Update from the Chair

It’s a busy time for the majority of our allocation holders in the Theodore Scheme right now, particularly for those irrigators planting cotton. After the past run of tough seasons we are hoping this will be a bumper crop for everyone.

Look out for local directors Peter French, Kirk Anderson and Greg Austin in the next few weeks as they chat to local allocation holders about the Board’s preferred corporate form for a new entity.

We also look forward to welcoming allocation holders, SunWater staff, local businesses and their families at our first public event to be held the afternoon and evening of November 6. This will be a great opportunity to find out more about the progress the Board has made on your behalf so far, and to provide your thoughts and suggestions. All the directors will be working on the BBQ so don’t miss out! We thank our sponsors Queensland Cotton, who are providing drinks.

Finally, thank you to our admin support Bron Christensen and the Project team, and most importantly the Interim Board members. Reading through this edition, you will be able to clearly see the significant time and effort they are committing to what are often complex issues.

Liz Alexander

The Board & project team deliberate on Corporate Form at the August meeting
Consultation Underway on the Board’s Preferred Corporate Form

This month our examination of the various corporate forms available to a new local entity managing the Theodore scheme identified, what we believe, to be the best structure for us.

A close examination of four governance options has resulted in us proposing to you that a Company Limited by Shares would best deliver to local allocation holders any benefits flowing from local management. Our proposal is based on the view that a future entity would be a not-for-profit organisation which is small in size, efficient, flexible and simple to administer.

Our preference for a Company Limited by Shares is based on the fact that this form will maximise tax savings using depreciation and allows a straightforward voting structure that permits one ML of water entitlement to equal one share and vote.

We are recommending that a future board have up to five members with at least two directors being local irrigators and two director positions reserved for independent (not allocation holder) directors. The independent directors will ensure that the board has the necessary balance of skills for its effective operation.

We propose that the future board and its staff would be supported by a Scheme Advisory Group that would represent the interests of all customers. The group would include customers from each section of the scheme including smaller water users.

Another important consideration when looking at corporate form is deciding who will make what decisions. We propose that in addition to decisions that are classified as “special” under the Corporations Act, 2001 and require a 75 per cent majority of votes cast to be carried, that decisions relating to change in ownership of the company or sale of assets over a certain value, also be considered “special.” The Board recommend this to further safeguard assets and equity of the scheme or the entire scheme from takeover. Other decisions will be considered “normal” and require a simple majority (over 50 per cent).

We came to our view after carefully weighing up the pros and cons of four governance structures, including remaining with SunWater, and we would be pleased to show you the thinking behind our process.

In our view, a Company Limited by Shares would be the best structure to deliver to Theodore improved operation of the scheme and benefits to flow back to allocation holders.

Before finally deciding to put forward this corporate form in our business proposal to government, we would like to hear from you. Local irrigator directors Peter French, Kirk Anderson and Greg Austin will be trying to catch up with as many of you as possible. However, you are also welcome to contact the Chair or any Director on our mobiles if you prefer. And of course, we welcome you to come to our information session on 6 November.

Thinking about Insurance and Strategic Risk Management

At the Interim Board meeting of September 23, the Board focused on reviewing and completing their Strategic Risk Management plan, and correspondingly focusing on insurance - what’s required, cost and availability. Obtaining and securing cost-effective insurance is one area where SunWater, due to its size and scale, was able to secure some advantage over a small local entity.

The Interim Board considered a report from Strathearn Insurance Brokers prepared as a high level review of insurance cover and costs estimated for each of the eight schemes. The good news is that the scheme should be able to buy insurance to cover the same sort of risks as are currently covered by SunWater, if it wants to. The bad news is that it will likely cost more and because of recent flood claims in Queensland, it will be difficult to obtain flood cover which we may need to buy separately based on Theodore’s specific flood and rainfall information.
Theodore Channel System Local Management Arrangements
Newsletter October 2013

The average cost of cover estimated by Strathearn for Theodore, excluding flood cover, was around $230,000 (ranging from high $342,000 to low $123,000 estimates). This compares with the current SunWater allocated insurance costs for Theodore of $45,000 (including flood). SunWater’s allocation is based on a calculated share of their total insurance costs across all of their business.

The Interim Board considered options for balancing the costs of insurance with the need to manage the risks to the scheme. The insurance provided by SunWater is comprehensive. The Board will do more work to identify areas where some of the risks currently insured by SunWater may be better managed through other mechanisms. For example, while SunWater currently insures 100% of its assets at estimated replacement value, Pioneer Valley Water only insure the most risky 10% of their assets. The Board is approaching local insurance brokers to visit the scheme to provide advice on the types and amounts of cover appropriate to the risk profile of the Theodore scheme, with better cost estimates to follow.

We are at the very start of engaging with this complex and difficult issue and will update stakeholders as we develop suitable proposals to safeguard Theodore’s assets and people.

Revisiting the Financial Position of Theodore Channel Scheme

The Theodore interim board is exploring what costs are likely to be under local management. While there is significant uncertainty, particularly around pricing of electricity and flood insurance, we already are confident that we will be able to reduce overhead and administration costs. Here is a recap of the financial situation to date:

Currently SunWater’s total costs for operating the Theodore Channel scheme are $1.3 million per year. Of this, $1.2 million are operating costs (e.g. labour, contractors and materials) and $0.1 million are capital costs for renewing and maintaining scheme assets (e.g. pumps). SunWater’s overhead and administration costs make up about half of the $1.3 million spend.

In 2012, the Queensland Competition Authority (QCA) established two important benchmarks; the price that would be required for the scheme break-even (the cost-reflective price), and the price to be paid by irrigators.

In 2013-14, the Part A (or fixed annual) charges paid by irrigators are below cost. This is due to Government’s policy of capping price increases. On the other hand, the Part B (or variable) water use charge covers what QCA’s estimated as the variable costs of running the scheme.

<table>
<thead>
<tr>
<th>Tariffs</th>
<th>2013-14</th>
<th>2014-15</th>
<th>2015-16</th>
<th>2016-17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part A or fixed costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>($ per ML of water allocation)</td>
<td>QCA efficient cost</td>
<td>$79.27</td>
<td>$81.25</td>
<td>$83.28</td>
</tr>
<tr>
<td></td>
<td>Price paid by irrigators</td>
<td>$51.21</td>
<td>$54.59</td>
<td>$58.11</td>
</tr>
<tr>
<td>Part B or variable costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>($ per ML of use)</td>
<td>QCA efficient costs = Price paid by irrigators</td>
<td>$30.88</td>
<td>$31.66</td>
<td>$32.45</td>
</tr>
</tbody>
</table>

Government pays a subsidy to cover the difference between the fixed cost-reflective price and the actual price paid by irrigators. This subsidy is currently about $0.4-0.5 million per year for the Theodore channel scheme. As you can see in the table, the recommended fixed charges increase by $2 per ML per annum (plus 2.5% CPI). This decreases the subsidy by about $30,000 per annum.

Government has not decided what to do after June 2017; however, the Board is cautious about whether this subsidy will continue under SunWater management and Government ownership.

If the QCA’s forecast costs were correct in 2012, the total channel subsidy for the current prices path 2013-17 would be about $2.1 million (nominal). In reality, the subsidy paid by government is greater than this, as there are other costs that SunWater meets, which are not paid by irrigators and which are not factored in to the table calculations, including recent increases in electricity prices and insurance premiums.

The Government is currently looking at recent SunWater cost increases. The Theodore interim board will receive the revised costs as soon as they are available. These will form part of the Theodore local management business proposal, which will be provided Government early in 2014.

August LMA Working Group meeting: Focus shifts to asset condition and legal matters

Liz Alexander attended the August LMA Working Group which is led by Independent Chair Leith Bouly, and comprised of the Chairs of the Theodore, Bundaberg, Burdekin-Haughton, Emerald, Eton, Lower Mary, Mareeba-Dimbulah and St George SunWater channel schemes. Progress on the scope of the engineering due diligence and identification of fundamental legal issues were key outcomes of the Local Management Arrangements Working Group (LMA WG) meeting last month.

This second meeting, held on August 8 and 9, focused on the detail required for interim boards to investigate the option of local management of the eight channel schemes currently owned and operated by SunWater.

The engineering due diligence (EDD) scope was agreed in principle, with each interim board to provide local information to the project team by August 16. Policy matters requiring resolution by government, such as metering standards, were raised by the Chairs as crucial to the EDD and completing their business proposal. The finalised scope will then proceed to the Inter-Governmental Advisory Group (IAG), the project’s peak governance body, for sign off.

A workshop was also held to discuss key issues that required legal advice and provide comment on scheme specific issues needing legal attention. Senior government departmental officials participated in the workshop to ensure the needs of government and the interim boards will be met by the legal due diligence. A finalised second stage legal scope will also be provided to the IAG this month.

The meeting also discussed the timeline, with some schemes able to meet the November deadline for business proposals to be submitted to government before summer crop commitments. Other schemes advised they would welcome an opportunity for further time to consult with customers.

Our Chair, Liz Alexander will be attending the next LMA WG meeting, scheduled for October 10 and 11.

Board Contacts
You can email the Board on theodore@lmairrigation.com.au or ring on the numbers below.

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liz Alexander (Chair)</td>
<td>0427 471 511</td>
</tr>
<tr>
<td>Kirk Anderson</td>
<td>0429 181 079</td>
</tr>
<tr>
<td>Greg Austin</td>
<td>0409 931 614</td>
</tr>
<tr>
<td>Peter French</td>
<td>0428 166 634</td>
</tr>
<tr>
<td>Mike Murray</td>
<td>0427 707 868</td>
</tr>
<tr>
<td>Jan Paul van Moort</td>
<td>0404 650 219</td>
</tr>
</tbody>
</table>

In Next Month’s Newsletter

- Phase 2, Legal Due Diligence Report: Key Findings for Theodore
- Liz Reports from Meetings with Ministers and Directors General at the Community Cabinet
- Working Group Update
- Your Feedback on our Preferred Corporate Form
- Highlights from our Public Forum

Upcoming Dates

- **Thursday, Friday 10th & 11th October**
  LMA Working Group meeting, Brisbane

- **Sunday, Monday 20th & 21st October**
  Community Cabinet, Emerald

- **Wednesday 23rd October**
  Interim Board meeting, Emerald

- **Wednesday 6th November**
  Public Forum, Theodore

- **Wednesday 27th November**
  Interim Board meeting, Theodore

- **Saturday 30 November**
  Draft business proposal provided for feedback