Murrumbidgee Customer Service Committee of State Water

Response to the IPART Review of bulk water prices from 1 July 2001 and the Department of Land and Water Conservation submission to IPART

Summary:

Nothing much has changed since the Department of Land and Water Conservation (DLWC) lodged its last submission in April 2000. It has not fulfilled its commitment to involve customer service committees (CSC's) in program development and review or costing and pricing and therefore the current submission has no support from State Water's customer base.

The submission continues to be prepared by DLWC and driven by its budgetary needs and Treasury constraints – not by State Water responding to the demands of its customers. With the exception of the annuity, which we have received separately but not reviewed, there are no itemised budgets for the next three years so we have no idea what programs are planned. In fact we have no idea what programs are being undertaken this current year, such is the lack of meaningful communication.

There is no demonstration of efficiencies gained and yet we continue to hear of concern among State Water staff that their programs are being cut to reduce costs. IPART noted at its public hearings last year that cutting costs is not the same as making efficiency gains.

Customers do not have confidence that we are not being over serviced or charged for services we do not require or have not requested. Nor are we confident that what we are paying for is being delivered efficiently.

Members of the Murrumbidgee Customer Service Committees are threatening to resign in protest at the lack of meaningful involvement they have and their inability to make State Water and the DLWC respond.

Each review of bulk water prices results in an increase for users and we move closer to the DLWC's view of full cost recovery without the institutional reform and efficiencies that could provide some balance to this whole process.

12 Month Deferral

The DLWC submission argues that a three year price path is necessary to spread the substantial increases it proposes over time to minimise dislocation. This logic does not fit with the rushed and restricted timeframe which the agency has given customers to properly consider and respond to IPART. If it was seriously interested in the welfare of its customers it would have involved them in preparation of the submission many months ago. We have been denied that opportunity, despite repeated requests.

The lack of detail in the submission shows it was rushed and ill conceived. We do not agree with the need to respond in the same way and ask IPART to set a price for 12 months during which time CSC's, NSW Irrigators' Council, State Water and the DLWC should develop a professional long term pricing strategy with IPART's assistance.

There are other major issues which we believe are planned for inclusion in future pricing submissions without us being given sufficient time to research and debate.

Furthermore we submit that the DLWC has failed to fulfill some very basic IPART preconditions for a medium term price path and therefore only a 12 month price determination should be granted.

The Tribunal indicated in Report No 7 in September 2000 that it would establish a longer term price path in future determinations "*once DLWC had made further progress with institutional reform and costing information*."

We contend it has done neither and that rather than enable the agency to ignore its customers for another three years, it should be forced to work through these major issues to the satisfaction of Customer Service Committees.

Until CSC's are satisfied there should be no referral to IPART and no change in the current water pricing. Either the CSC's have a purposeful function or they be disbanded. It is a nonsense for State Water and the DLWC to treat them with the contempt they do while claiming they have consulted with customers.

Financial matters

We understand the department follows normal business practice when it comes to budgets. Staff would be expected at a minimum to provide full details of proposed programs, relatively firm projections of costs and justification for any increases to senior management. Why then has management not given the CSC's the opportunity to apply the same independent rigour to the process. The Murrumbidgee CSC has been given no specific detail on the costs we will face during the next three years, nor any detail about the programs/projects that customers are expected to pay for.

This is the paternalistic approach CoAG has sought to reform.

IPART has suggested benchmarking State Water against its counterparts in other states and this is one instance where a lot could be learnt from Goulburn Murray Water (GMW) in Victoria. When GMW introduced major pricing reform it was on the basis of detailed financial projections and the close involvement of customer service committees in all aspects of the process. The Customer groups have been an integral part of the process every step of the way, with the power and responsibility for changing project priorities while the company committed to meeting efficiency targets and justifying the necessity and extent of the programs for which it sought funds. The overriding goal is to reach full recovery of the cost structure by 2001. During the seven years of the agreement there have been no new charges introduced nor any alteration to the cost sharing ratio.

It is timely to review the recommendations made by IPART in its previous two determinations and the response by State Water and the DLWC. It seems useless for IPART to continue to set performance indicators for the department if it receives no penalty or public admonishment for failing to perform.

Water users reluctantly accepted substantial price increases in 1998 and 2000 in the belief that IPART would provide some balance to the reform process. This has not occurred and the DLWC continues to ignore IPART, NCC and CoAG in the areas of efficiency, transparency, consultation and institutional reform. We have not seen any benchmarking, performance indicators, service agreements, or contestability. All these were specifically requested by IPART last year.

The DLWC submission acknowledges that part of its aim is to ensure NSW is eligible for the third tranche payment from the Commonwealth Government. However it is wrong in assuming that full cost recovery will be the only criteria by which eligibility will be judged.

The National Competition Council makes it quite clear in its publication -Third Tranche Assessment Framework 5 February 2001 – that *"the reform program is aimed at improving the efficiency and effectiveness of water service providers…."* and *"A key focus of the third tranche and future assessments will be seeking information from jurisdictions that the reforms, structures and systems are generating real benefits."*

The only mention of efficiency by DLWC is the comment that the submission is "premised" on overall operating costs being efficient. Where is the evidence? Where is the benchmarking that CoAG and IPART have requested?

Full cost recovery, which is the basis of the submission, must be based on efficient costs. We are not convinced this is the case and therefore the DLWC three year application is premature.

IPART's September 2000 Determination said *"it is essential that DLWC and State Water develop, in conjunction with CSC's, performance indicators and quantify service levels to allow efficiency levels to be properly assessed."* (page 9)

This has not been achieved and while the two consultancies announced by IPART may assist, they do not abrogate State Water from negotiating service levels and costs with customers.

IPART also asked State Water to allow *"CSC's and other stakeholders sufficient time to review costs and service levels."* (Page 8 September 2000 Determination) The Murrumbidgee CSC has not had any exposure to costs and any discussion on service levels has been restricted to water distribution services in very general terms.

Our CSC has not even been given details of the current programs and their costs. The DLWC submission gives no specific detail about what is intended, other than total costs. Given that the water reform agenda is driven by river management committees on which water extractors are the minority, the department cannot seriously expect users to pay 50% of these programs and their cost without even the courtesy of some detail. It is another prime example of the lack of accountability and transparency.

Murrumbidgee CSC takes exception to the DLWC statement on page 2 that *"in each case IPART has previously determined that these costs should be incorporated into full cost recovery*." This is not correct. We don't remember any instruction from IPART, or agreement from water users, to

* an annuity for environmental and safety compliance costs
* water use compliance costs
* a share of water management planning and annual implementation programs and reporting.

On page 11 of the September 2000 Determination IPART says: *"The main areas of growth cited are new risk assessment studies for its TAMP, and the costs of implementing a water reform program. DLWC intends to explain these costs to State Water's CSC's prior to making a submission to the Tribunal in 2001."* That explanation has not taken place and those costs should not be included until it does and CSC's are satisfied that the programs are legitimate and the costs efficient.

This particularly applies to the TAMP. Murrumbidgee CSC has not yet had the chance to debate the content, priority or risk management strategy of the regional asset program and has specific concerns about the inclusion of environmental and safety compliance programs. The latter have always been a community cost paid by government and this has been reinforced several times during bulk water pricing negotiations between water users and the DLWC.

We believe a number of projects included in the TAMP document are unnecessary and many should not be included as a user cost. We will provide more specific detail.

Principle (2) Beneficiary Pays

It is wrong to claim, as the submission does on page 2 when proposing increases in irrigator's share of certain costs, that cost sharing "*ratios are a result of extensive public review since 1996 through the IPART price setting process.*" There has not been extensive public review of cost sharing ratios. In fact IPART said in July 1998 that it would review how costs are shared during the next pricing review in 2000/2001 but was unable to do so last year as "*considerable work is still required to provide all the cost information the Tribunal believes should be made available*." (page 1 Determination No. 7)

Water users would like to take part in such a review with IPART and the department when we are provided with information on which we can objectively comment and given sufficient time to properly resource and research such issues. Until then there should be no direct or indirect change in the current cost sharing ratios.

In fact it seems surprising there has been no reference to what is happening with the water reforms in other states seeing this process is an initiative of all Australian governments. It would be interesting, maybe even comforting, to know that NSW is not well ahead of the other states in implementing the reforms and that the cost sharing ratios are the same Australia wide.

Principle (3) Minimise Dislocation

It is also incorrect for DLWC to claim it has recently briefed Customer Service Committees on key aspects of the submission. What CSC's representatives (as not all CSC members were invited) received were guesstimates of the likely outcomes if the DLWC wish list was acceptable to IPART. Murrumbidgee CSC was told it could expect a 50% increase. A month later the submission says it will be less than 20%. Last year IPART said Murrumbidgee had achieved full cost recovery. Surely a business the size of DLWC/State Water has a more reliable long term business plan than indicated by such erratic estimates.

Water users object strenuously to the dislocation to their businesses caused by the inclusion of new costs or new cost sharing ratios every time bulk water pricing is discussed. This has occurred regularly since 1990 when the predecessor to the bulk water charge, the DSC, was introduced. If the DLWC is serious about minimising dislocation it must do more long term planning and confidently advise customers that it will not change the basis of pricing for the next decade.

Institutional Reform

Principle (1) Cost Recovery

The lack of independence of State Water is highlighted throughout the submission by the way in which DLWC and State Water are interchanged and DLWC is used to describe functions which are the responsibility of State Water. ie. "*DLWC's total operating costs*" (Page 1 of the Executive Summary) and "..*DLWC is expected to maintain and in many cases enhance service provision with substantially lower levels of funding*." (Page 22).

On page 2 (1.2) there is another example to challenge the claim of independence of State Water. *"The …. State Water… annual operating plan (is) consistent with DLWC's resource management plans*." Having determined the resource management plan which State Water will comply with, the DLWC then has exclusive right to supply the service at an uncontestable cost.

The DLWC submission reinforces the general concern among customers that DLWC treats the State Water budget as captive and some costs being paid by water users may not be their responsibility.

IPART made this point in July 1998 when expressing its concern that "*other parts of DLWC with which State Water may develop service agreements, must also operate efficiently. Otherwise, inefficient costs incurred elsewhere in DLWC may be passed on to water users.*" (p 31) We have no evidence that service agreements do exist, and if so that they have been negotiated at arms length.

IPART also made the point (page 33) that State Water must carefully scrutinise the standards which external regulators (including DLWC) seek to impose on the business. We have no evidence that this has happened as we have been denied the opportunity to review budgets, programs or outputs.

Even the National Competition Council challenges the DLWC page 3 assertion that the establishment of State Water as a separate commercial business unit of DLWC achieves the institutional reform required by CoAG. The NCC insists on, at the very least, separate ministers. Water users insist on a completely separate business entity. If the department can't see the conflicts caused by it being service provider, resource steward, standard setter and regulator then it is obviously time for someone external to step in and force the change.

It is common knowledge within the department that Treasury has reduced the DLWC budget allocation which means that for DLWC to retain staff and continue with certain projects, it must recover that shortfall by shifting costs to State Water either directly or through the IPART pricing process.

By remaining within the department and using the same financial management system which they admit requires "*disaggregation*" of bulk water costs, State Water leaves itself open to exploitation by its senior partner. And DLWC obviously takes advantage of the situation. "*As State Water is a commercial business within DLWC, it relies on these service to comply with departmental protocols and policies. Consequently, none of the services provided under service agreements can be substituted by those of commercial service provider.*" (Page 5)

Thankfully the National Competition Council shares our concerns

"Proper institutional arrangements foster efficiency and competition, promote outcomes that are in the public interest and protect important environmental, community and consumer values.

Institutional arrangements provided for in the CoAG framework have at their heart the removal of conflicts of interest. The reforms introduce role clarity and provide an ongoing assurance of service assessment, review and improvement. Service providers are able to focus on their core business while subject to open and transparent accountability mechanisms.

Because of the concentration of service providers in the hands of government, transparent, independent, consistent and accountable arrangements between the service provider and the government's regulators are important. Any arrangement regulating service providers should at the very least ensure that conflicts of interest are identified and addressed. This provides the greatest potential for the benefits of rigorous institutional arrangements to flow to water users, communities and the environment.

The reforms agreed to in the CoAG Framework directly or implicitly recognise that, where there is unclear or incomplete separation between responsibilities for service provision and regulation:

* *there is an overlap in various functions and obligations and this provides an environment for conflicts of interest;*

* *there is a divided focus between the commercial imperatives of the service provider and the duties and responsibilities of the regulators; and*

* *there is an incentive for regulation to favour the government service provider over other actual or potential providers (eg. non-government or local government).*

If there is an inadequate degree of separation, other participants in the industry may doubt whether the regulator treats them in the same manner as government service providers. Community groups including environmental advocates and business organisations will question the independence of the regulator and raise concerns about the transparency of decision making. Consumers may be concerned that water quality, pricing and domestic connection standards are the responsibility of the body or person who is also responsible for providing the service.

Separation of service provision and regulatory responsibilities should provide for rigorous ringfencing arrangements. In addition, separate organisations should be responsible for service provision (such as a government-owned or private corporation) and regulation (such as a government department or statutory authority).

These arrangements alone, however, will not be sufficient. The degree of transparency, regulatory independence and accountability will provide relevant touchstones.

The Council will look for jurisdictions, at a minimum to separate service provision from regulation, water resource management and standard setting. Jurisdictions will need to demonstrate adequate separation of roles to minimise conflicts of interest." (NCP Third Tranche Assessment Framework page 8.12 February 5 2001)

Resource Management and Externalities

We are very confused by the wording on page 12 of the submission under the heading Water use compliance. Dot point 5 claims there is a need to provide information on water use, but this is already paid for 50% by users in PA 1 and 70% in PA2. Dot points 2 and 3 refer to water sharing which users are already paying 50% of in PB1. This looks suspiciously like double dipping.

Furthermore the submission seeks to recover 50% of the cost of compliance plans and activities and implementation. Enforcement, prosecution and education strategies are referred to as is their desire to generally ensure that water is managed sustainably. The beneficiaries of this will be the environment and general community, and to a lesser extent irrigators. Given that the water reforms will benefit the irrigators less and the environment and general community more, it is pertinent to remind IPART of the beneficiaries principal.

The DLWC submission draws a very long bow when it claims irrigators are beneficiaries of many of the initiatives they now include in their full cost recovery basket. We again seek the proper opportunity to review the cost sharing ratios.

We are concerned that the delay is separating the regulator and the service provider is providing DLWC with the opportunity to shift costs to consumers which it would otherwise not have the opportunity to do. Water use compliance is one such product with page 12 of the DLWC submission referring to the need to recover 50% of the compliance plans and activities to ensure that statutory water management plans and provisions are adhered to. "*This requires an appropriate mix of enforcement, prosecution and education strategies*." Surely the agency cannot expect consumers to pay for these Regulator costs. It does not charge landholders to implement vegetation plans? Does EPA impose similar costs on the businesses it regulates?

The Water Management Act will, via each valley water management plan, access licence and water use approval, put the onus on land holders to use the water available to them sustainably. Each land holder will have to regularly report on compliance with their licence and the valley management plan. It is inequitable to also spread the costs of regulation and compliance for which government is responsible over all users via the charging mechanism proposed.

The two comments on page 2 of the submission "*widespread natural resource degradation caused by inappropriate pricing practices of bulk water*" and "*The underpricing of bulk water services will perpetuate ecological degradation because water services are not allocated to those users who value them most*. *As a result water is used in an inefficient manner*" also indicate the authors are regulators rather than a service providers.

While we take exception to both comments because they are generalist, counter productive and incorrect, we are more concerned that the arguments have been used to justify full cost recovery when what is really required for customers and IPART to properly evaluate the submission is more substantial detail and costing on the proposed projects.

Past government policies played a big part in inefficient water use along with a lack of proper education and training. We are all aware government policies have changed. Water use habits have too. The challenge is to ensure that the group being asked to sacrifice most in this process is not used as a scapegoat.

Efficient Costs

The submission is "*premised*" on overall operating costs being efficient. However there is little if any evidence to back up this statement. Where is the benchmarking that CoAG and IPART have requested?

Instead, it seems, the submission assumes that the 20% productivity improvement imposed by IPART in 1998 was a once off and that no further efficiencies are expected either by IPART or customers. "*The efficient level of State Water operating costs and the resource manager operating costs were defined by IPART in 1998.*" (page 3) Nothing could be further from the truth.

On one hand the submission claims that efficiency gains have been built into the bulk water cost estimates for the two years concerned. (page 22) But in the same paragraph it says "*DLWC's forward estimates for 2002/03 and 2003/04 continue to be subject to budgetary constraints*" and in the next paragraph it is pointed out that high bulk water costs are due to full cost recovery. In other words consumers are being asked to make up for the DLWC budget cuts.

The submission makes several references to full cost recovery and the removal of cross subsidies that are not consistent with efficient and effective service, use or provision (CoAG). However the submission concentrates only on full cost recovery and ignores the need for simultaneous delivery of efficient services.

Cost Sharing

Renewals Annuity

Considerable money has been spent developing the TAMP and the process is claimed to have been given the highest rating of any NSW government asset management planning process.

Our understanding is that the TAMP enables State Water to determine the priority of capital expenditure each year. Given the resources allocated to TAMP and the Annuity, users rightly expect capital expenditure to faithfully mirror the TAMP priorities.

However the Murrumbidgee financial accounts seem to indicate that the level of capital expenditure depends very much on the excess of income over expenditure in the Operating Account. There is no separate accounting for the annuity so we don't know how much has been collected specifically for that reason. The following figures are taken from the Murrumbidgee Investment Expenditure reports for 1998/1999 and 1999/2000.

1998/99

Total capital expenditure	$ 614,853
prior year Annuity funds	nil
c/f Operating surplus in current year	$1,601,991
Government Renewals Contribution	$ 49,239
Total Funds available	$1,651,231
Total Surplus/Deficit	$1,036,378

Why isn't the government contribution 10% of capital expenditure?
Presumably there was no annuity collected in 1997/98 which explains the lack of any funds carried forward?
Why is the operating surplus included here?

1999/2000

Total Capital Expenditure	$1,006,642
Funded by:	
Government capital contribution	$ 413,438
Annual Capital funding surplus/deficit	$ (593,204)
Prior year annuity funds c/f	$ 708,327
Operating Surplus in current year	$3,139,446
Total Funds available	$3,847,772
Capital Funding surplus/deficit	$2,546,242

Where does the prior year annuity funds carried forward come from?
Where does the annual capital funding deficit come from?
If the operating and capital accounts are mixed together like this, how do we ensure that funds are allocated to the correct programs and that capital works are not unfunded in the future like they have been in the past?
In contrast to the previous year, the government capital contribution this year looks exceedingly generous.
Where has the annuity funds carry forward come from?

We are concerned that DLWC has mistakenly assumed that TAMP safety and compliance costs should be charged 90% to users when the programs and their costs have not been discussed with those customers who will gain minimal benefit from such expenditure. It is absurd that of the $24,321,000 sought for compliance expenditure in Murrumbidgee over the next 30 years that $18,000,000 or 75% will be spent during the first five years.

Having been slick enough to hand over majority responsibility for the assets they have neglected for so long, now the bureaucracy insist we be denied any say in their management.

Rate of Return

Confounding us even further is the claim that we should pay government for the cost of capital we are contributing to the annuity to look after the assets they neglected. We don't know how it got into the CoAG framework but we suspect it was the work of economists and bureaucrats who failed to see its impracticality.

Imposing a rate of return as proposed is nothing more than an illegal tax and we oppose it strongly.

Administrative Costs

We understand State Water paid almost $3,000,000 for head office and regional corporate support in 1998/99 and would be interested to see what services were charged for last year and in future years given that State Water now has its own office in Dubbo. We are particularly keen to see what the cost is for financial management, billing and information technology given that we received three different financial statements for 1999/2000, the last nine months after year end. It may be possible we are not getting good value for money.

It is more than likely we are being over serviced in this area given that DLWC admits that "*resource management costs are extracted manually*" (appendix 1, page 1) and "*bulk water costs are disaggregated by water source, by regional location and by function*." (Page 14) Both these actions sound unnecessarily costly and could be more effectively achieved by having a separate computer system for this supposedly "*discrete commercial entity.*" (page 6)

We remain concerned that "*costs of any shared program activity …. is apportioned according to a defined protocol… asset values, water volume delivered or number of effective full time employees as appropriate"* (Appendix 1, page 2 when three pages later we are told that many of these services are not contestable or discretionary "*As State Water is a commercial business within DLWC, it relies on these services to comply with departmental protocols and policies. Consequently none of the services provided under service agreements can be substituted by those of commercial service providers*."

That being the case water users should not pay for services a separate commercial entity would not require or any cost over and above commercially competitive rates for services it does require. Importantly the right to decide should belong to State Water, not the DLWC. Even then, until it is completely private there is a case for efficiency rebates or discounts to customers given the delay in changing the culture and delivering real efficiencies.

Impact of increased water charges

The Tribunal twice makes the comment in its September 2000 Determination that bulk water costs represent only a small proportion of total on farm costs.

Appendix 7 of the DLWC submission perpetuates this fallacy by choosing nonsense crops for comparison. Rice is undoubtedly the largest water using crop in this valley and to use soybeans and sorghum for any impact study is nonsense. To be meaningful the study must take into account the reduced water access and other costs which impact on the profitability of irrigators. Bulk Water costs may not, of themselves, cause a business to become unprofitable, but if they contribute to that situation that fact must be acknowledged. Many farms carry high debt and are undertaking capital expenditure to achieve long term sustainability.

The farming community within the Murrumbidgee and Coleambally irrigation areas are committed to spending almost $300 Million over 30 years to implement land and water management plans at the same time as their profit capacity is reduced by environmental flows. The bulk of that expenditure fall to less than 2,500 farmers. Neither of these substantive issues have been considered in the simplistic study in Appendix 7.

Ends.