**Hunter Water Corporation**

**Submission to the**
**Independent Pricing and Regulatory Tribunal on**
**Bulk Water Pricing**

**May 2001**

"This Submission

Hunter Water Corporation has reviewed the April 2001 Bulk Water Submission by Department of Land and Water Conservation (DLWC).

The DLWC submission proposes to increase Hunter Water's bulk water price substantially over the next three years from the current charge of $1.80 per megalitre to $3.10 per megalitre in 2003/04. **This represents a real increase of 67% in three years.** Hunter Water has concerns about the determination of this price increase on a number of levels.

First, the proposed price for 2001/2002 is essentially a real indexation increase of the current charge (an increase of 19%) with indexation being applied since 1995, presumably to cover the 15% real price decline quoted in the DLWC submission. This approach is quite different to that used to calculate the charges for other unregulated and groundwater users. For all other users, a cost-reflective approach, rather than indexation, is used to establish the base (2001/02) charge. This difference in approach means that the proposed price increases for Hunter Water **are significantly higher** than the charges applying to other users of the **same resources.**

The DLWC does propose some parity between the charges for Hunter Water Corporation and other unregulated river and groundwater users. However, this is limited to the annual real increment in charges post 2001/02. From 200 1/02, the incremental price increase each year proposed by DLWC is the same as the increments applied to the charge for other users of unregulated rivers (20% per year).

It is Hunter Water's belief that a consistent methodology and charge should be applied for all users of unregulated rivers and groundwater in line with the Council of Australian Governments (COAG) principles of cost recovery and the removal of cross subsidies in services use and provision.

In addition to the inconsistencies in methodology, the DLWC proposal for metropolitan water charges has **overlooked the contributions** that Hunter Water makes directly to management of water resources, both locally and to wider State and national programs.

Also, now that volumetric charges are being established for both unregulated users and groundwater users, there is an opportunity to recognise the different sources accessed by Hunter Water and apply separate surface water and groundwater charges.

Hunter Water's comments on the content of the DLWC submission are outlined after the following section, which details the source and volume of the Corporation's bulk water extraction.

## Bulk Water Use by Hunter Water

Bulk water charges were introduced as "water management charges" in 1995 and Hunter Water Corporation has paid those charges since their inception. The original charge was set somewhat arbitrarily in 1995 and was an interim measure until a more cost reflective and robust approach could be developed.

The table below shows the volumes of water (in megalitres) accessed by the Corporation since 1996 split into surface and groundwater. It also shows the charges paid. The table includes figures for 2000/01 because annual volumes are calculated each year for the 12 months ending 19 April to coincide with the Corporation's annual water accounting and reconciliation processes.

**Table 1**
**Bulk Water Use**

| Source | 1996/97 | 1997/98 | 1998/99 | 1999/00 | 2000/01 |
|---|---|---|---|---|---|
| Unregulated surface water *(ML)* | 55,064 | 46,663 | 41,025 | 39,116 | 55,278 |
| Groundwater *(ML)* | 11,474 | 13,051 | 21,174 | 13,761 | 20,297 |
| TOTAL *(ML)* | 66,538 | 59,714 | 62,199 | 52,877 | 75,575 |
| Bulk water charge *($)* | $119,800 | $107,500 | $112,000 | $95,200 | $136,000 (a) |

*(a) Projected charge based on volume accessed for 2000/01*

## Decline in Real Revenue

The DLWC submission proposes indexation of the existing metropolitan utility charge to address a perceived "decline in real revenue" from the metropolitan utilities since 1995.

The proposal by DLWC recommends that the metropolitan water charges increase from $1.80 per megalitre to $2.15 per megalitre in 2001/02. According to the DLWC submission, this has been indexed from 1995 to redress a decline in real annual revenue resulting from stable nominal bulk water charges over that period. This amount would then increase at 20% per year in line with other unregulated users.

Hunter Water Corporation argues that the 1995 start-point for the period being indexed was before the existence of the Corporation's Water Management Licence. As mentioned above, the charge derived in 1995 was somewhat arbitrary. It loosely took account of costs being incurred by the former Department of Water Resources in local resource management for the Corporation and work being undertaken to develop a

licensing and regulatory framework for the major corporations. In this context, it took account of one-off regulatory costs and was not as rigorous as the recent work for the current submission in assessing the Department's resource management costs for various classes of users (ie regulated, unregulated and groundwater). Given the arbitrary nature of the charge, it is not really satisfactory as the basis for an indexation approach.

In addition, the costs that were recovered by the resource management charge since 1995 have been supplemented by separate financial contributions by HWC, which are still being made.

On these grounds, it is the Corporation's belief that the current $1.80 per megalitre charge, with its origins in 1935, is not sufficiently robust to be used as the basis for an indexed cost-reflective charge in 2001/02 and beyond. Further, it seems inconsistent to opt for an indexation approach for the Corporations when a cost-recovery basis is being used for all other users and when that cost-recovery approach derives lower charges. This is discussed further in the following section.

### **Parity with Other** Users

The proposed indexing for metropolitan users is not consistent with the pricing methodology applied for other unregulated river users. The DLWC's proposed unregulated river charges are based on the recovery of costs incurred in the management of these unregulated rivers in the Hunter region. However, the DLWC submission proposes a different methodology – indexation of the existing charge - for determining prices for metropolitan and other unregulated users.

While it is recognised that the charges for other users are a staged introduction of full cost recovery, the proposal to index the charge for major utilities does result in the water utilities paying significantly higher charges than other uses accessing the same sources. Under the DLWC proposal, the metropolitan utilities will continue to pay higher charges than other user groups because charges for all users are to be increased by a constant 20% per year throughout the price path period.

The proposed unregulated use charge in the DLWC submission is $1.70 per megalitre for 2001/02, increasing by 20% each year for the following two years. This means that the proposed metropolitan charge of $2.15 for 2001/02 is 26% **higher** than for other users extracting water from unregulated rivers and this gap is maintained each year under the DLWC proposal.

The focus on indexing the existing charge also ignores the fact that Hunter Water uses both surface and groundwater. Hunter Water Corporation obtains around 25% of the water subject to bulk water charges from the coastal groundwater resources.

The general groundwater charge proposed by the DLWC submission for the Hunter region (and all other coastal regions) is $1.32 per megalitre in 2001/02, increasing by 20% in the followings years. By comparison, the proposed Hunter Water charge of $2.15 per megalitre would be 63% **higher** than that applying to other groundwater

users in the Hunter and, as in the case of the unregulated river charges, the gap will be maintained each year of the price path.

The application of a 20% increase in charges each year to all users will mean that the major utilities will pay more than other users under the indexation approach because the major utility charge states at a higher level. As a result, the major utilities will be paying significantly more than other users even at the end of the price path and parity with other users is not reached or even approached.

It is appreciated that there are difficulties in assessing the true costs imposed by different types of user (major utilities, towns, irrigators etc). This will make it difficult to establish whether there are legitimate conceptual or economic reasons why HWC's charges for water sourced from unregulated rivers or groundwater should exceed the unregulated user or groundwater charges especially by the margins shown above. On a number of grounds, it can be argued that HWC should pay less than other users. These include:

- The Water Management Licence issued to Hunter Water Corporation by DLWC in 1998 has a provision for an "annual management fee" to cover "reasonable costs relating to the licence and incurred by the Department of Land and Water Conservation in monitoring and auditing of activities, ensuring compliance, reviewing and managing the licence" (Clause 7.1 (a)).

  This annual fee is charged in addition to the annual bulk water charge determined by IPART and referenced in the licence (Clause 7.1 (b)). This management fee amounted to $3 1,450 in 1999/2000. The fee in that year was high due to the regulatory requirement for the DLWC to carry out the initial 6 month review of the Corporation's water management licence and it is likely to be lower in other years. A periodic review of the licence is required every five years and it is expected that the fee will be substantial in review years. A management fee is charged each year in addition to the bulk water charges.

  While it is acknowledged that other users also pay separate licence fees, it is important to note that the annual management fee charged to Hunter Water is variable and charged as a cost recovery fee. Thus it provides a mechanism for any additional administration expenses to be recovered by DLWC and there is no need to have any contingency provision in the bulk water charge to cover unexpected administrative costs.

- Hunter Water Corporation's water management licence includes very detailed monitoring and reporting requirements, which are met at the Corporation's expense. These functions essentially replace the metering and monitoring functions that the Department provides for other users at a cost to be recovered through the bulk water charges.

- HWC currently contributes financially to a range of catchment management activities in throughout the Hunter region. This includes research, sponsoring streamwatch activities, catchment studies and a range of landcare and total catchment management (TCM) initiatives. One of the most significant contributions is the Corporation's support for the Williams River TCM

Committee by paying 50% of the salary of the Total Catchment Management Co-ordinator. This is additional to bulk water charges and benefits all unregulated users in the Williams River catchment.

- Hunter Water Corporation has for many years made separate contributions to DLWC and its predecessor agencies for the funding of a range of national initiatives and programs under the Agricultural and Resource Management Council of Australia and New Zealand (ARMCANZ). This is a further cost borne by Hunter Water in addition to bulk water charges. In 1999/2000, DLWC sought a contribution of $24,000 from Hunter Water for ARMCANZ and COAG water projects. This issue is discussed further in the next section of this submission.

- Hunter Water is a large user of water in the Hunter Region. Its annual extraction of water from the natural sources ranges between 50,000 and 80,000 megalitres per year depending on seasonal conditions. The DLWC have estimated that irrigation use from both surface and groundwater in the region ranges from 40,000 to 100,000 megalitres per year and this use is spread over several thousand licence holders.

  Clearly, there exist economies of scale in the Department's management in relation to Hunter Water Corporation. For example, the single point of interface for billing and administration would mean the Department's costs in these areas in relation to Hunter Water are less than for the large number of irrigators whose use totals a similar volume to that of the Corporation. Also, resource management initiatives are easier and less costly to implement with one large user than with the more fragmented irrigation community. This is particularly so for the management of the coastal groundwater aquifer system, where management of aquifer is largely controlled by the conditions in the Corporation's water management licence.

In summary, there are four key points that indicate that the proposed $2.15 charge for the metropolitan utilities in 200/02 is both inappropriate and inequitable. These are:

- The current charge for metropolitan users was arbitrarily set in 1995 and was an interim measure until a more robust and cost-reflective methodology could be established. The arbitrary nature of the original charge makes it an unsatisfactory basis for an indexation approach.

- the indexation approach to establishing the metropolitan charge produces a charge of $2.15 per megalitre that is **substantially higher** than charges for other users and does not have any conceptual or economic parity with the charges for other users. Also, because charges for all users (utilities and others) are increased by 20% per year, the major utilities will still pay more than other users at the end of the price path.

- the charges for other users have been derived from DLWC's analysis of costs and are believed to be cost reflective for type of user (regulated river, unregulated river and groundwater) and region. By comparison, **the iadexation approach used to derive the bulk water charge for the major utilities is not transparently linked to actual costs or cost recovery,** and

- the failure to recognise and value the financial and resource management contributions that the Corporation makes in addition to bulk water charges. Similarly, some of the costs borne by DLWC for other users (such as metering and monitoring) are internalised to Hunter Water via conditions in the Corporation's water management licence.

Clearly too, the introduction of volumetric charges for groundwater users, means that there is an opportunity to recognise the different sources accessed by Hunter Water Corporation with both a surface charge and a groundwater charge.

## Funding of National Initiatives

As discussed in the 1999/2000 HWC submission to IPART on Bulk Water Pricing (see Attachment A), HWC provides funding to national initiatives associated with the Council of Australian Governments (COAG), the Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) and the development of the National Water Quality Management Strategy (NWQMS).

These costs are shared among HWC, Sydney Water Corporation and DLWC based on a methodology developed in the 1980s when there was no other mechanism for recovering these costs. (A revision of the formula early last year reduced the proportionate contributions required from Hunter Water and Sydney Water and provided for a contribution fi-om Sydney Catchment Authority). Over time, inequities have developed with this system - for example, the cost sharing formula does not seek a contribution from other significant urban water utilities such as Gosford and Wyong Councils.

With the introduction of bulk water charges for the major metropolitan utilities in 1995, the original purpose of the old cost sharing arrangement between these three NSW agencies was redundant. Nevertheless, DLWC has continued to separately bill the metropolitan utilities for these contributions on the old 1980s formula.

It is proposed by HWC that the cost of funding these national programs should be incorporated into the bulk water charges of *all* bulk water users rather than by an arbitrary split of the costs between the State's three largest water agencies. That way, the cost of these initiatives and programs can be shared fairly **by all water users** and incorporated in one charge rather than the current ad hoc arrangement applying only to the major agencies.

## Catchment Initiatives for Sydney Catchment Authority

The DLWC submission argues that the level of resource management will increase during the next 5-l 0 years due to a projection of dramatic increases in water extractions by the Sydney Catchment Authority (SCA) and therefore metropolitan water prices should increase to cover these costs.

These initiatives are not relevant to HWC and therefore the costs should not be part of the rationale for higher bulk water charges for Hunter Water. Rather the regional

- Some costs, covered by the bulk water charges for other user groups, are internalised to Hunter Water via conditions in the Corporation's water management licence.
- The Corporation has made separate contributions to DLWC to meet the cost of a range of national initiatives

6. Hunter Water Corporation believes that it would be appropriate for the cost of national resource management initiatives be included in the bulk water charges of all users as discussed in the HWC's 2000/01 submission (Attachment A).

7. The Corporation also believes that HWC's bulk water charges be split between the unregulated surface water charge and the groundwater charge for the Hunter region to reflect the composition of extraction. Table 2 below shows how these charges would be distributed. The charges quoted in the table are those for unregulated and groundwater users in the Hunter region for 2000/01. The volume of extraction is based on the average extraction levels by Hunter Water Corporation over the last five years.

**Table 2**
**Hunter Region Charges**
**2001/02**

| Source | Average Annual Extraction – HWC (ML) *(a)* | Proposed Charges by Source Hunter region (b) | Total Charge |
|---|---|---|---|
| Unregulated surface | 47,000 | $1.71/ML | $80,370 |
| Groundwater | 16,000 | $1.32/ML | $21,120 |
| **TOTAL** | 63,000 | | **$101,490** |

***(a) Average extraction levels over last 5 years. (b) DLWC proposed unregulated river and groundwater charges for the Hunter region for 2001/02.***

## Recommendation

Hunter Water Corporation acknowledges that the 2001/02 charges for other unregulated river and groundwater users are still moving towards full cost recovery.

Given that the price path proposed by DLWC for unregulated and groundwater users is a staged move to cost recovery and given the position outlined earlier that there are economies for DLWC in dealing with Hunter Water Corporation, **it is reasonable to propose that the Corporation's charges not be indexed from the current charge as proposed by DLWC.**

**Rather, the bulk water charges applying to Hunter Water should remain at the current level ($1.80 per megalitre) until Hunter region charges for unregulated rivers and groundwater reach the existing Hunter Water charge. From that point, the price path charges for other users should apply.**

This would also provide a means to moving towards a more robust and equitable basis for Hunter Water's charges and would provide an opportunity to charge separately for surface and groundwater. The price path for Hunter Water's charges under this approach is shown in Table 3 below.

**Table 3**
**Alternative Proposal for Bulk Water Charges for Hunter Water Corporation**
*($/megalitre)*

| Source | 2001/02 | 2002/03 | 2003/04 |
|---|---|---|---|
| Surface (unregulated river) | $1.80 (a) | $2.05 | $2.46 |
| Groundwater | $1.80 (a) | $1.80 (a) | $1.90 |

*(a) DLWC staged charges are less than current Hunter water charge of $1.80 in these years.*

Under this alternative proposal, the total 2003/04 cost to Hunter Water would increase to $146,020. This is a real increase over the 3 years of almost 30% when compared with the total cost based on the current charge. Table 4 below shows the 2003/04 position under the current charges, the DLWC's proposal for metropolitan water utilities (MWU), and the alternative approach using the unregulated river and groundwater charges. From the table, it can be seen that the alternative proposal yields less revenue to DLWC in 2003/04 than does the DLWC MWU proposal (indexation from the current charge), but still delivers the significant real increase of 30% over current charge quoted earlier.

**Table 4**
**Comparison of DLWC Proposal and HWC Alternative at 2003/04**

| Source | Average extraction *(ML)* | At Current Charge *($1.80 per ML)* | DLWC Proposal for MWUs (Indexation approach) | | HWC Alternative Proposal | |
|---|---|---|---|---|---|---|
| | | | Charge per ML(a) | Total charge | Charge per ML(b) | Total Charge |
| Unregulated | 47,000 | $84,600 | $3.10 | $145,700 | **$2.46** | **$115,620** |
| Groundwater | 16,000 | $28,800 | $3.10 | $ 49600 | **$1.90** | **$ 30,400** |
| Total | 63,000 | $113,400 | | $195,300 | | **$146,020** |

*(a) $2.15 charge for 2001/02 indexed to 2003/04 at 20% per year - see section 5.4.1 of DLWC submission. (b) Source - DLWC submission Table 5.3 for unregulated river charges and Table 5.4 for groundwater charges.*

The approach outlined above provides for some convergence of the bulk water charges paid by major utilities and the charges paid other users over the price path. However, in the longer term, it would be desirable to base utility pricing on a more explicit appreciation of the actual costs of resource management attributable to bulk water extraction by the major utilities. It would also be desirable to explicitly consider the economies relating to the water utilities and to take account of the other financial and resource management contributions made by the utilities. With this in mind, it is also recommended that IPART and DLWC consider including a more explicit analysis of these costs and contributions in the lead up to next bulk water determination in 2002.

## Further Information

Hunter Water Corporation welcomes the opportunity to discuss the material presented in this submission with the IPART officers at any time. All enquires regarding this submission should be directed to:

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## References

Department of Land and Water Conservation (NSW), 2001, **Submission to IPART Bulk Water Pricing: 2001/02-2003/04, Sydney,** April

Water Administration Ministerial Corporation (NSW), 1998, *Water Management Licence: Part 9 Water Act 1912,* Issued to Hunter Water Corporation on 26 December 1998.

Water Resources Commission (NSW), **1995, Water Resources of the Hunter Valley,** Parramatta.

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**Attachment A**

## Funding of National Initiatives

An Extract from Hunter Water Corporation's
2000 Bulk Water submission

One matter relevant to the review of bulk water charges is that not all the costs that DLWC allocates to Hunter Water are included in the water management charge. In particular, the costs of various national initiatives associated with the Council of Australian Governments (COAG) and the Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) are shared among DLWC, Sydney Water Corporation and Hunter Water Corporation on a formula devised in the 1980s when there was no other mechanism for recovering these costs.

The basis for the sharing of costs goes back many years to the time of the former Australian Water Resources Council (AWRC). At that time, the three principal water agencies in NSW agreed to share costs on the following basis:

- Sydney Water Board - 62.5%
- Hunter Water Board - 18.75%, and
- Department of Water Resources - 18.75%.

This cost sharing arrangement was necessary at the time as there was no other way of collecting funds from all three major NSW water agencies. Since then, there have been a number of developments that justify a review of this cost sharing arrangement. Included amongst these is the changing nature of the water industry with urban utilities concentrating on service provision and stepping back from any direct involvement in resource management policy and standard setting.

There is also a question of relevance to Hunter Water of the projects being funded under this arrangement. The projects cover a wide range of interests and, in many cases, are resource management issues that are primarily of concern in the western areas of NSW. Yet, the simple proportionate cost split still has Hunter Water funding part of these projects even though they may be of no direct relevance to this organisation or the region in which it operates. Also, Hunter Water is not directly represented in any of these national forums and therefore does not get a say in establishing the projects or in the conduct of these projects. As such, these costs are a relatively small, but uncontrollable and highly variable, cost to the Corporation which presents difficulties in budgeting and achieving the cost savings on which our own price determination is based.

Because of the wide interests of ARMCANZ (in both agriculture and resource management), important national projects for the urban water sector - such as inter-agency performance benchmarking, urban plumbing codes, appliance efficiency labelling and drinking water quality - which were formerly conducted under the ARMCANZ umbrella are being undertaken now through the Water Services Association which is funded directly by urban agencies throughout Australia.

These changes, coupled with the fact that recent revisions to the Water Act provide for major urban utilities to now pay water management charges to DLWC, mean that the cost sharing arrangement has outlived its original purpose of providing a way for the State's principal water agencies to share the costs of national projects.

Hunter Water raised this issue with the Director General of the Department of Land and Water Conservation in late 1999. In response, and with the advent of the Sydney Catchment Authority, the Director General proposed a revised cost split with Hunter Water contributing 10% of the NSW costs of national projects instead of 18.75%. However, it is Hunter Water's view that this does not address the fundamental issues of the relevance of the projects to the urban sector and to Hunter Water and whether there is a need for such a mechanisms now that water management charges are in place.

In summary, it is Hunter Water's view that the costs of supporting the national initiatives should not continue to be collected by an arbitrary split of the costs among the State's four largest water agencies. Rather, the costs should be incorporated in the bulk water charges of all users, In so doing, IPART would need to be satisfied that DLWC has in place mechanisms to ensure that the costs are appropriately allocated to the charges of various users groups – irrigators, towns, and larger urban authorities.

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