

HOW IPART HAS MADE ITS DRAFT DETERMINATION

REVIEW OF PRICES FOR THE WATER ADMINISTRATION MINISTERIAL CORPORATION OCTOBER 2010

IPART takes a “building block” approach to determine water prices that involves:

- Establishing the efficient operating and capital costs of the NSW Office of Water (NOW)
 - Determining the share of these costs that should be paid by water users, using the impactor pays principle
 - Allocating costs to different valleys and between regulated, unregulated and groundwater sources
 - Setting the split between fixed (entitlement) charges and usage charges
 - Determining forecasts for entitlement and usage volumes to set entitlement and usage charges
 - Establishing the efficient, incremental cost of specific activities including meter services and transaction consents, and setting separate charges for these activities
 - Considering impacts on users, and making relevant adjustments
 - Establishing a reporting framework for NOW.
- IPART sets new charges to reflect users share of NOW’s efficient costs
 - IPART is seeking stakeholder feedback on key areas of the Draft Determination

This fact sheet provides a brief summary of this approach. Detailed information is available in the full report of the Draft Determination.

Establishing NOW’s efficient costs

NOW provided IPART with several submissions of its proposed operating and capital costs for the review period. IPART conducted an extensive review of NOW’s submissions and determined that NOW could recover \$110 million from users over the three year period. This is around 41% less than NOW’s submission. The main reasons for the difference between NOW’s submission and IPART’s Draft Determination are:

- IPART has assessed that NOW could be more efficient in delivering core services. IPART has allowed efficient operating costs of \$53 million by 2013/14, about 24% less than NOW’s proposal.

- NOW did not provide sufficient information to increase the users' share of costs for activities associated with the Murray Darling Basin Authority. The total cost of these activities met by users has been maintained at current levels.
- NOW proposed an additional 16 activities associated with meeting the requirements of the Commonwealth water reforms. In the Draft Determination, IPART has accepted that the costs of only 5 of these 16 activities should be recovered from users. The remaining activities were not consistent with the Monopoly Services Order, considered inefficient, not consistent with best practice water management or were being funded by other parties.
- NOW sought to recover a depreciation on and the cost of capital of past capital investments. IPART's investigations found that NOW's asset management and planning systems were inadequate to allow the recovery through prices of past investments. IPART's Draft Determination includes depreciation and the cost of capital on efficient and prudent investments made after 1 July 2011.
- NOW proposed that its prices be set to fully recover the user share of its costs. However, to help mitigate the impact of price rises on water users, IPART's Draft Determination sets prices so that NOW's estimated level of cost recovery transitions from 88% in 2009/10 to 94% in 2013/14.

Establishing the user share of costs

NOW's costs are shared between users and government on the basis of the impactor pays principle. This means that costs are allocated to users according to the contribution they make to the cost being incurred. Each of NOW's activities were analysed and costs have been allocated between users and Government on a case by case basis for each activity.

Allocating costs to different water source types and valleys

NOW does not record costs on a valley by valley basis. To assign costs to each valley, NOW identified key cost drivers for each activity. Costs associated with the Murray-Darling Basin and Commonwealth water reforms have not been allocated to coastal regions.

NOW proposed to allocate groundwater costs to "coastal" and "inland" regions, instead of valleys, and to set "coastal" and "inland" groundwater prices accordingly. IPART accepts this proposal, as it reflects NOW's cost drivers associated with managing groundwater, the limitations in available data, and in some regions, groundwater sources are not confined to a valley. The Draft Determination includes a transition towards common prices for coastal and inland groundwater users.

NOW has used a different method of allocating costs in this determination. IPART views this new approach as being more robust and transparent than the method used in the 2006 determination. These changes mean that the extent of price change varies between the valleys.

Establishing the two part tariff

IPART's Draft Determination establishes a "two-part tariff" for all users that have a meter. This two part tariff has been set so that NOW recovers 70% of forecast revenue from fixed charges based on entitlement volume, and 30% from charges based on metered usage from most valleys, except the North Coast. Where a water user does not have a meter, IPART's Draft Determination sets a one-part fixed charged based on entitlement. In its submission, NOW proposed that all costs be recovered from fixed charges.

Establishing entitlement and usage forecasts

IPART has used estimates of entitlement in each valley based on information provided by NOW.

Usage forecasts in regulated rivers have been based on a 20-year rolling average of extractions. This is consistent with IPART's recent State Water determination.

NOW did not provide usage forecasts for unregulated rivers and groundwater sources. IPART has assumed that 100% of entitlement will be used, which is consistent with available water determinations for these water sources. This assumption generates price outcomes favourable to users.

The total entitlement volumes of Hunter Water and the Sydney Catchment Authority have been included when allocating costs and setting prices for the Hunter and South Coast.

Meter service and reading charges and consent transaction charges

IPART's Draft Determination sets new meter service and reading charges, which relate to the costs associated with reading all meters and maintaining government installed meters in unregulated river and groundwater areas. These charges range from \$105 per meter to \$679 per meter.

NOW proposed to increase the fees it charges for processing consent transactions such as approvals. IPART's Draft Determination includes costs for these activities that are reasonable and efficient.

Considering impacts on users

IPART acknowledges that the price increases in many water sources and regions are significant. To help mitigate the impact of increases on users, IPART has set prices so that annual increases in bills for most users with assumed usage patterns should not exceed 20%.

Establishing a reporting framework for NOW

NOW has inadequately responded to concerns relating to systems and performance that IPART raised in its last determination. IPART has written to the Minister for Water with specific recommendations about improvements to NOW's financial and reporting systems and approach to consulting with stakeholders. The Draft Determination establishes a reporting framework for NOW, which aims to ensure that NOW improves the transparency of its expenditure and outcomes achieved.

IPART is keen to hear your views on the Draft Determination and Report, including:

- The method of allocating costs between valleys and water sources
- The structure of prices, including setting a two part-tariff for all metered users
- The proposed opening value of NOW's regulatory asset base and enabling NOW to include the cost of capital for new investments made after 1 July 2011
- IPART's assessment of additional activities associated with Commonwealth reforms
- The structure of the new meter charges for government installed meters and for user owned meters
- Our approach to managing impacts on users

How to find more information.

To obtain a copy of IPART's Draft Report, or for further information please visit www.ipart.nsw.gov.au or contact Amanda Chadwick:

Email: amanda_chadwick@ipart.nsw.gov.au

Telephone: (02) 9290 8453

Fax: (02) 9290 2061

How to make a submission.

Submissions to this review are due on the 29th November

Send your submissions to:

Email: ipart@ipart.nsw.gov.au

Fax: (02) 9290 2061

Mail: Water Administration Ministerial Corporation Price Review 2010
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230