IPART DETERMINATION OF BULK WATER PRICES

LACHLAN VALLEY WATER

November 2001

RESPONSE TO DRAFT REPORT ISSUED BY IPART

This document has been prepared by Lachlan Valley Water, representing water users in the Lachlan Valley, in response to the Draft Report by the Independent Pricing and Regulatory Tribunal determining bulk water prices for 3 years from 1 October 2001.

We welcome the opportunity for further input to the process and have identified the following key issues:

Approval of a 3 Year Price Path

The Tribunal noted that "DWLC still has considerable scope to further refine its structural separation and financial information". For us the most important areas where DLWC has not met the requirements set down by IPART in its July 2000 Determination are:

- the Department has again failed to provide sufficient information to determine accountability and transparency in the operation of State Water
- State Water has not been effectively established as a separate business unit, particularly in regard to transparent service agreements and reviewing the contestability of such agreements.
- Customer Service Committees are unable to provide informed advice on service levels and asset management priorities due to a lack of financial information and inadequate consultation.

In view of this we believe that a 1 year price path would provide the necessary compulsion for DLWC to further refine its financial information. The Tribunal has been clear about the standards it expected DLWC to meet and its continuing failure to do so indicates that there needs to be a process for ensuring those requirements are met and disincentives for not doing so. In our view a 3 year price path would, in effect, encourage DLWC to continue its non-compliance with past requirements and send a message that the move to full cost recovery has greater priority that implementing other aspects of water reform including institutional separation and full cost disclosure.

Customers have little faith in the figures currently being presented. In 1998 the Lachlan regulated river was expected to be at full cost recovery by 2000/01 but we now find that another 3 years of 8% per annum price increases are required to achieve full cost recovery.

A 1 year price determination would also send a very clear signal that DLWC must make genuine and substantive progress in establishing State Water as a separate, commercial business unit. We find it hard to understand why basic instruments such as the operating authority and water access authority have not been finalised and believe this is a further indication that DLWC has been selectively implementing aspects of the COAG Water Reforms.

State Water Compliance Capex

We note that PricewaterhouseCoopers recommends increasing the overall compliance capital expenditure, largely to enable State Water to undertake more dam upgrades. We are disappointed that the PwC report did not more closely investigate the potential for alternative risk mitigation options and whether a different basis should be used for assessing and allocating compliance costs.

We believe that if the community requires an increased standard of safety and it is largely the assets of the wider community that benefit from the increased standards, then the community should be prepared to meet that cost.

In assessing the cost of a compliance upgrade versus the benefit gained by the reduction in risk, an alternative method of risk mitigation would be to insure against the damage caused by a failure of the structure. It is possible to calculate the value of the assets and income that different sections of the community have at risk in the event of a dam failure, and the cost of insuring against this risk.

An alternative method of costing risk mitigation therefore is to compare the premium that water users would pay to insure against the risk of a dam failure with the cost of the physical upgrade and assess that difference as the proportion to be borne by the community. We believe this is a more appropriate method to allocate compliance costs and would focus the attention of the community on the relative cost of achieving a higher standard of safety.

Allocating Costs Between Users and Government

As outlined in our earlier response to the ACIL and PwC reports, we have reservations about the legacy cost concept, in particular, the assessment of certain expenditure items as either legacy or forward looking costs. As the Tribunal acknowledges, there is a degree of subjectivity in ACIL's allocation of costs.

In particular, we question the legacy component of some of the examples of legacy costs given in Table 5.1.

For example, we believe management of algae due to nutrient runoff and flows depressed by extractions has a high rather than a low legacy component indicated in Table 5.1. Nutrient runoff is largely a reflection of land use throughout the whole catchment and should be considered as a legacy of past or current land use practices, frequently unrelated to present extractive use.

We also consider that upgrades of assets to reflect new information or risk assessments have a high legacy component. If the new information or risk assessment refers to an asset constructed pre-1997 then we believe that is similar to the situation where community standards change and necessitate alterations to a structure. The underlying reason that the cost is incurred is that the structure was constructed to different standards, not that different information is now available.

There is considerable scope for cost shifting and we recommend this be addressed by establishing a working group of stakeholders to develop appropriate cost allocation principles for legacy costs that are well understood and supported by stakeholders.

Summary

1. **That a 1 year price path, with further price increases subject to DLWC meeting the Tribunal's stipulated requirements, would provide the incentive for DLWC to make satisfactory progress in providing improved financial information and effectively separating State Water from DWLC.**

2. **That alternative risk mitigation options be used as the basis for allocating costs for compliance capex. That the cost of insuring against the failure of a structure be considered as an appropriate method of assessing the cost to be allocated to users.**

3. **That the allocation of expenditure items as legacy or forward looking costs be addressed through the establishment of a working group of stakeholders to develop appropriate cost allocation principles for legacy costs.**