

15th November 2002

Chris Spangaro
Program Manager, Water Pricing
IPART
PO Box Q290,
QVB Post Office, NSW, 1230

Dear Chris,

**RE: Submission on IPART's Review of Maximum prices
charged by the Metropolitan Water Agencies**

Incitec operates a manufacturing site at Kooragang Island in Newcastle, which inputs natural gas, electricity and water to produce ammonia and ammonium nitrate for use in the agricultural and mining industries. We provided feedback in 2000 on IPART's last determination of Hunter Water Corporation's (HWC) pricing. As a water-only customer of HWC, we are pleased again to have the opportunity to comment on IPART's Issues Paper - Review of Maximum Prices Charged by the Metropolitan Water Agencies dated June 2002. We have focused our response on HWC's Pricing Submission for 2003/04 and 2004/05 dated September 2002.

Incitec would like to compliment HWC on providing an informative pricing submission (dated September 2002). Within the submission, the comparison tables between the current charges and the proposed charges are helpful but more information is still required to fully assess the reasonableness of the proposed charges and the resultant financial impact on end-users.

While we are in agreement with HWC's business objectives which centre on "a theme of continuous improvement which includes continuing to pursue further efficiency and operating cost reductions"¹, it is unclear, in light of HWC's comments that "adjustments need to be inline with inflation"², *what* type of activities will be undertaken to achieve this aim in 2003/04 and 2004/05. It is also unclear whether "CPI-X" was used in the price calculation and with the proposed price increases to the Kooragang area, Incitec seeks clarification of these matters. Incitec is in support of IPART's price cap of CPI-X where X was 2% in the last 3 years as this mechanism has promoted efficiency within HWC, which a "CPI increase only" will not achieve. This mechanism should be used as an example for other regulated businesses. While this mechanism is better than the alternative proposed, Incitec's preference would be for a benchmark model which identifies what the true costs are, what an acceptable level is and then apply the CPI-X methodology to drive productivity improvements. A step towards this would be providing end-users with access to such a model.

¹ HWC's Submission Sep 02, p.2

² HWC's Submission Sep 02, p.35

As a water-only customer, we are concerned about potential cross-subsidies between the water, sewer and stormwater businesses, as there was no comparison between revenue and capital expenditure of the three separate entities in HWC's report. To make a proper assessment, we would like HWC to provide information in terms of \$/kl (so we understand) on how the prices have been derived with reference to HWC's margin, capital expenditure, depreciation, raw water/storage, chemical treatment, transportation, etc. We also suggest that these three businesses have their individual financial summary included in HWC's future pricing submissions.

Incitec is extremely concerned about the HWC proposal to combine Kooragang and Tomago into one location – "Kooragang/Tomago". We question the reasons for and benefits of this proposal. From the information provided, it is proposed that Kooragang's third tier price will be \$0.759/kl in 2003/04, a 2.3% increase on the 2002/03 price of \$0.742/kl. This is a significant increase in comparison to other third tier zones particularly Tomago with a proposed *decrease* of 2.7%. If HWC believes that Tomago was overpriced previously, then our suggestion is that Tomago's price going forward should be reduced without disadvantaging Kooragang. HWC's alternative naturally results in a cross-subsidy, which is in conflict with National Competition Policy and the COAG Reforms.

Incitec argued last time that "it is essential that the individual industrial customers have a right to negotiate with HWC"³. This was in response to HWC's recommendation that the introduction of third tier pricing met the needs of industry and hence obviated this right. With this in mind, we have two prime examples of the inability to negotiate with monopoly service providers.

Example 1. In relation to the last determination, the introduction of the third tier price was delayed until the second year of the price determination. We approached HWC to negotiate in good faith an earlier commencement of the third tier price with information that supported our hardship to no avail.

Example 2. Incitec's operation at Kooragang Island is vast and has multiple manufacturing plants adjacent to each other within the same site. The land is under multiple titles which are 100% owned by Incitec. HWC however treats this site as two separate water consumers and provides us with two separate accounts. On one side of our site, we gain the benefit of third tier pricing, while on the other side of our site, we are charged higher prices. We approached HWC on this several times but no real progress has been made.

We are therefore seeking IPART's support for stipulating in their price determination the right for customers to negotiate. We are also in favour of customers, especially large industrial water users, having the right to negotiate individual supply agreements. Individual service standards could also be incorporated in such an agreement. We disagree with HWC's suggestion that there should be a trade-off between cost and service level⁴ and IPART's suggestion of customers' demonstrated willingness to pay for higher service levels⁵. The cost of technology is constantly coming down and businesses are becoming more efficient and effective. It

³ Incitec Submission Apr 02, p.17

⁴ HWC Submission Sep 02, p.13

⁵ IPART Issues Paper Jun 02, p.13

would be difficult if not impossible to define a set service standard that reflects all customers' requirements and willingness to pay. There needs to be the ability to agree individual service standards based on individual needs.

HWC's report indicated that the capital expenditure in 1996/97 was \$16.2M compared to \$63.45M in 2003/04. This is a 292% increase in capital expenditure since 1996/97. HWC's proposed capital for 2003/04 is \$63.45M, \$11.6M of which is in relation to "office relocation". We understand that "office relocation" includes the replacement of the existing head office facility and incorporates improvements to existing occupational health and safety standards. \$11.6M seems excessive and we urge IPART to seek further clarification of the actual requirement, the cost breakdown, the cost/benefit analysis and whether other less costly solutions are possible and practicable.

IPART has suggested a two-year price path. In contrast, Incitec is in favour of a longer-term price path of greater than 2 years. This is driven by customers' needs for price certainty. In Incitec's instance, this will assist with budgets, forecasting and business plans. However, with longer-term price paths, there should be provision for a review mechanism which allows for adjustments, particularly rebates to customers, in certain circumstances.

HWC's report mentioned that there is a number of current communication channels to customers⁶. We recommend that a review be conducted which questions the effectiveness of said channels, whether they are cost effective and whether they are widely utilised.

We encourage IPART to:

- Obtain the additional information offered by HWC in their report:
 - Financial performance of HWC's subsidiary, Hunter Water Australia Pty Limited (HWA). This is to verify that there are indeed no cross-subsidies between HWC and HWA.
 - Details of the savings initiatives that were factored into financial modelling.
- Consider the impact of their determination on the end-users, and
- Make information provided to IPART, accessible to customers on request.

We would be happy to discuss or clarify our comments if required, please contact Christine Ip on (07) 3867 9849 or myself on (07) 3867 9404.

Kind regards,
Mary Goodwin
Energy Development Manager
Incitec Ltd

⁶ HWC Submission Sep 02, p.15