>• Special resolutions require 75% of all votes cast at the meeting.</li> <li>• Special Resolution required for: <ul style="list-style-type: none"> <li>• Change to company name;</li> <li>• Change to type of entity;</li> <li>• Change to constitution;</li> <li>• Change to membership rights for which the constitution provides no guidance or procedure;</li> <li>• Decisions regarding sale, transfer or issuing new ownership rights;</li> </ul> </li> </ul>

	<ul style="list-style-type: none"> <li>• Disposal or purchase of capital assets beyond a value to be specified in the constitution; and</li> <li>• Decisions regarding expenditure of cash assets beyond a value to be specified in the constitution.</li> </ul>
<b>Board</b>	<ul style="list-style-type: none"> <li>• Maximum of 5 directors.</li> <li>• Board will consist of a chairman, shareholder directors and a minimum of two independent directors.</li> <li>• Directors appointed for 4 year terms with no limit on the number of consecutive terms that may be served.</li> <li>• Elections of directors to be held every 2 years with no more than three directors retiring and being subject to re-election at a time.</li> <li>• Board will appoint one of their members to act as chairman of the board. The term for the chairman will be 4 years. The chairman will be able to serve a maximum of 2 consecutive terms as chair.</li> <li>• Board will be skills-based.</li> <li>• Resolutions of the board will be passed by majority vote.</li> <li>• A board selection sub-committee will be convened every two years to coincide with the rotation of directors.</li> <li>• The board selection sub-committee will nominate candidates to be put forward for election at the AGM.</li> <li>• All directors will be appointed by the company at the AGM from the recommendations put forward by the board selection sub-committee.</li> </ul>
<b>Shareholder Advisory Group (SAG)</b>	<ul style="list-style-type: none"> <li>• Comprised of a cross section of shareholders (small and large and from all three distinct areas within the channel scheme) with a minimum of one member being a shareholder director.</li> <li>• Purpose of group is to provide feedback and recommendations to the executive officer on operational matters.</li> <li>• Likely terms of reference: <ul style="list-style-type: none"> <li>a. SAG will meet with the executive officer of the company and other staff as requested by the executive officer at regular intervals;</li> <li>b. The executive officer will refer matters to the SAG for discussion and feedback with recommendations as appropriate;</li> <li>c. SAG will raise matters of emerging or immediate importance to the company or shareholders more generally; and</li> <li>d. The company's staff will provide secretariat for the SAG.</li> </ul> </li> <li>• To be guided by the existing SunWater Irrigator Advisory Charter and Framework.</li> </ul>
<p><b>Protection of Minority Shareholders</b></p> <p><i>Note that "minority" is a technical term which describes a shareholder who can vote, but does not possess enough of shares to impact on the direction of the company without the support of other shareholders.</i></p>	<p>Minority shareholders to be protected by:</p> <ul style="list-style-type: none"> <li>• <i>Capped maximum shareholding</i> - a shareholder may not own more than 49% of the total shares on issue;</li> <li>• <i>Board</i> - a skills based board;</li> <li>• <i>Shareholder Advisory Group</i> - comprised of a cross section of shareholders (small and large and from all three distinct areas within the channel scheme) to provide feedback and recommendations to the executive officer on operational matters;</li> <li>• <i>Quorum</i> - for a meeting of members is 7 shareholders; and</li> <li>• <i>Special Resolutions</i> - Certain decisions in relation to the acquisition or disposal of capital assets or expenditure of cash assets require a special resolution with at least a 75% approval from the total number of shareholders.</li> </ul>