

LOCAL MANAGEMENT ARRANGEMENTS WORKING GROUP

# FINAL REPORT

STAGE 1 - REVIEW INTO LOCAL  
MANAGEMENT ARRANGEMENTS  
FOR SUNWATER'S CHANNEL  
IRRIGATION SCHEMES.

FOR THE DIRECTOR GENERAL-DEPARTMENT OF ENERGY & WATER SUPPLY

31 October 2012

## SUFFICIENT CONSENSUS

Members of the Local Management Arrangements Working Group believe that the recommendation to move to Stage 2 of the investigations and the process proposed in this report represent the best opportunity to meet the Success Factors stipulated in the Terms of Reference.

- ▶ Commitment by stakeholders
- ▶ Minimal transition cost and long term liability for government
- ▶ Long-term financial viability (including efficiency and affordability of services matched to customer needs)
- ▶ Long-term environmental sustainability of the supply, delivery and drainage systems.
- ▶ Capacity to meet regulatory obligations and governance standards.
- ▶ Identified and realistic transition pathways
- ▶ Growth and development of agribusiness is enabled.

MEMBER	SIGNATURE
Warren Males	
Ian Johnson	
Michael Murray	
Tom Vanderbyl	
Mark Mammino	
Dale Holliss	
Mario Barbagallo	
Josephine Prior	
John Palmer	
Allan Birt	
Joe Moro	
Scott Armstrong	
Peter French	
Ross Burnett	
Leith Bouilly	

## REVIEW RECOMMENDATION

With a focus on the critical success factors cited in the Terms of Reference the Local Management Arrangements Working Group (Working Group) deliberated key questions and possible responses to them. The conclusions drawn from those deliberations result in the following recommendation to the Director-General of the Department of Energy and Water Supply:

*That the Queensland Government:-*

1. Acknowledge the unanimous support of the Working Group members to proceed to Stage 2 of the investigation and negotiation of the transfer of the 8 SunWater Channel Schemes to local ownership and management as 'going concerns'.
2. Note that the transition to Local Management Arrangements may offer a mechanism to assist the Government's commitment to build agriculture as one of the four pillars of the economy with the specific target of doubling food production by 2040.
3. Note that successful transition of Government owned irrigation schemes to Local Management Arrangements has occurred in New South Wales and Western Australia.
4. Agree to put in place the necessary approvals and arrangements by December 2012 to implement Stage 2 as recommended by the Working Group.
5. Accept SunWater's offer to provide investment for the Stage 2 process to enable 8 Interim Boards to develop Local Management Arrangement Proposals.
6. Note that Stage 2 will provide government and scheme irrigators with the necessary data, business analysis and planning to determine whether or not Local Management Arrangements will be sustainable over the long term.
7. Note that progression to Stage 3 is contingent on Government's formal consideration of individual scheme based Local Management Arrangement proposals and it is likely that the timing for this will be the second half of 2013.
8. Note that it is likely that separation payments will be required to facilitate the transition to Local Management Arrangements and that accurate assessments of the quantum will only be possible through the Stage 2 process.
9. Note that the timing proposed for Stages 2 and 3 is ambitious.
10. Note that no conclusion has been drawn in this report in relation to what the final outcomes might be for either Stage 2 or 3.

## REVIEW CONCLUSIONS

1. Based on the successful experiences in WA and NSW the transition to Local Management Arrangements represents a real opportunity to realise the Qld Government's commitment to build agriculture as one of the four pillars of the economy and the specific target of doubling food production by 2040.
2. This reform, at this time, with the strong support of key stakeholders presents a unique opportunity to vest in regional irrigation communities the assets and capability required to enable agribusiness to grow and prosper. Local owners with a significant stake in the operation of the schemes have a much greater incentive to be successful in acting commercially for the interests of irrigation communities than an absentee landlord.
3. The likely consequence of choosing to do nothing will be to lock in what is seen by all parties as an unsustainable future where regional communities lose a leadership opportunity, the irrigation schemes are run from Brisbane and either government continues to provide significant subsidies or the schemes ultimately fail.
4. Whilst there is strong support for change, it is essential that diligent and robust analysis is undertaken at the individual scheme level prior to any of the parties committing to Local Management Arrangements and the necessary investment likely to be required to ensure success.
5. The preferred model to move forward is the establishment of Interim Boards to engage with local customers, SunWater staff and other stakeholders and is critical to achieving sufficient consensus to proceed to Local Management Arrangements at the scheme level.
6. The successful transfer of 'going concern' businesses (assets and operations) will be dependent on the processes, resources and support provided to Interim Boards through due diligence, transfer and transition. SunWater has offered to provide the investment required to resource this process.
7. In order to achieve long term sustainability of the new businesses and remove ongoing government liability in relation to community service obligations and risk of asset failure it is likely that the Interim Boards will seek separation payments in the transfer negotiations together with closer regulation of bulk water prices. It is not possible (due to the absence of business plans based on sound due diligence) or appropriate (due to the conflict of interest of members) for the Working Group to attempt to estimate the quantum of separation that might be required. Ultimately this will be a matter to be negotiated between the Interim Boards and Government with the shared objective of enabling long term sustainability of the schemes.
8. The development of Local Management Arrangement proposals for government consideration and the final negotiation of these proposals require a further two stage process with formal consideration by Cabinet built in to ensure that public interest matters are properly dealt with. Governance and oversight will be important in Stages 2 and 3 to ensure transparency, maintain energy and commitment contain costs and ensure that the risks and long term liabilities of proposed new entities and government are minimised.

## RECOMMENDED STAGE 2 AND 3 SCOPE

Over the course of the Stage 1 review it became apparent that a number of matters such as the identification of preferred corporate forms and specific transfer and separation costs would not be able to be determined prior to due diligence being completed at the individual scheme level.

Consequently, the Working Group recommends a revised scope and timing for Stages 2 and 3 to allow both government and irrigators to properly consider and negotiate the opportunities and risks associated with the transition to Local management arrangements:-

### STAGE 2

- By December 2012 appoint Interim Boards and General Managers in the 8 schemes with the authority to undertake due diligence, engage with customer stakeholders and develop a transfer proposal.
- By December 2012 establish governance arrangements (including a statement of the negotiation principles) and necessary project teams to oversight and support the due diligence process, the development of transfer proposals, draft contract documentation and negotiations between the Interim Boards, SunWater and Government.
- By June 2013 Interim Boards finalise proposals for Cabinet consideration.
- By September 2013 achieve Cabinet consideration of the proposals and approval of the terms of transfer for each scheme within which final negotiations can proceed.

### STAGE 3

- By October 2013 finalise negotiations with each of the schemes – including the transition arrangements and periods.
- By October 2013 have a first draft of enabling legislation available for consultation.
- By December 2013 achieve Cabinet approval for the transfer of the schemes to Local Ownership and Management.
- By December 2013 finalise shareholder membership, establish the final entities, elect or appoint Directors, finalise and enact enabling legislation.
- From January 2014 commence operation of the new entities and the transitional arrangements (1-3 years).

## Contents

SUFFICIENT CONSENSUS	2
REVIEW RECOMMENDATION	3
REVIEW CONCLUSIONS	4
RECOMMENDED STAGE 2 AND 3 SCOPE	5
STAGE 2	5
STAGE 3	5
TERMS OF REFERENCE FOR THE REVIEW	9
OVERVIEW OF LOCAL MANAGEMENT ARRANGEMENTS IN OTHER JURISDICTIONS	11
LOCAL MANAGEMENT ARRANGEMENTS WORKING GROUP DELIBERATIONS	13
WHY MOVE TO LOCAL MANAGEMENT ARRANGEMENTS IN QUEENSLAND?	13
WHAT IS THE BUSINESS TRANSACTION AND HOW CAN LONG TERM LIABILITY TO GOVERNMENT BE MINIMISED?	15
HOW SHOULD THE BUSINESS TRANSACTION BE FACILITATED?	18
RECOMMENDED STAGE 2 AND 3 SCOPE	20
GOVERNANCE	21
STAGE 2. DISCOVERY, PREPARATION AND ENGAGEMENT	21
STAGE 3. NEGOTIATION AND TRANSFER	23
STAGE 2 AND 3 IMPLEMENTATION INVESTMENT REQUIREMENTS	23
WHAT IS THE SCOPE OF ENABLING LEGISLATION?	23
POLICY AND SCHEME BASED ISSUES	24
HOW MIGHT THE SEPARATION INVESTMENTS BE ESTIMATED?	24
LOCAL MANAGEMENT ARRANGEMENTS PROCESS RISKS	26
REFERENCES	26
APPENDIX A – TERMS OF REFERENCE	27
APPENDIX B – EXPERIENCE IN NSW & WESTERN AUSTRALIA	34
WESTERN AUSTRALIA (ROBERTS AND HENNEVELD, 1997)	34
NEW SOUTH WALES (MCGLYNN 1998)	36
APPENDIX C – OWNERSHIP STRUCTURING OPTIONS	37
APPENDIX D – DUE DILIGENCE	47

### **Irrigators' Call for Change**

Since the late 1990's local management of the SunWater Channel Scheme's has been seen to be desirable by various stakeholders. While local management in various forms has been considered a number of times by previous governments there has not been sufficient interest and commitment to reach agreement about the desired outcomes and appropriate processes to achieve them.

During the course of a recent Queensland Competition Authority Pricing Review, the Queensland Farmer's Federation (QFF) and Queensland Canegrower's (Canegrowers) together with local irrigation groups expressed concerns over the long-term sustainability of the irrigation sector, especially in SunWater's Channel Schemes and called for change.

They proposed again that Local Management Arrangements (LMA) could potentially deliver increased efficiencies (including reduced costs) in the channel systems by ensuring that future services and capital investment were more closely aligned with irrigator's needs and wants.

### **SunWater's Support for Change**

At the time of Corporatisation of SunWater in 2000-01, there was a clear expectation that water user groups would be given the opportunity to make submissions arguing for local user management providing certain conditions were met. At the time, SunWater argued that it should retain control of the schemes on the basis of economies of scale, business capability as well as the viability of the newly formed company itself. In addition, the prevailing economic policy imperatives of the government of the day were significant drivers in supporting SunWater's position.

Twelve years on, the state government's policy drivers have clearly evolved and SunWater's commercial fundamentals have changed. SunWater's involvement in managing the eight channel systems now provides a limited contribution to the overall commercial performance or viability of the business.

Ongoing management of the channel schemes for a zero financial return is at odds with SunWater's key commercial objective of facilitating, developing, delivering, managing and owning bulk water infrastructure for profit in the form of a dividend to government.

SunWater is of the view that transferring ownership and control of the irrigation channel schemes to local management will provide an appropriate pathway for customers to take on the channel distribution business – including transforming and rebuilding them as sustainable going concerns which contribute economic returns to the community.

## **State Government Initiative**

On the 5<sup>th</sup> July, the Queensland Government announced the commencement of an investigation into the potential for Local Management Arrangements in SunWater's 8 distribution schemes. This announcement followed the release of the State Government's new 2012-17 rural irrigation price path which adopted the recommendations of the Queensland Competition Authority pricing review causing irrigators to again question the long term sustainability of the SunWater Channel Schemes.

This initiative of the State Government has been well received and interpreted as genuine step towards a thorough investigation of the irrigation sectors preference for a model or models that enable the successful transfer of the channel schemes from the state government (SunWater) to sustainable local management and ownership arrangements

The Minister for Energy and Water Supply established a Working Group made up of an independent Chair, representatives from each channel scheme, SunWater as well as peak industry bodies to consider options relating to the management and ownership of all assets and services associated with the 8 irrigation channel systems that are currently owned and managed by SunWater. These are Mareeba-Dimbulah, Burdekin-Haughton, Eton, Emerald, Bundaberg, Lower Mary, St George and Theodore.

## **Expectations**

The Local Management Arrangements Working Group has engaged and is reporting on the basis that there is sufficient consensus amongst all of the parties that serious consideration should be given to transferring the 8 distribution systems from the state government (SunWater) to sustainable local management and ownership arrangements.

There is very strong support from irrigators and SunWater for moving into a commercial due diligence phase in order to test the long term sustainability of the current and alternate models and to quantify the real opportunities and risks associated with change.

While there is a high level of optimism and commitment to moving to Local Management Arrangements there is also a practical and pragmatic understanding within the Working Group that this will only occur if the business case's developed in Stage 2 support the key success factors.

No conclusion has been made in this report with regard to what the final outcome of either Stage 2 or Stage 3 will be.

This report does conclude that there is sufficient consensus amongst key stakeholders to move to Stage 2.



## TERMS OF REFERENCE FOR THE REVIEW

Terms of Reference (Appendix A) for the review were issued by the Director-General, Department of Energy and Water Supply on 15<sup>th</sup> August 2012 splitting the process into two stages:

- Stage 1 - an investigation of the issues relating to the sustainability of the channel schemes, identification of a range of Local Management Arrangements options, an evaluation of their opportunities and risks, and recommendation to Government of a short-list of Local Management Arrangements models that should be further considered.
- Stage 2 – If government decides to investigate further then Stage 2 would involve detailed assessment of approved options, identification of preferred option with an implementation plan (including due diligence).

The following provides a guide as to how matters required to be considered in the Stage 1 Report were addressed:-

1. Overview of literature and relevant experience in LMA in Qld and other jurisdictions.
  - The most relevant literature available provides overviews of the processes involved in moving to local management arrangements in NSW and WA in the 1990's. There does not appear to be any published material analysing the success or otherwise of the new entities. This would be a significant exercise to undertake and given that there have been no reported failures and the anecdotal evidence indicates ongoing irrigator support for the privatised entities it may be assumed that they have been successful.
  - See section on "Overview of Local Management Arrangements in Other Jurisdictions" and Appendix B.
2. Identify the current issues (and their relative priority) to be addressed in moving to Local Management Arrangements in Qld.
  - See section on "Local Management Arrangements Working Group Deliberations".
3. Identify potential local management model options and recommend a short list of preferred approaches with an assessment against the strategic objective success factors.
  - Local management model options were identified and the preferred approach to ensuring that the final corporate forms are appropriate is the establishment of interim boards to undertake due diligence, develop business plans to meet the success factors and negotiate the transfer of individual schemes from government.
  - See sections – "Local Management Arrangements Working Group deliberations", "Recommended Scope for Stage 2 and 3" and Appendix C.
4. Clarify the specific opportunities and risks and mitigation strategies associated with each of the identified options from the perspective of key stakeholders including irrigators, Government and SunWater.

- The working group deliberations revealed that while it is possible to identify high level risks and opportunities it will only be through the due diligence process that these can be quantified for all of the stakeholders and mitigations considered.
  - See section on “Recommended Scope for Stage 2 and 3”.
5. Identify the regulatory and reporting obligations (existing and new) applicable to preferred local management options.
    - Regulatory and reporting arrangements have been considered generally and identified in the report. Specific identification of matters that enabling legislation should address will emerge through the Stage 2 process and corporate compliance and reporting will be contingent on the chosen corporate forms.
    - See sections “Local Management Arrangements Working Group Deliberations” and “Recommended Scope for Stage 2 and 3”.
  6. Identify significant scheme-specific issues/risks, how they may impact on the implementation of preferred Local Management Arrangement’s and the process through which they should be resolved.
    - See “policy and scheme based issues” and “Recommended Scope for Stage 2 and 3”.
  7. Identify the extent of support from irrigators for a move to the preferred Local Management Arrangements model(s).
    - See Sufficient Consensus Statement, Recommendation and Conclusions at the front of this report.
  8. Identify potential costs to government of transition and any longer term liabilities that arise from the preferred model/s.
    - It is not possible at this time (in advance of the development of business plans based on robust due diligence) or appropriate (due to the conflict of interest of members) for the Working Group to attempt to estimate the quantum of separation payments that might be required. Ultimately this will be a matter to be negotiated between the Interim Boards and Government with the shared objective of enabling long term sustainability of the schemes.
    - See section on “How the separation investment requirements might be estimated?”, “Recommended Scope for Stage 2 and 3 and Appendix D.

## OVERVIEW OF LOCAL MANAGEMENT ARRANGEMENTS IN OTHER JURISDICTIONS

Reviews from both WA and NSW offer useful Australian insights into the potential benefits arising from moving irrigation infrastructure and operation at the distribution system level out of government ownership and management into locally based entities. These reviews have been largely focused on the rationale for proceeding, key principles, processes undertaken and corporate models adopted.

There does not appear to be any published material analysing the success or otherwise of the new entities in these States. This would be a significant exercise to undertake and given that there have been no reported failures and the anecdotal evidence indicates financial success and ongoing irrigator support for the privatised entities it may be assumed that they have been successful.

As has been the case in all States both the WA and NSW irrigation schemes were established with heavy subsidies and in the 1990's the need for change was recognised across government and industry. The irrigation reform process was subsequently encapsulated in the Council of Australian Government's (COAG) water reform framework, which later became part of the National Competition Policy reform package. The key elements of the COAG water reform package relating to irrigation schemes include giving growers a much greater say in the management of irrigation schemes and the recovery of the full economic cost of supplying water to growers, with any subsidies made transparent.

The short overview of the WA and NSW experiences in Appendix B provide guidance for Qld in the journey to achieve Local Management Arrangements.

Worth highlighting here is the approach adopted in Western Australia where ownership of the irrigation schemes has been transferred to grower-owned irrigation cooperatives. Under this approach the irrigation cooperatives assumed responsibility for delivering retail water services to growers and on-going ownership and management of the irrigation assets. The WA Water Corporation remains responsible for the supply of bulk water to the irrigation cooperatives and the management of the headwork's assets.

The transfer of the irrigation schemes was a complex divestment of publicly owned assets. It involved the Government, Government agencies, the Water Corporation and the growers, and each of these stakeholders had different criteria for determining whether a transfer should proceed.

***For Government, the long-term benefits to the State had to outweigh the costs incurred in implementing the transfer of publicly owned assets to private ownership.***

***For the Water Corporation, the transfer had to be financially sound and have a positive impact on the Corporation's bottom line.***

***The growers required the creation of a financially viable cooperative capable of delivering efficient water services to its members.<sup>1</sup>***

---

<sup>1</sup> Roberts, E.J, and Henneveld, M. 1997. *Grower takeover of irrigation schemes in Western Australia: the quiet revolution*. Water Corporation, 629 Newcastle Street, Leederville, Western Australia, 6007

These criteria mirror the success factors articulated in the Terms of Reference for this review and are highly relevant to the proposed Stage 2 and 3 processes.

While little formal analysis has been undertaken to assess the actual success achieved by moving to Local Management Arrangements in other jurisdictions the following overview of the benefits irrigators claim to have achieved in the Jemalong Irrigation district provides an insight into the opportunities that Qld schemes might realise.

### **Jemalong Irrigation**

Jemalong Irrigation District is a privately managed gravity-fed, channel irrigation delivery system in the Lachlan Valley that was privatised in March, 1995.

The district is managed by Jemalong Irrigation Limited, an unlisted public company, with irrigator shareholders who hold shares in proportion to their irrigation entitlement. In total Jemalong Irrigation holds 99,877ML of Lachlan Valley water entitlement and on average diverts approximately 80,000 megalitres of water to meet the irrigation requirements of 119 shareholders.

Jemalong Irrigation has a 17-year history of successfully managing the formerly government run scheme.

Given the length of time since privatisation it is difficult to make meaningful water delivery cost comparisons, however, an indication of efficiencies can be gained from changes in staffing levels which have fallen from approximately 23 in the mid-1980s to five today. Some 95% of all maintenance work is carried out in house.

**The management has also been able to successfully negotiate the worst drought on record where water allocations averaged just three per cent over an eight year period. During much of this period the management was able to waive the fixed charge component of its water charges for four years, and a partial waiver for two years, using investment funding and new customer revenue to meet the critical expenditure requirements of the company. Post-drought, “profits” are being returned to the company’s reserves.**

Careful management, a targeted capital replacement program, and an active investment policy have allowed Jemalong to build its capital reserve fund to approximately \$7.8 million. **The fund commenced at privatisation with a \$2 million (one-off) separation payment from the State Government which recognised the sub-optimal state of Jemalong’s irrigation assets.**

In addition to the separation payment, the transfer included approximately \$500,000 of start-up working capital.

In summary privatisation has allowed:

- A flexible approach to pricing and expenditure, which is closely aligned to the business conditions experienced by customer/shareholders.
- The adoption of significant operational efficiencies.
- The introduction of new customers.
- A significantly flatter price increase path.

Further information on Jemalong Irrigation, including its current pricing structure can be found at <http://www.jemalongirrigation.com.au> .

## LOCAL MANAGEMENT ARRANGEMENTS WORKING GROUP DELIBERATIONS

The LMA Working Group met formally three times over the duration of the review. The initial meeting revealed a range of issues that would need to be addressed in order to meet the success factors outlined in the Terms of Reference. A presentation on Ownership Structuring Options (Appendix C) was provided. This assisted the Working Group to conclude that while the use of cooperatives and/or companies limited by shares or guarantee are attractive, the preferred models/arrangements would not be established until each scheme could resolve the business objectives for future operations through a due diligence process.

Deliberation over the key questions arising from the initial issues identification and resolution of the preferred approach to considering Local Management Arrangements occurred at the Working Group's second meeting. The development of the responses to a number of key questions was informed by an overview of the due diligence process from an acquirer's perspective provided by an external advisor. (Appendix D).

Prior to the third meeting where the review's conclusions and recommendation were consolidated, Working Group members actively engaged with key groups at the scheme level to ascertain the level of support for moving to Stages 2 and 3 based on the approach outlined in this report. The Peak Industry Organisations arranged to bring a number of irrigators from SA and NSW to Brisbane to brief Working Group members about their experience in moving to local management arrangements over the last decade or so.

The Working Group advice is synthesised in this report under key question headings as follows.

### WHY MOVE TO LOCAL MANAGEMENT ARRANGEMENTS IN QUEENSLAND?

Historically, rural water infrastructure has been constructed for reasons other than pure commercial investment and return. The SunWater schemes were created by governments over a long period of time based on genuine belief that the provision of a water supply to encourage regional development, irrigated agriculture and agricultural export markets will realise net economic and social gains across the broader community.

Customer stakeholders argue that since Corporatisation in 2001 SunWater has been constrained in its ability to optimise the operation of individual Channel Schemes resulting in escalating costs and reduced water usage in some regions. This has meant that it has been difficult to recover the full costs of operating the schemes and Community Service Obligation (CSO) payments have been provided by the state to maintain and operate the schemes. Many customers and stakeholders believe that this situation is unsustainable and unacceptable for both government and irrigators.

The Council of Australian Governments (COAG) Water Reform Framework supports local management of irrigation schemes as a means of promoting the efficient provision of water supply through user involvement.

While the estimated replacement cost of the assets may be in the vicinity of \$1 - 1.5 billion, the current book value is close to zero due to the limited revenue generated by the schemes. On this basis the schemes are unlikely to be attractive to investors other than the users. Therefore, it is not proposed that the distribution schemes be presented to the market for sale. The Channel Schemes do have value to the local users who have indicated strong interest in taking them over under new ownership and operating arrangements.

Local user ownership and management will allow the assets to be managed for the long term within a framework that supports the economic development of the local customer enterprises and maintains the assets at a standard which can deliver the level of service required by those customers.

The proposal to transfer the schemes to local ownership and management is consistent with the original objectives for scheme establishment and with the approaches taken in other jurisdictions.

The successes derived from moving to local management arrangements in both WA and NSW provide strong support to continue the good faith negotiations between irrigators, SunWater and the Qld Government with the aim of meeting the objectives of all parties.

Economic and financial efficiencies have been achieved by SunWater over the last decade and it is considered that further opportunities for significant efficiency gains are minimal under the current arrangements. Whether there are further economic and financial efficiency gains that can be made through local ownership and management will be tested in the due diligence process.

Regardless of the level of economic and financial efficiencies that can be realised there are real benefits from moving to local management through the schemes becoming self-determining with regard to business strategy and pricing, improved relationships with customers, tailoring service standards and managing risk appropriately. Together with even modest increases in operational efficiencies these benefits are significant incentive for irrigators to move to local ownership and management.

This reform, at this time, with the strong support of key stakeholders presents a unique opportunity to vest in regional irrigation communities the assets and capability required to enable agribusiness to grow and prosper. Local owners with a significant stake in the operation of the schemes have a much greater incentive to be successful in acting commercially for the interests of irrigation communities than an absentee landlord.

Customer stakeholders are confident that net benefits will be realised from local ownership, control and decision making and that financial benefits from good management will be kept and re-invested regionally.

Reducing/removing the ongoing tensions between irrigators and government/SunWater in relation to scheme operation and pricing will allow engagement with government to be refocused on broader policy matters that are important to both industry and government.

SunWater's business drivers and commercial fundamentals have changed substantially since its establishment in 2000. SunWater recognises that its involvement in managing the eight channel schemes now provides limited contribution to the overall commercial performance or operational viability of the business. SunWater acknowledges that the ongoing management of the channel schemes for zero financial return is at odds with its key commercial objective of facilitating, developing, delivering, managing and owning bulk water infrastructure for profit in the form of a dividend to government.

SunWater is therefore of the view that transferring ownership and control of the irrigation channel schemes to local management will provide an appropriate pathway for customers to take on the irrigation channel transport businesses – including transforming and rebuilding them as sustainable 'going concerns'.

Whilst there will be variation from scheme to scheme the Working Group have identified the following specific objectives that can be achieved by moving to Local Management Arrangements.

- Improve the efficiency, accountability and sustainability of the schemes.
- Deliver the locally agreed level of service to customers in order to ensure individual businesses are successful.
- Enable local decision makers to undertake appropriate rationalisation, divestment, optimisation, modernisation and expansion etc.
- Increase the production of food and fibre and enhance regional development opportunities.
- Clarify risk sharing between government and the new entities
- Minimise regulatory burden.
- Ensure appropriate sharing with government the risk and cost of any public good operations at the scheme level (i.e. environmental management, recreational use, local government services, flood mitigation etc.).
- Adopt not for profit, cost recovery models for the businesses.

It will be through the achievement of these objectives that the reform process will be able to contribute to the realisation of the government objective of building agriculture as one of the four pillars of the economy and the specific target of doubling food production by 2040.

#### WHAT IS THE BUSINESS TRANSACTION AND HOW CAN LONG TERM LIABILITY TO GOVERNMENT BE MINIMISED?

Similar to the NSW and WA approaches in the mid-late 1990's it is proposed that the irrigation distribution schemes be transferred as 'going concerns' from SunWater to scheme based entities.

#### **Going Concern**

The definition of '**going concern**' for the purposes of this initiative is - *a business that is currently operating, and which can demonstrate that it is able to keep operating indefinitely.*

The business can demonstrate:

- A current active base of regular customers.
- Skilled employees who know the business and who have strong business relationships with customers and vendors.
- Infrastructure, equipment, supplies, furniture and fixtures that are in good condition.
- Sufficient reserves to meet asset renewal requirements over the long term.
- Capacity to generate sufficient revenue to cover operational costs.
- Necessary licences and approvals to operate the business.
- Appropriate business operating model and governance standards.

### **SunWater Staff**

The Working Group is acutely aware of the critical nature of the capabilities, knowledge and skills of SunWater staff in maintaining continuity of service throughout the change process. These people will be critical to ensure the successful transition to, and efficient and effective operation of, the new entities. In negotiating the transition arrangements, SunWater will undertake to ensure that the entitlements and working conditions of its staff are recognised.

A successful transition to local management would require the development and implementation of a robust and respectful change management plan for SunWater staff. SunWater has committed to fully engaging with its staff – both in terms of maintaining open communications and undertaking consultations in each regional location as well as in Brisbane – in advance of and throughout the transition process.

### **Asset Ownership**

The Working Group considered whether it is necessary for the proposed new local management entities to own the assets. The conclusion reached is that asset ownership at the scheme level is:-

- **A necessary prerequisite to setting risk appetite and decision making with regard to level of service and therefore to meeting key scheme operating objectives. It is only through ownership of the assets that commercial decisions can be taken with regard to rationalisation, divestment, optimisation, modernisation and expansion etc. Any external regulatory control other than a requirement to ensure that the assets are ‘fit for purpose over the long term’ will incur unnecessary costs.**
- Necessary to enable access to capital.
- A prerequisite under the current regulatory environment to holding operating licences and being a water service provider. (Note – there is a government proposal to amend this requirement in 2013)
- **Important to the achievement of the States objective of limiting future liability. Interim Boards will need to demonstrate to government the adequacy of the proposed governance arrangements identified in Stage 2 to protect the long term nature of the asset base.**



## Bulk Water Supply

Under the terms of this review SunWater will retain ownership and responsibility for the bulk supply assets. The Working Group note that in order to achieve confidence and certainty in the bulk relationship at the scheme level it is necessary that:-

- Simplification/modification of the current contracting arrangements be undertaken to achieve a secure relationship between SunWater and the Schemes and water allocation holders.
- Bulk pricing should continue to be regulated with **mandated** consultation arrangements with the new entities.
- Bulk pricing should not inhibit the new businesses capacity to achieve financial sustainability and consideration of **long term fixed price contracts** for bulk water to support the sustainability of the schemes has been suggested as a mechanism to achieve this.
- Consultation by government with the new entities over changing standards and associated costs relating to bulk water provision should be mandated. Issues such as dam safety regulation and upgrades are likely to represent a significant bulk water price risk to the new entities.
- There is scope for the new entities to negotiate and secure the opportunity to manage non-channel irrigation deliveries within the bulk schemes (i.e. river irrigation customers).

## Business Model and Separation Payments

Prior to privatisation in NSW the irrigation infrastructure assets had been 'run to fail' for a long time and significant separation payments were negotiated by each of the new entities to facilitate the transfer of 'going concern' businesses.

SunWater has sought to maintain the assets in good working order and the Queensland Competition Authority has made recommendations for improved planning for asset renewals. A number of submissions to the Queensland Competition Authority 2012 process claimed that infrastructure in some schemes is in excess of customer requirements.

The proposed due diligence process will reveal the current condition and adequacy of the assets, the adequacy of the renewals planning, the adequacy of the accrued renewals annuity and the capital required to provide efficient and prudent long term investment in the capital program.

The 2012 Queensland Competition Authority pricing review considered a 20 year renewals plan. The interim entities may be better served by considering the SunWater 30 year renewal plans for each scheme.

With independently validated information available the interim entities may request government to consider, as was the case in NSW, a once off contribution to asset renewal programs in return for a commitment that the new entities take full responsibility to establish and manage an adequate annuities reserve from the date of transfer.

With regard to the variable capacity of the schemes to generate revenue sufficient to cover operating costs it is likely that a number of the new entities will seek to reach agreement with government on the Community Service Obligations currently provided to SunWater. While the Community Service Obligations payments contain allowance for asset annuity it is likely that operating revenue shortfalls and asset annuity requirements will be considered separately during due diligence at the scheme level.

A key success factor for government in considering the investment that will be required to implement the transfer of 'going concern' businesses to local ownership and management is to minimise the long-term costs and liabilities to the state. The long-term benefits should outweigh the costs incurred in implementing the transfer of publicly owned assets to local ownership and management. There are likely to be both direct and indirect financial and non-financial benefits which will be quantified and qualified during the Stage 2 due diligence process.

**As has been the experience in other jurisdictions meeting the collective objectives of the schemes, SunWater and Qld government over the long term will require:-**

- **Investment in providing sufficient support and resources to successfully transition the irrigation businesses as 'going concerns' to local ownership and management.**
- **Negotiation of separation payments at the scheme level to ensure adequate asset annuity renewal funds and bring to conclusion the program of community service obligation payments.**
- **Development of enabling legislation to provide clarity with regard to risk and liability.**

The likely consequence of choosing to do nothing will be to lock in what is seen by all parties as an unsustainable future, where regional communities lose a leadership opportunity, the irrigation schemes are run from Brisbane and either government continues to provide significant subsidies or the schemes ultimately fail.

Given the high degree of variation in scale and financial performance between the schemes it is likely that the transfer and transition will need to be staged over one to three years.

#### **HOW SHOULD THE BUSINESS TRANSACTION BE FACILITATED?**

The transfer and transition of the irrigation schemes will be a complex process where the interests of Government, Government agencies, SunWater and the local irrigators whilst generally strongly aligned may come into conflict at times. The establishment of robust governance arrangements is essential to ensure that each of these stakeholders can effectively negotiate to achieve their necessarily different criteria for determining whether a transfer should proceed.

In considering how to go about negotiating the transfer and transition of the schemes as going concerns a set of important questions have been considered by the Working Group.

How do individual schemes:-

- Properly engage all customers and stakeholders?
- Undertake appropriate due diligence?
- Determine what is required to ensure financial sustainability?
- Negotiate the transaction with government and SunWater?
- Determine the appropriate corporate form?

**The practical and pragmatic response is to establish Interim Boards (Pty Ltd) at the scheme level with the necessary skills and resources to negotiate the transfer from SunWater and establish the new businesses. Without the protection, legal authority and status afforded by an appropriate governance structure it is unlikely that the schemes would be prepared to engage in what is a very complex transaction.**

The Interim Boards should be established with constitutions which will enable them to:-

- Determine the shared objectives to be represented in the sale negotiation with government and final corporate constitution.
- Gain access to all of the necessary data to undertake an effective due diligence process.
- Prepare a proposal for locally owning and managing the scheme over the long term.
- Negotiate with customers, stakeholders and government.
- Provide input into enabling legislation.
- Establish the appropriate corporate form for the long term operation of the schemes.
- Complete the separation of the business functions and staffing arrangements prior to legal separation.
- Advise and negotiate with SunWater in relation to investment through the capital program during Stage 2.

The constitutions should contain wind-up clauses that take account of the circumstances where agreement is or is not reached with government to conclude the transfer and transition process.

It is clearly understood by all parties that these interim companies are to be established for the express purpose of undertaking the necessary work to conclude Stage 2 on behalf of the individual schemes.

The appointment of the Interim Boards could be undertaken through the following process:-

- Each scheme to nominate individuals to be invited by the Minister for Energy and Water Supply to establish and Chair the Interim Boards to undertake the tasks outlined above.
- Subsequent to their appointment the Chairmen would conduct a selection process supported by the Independent Chair of the Government and Industry Oversight Groups.

- 5-7 Directors will be selected to achieve the agreed skills mix. The majority of Interim Directors will be irrigators but each board will have a least 2 independent appointments.
- Governance training will be provided to the Directors of the Interim Boards.
- Boards will be provided with funds from the Stage 2 budget to remunerate Directors.
- Interim Boards to appoint a General Manager funded through the Stage 2 budget with schemes sharing GM's where possible.

SunWater has proposed that during the Stage 2 process, access to confidential data will be provided and managed through a secure electronic Data Room. The Project Team will pre-populate the Data Room with information likely to be relevant to each scheme for the due diligence process. The Data Room will also be further populated with any information requested by the Due Diligence consultants and the Interim Boards. The Data Room will be set up in order to provide common access for generic information, models or data sets plus scheme specific access for data relating to particular schemes.

## RECOMMENDED STAGE 2 AND 3 SCOPE

Over the course of the Stage 1 review it became apparent that a number of matters such as the identification of preferred corporate forms and specific transfer and separation costs would not be able to be determined prior to due diligence being completed at the individual scheme level.

Consequently, the Working Group recommends a revised scope and timing for Stages 2 and 3 to allow both government and irrigators to properly consider and negotiate the opportunities and risks associated with the transition to Local Management Arrangements:-

### STAGE 2

- By December 2012 appoint Interim Boards and General Managers in the 8 schemes with the authority to undertake due diligence, engage with customer stakeholders and develop a transfer proposal.
- By December 2012 establish governance arrangements (including a statement of the negotiation principles) and necessary project teams to oversight and support the due diligence process, the development of transfer proposals, draft contract documentation and negotiations between the Interim Boards, SunWater and Government.
- By June 2013 Interim Boards finalise proposals for Cabinet consideration.
- By September 2013 achieve Cabinet consideration of the proposals and approval of the terms of transfer for each scheme within which final negotiations can proceed.

### STAGE 3

- By October 2013 finalise negotiations with each of the schemes – including the transition arrangements and periods.
- By October 2013 have a first draft of enabling legislation available for consultation.
- By December 2013 achieve Cabinet approval for the transfer of the schemes to Local Ownership and Management.

- By December 2013 finalise shareholder membership, establish the final entities, elect or appoint Directors, finalise and enact enabling legislation.
- From January 2014 commence operation of the new entities and the transitional arrangements (1-3 years).

## GOVERNANCE

The proposal to transfer the SunWater Channel Schemes to Local Management Arrangements is a significant public policy and commercial matter which will require leadership and oversight at government, industry and scheme levels to ensure a fair, efficient and effective outcome.

Should government decide to proceed on the basis of the Working Groups recommendation there appears to be two distinct stages required to reach a successful conclusion to the transfer of the schemes to Local Management Arrangements each with different governance arrangements.

Whilst oversight arrangements and timing are ultimately a matter for government to determine, the Working Group offers the following proposal which takes account of industry and scheme level requirements for consideration.

### STAGE 2. DISCOVERY, PREPARATION AND ENGAGEMENT

Stage 2 can be described as those activities associated with forming the interim entities, undertaking due diligence, engagement with irrigator's, preparation and submission of the entities' proposals to own and operate the schemes, identification of policy issues requiring resolution and drafting of enabling legislation. This discovery and preparation stage requires that all of the stakeholders are actively engaged in a wide range of discussions and problem solving. The following arrangements are proposed to facilitate this stage.

- Establishment of a high level interdepartmental committee (IAG/IDC) to champion the reform process and ensure that sound public policy principles are followed.
- The IAG/IDC establishes Government (GOG) and Industry Oversight Groups (IOG) with tailored terms of reference and a common Independent Chair, **to ensure that the level of engagement and influence, desired by industry and the schemes occurs around the transfer process and policy issues, without compromising the commercial in confidence nature of the transfer negotiations.**

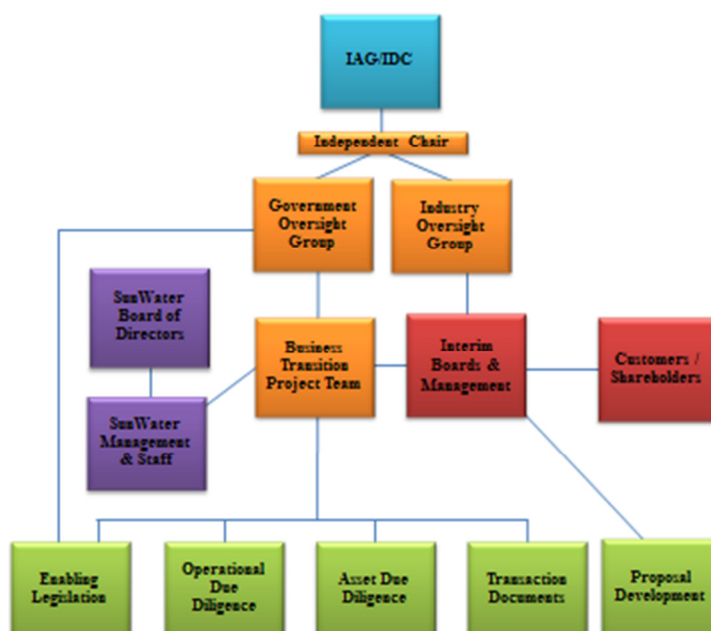
The individual terms of reference would include a requirement for the GOG and IOG to consult closely on the development of a set of negotiation principles to guide the development of scheme business proposals and the transfer and transition process.

- GOG Membership – independent Chair, Department of Energy and Water Supply, Queensland Treasury, Queensland Treasury Corporation, Department of Natural Resources and Mines, Queensland Competition Authority, Department of Agriculture Fisheries and Forestry, Department of State Development and Infrastructure Planning.

- IOG Membership - independent Chair, Chairmen of the Interim Boards, Irrigation Peak Body representatives, SunWater, DEWS and with Technical support provided by the Business Transition Project Team.
- In consultation with the IOG the GOG will approve the appointment of a Business Transition Project Team (BTPT). This technical team, reporting to the GOG and hosted by SunWater, will be made up of a small number of people with relevant expertise seconded for the term of the project to:-
  - provide effective project management discipline
  - support/provide the Interim Boards with information, resources and expertise to enable completion of the due diligence
  - coordinate and procure due diligence services from specialist consultants and experts
  - scope enabling legislation
  - developing transfer documentation and service level agreements for the implementation phase
  - provide information and support to government as and when required in relation to progressing negotiations and finalising settlement.
- The Minister for Energy and Water Supply invites nominees from each scheme to establish and Chair interim companies with model constitutions that empower the Boards to undertake the necessary work to secure a transition to Local Management Arrangements.
- The Department of Energy and Water Supply, informed by the BTPT would undertake the identification and scoping of the legislative requirements arising through Stage 2. Drafting and consultation would occur during Stage 3.

**At the completion of Stage 2 the Interim Boards would submit proposals (June 2013) for Cabinet consideration in around September 2013 with an expectation of a decision to proceed/not proceed to the negotiation and implementation phase in Stage 3.**

#### STAGE 2 – OVERSIGHT, DISCOVERY, PREPARATION & ENGAGEMENT ARRANGEMENTS



### STAGE 3. NEGOTIATION AND TRANSFER

Stage 3 can be described as the negotiation of the proposal, the drafting and negotiation of the transfer documents, the drafting and negotiation of transition plans, the establishment of the preferred entities, identification of shareholders, recruitment of Directors, finalisation of enabling legislation and the completion of transfers.

At this point the detailed negotiation should be able to be conducted between the Interim Boards and SunWater/Government without broader consultation in order to protect the interests of all parties. Should this prove not to be the case, revised arrangements could be put in place at the conclusion of Stage 3.

The IAG/IDC would determine the necessary governance oversight arrangements for this stage prior to the completion of Stage 2.

### STAGE 2 AND 3 IMPLEMENTATION INVESTMENT REQUIREMENTS

SunWater has offered to provide the investment required to support the Stage 2 process subject to the approval of their 2012/13 Draft Statement of Corporate Intent (SCI) by Shareholding Ministers. The quantum proposed in the Draft SCI is based on a workplan and budget that reflects the scope of Stages 2 and 3 as outlined in previous sections.

Subsequent to the 2012/13 SCI approval, the Government Oversight Group will consult with the Industry Oversight Group on the feasibility of the workplan prior to approval of the budget at its first meeting.

The Working Group noted that this investment is critical to enabling all schemes to have a 'fair go' at developing long term sustainable business proposals that meet the collective success factors for Local Management Arrangements.

### WHAT IS THE SCOPE OF ENABLING LEGISLATION?

In order to ensure that the new entities are able to operate with a minimum regulatory burden, it is proposed that from the date of establishment they are subject to a single piece of legislation in relation to the water business ownership and operation.

The scope of the enabling legislation is envisaged to be:-

- Facilitate the transfer of irrigation scheme assets and businesses from SunWater to the corporate form preferred by individual irrigation schemes
- Provide the necessary licences and authorisations for the schemes to operate (Distribution Operations Licences and contractual arrangements etc.)
- Provide the regulatory framework for the new entities to enable their long term viability and mitigate/remove the long term risk to government of asset and/or operational failure. This could include asset management and environmental management plans.

- Provide assurance with regard to assignment of contingent liabilities (environmental contamination etc.)
- Clarify the relationship with SunWater as the bulk supplier
- Clarify responsibility for public assets such as roads bridges and culverts
- Provide a mechanism to levy drainage charges to irrigators and other beneficiaries

## POLICY AND SCHEME BASED ISSUES

The Working Group has identified issues that require resolution either by government or by the Interim Boards as they prepare their proposals to move to Local Management Arrangements.

1. Assessment of distribution loss requirements and determination of the volume of allocations to be transferred to each scheme
2. Clarification of the application of the State Metering Policy to the Channel Schemes and estimates of cost
3. Irrigators in the Burdekin River Irrigation Area wish to resolve a long standing issue in relation to the supply of 185,000ML to the Burdekin Water Boards free of charge, with the costs of this supply being recovered from all remaining water users.
4. Irrigators and stakeholders in the Bundaberg Water Supply Scheme wish to resolve a long standing issue in relation to nodal vs. postage stamp pricing<sup>2</sup>.
5. Irrigators in the St George Scheme will require resolution to the long standing issue in relation to the status of Thuraggi Channel.

It is likely that many scheme based issues will be identified during the due diligence process that will require resolution prior to the finalisation of a transfer process. The majority of these are likely to be resolved at the scheme level as part of the development of business proposals given that ownership, operational responsibility and decision making powers will transfer to the new entities.

## HOW MIGHT THE SEPARATION INVESTMENTS BE ESTIMATED?

The 2012 Queensland Competition Authority review provides useful data to complement SunWater data and inform the due diligence process for both government and the Interim Boards.

In order to meet community expectations in relation to the allocation of public capital for this important initiative it is critical that the calculation of separation payments for the schemes is transparent, defensible and produces long term net benefits for the State.

At the time of establishment of the local management arrangements the new entities will assume responsibility for the risks associated with the ownership and management of the schemes over the long term.

---

<sup>2</sup> Submission received from Canegrowers Isis and Isis Central Sugar Mill Co. Ltd.



Estimation of the scale of separation payments required to ensure financial viability of the schemes over the long term is problematic for the Working Group for two reasons. Firstly, the members have a direct conflict of interest as representatives of the schemes, Industry and SunWater. Secondly, until the due diligence process is undertaken and business proposals developed any estimate of capital investment requirements would be premature and extremely unreliable because the only business model that could be reliably considered is the SunWater model. The Interim Boards will be able to consider a range of options for operations and asset and risk management that will reveal different capital requirements.

Two of the issues that must be considered in calculating separation investments are revenue shortfalls and annuity renewals.

The Queensland Competition Authority determined the efficient costs of SunWater operating and maintaining the schemes and revenue in most schemes is projected to fall short of costs over the coming 5 year price path. It is likely that future price paths will be similar. The short fall is currently funded either by direct Government injection of Community Service Obligations (which currently include an allowance for asset annuities) or absorbed by SunWater and reflected in lower dividends paid to Government.

The operating revenue shortfall (Community Service Obligation less the annuity allowance) can be estimated for each scheme and the Net Present Value (NPV) of that short fall for a future period at the time of settlement might be considered as a starting point for estimating a separation investment to secure long term financial sustainability of the schemes.

The funds retained or owed within renewals annuity accounts at the time of settlement would also need to be factored into financial arrangements. The adequacy of the renewals annuity funds would be assessed against the asset condition and adequacy assessments and asset renewals plans that are undertaken during the due diligence and proposal development phase. Where these are demonstrably inadequate, Interim Boards are likely to seek and negotiate capital injections at the scheme level. The Interim Boards would also be likely to seek the 30 year renewals profile from SunWater for assessment to ensure that no known major capital expenditure is overlooked.

Some combination of an NPV of a future stream of community service obligations (operating revenue) and capital injections for a renewals annuity is likely to result in the calculation of a separation investment that will secure financial sustainability for each scheme.

At the time of the finalisation of this report it is understood that Queensland Treasury Corporation was modelling for Government the potential bookends of investment requirement for separation payments based on the SunWater business model. Interim Boards will undertake their own independent assessments as part of the due diligence.

## LOCAL MANAGEMENT ARRANGEMENTS PROCESS RISKS

As with any significant project there are a number of risks as outlined below. In this case it is unlikely that any of these cannot be overcome with good communication, sound processes and right intentions from all participants.

- ▶ Political support at local and State levels
- ▶ Maintenance of commitment and energy.
- ▶ Management of expectations.
- ▶ Investment in stage 2 and separation payments seen as a cost rather than a long term investment in regional community and agribusiness.
- ▶ Decision by schemes (some or all) not to proceed beyond due diligence.
- ▶ Inability to transfer long term risks from government to new entities
- ▶ SunWater dominance or disengagement from the process
- ▶ Undue haste or delay
- ▶ Unnecessary complication of process

## REFERENCES

- INDEC, 2012. Due Diligence from an acquirer's perspective. (Appendix D)
- McDougall, David., 2012. Ownership Structuring Options. (Appendix C)
- McGlynn, T. 1998. *Irrigation reform. Corporatisation and privatisation of water. Going the full Monty*. NSW Department of Land and Water Conservation.
- Roberts, E.J, and Henneveld, M. 1997. *Grower takeover of irrigation schemes in Western Australia: the quiet revolution*. Water Corporation, 629 Newcastle Street, Leederville, Western Australia, 6007

**THE DIRECTOR GENERAL OF THE DEPARTMENT OF ENERGY AND WATER  
SUPPLY TERMS OF REFERENCE**

**FOR THE WORKING GROUP UNDERTAKING A REVIEW INTO LOCAL MANAGEMENT ARRANGEMENTS  
FOR SUNWATER'S CHANNEL IRRIGATION  
SYSTEMS**

**Background**

On 5 July 2012, the Queensland Government announced the commencement of an investigation into the potential for local management arrangements (LMA) in SunWater's 8 distribution systems. This announcement followed the release of the State Government's new 2012-17 rural irrigation price path which adopted the recommendations of the Queensland Competition Authority (QCA) pricing review.

Local management has been identified as desirable by various stakeholders. It has been considered and rejected by previous Governments a number of times for various reasons. During the course of the QCA's pricing review, the Queensland Farmer's Federation (QFF) and Queensland Canegrower's (Canegrowers) together with some local irrigation groups expressed concerns over the long-term sustainability of the sector, especially in SunWater's distribution channel systems. It has been proposed by these groups that LMA could potentially deliver increased efficiencies (including reduced costs) in channel systems by ensuring that future services and capital investment were more closely aligned with what irrigators want and need.

The Government has indicated its strong support, consistent with users expressed preference, for a model or models (including transition arrangements) that enable the successful transfer of the 8 distribution schemes from the state government (SunWater) to sustainable local management and/or ownership arrangements.

This transition must support the Government's commitment to build agriculture as one of the four pillars of the economy and the specific target of doubling food production by 2040.

The Minister for Energy and Water Supply has established a working group to be chaired by Ms Leith Bouilly with the brief of "developing sustainable local ideas for the SunWater's channel water services". The working group is to "include representatives from SunWater as well as local and peak irrigation bodies".

This is an unprecedented opportunity for all stakeholders to engage and lead the evolution of the channel irrigation systems in Queensland in order to support the prosperity of regional communities.

**Strategic Objective of the Review**

The overall strategic objective of the review is to identify innovative, efficient and sustainable LMA option(s) for the future management and/or ownership of SunWater's irrigation channel systems. To achieve this, the working group will scope out the issues to be addressed to enable LMA and evaluate the options.

The key success factors against which the LMA options will be assessed include but are not limited to:

- 1) Commitment by stakeholders
- 2) Minimal transition cost and long term liability for government
- 3) Long-term financial viability (including efficiency and affordability of services matched to customer needs)
- 4) Long-term environmental sustainability of the supply, delivery and drainage systems.
- 5) Capacity to meet regulatory obligations and governance standards.
- 6) Identified and realistic transition pathways
- 7) Growth and development of agribusiness is enabled.

## **Scope of the Review**

The scope of this review will include consideration of options relating to the management and/or ownership of all assets and services associated with the 8 irrigation channel systems that are currently owned and managed by SunWater: Mareeba-Dimbulah; Burdekin; Eton; Emerald; Bundaberg; Lower Mary; St George and Theodore.

### ***Services to be covered by the review***

The scope of this review will include all services associated with the transport (including pumping) of irrigation water from watercourses to irrigators via the 8 irrigation channel systems listed above. The review will also include services associated with the management and ownership of drainage systems within the channel systems.

### ***Assets covered by the review***

The assets include property, equipment, systems and infrastructure associated with irrigation channel systems, pumping stations and drainage systems. The assets also include distribution loss water allocations considered necessary to the operation of the irrigation channel systems.

The assets exclude all those associated with bulk water storage and distribution infrastructure (e.g. all bulk water head works assets such as dams, weirs and barrages, industrial pipeline systems. Assets associated with other irrigation entities such as the Pioneer Valley Water Board and the Burdekin Water Board are also excluded.

### ***Issues to be covered by the review***

Local management will only be effective if it has commitment and ownership by the local stakeholders. A move to LMA is likely to be quite complex and it is important that time is spent identifying the issues that must be addressed from the perspective of all stakeholders early in the process. There will be significant issues that apply across all schemes and matters that are specific to individual schemes now and in the future.

The review will canvass the views of peak irrigation bodies and SunWater as well as irrigators and where appropriate other significant stakeholders from each of the systems.

### **Communications during the review**

During the course of the review, the Chair in consultation with the working group will prepare appropriate communications about the progress of the review for dissemination by SunWater and peak and local irrigation bodies.

The Chair will also provide progress reports to the Inter-department Advisory Group (IAG) at agreed intervals.

### **Working Group Membership and Operation**

The working group includes membership from QFF, Canegrowers, Cotton Australia, Sunwater and representatives from the 8 irrigation schemes. Selection of the irrigation scheme representatives takes into account commodity, geography, specific scheme issues and value chain.

Working group membership is at Appendix A.

Working group members will be required to sign a Confidentiality Agreement (Appendix C) and adopt the Working Group Protocol (Appendix B).

The Chair and the working group will be supported as considered necessary by a Technical Support Team of personnel from SunWater and peak irrigation bodies.

The working group will meet at least three times:

1. Initiation meeting – identification of issues, ideas and desired characteristics of LMA models.
2. Deliberation meeting – consideration of issues analysis and initial LMA model evaluation.
3. Consolidation meeting – further short listing of preferred LMA models and recommendations to IAG.

### **Review Oversight**

An IAG will provide oversight and advice to the review and will be chaired by the Director-General of the Department of Energy and Water Supply (DEWS) and include representatives from the other relevant Departments.

The Chair of the Working Group will report to Government via the IAG.

The Chair of the Working Group will be invited to attend meetings of the IAG as an observer including to present the Stage 1 Deliverables.

From an administrative perspective the IAG point of contact for the Chair of the Working Group will be the DEWS Project Manager, Rose McGrath, A/Director of Rural Water Policy and Pricing, [Rose.mcgrath@dews.qld.gov.au](mailto:Rose.mcgrath@dews.qld.gov.au)  
Tel: (07) 3405 3555.

### **Methodology**

The review will be undertaken in two stages:

Stage 1. An investigation of the issues relating to the sustainability of the channel schemes, identification of a range of LMA options, an evaluation of their opportunities and risks, and recommendation to Government of a short-list of LMA models that should be further considered. The Stage 1 report is due by 31 October 2012; and

Stage 2. If government decides to investigate further then Stage 2 would involve detailed assessment of approved options, identification of preferred option with an implementation plan (including due diligence). The Stage 2 report and implementation plan would be due to the IAG by end of March 2013.

### **Stage 1 - Approach**

It is proposed that the approach applied in Stage 1 will cover the following:

1. Overview of literature and relevant experience in LMA in Queensland and other jurisdictions.
2. Identify the current issues (and their relative priority) to be addressed in moving to local management arrangements in Queensland.
3. Identify potential local management model options and recommend a short list of preferred approaches with an assessment against the strategic objective success factors.
4. Clarify the specific opportunities and risks and mitigation strategies associated with each of the identified options from the perspective of key stakeholders including irrigators, Government and SunWater.
5. Identify the regulatory and reporting obligations (existing and new) applicable to preferred local management options.
6. Identify significant scheme-specific issues/risks, how they may impact on the implementation of preferred LMA's and the process through which they should be resolved.
7. Identify the extent of support from irrigators for a move to the preferred LMA model(s).

8. Identify potential costs to government of transition and any longer term liabilities that arise from the preferred model/s.

### **Stage 1 - Key Deliverables**

It is expected that an Issues Report will also be provided to the IAG by the Chair of the Working Group after the first meeting of the working group. The IAG will provide feedback to the working group on the Issues Report for consideration in the preparation of the Stage 1 Report.

A Stage 1 Report addressing the objectives for Stage 1 will be provided to the DG of DEWS on or before 31 October 2012.

A decision on the release of the Stage 1 report will be a matter for the IAG.

## **Appendix A. WORKING GROUP MEMBERS**

### **Bundaberg / Isis**

Mark Mammino  
Dale Hollis

### **Burdekin**

Mario Barbagallo

### **Eton**

Josephine Prior

### **Pioneer Water Board**

John Palmer

### **Lower Mary**

Allan Birt

### **Mareeba Dimbulah**

Joe Moro

### **St George**

Scott Armstrong

### **Theodore**

Peter French

### **Emerald**

Ross Burnett

### **Canegrowers**

Warren Males

### **QFF**

Ian Johnson

### **Cotton Australia**

Michael Murray

### **Sunwater**

Tom Vanderbyl

The DEWS Project Manager and/or other Departmental representatives including from other Departments may be invited as observers at working group meetings. Others may also be invited as observers as may be considered necessary to facilitate the efficient and effective conduct of the review. This will be a matter for the working group.

## **Appendix B. Working Group Protocol**

Working group members will agree to adopt and act in the spirit of the following code of conduct:

- To act in good faith and in the best interests of all parties with interest in and responsibilities for the
- Sunwater irrigation schemes.
- To respect the confidentiality of material as advised by the Chair.
- To work with good will and in a collaborative manner.
- To be frank, open and tactful in working group meetings.
- To give proper consideration to all matters and material brought to the working group.
- To actively seek technical and other information/views out of session in order to enable active
- participation in working group deliberations.
- To respect and take into account the views and values of other members, departmental staff and all
- persons with whom the working group interacts.
- To actively seek the views of other people in their organisations/sector/networks in relation to matters
- that are or should be being considered by the working group.
- To actively and accurately communicate working group deliberations including alternate views to their
- own networks while observing confidentiality.
- To make full and complete disclosure at the earliest opportunity of any personal involvement which
- might result in a conflict of interest, pecuniary or otherwise?



### WESTERN AUSTRALIA (ROBERTS AND HENNEVELD, 1997)

The impetus for change in WA came from growing concern in the late 1980s by government and growers alike about the poor financial performance of the State-owned irrigation schemes, the deteriorating condition of the ageing infrastructure, and inefficient water use and environmental degradation. There was also a level of grower dissatisfaction with the way that the schemes were being run, particularly in light of significant price increases introduced by the then Water Authority of Western Australia at that time. This led to a call by growers to have a greater say in the way the irrigation schemes were being managed.

The approach adopted in Western Australia by the Water Corporation has been to transfer the ownership of the irrigation schemes to grower-owned irrigation cooperatives. Under this approach the irrigation cooperatives assume responsibility for delivering retail water services to growers and on-going ownership and management of the irrigation assets. The Water Corporation remains responsible for the supply of bulk water to the irrigation cooperatives and the management of the headwork's assets.

The transfer of the irrigation schemes was a complex divestment of publicly owned assets. It involved the Government, Government agencies, the Water Corporation and the growers, and each of these stakeholders had different criteria for determining whether a transfer should proceed.

For Government, the long-term benefits to the State had to outweigh the costs incurred in implementing the transfer of publicly owned assets to private ownership.

For the Water Corporation, the transfer had to be financially sound and have a positive impact on the Corporation's bottom line.

The growers required the creation of a financially viable cooperative capable of delivering efficient water services to its members.

Within the Water Corporation the irrigation transfer projects were managed as significant change management projects. Dedicated project teams with project management, financial, economic, engineering and legal skills were established to manage and negotiate the transfers with growers. The regional staff and specialist groups within the Water Corporation supported the project teams.

To ensure the growers had the best information available to enter into negotiations, the Water Corporation paid for legal, business and engineering consultants to advise them. Included in the engineering and business consultants' tasks was the preparation of detailed asset management plans and business plans for the new cooperatives.

Further specialist advice on corporate governance, business structures, taxation and community consultation was provided to the growers on an 'as and when required' basis.

The rights and obligations of both parties in the transfer of the irrigation schemes and the subsequent management of the schemes were set out in three agreements. As with any acquisition/divestment, due diligence was a critical element in the process.

The agreements were:

- The Business Transfer Agreement;
- The Asset Transfer Deed; and
- The Water Supply Agreement.

The Business Transfer Agreement set out the obligations on the Water Corporation in transferring the business, including the transfer of non-irrigation customers, plant and equipment, spare parts and other stock, and business records and other intellectual property. It also covered matters such as the assignment of licences and contracts and the treatment of debtors and creditors. A condition precedent in the Business Transfer Agreement was a requirement for a comprehensive business plan for the new cooperative covering the cooperative structure, financial projections and cash flows, business risk assessment, taxation, insurance, billing and revenue collection and customer relations. The business consultant advising the growers produced this plan.

The Asset Transfer Deed set out the detail of the asset transfer, including the mechanism of asset transfer under a Transfer Order, representations, covenants and warranties with respect to the assets, passing of title and risk, and Water Corporation commitments towards repairs and maintenance of the assets following transfer.

The Water Corporation funded an engineering consultant to prepare an asset management plan for the cooperatives covering an asset register, asset condition, the asset renewals profile, a capital investment strategy, a resource plan, operations and maintenance plans, and contingency plans. The asset management plan was included as an attachment to the Asset Transfer Deed, and was also a prerequisite for securing an operating license for the irrigation cooperatives.

The Water Supply Agreement described the terms and conditions under which the Water Corporation would supply water to the irrigation cooperatives. It covered conditions of supply, delivery systems and supply points, metering and metering points, water losses; water quality and water charges.

In taking over the schemes the irrigation cooperatives have taken responsibility for the management of the schemes in an environmentally sustainable way. This has required clear identification of environmental problems and agreement on the sharing of responsibility for these problems and any consequent environmental liability. Sharing of liability and agreed environmental indemnities were set out in the Asset Transfer Deed and the Business Transfer Agreement.

The success of the irrigation reform program in Western Australia has been attributed to a combination of factors, including:

- The dedication and enthusiasm of growers who had a vision for their industry and were prepared to pursue it over a number of years;
- The strong commitment of the Water Corporation to the reforms and its preparedness to provide the necessary legal, financial and engineering resources to achieve a successful outcome; and
- The willingness of successive State governments to implement the reforms and provide the necessary financial support to the newly formed irrigation cooperatives to achieve financial sustainability.

#### **NEW SOUTH WALES (MCGLYNN 1998)**

Water delivery from the bulk off take to the irrigator's wheel or meter and drainage from the farm to channels or disposal areas were the two prime functions that were transferred by the NSW Government to local autonomy and control.

The objectives for both the decision to, and mode of, transfer were to:

- improve the efficiency, accountability and sustainability of the NSW rural water system as a whole,
- deliver a service to growers at an economic cost, and
- minimise and cap the cost of the schemes to the Treasury and the taxpayer.

To allow local autonomy to progress, a 'negotiation package' for future asset renewals and Land and Water Management Plans was formulated in NSW. Local autonomy and control over local decisions and functions in a better structured water industry allowed the state the opportunity to cap these subsidies and to pay out the future stream of subsidy payments as a one-off negotiated deal. Whilst the NSW Government negotiated 'separation' funding contributions towards asset programs, thereafter the irrigation corporations have been fully responsible. Government funding was conditional upon the corporate entities establishing appropriate reserves.

The Corporate forms adopted by NSW entities include Public Companies limited by shares and cooperatives. Some 10 years on from privatisation in NSW the performance of the schemes in moving from a government culture to a customer focused commercial operation indicates that this has been successful.

**WORKING GROUP  
LOCAL MANAGEMENT ARRANGEMENTS  
CHANNEL IRRIGATION SCHEMES**

**Ownership & Management  
Structuring Options**

**Issues**

- Rationale
- Scheme Characteristics and Participants (number, relative size and objectives)
- Capacity for Shared Objectives
- Asset Ownership
  - Transfer of title/ownership
  - Long term lease
- Management Capacity
  - Operations
  - Assets
- Financial Viability
  - Scheme Shortfall
  - Funding – operations and capex
- Regulatory obligations and governance
- Risk management and sharing/allocation
- Intergenerational equity

## Objectives

- Lower delivery costs
- Management decision making and control
  - Operating and maintenance costs
  - Capital expenditure - nature and timing
    - Replacement
    - Upgrade
  - Pricing parameters
- Mutuality benefits

## Ownership Structure Options

- Partnership
- Limited Partnership
- Unincorporated Joint Venture
- Cooperative
- Company
  - Limited by shares
  - Limited by guarantee
- Unit Trust
- Combinations

## Ownership Structure Options

### Partnership

#### Description

Two or more individuals, companies or other entities join together to carry on a business or enterprise with a view of profit. No separate legal existence from the partners

#### Advantages

- Inexpensive and no formalities required to establish except for partnership agreement
- Informal/flexible arrangements by agreement.
- Establishment costs are minimal.
- Partnership not liable to pay tax.
- Governed by partnership laws including Partnership Act
- Each partner responsible for its own tax.

#### Disadvantages

- Unlimited joint & several liability
- Potentially unwieldy management & decision making
- Cannot transfer interest in partnership easily.
- May be construed to be partnership even if unintended.
- A partner can bind the other partners to a contract without their authority.

## Ownership Structure Options

### Limited Partnership

#### Description

A partnership with one or more general partners and one or more limited partners. Limited partners are liable only for the commitment of agreed amount of capital and have no right or responsibility for management. The general partner(s) is responsible for management and the debts of the LP if it is unable to meet its obligations.

#### Advantages

- As for partnership
- Limited partners liability restricted

#### Disadvantages

- General partner(s) have full management control
- May create funding difficulties

## Ownership Structure Options

### Unincorporated Joint Venture

#### Description

An Unincorporated Joint Venture is an association of participants which lacks both form and equity capital. It is bound by the terms of the contract between the participants and the commercial activity that they agree to undertake collectively. Parties receive their share of income/product separately and right to separately dispose of it. Usually separate operator/manager

#### Advantages

- Each party is only liable separately
- Management activities are governed by the joint venture agreement
- Each party controls product
- Taxed as a partnership

#### Disadvantages

- JV agreements often complex
- Separate asset ownership problematic
- No joint "profit"
- Usually separate manager/operator

## Ownership Structure Options

### Co-operative

#### Description

A co-operative is an incorporated body registered under the Co-operatives Act 1997. A co-operative is a user owned business run by an association of persons. It is a separate legal entity with limited liability for members.

Co-operatives can be trading (members can share in profits made from trading and the asset growth based on their share capital) or non-trading (a "not for profit" with or without shares prohibited from distribution of surplus funds to members from profits or upon winding up)

#### Advantages

- Separate legal entity with limited liability
- Governed by co-operative principles including voting based on membership
- Possible tax advantage under Division 9
- Well defined governance structure
- Understood and used in rural enterprises

#### Disadvantages

- Often restricted access to capital and debt
- Must comply with the Co-operatives Act and some provisions of the Corporations Law including approval of rules, disclosure statement, annual reporting and audit
- Registrar vested with strong powers of investigations and enforcement
- Cooperative principles can be restrictive or impact management

## Ownership Structure Options

### Company –Limited by shares

#### Description

Separate legal entity with liability limited to value of shares and governed by the Corporations Act and may be private (proprietary) or public.

#### Advantages

- Limited liability
- Well understood governance and management structures
- Shareholders Agreement and/or Constitution may prescribe management approach and activities
- Possibly small proprietary company compliance requirements
- Share transfers simple but possible restriction if desired
- Different classes of share if needed
- Financing easier

#### Disadvantages

- Shareholders may not be able to influence management decision making
- Shareholder number limited to 50
- Taxation as a separate entity with no pass through benefits
- Compliance requirements and costs

## Ownership Structure Options

### Company –Limited by guarantee

#### Description

Separate legal entity with liability limited to specified amount members guarantee to contribute and governed by the Corporations Act. Must be public.

#### Advantages

- As for company limited by shares other than small proprietary company compliance requirements and ease of funding
- Unlimited number of members

#### Disadvantages

- Public company compliance requirements including audit
- Financing may be more difficult
- Shareholders may not be able to influence management decision making
- Taxation as a separate entity with no pass through benefits



## Ownership Structure Options

### Unit Trust

#### Description

A trust is an obligation whereby the trustee holds property for the benefit of another (the beneficiary) or for the advancement of specific purposes. A unit trust derives income, usually in the course of conducting a business, under a deed, where its "capital" is represented by units usually of equal amounts. The number of units owned by a unit holder determines the entitlement to the income distributed annually and the interests held in the assets of the trust.

#### Advantages

- Limited liability
- Units define that party's interest in the assets and income of the trust;
- Can be easily transferred and can be re-acquired by the trustee.
- Less regulation than a company;
- Taxation advantages over a company (in some cases);
- The trust deed can be tailored to the needs of unitholders and may prescribe management approach and activities

#### Disadvantages

- Losses quarantined
- May be public trading trust and taxed like a company if >50 unitholders

## Ownership Structure Options

### Comparison Matrix

Structure	Partnership	Limited Partnership	Unincorporated Joint Venture
<b>Jurisdiction</b>	State	State	Commonwealth
<b>Governing legislation</b>	Partnership Act	Partnership Act	Tax Act
<b>Ownership</b>	Partners may be corporate entities	1 + General Partner (s) 1+ Limited Partner (s)	Severally proportionate to interest
<b>Control</b>	Partners	General Partner	Set by Joint Venture Agreement
<b>Governance</b>	NA-possibly Partnership Agreement	Partnership Agreement	Joint Venture Agreement

## Ownership Structure Options Comparison Matrix

Structure	Partnership	Limited Partnership	Unincorporated Joint Venture
<b>Management/Operations</b>	As agreed by partners	General Partner	Usually separate vehicle with management agreement
<b>Liability</b>	Joint & Several	General partner - Unlimited Limited Partner - Nominated amount	Several
<b>Compliance</b>	Minimal	Registration	Usually detailed reporting and accountability
<b>Financing</b>	Depends on partners position	Restricted	Undertaken separately by joint venture parties

## Ownership Structure Options Comparison Matrix

Structure	Trading Cooperative	Company limited by shares (Proprietary)	Company limited by guarantee	Unit Trust
<b>Jurisdiction</b>	State	Commonwealth	Commonwealth	State
<b>Governing legislation</b>	Co-operative Act Corporations Act.	Corporations Act.	Corporations Act.	Trust Act
<b>Ownership</b>	Shares issued to members who use the services or products	Shareholders in accordance with the company's constitution Can have different classes of members with different voting rights.	Members in accordance with the company's constitution Can have different classes of members with different voting rights.	Unit holders in accordance with the Trust Deed

## Ownership Structure Options Comparison Matrix

Structure	Trading Cooperative	Company limited by shares (Proprietary)	Company limited by guarantee	Unit Trust
<b>Control</b>	Generally one vote per member Only active members vote  Ownership interest transferable among members	Voting rights attached to shareholding Shares transferable usually subject to restrictions in Constitution	Generally one vote per member  Generally not transferable	Voting attached to unit holding  Units transferable
<b>Governance</b>	Rules Board of Directors	Constitution Board of Directors	Constitution Board of Directors	Trust Deed Trustee

## Ownership Structure Options Comparison Matrix

Structure	Trading Cooperative	Company limited by shares (Proprietary)	Company limited by guarantee	Unit Trust
<b>Management Operations</b>	Entity responsible	Entity responsible	Entity responsible	External management vehicle
<b>Liability</b>	Limited	Limited	Limited	Limited
<b>Compliance</b>	Registration under Cooperatives Act Registrar has certain powers Reporting to Registrar	ASIC Registration & Regulation	ASIC Registration & Regulation Audit if turnover >\$1m	Governed by Trust Deed

## Ownership Structure Options Comparison Matrix

Structure	Trading Cooperative	Company limited by shares (Proprietary)	Company limited by guarantee	Unit Trust
<b>Financing</b>	Members Cash Flow Debentures Bank Debt Government Debt	Shareholders Cash Flow Bank Debt	Members Cash Flow	Unitholders Cash Flow Bank Debt
<b>Ownership limits</b>	Minimum 5 members 20% Max interest	Minimum 1 Maximum 50 shareholders	Unlimited members	Unlimited Unitholders
<b>Distribution of earnings</b>	Rebates Dividends Bonus Shares	Dividends Bonus Shares	Prohibited	Distributions

## Ownership Structure Options Comparison Matrix

Structure	Trading Cooperative	Company limited by shares (Proprietary)	Company limited by guarantee	Unit Trust
<b>Taxation</b>	As a company but provisions of Division 9 apply if a "tax cooperative"	Usual company tax rules apply	Usual company tax rules apply	Pass through of income and capital gains possible
<b>Public inspection of ownership registers?</b>	No Members have right	No ASICs search	Yes	No

## Options Evaluation Example

	Delivery Costs	Management Decision Making	Mutuality	Funding	Overall Ranking
Partnership	✓✓	✓✓	✓✓	✗	5
L Partnership	✓✓	✓	✓	✗	6
UIV	✓	✓✓	✗	✗	7
Co operative	✓✓✓	✓✓✓	✓✓✓	✓✓	1
Coy - Shares	✓✓	✓✓	✓	✓✓✓	2
Coy - G'tee	✓✓	✓✓	✓	✓✓	4
Unit Trust	✓✓	✓✓	✓	✓✓	3
✓✓✓ Option is extremely effective in satisfying the requirements of the objective					
✓✓ Option is effective in satisfying the requirements of the objective					
✓ Option just satisfies the requirements of the objective					
✗ Option is ineffective in satisfying the requirements of the objective					

## Management Structure Options

- In house
- Outsource
  - SunWater
  - Local Government
  - Private sector
- Combination



Review of Local  
Management  
Arrangements

Due Diligence from  
an acquirer's  
perspective

Working Group  
13 September 2012

**INDEC**

## OUTLINE OF PRESENTATION

- Introduction
- What is due diligence?
  - Buyer Beware & Prepare
  - Typical due diligence framework
  - Key issues to consider
- Buyer Beware (what are you acquiring?)
- Buyer Prepare (the plan for successful acquisition)

Disclaimer: This is not a comprehensive due diligence list. The objective of this presentation is to provide general background and a basic level of understanding of a typical due diligence process from an acquirer's perspective. It is not designed to provide specific advice on strategy or risks or whether or not it is prudent to proceed with the transaction currently under consideration.

## WHAT IS DUE DILIGENCE (1)? BUYER BEWARE & BUYER PREPARE!

### Due diligence - Buyer beware

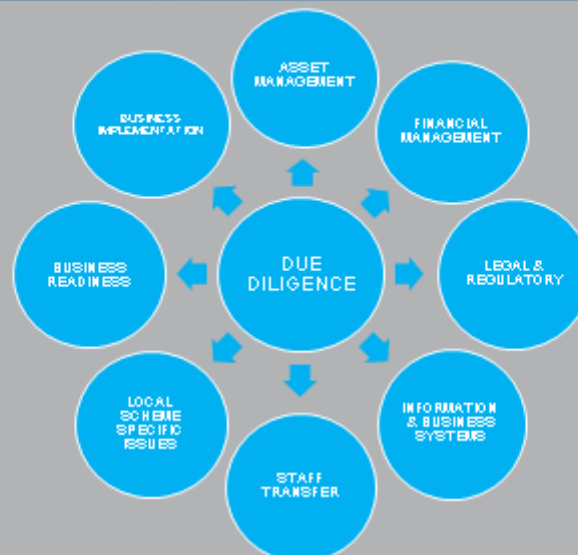
- Opportunity for a potential acquirer to seek information, ask questions and conduct analysis
- Gather only information needed to gain a thorough understanding of the business & condition of assets to assess how it can be operated sustainably under future local management arrangements

### Due diligence - Buyer prepare

- Model how the new business can be operated sustainably under future local management arrangements
- Model financial and operational impacts of different business structure options and prepare robust & credible financial and operational plans for the selected new business structure(s)



## WHAT IS DUE DILIGENCE (2)? TYPICAL DUE DILIGENCE FRAMEWORK



## WHAT IS DUE DILIGENCE (3)? KEY ISSUES TO CONSIDER

- Focus on key strategic acquisition & operational issues
- Establish strategic objectives of acquisition (local management) to inform & guide due diligence to better test achievability, risks & opportunities
- Identify information needs to enable appropriate analysis to inform decision making
  - Have list prepared well in advance
  - List may differ for each scheme or region to account for local conditions & issues
- How will the Due Diligence process be managed?

## Buyer Beware (1) (What are you acquiring?)

### Irrigation business assets

- Which relevant business assets are currently used (fixed infrastructure, equipment and facilities)?
- Can all those assets be clearly defined as bulk or distribution?
- Have the assets been physically verified?
- What is the condition of the assets and is there currently any maintenance backlog? Is this consistent with annuity balances?
- What are the asset performance standards?
- What are the current operations and asset management plans?
- What is the current maintenance and renewal plan timetable and costs?
- Are there any necessary major asset renewal projects not currently proposed?



## Buyer Beware (2) (What are you acquiring?)

### Irrigation business activities

- Which relevant business activities are currently carried out?
- How are the activities currently carried out?
- What resources are currently required to carry out the activities (staffing, systems, facilities, equipment, etc)?
- What is the current organisation structure and staff employment arrangements?
- What are the current major business processes and which of these should be transferred?
- What processes and business systems are currently in place to support customer service and billing?

## Buyer Beware (3) (What are you acquiring?)

### Financial/intellectual property assets and arrangements

- Which financial/intellectual property assets and arrangements should be transferred?
- What are all the legal & regulatory requirements faced by the relevant part of the current business?
- Are there plans to change and/or introduce new requirements in the future?
- What IT and other critical systems are currently used by the business?

### Legal and Regulatory

- What are the pricing & customer service standards?
- Are there any land tenure issues?

## Buyer Beware (4) (What are you acquiring?)

### Costs and Revenues

- For the part of business being transferred how have total revenues compared with total costs for the last three years and do projected revenues cover costs in the future?
- What impact does more or less water use have and what flexibility is there to vary costs, and to what extent?
- What are the key costs drivers and which costs are fixed and variable?
- What are the financial projections of the business for the next 12 months and 10 years under current management arrangements?
- What is the current cash requirement (working capital) to pay staff, suppliers and other commitments?
- Is the business generating sufficient cash to fund its operations and asset renewals?

## Buyer Beware (5) (What are you acquiring?)

### Liabilities

- Are there any unexpired purchasing commitments?
- What are the amounts and terms of any other debt agreements?
- Are there any potential tax liabilities?
- Is expert tax advice required?

### Insurance

- Which of the relevant activities are insured?
- Are there any uninsured or self-insured risks in the current business?

## Buyer Prepare (1) (Business Readiness)

### Business structure and operation after separation

- What should the structure of the new business be?
- What governance arrangements should the new business have?
- Will the new business need transitional support from SunWater?
- If support is needed, what activities and how is this agreed?
- How will the business operate with SunWater as bulk water provider?
- How can the business develop new opportunities?

### Stakeholder management

- How should the new entities interface with SunWater?
- How should the new entities interface with other stakeholders?

## Buyer Prepare (2) (Business Readiness)

### Assets

- How will the business assets be used in the new business (fixed infrastructure, equipment and facilities)?
- What public assets such as roads, culverts etc. will transfer and what are the ongoing obligations to maintain and repair?

### Activities

- How will the main business activities and processes that will be transferred operate?
- What processes and business systems are currently in place to support customer service and billing?

### Buyer Prepare (3) (Business Readiness)

#### Staff and other resources

- What resources will be required to carry out the transferred activities (staffing, systems, facilities, equipment, etc)
- What is an appropriate organisation structure to deliver the activities being transferred?
- Which staff are required to deliver the activities being transferred?
- What are the conditions of any transfer (employment contracts and/or employment arrangements & conditions)
- What facilities and equipment are required to house any transferred staff (depots, office accommodation, etc.)?

### Buyer Prepare (4) (Business Readiness)

#### Costs and Revenues

- What are the projected costs and revenues for the new business?
- Should currently proposed major capital expenditure programs go ahead in the new business?
- Will projected revenues cover costs in the future?
- What impact does more or less water use have?
- Can alternative pricing arrangements be implemented?
- What are the future key costs drivers and which costs are fixed and variable?
- What flexibility is there to vary costs and to what extent and what costs can be avoided under local management?

## Buyer Prepare (5) (Business Readiness)

### Funding

- What are the annual funding needs over the next 10 years to operate the new business and fund asset maintenance?
- If external funding is required, what are the options available?

### Cash flow

- What is the projection of cash flow for the next 12 months and 10 years?
- What is the cash requirement (working capital) for day one to pay staff, suppliers and other commitments?

### Financial Projections

- What are the financial projections of the business under a local management arrangement?
- Can the business generate sufficient cash to fund its operations and asset renewals?

## Buyer Prepare (6) (Business Readiness)

### Liabilities

- How will any unexpired purchasing commitments be managed?
- How will any liabilities be managed?
- Are there any potential tax liabilities?
- Is expert tax advice required?

### Insurance

- What options are available to insurance the new business and its activities?
- Are there any uninsured risks that the business does not appear to be aware of or is ignoring?

## Buyer Prepare (7) (Business Readiness)

### Legal and Regulatory

- Do legal and regulatory requirements change under local management and does this alter the risk profile and cost base of the business?
- Is expert legal opinion required?
- What are the future pricing & customer service standards?
- What are the future legal requirements related to governance arrangements?
- What are the future legal and regulatory requirements related to asset management?
- Will there be any land tenure issues?
- What will be the future legal requirements related to industrial relations?

## Buyer Prepare (8) (Business Readiness)

### Information and business systems

- What IT and business systems should the new business use?
- How will any IT and business systems currently in use be transferred to the new business and over what time frame?
- What historical business records will the new business require?
- What data should be transferred and how?

## Buyer Prepare (9) (Business Readiness)

### Local Scheme Specific Issues

- Are there any legacy issues impacting on scheme performance?
- Are there any current local arrangements that must continue into the future?
- Is there anything that has to change?
- How will channel distribution losses be treated?
- How will main channels be treated if non-irrigation customers also receive a benefit?
- How should pump stations located within bulk supply structures be treated?
- Are there any other issues unique to your scheme that haven't been adequately captured in the other parts of the due diligence process?

## IMPLEMENTATION

### What?

- What are the key implementation tasks?

### When?

- When will the key transfer and implementation milestones occur?

### Who?

- Who will manage and resource the business transition and implementation?

### How?

- How will the implementation of the new business be managed?
- How can you ensure that service standards are maintained during transition?
- How will the key implementation risks be managed and mitigated?

## SUMMARY

- What are the key objectives of the acquisition?
- What information is required to make a decision?
- What are the key risks and opportunities of the acquisition?
- How does government policy influence achievement of objectives?
- What is the business structure and operating strategy?
- Will the new business deliver on the objectives and how quickly?
- Can the business operate on a lower cost base?
- Can revenue and pricing be better aligned to objectives?
- How can the business develop new opportunities?
- How does business operate with SunWater as bulk water provider?

## BUYER BEWARE & BUYER PREPARE!





## QUESTIONS?



## CONTACTS & FURTHER INFORMATION

Mr David Gotze  
☎ 0417 035 244  
[david.gotze@indec.com.au](mailto:david.gotze@indec.com.au)

Mr Sandro Marin  
☎ 0430 034 511  
[sandro.marin@indec.com.au](mailto:sandro.marin@indec.com.au)