NSWIC
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**SUBMISSION to**

Independent Pricing and Regulatory Tribunal

# WaterNSW Regulated Water Charge Review Draft Determination: 1 July 2017 to 30 June 2021

April 17 2017

# Introduction

The NSW Irrigators' Council (NSWIC) is the peak body representing irrigators and the irrigation sector in NSW. NSW irrigators hold water access licenses to access regulated, unregulated and groundwater systems. Our Members include valley water user associations, food and fibre groups, irrigation corporations and commodity groups from the rice, cotton, dairy and horticultural industries.

NSWIC engages in advocacy and policy development for the irrigation sector. As an apolitical entity, the Council provides advice to all stakeholders and decision makers.

This submission represents the views of the Members of NSWIC in respect to the Independent Pricing and Regulatory Tribunal (IPART) Draft Determination and Draft Report on WaterNSW's rural bulk water services from 1 July 2017 to 30 June 2021.

However, each Member reserves the right to independent policy on issues that directly relate to their areas of operation, or expertise, or any other issue that they may deem relevant.

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## Form of Regulation & Annual Pricing Reviews

### Length of Determination

Recommendation 1:

NSWIC recommends that IPART:
- freeze regulated water charges in both the NSW North Coast and NSW South Coast valleys;
- insist that WaterNSW complete its North Coast Pilot at the earliest opportunity; and
- conduct a similar study in the NSW South Coast.

Recommendation 2:

NSWIC recommends that any efficiency dividends from the NSW water reform process be linked to WaterNSW's service delivery are passed on to water licence holders at the earliest opportunity, preferably at the annual pricing reviews.

### Annual Pricing Reviews

Recommendation 3:

NSWIC recommends that IPART consider embedding an efficiency assessment in its annual pricing reviews for the NSW Murray-Darling Basin Valleys in order to capture the progressive efficiency savings from the NSW water reform process, the amalgamation of the Sydney Catchment Authority with State Water Corporation into WaterNSW, as well as the transfer of functions between DPI Water and WaterNSW.

Recommendation 4:

NSWIC recommends that IPART conducts a Cost Benefit Analysis of both an annual price setting approach and a four-year price path, should the WCIR be amended until 2020/21.

### Operating Licence Review

Recommendation 5:

NSWIC recommends that IPART consider (in the context of future WaterNSW costs) NSWIC's submission to IPART on the review of WaterNSW's operating licence, which is appended to this submission (APPENDIX B).

## Revenue Requirement

Recommendation 6:

NSWIC recommends that IPART take the view in its final Determination that water licence holders in NSW must remain the focal point of the water reform process and must be the direct beneficiaries of any efficiency savings achieved by WaterNSW in this upcoming regulatory period.

**Additional Costs**

Recommendation 7:

NSWIC recommends that IPART adopt NSWIC's detailed submission recommendations on the UOM, the volatility allowance and the MDBA/BRC charges, and adjust regulated water charges accordingly.

## Operating Expenditure Allowance

**Amalgamation of Sydney Catchment Authority and State Water Corporation**

Recommendation 8:

NSWIC recommends that IPART offset WaterNSW's OPEX efficiency savings with the balance of the 'Overs and Unders Mechanism.

**Transfer of Functions between DPI Water and WaterNSW**

Recommendation 9:

NSWIC recommends that IPART impose a further significant efficiency dividend on WaterNSW - in line with the State Water Corporation and Sydney Catchment Authority merger savings - to ensure that WaterNSW is incentivised to expedite the integration of DPI Water staff and regulatory responsibilities into their business and find additional efficiencies.

## Capital Expenditure

Recommendation 10:

NSWIC recommends that IPART requests WaterNSW to provide detailed CAPEX program and background information for the 2017 price Determination.

**Level of CAPEX**

Recommendation 11:

NSWIC recommends that IPART address the holding cost paid by WaterNSW's customers on any under-spent CAPEX by WaterNSW. Preferably, IPART should include a 'penalty' for the past under-spent CAPEX and return the holding costs to customers. In addition, IPART should review the pre-1997 capital expenditure cost share framework as it appears to significantly shift CAPEX to WaterNSW's customers in the 2017 Determination.

## Regulated Asset Base

### Growth in RAB

<u>Recommendation 12:</u>

Given the central importance of the RAB for future regulated water charges, NSWIC recommends that IPART reviews its approach to setting WaterNSW's RAB for this price Determination to reduce the rate of increase in cost over the Determination period.
NSWIC also recommends that WaterNSW's past CAPEX should be heavily scrutinised for efficiency and prudency to ensure that the future cost burden on WaterNSW's customers is minimised.

### Roll Forward RAB

<u>Recommendation 13:</u>

As WaterNSW's customers' pay a return on capital on all under-spent CAPEX, NSWIC recommends that IPART conduct a thorough investigation of WaterNSW's past CAPEX and the associated aggregate holding costs to customers.

<u>Recommendation 14:</u>

NSWIC recommends that the WaterNSW RAB value must be based on actual expenditure figures rather than forecasts, given the intrinsic link to regulated water charges.

<u>Recommendation 15:</u>

NSWIC recommends that the opening RAB value be set at the end of the third quarter, based on updated information from WaterNSW which should include actual CAPEX figures together with an update on forecast expenditure for the remaining quarter.

## Weighted Average Cost of Capital

<u>Recommendation 16:</u>

NSWIC recommends that IPART use the WACC methodology in the NSW MDB valleys as a WACC for the NSW coastal valleys.

### WACC Beta and Risk Premium

<u>Recommendation 17:</u>

NSWIC recommends that a further review of the beta value is justified for WaterNSW's WACC calculation. In addition, NSWIC recommends that IPART should consider removing either the risk premium from the WACC calculations or the volatility allowance, as one duplicates the other as a risk premium for WaterNSW.

## MDBA Pass-Through Charges

Recommendation 18:

NSWIC recommends that IPART make a clear distinction between the MDBA charges that are imposed on regulated water licence holders in the NSW Murray and Murrumbidgee valleys vs those that are imposed through the Water Administration Ministerial Corporation.

### MDBA Cost Transparency

Recommendation 19:

NSWIC recommends a further deduction to MDBA charges to reflect the lack of transparency and clarity around their prudence and efficiency.

Recommendation 20:

NSWIC recommends that IPART – as far as possible – conduct an efficiency review of MDBA and BRC related costs and apply its previous cost sharing approach to these charges.

## Overs and Unders Mechanism vs Revenue Volatility

### Overs and Unders Mechanism

Recommendation 21:

NSWIC recommends the continuation of the UOM mechanism as originally proposed by the ACCC, and in addition, that the balance of the UOM be recovered over the longer term and not be fully 'repaid' over the course of the next Determination.

### Revenue Volatility Allowance

Recommendation 22:

NSWIC recommends that IPART reject the volatility allowance as an inappropriate approach to risk shifting by WaterNSW, and that IPART explicitly not determine for any reintroduction of a revenue Volatility Allowance on the grounds that WaterNSW is sufficiently protected from supply side risk through the cost share framework, the current fixed to variable tariff structure and the fact that it is a monopoly service provider.

## Cost Sharing Framework

Recommendation 23:

NSWIC recommends that IPART:

- Conduct a separate review of the cost share framework on the basis of Frontier Economics Report;

- That improvements be made to the current cost share framework in recognition of the additional demands imposed on WaterNSW from its environmental customers (through both rules based planned and held environmental water);
- That improvements to the current cost share framework also be made around the category of 'legacy issues';
- That provisions be made to capture all beneficiaries of WaterNSW's infrastructure and services who currently do not pay for the operation or maintenance of the infrastructure.

## Forecast Entitlements & Usage Volumes

Recommendation 24:

NSWIC recommends that a consumption forecasting model that takes into consideration the full IQQM data is the most valid method available and should be applied in this Determination.

## Tariff Structure and High Security Premium

### Fixed to Variable Tariff Structure

Recommendation 25:

NSWIC welcomes IPART's draft decision to continue the current 40:60 fixed to variable tariff structures for the NSW Murray-Darling Basin Valleys.

Recommendation 26:

NSWIC rejects IPART's approach to the calculation of the reliability ratio and recommends that a longer dataset should form the basis of the High Security Premium calculations.

## Metering Charges

Recommendation 27:

NSWIC rejects WaterNSW's proposed meter service charges and recommends that IPART revise costs down for small size meters (both telemetered and non-telemetered).

### Meter Reading Charges

Recommendation 28:

NSWIC recommends that IPART not approve WaterNSW's proposed Meter Reading charges prior to the completion of DPI Water's Water Take Measurement Strategy.

## ICD Rebates

Recommendation 29:

NSWIC recommends that the current ICD rebates be maintained.

## Trade Processing Charges

Recommendation 30:

NSWIC recommends that the proposed approach to the Trade Processing Charge should be adopted, and that the Trade Processing Charge should be fixed for the entire Determination.

## Coastal Valleys

Recommendation 31:

NSWIC recommends that IPART initiate a separate review on the preliminary options for NSW Coastal Valleys as outlined in its Issues Paper, which sit outside WaterNSW's regulated water charge review.

## Efficiency Carryover Mechanism

Recommendation 32:

NSWIC rejects IPART's proposal to introduce an Efficiency Carryover Mechanism in this pricing Determination and recommends further consultation with stakeholders around such a mechanism for future Determinations. In addition, NSWIC recommends that any future form of efficiency mechanism must consider the 'sharing of benefits' between customers and WaterNSW.

# Detailed Comments

These specific comments reiterate and build on the previous NSWIC Submission to the IPART Issues Paper relating to the current WaterNSW Water Charge Review Determination.

# Chapter 1: Form of Regulation & Annual Pricing Reviews

Length of Determination

As we outlined in our response to the IPART Issues Paper, NSWIC is broadly supportive of a four-year pricing Determination for WaterNSW's regulated water charges, except in the NSW coastal valleys.

Despite a commitment to apply a 'new approach to setting prices' in the NSW coastal valleys, IPART has only proposed a price freeze in the NSW North Coast and a price *increase* in the NSW South Coast. As NSWIC emphasised in previous submissions, the current level of water charges in the NSW coastal valleys is already too high for viable use of irrigation. The framework for setting regulated charges needs to be amended to better ensure the financial sustainability of irrigation on the coast. For that reason, NSWIC and its coastal members remain frustrated and deeply concerned that IPART has proposed to defer a looming cost crisis for another four years until the 2020/21 Determination of WaterNSW's regulated water charges.

**Recommendation 1:**

**NSWIC recommends that IPART:**

- **freeze regulated water charges in both the NSW North Coast and NSW South Coast valleys;**
- **insist that WaterNSW complete its North Coast Pilot at the earliest opportunity; and**
- **conduct a similar study in the NSW South Coast.**

Once these steps are complete, NSWIC submits that IPART should revisit charges for the NSW coastal valleys.

Despite NSWIC's reservation about the four-year price Determination for the NSW coastal valleys, NSWIC welcomes IPART's assessment that a four-year time period will provide a 'reasonable period for passing on efficiency gains that are expected from [WaterNSW's] restructuring program'. As the Council has voiced to IPART on multiple occasions, water licence holders <u>expect</u> an efficiency dividend from this NSW water reform process at the earliest opportunity. To date, the process has been deeply frustrating, enormously disruptive, and costly due to the movement of staff between agencies and the enormous loss of corporate knowledge as a consequence.

**Recommendation 2:**

**NSWIC recommends that any efficiency dividends from the NSW water reform process be linked to WaterNSW's service delivery are passed on to water licence holders at the earliest opportunity, preferably at the annual pricing reviews.**

Annual Pricing Reviews

Given IPART's obligation under the *Water Charge (Infrastructure) Rules 2010* (WCIR) to review WaterNSW's regulated water charges in the NSW Murray-Darling Basin valleys on a yearly basis, NSWIC recommends that IPART considers embedding an efficiency assessment in its annual pricing reviews in order to capture the progressive efficiency savings from the NSW water reform process, the amalgamation of the Sydney Catchment Authority with State Water Corporation through the formation of WaterNSW, and the transfer of functions from DPI Water to WaterNSW. The Council considers the annual pricing review to be the ideal opportunity to pass on these efficiency savings to customers and/or offset any potential consumption shortfalls within a year so that water licence holders are subject to less price volatility within a Determination period.

**Recommendation 3:**

**NSWIC recommends that IPART consider embedding an efficiency assessment in its annual pricing reviews for the NSW Murray-Darling Basin Valleys in order to capture the progressive efficiency savings from the NSW water reform process, the amalgamation of the Sydney Catchment Authority with State Water Corporation into WaterNSW, as well as the transfer of functions between DPI Water and WaterNSW.**

Despite our previous statement, NSWIC acknowledges that there is ongoing regulatory uncertainty around the WCIR as the Federal Minister for Agriculture and Water Resources, the Hon. Barnaby Joyce, has not responded in full to the ACCC's final advice on the review of the Water Charge Rules. Should the WCIR be amended prior to the completion of IPART's review, or within the next regulatory period, NSWIC recommends that IPART considers benefits and costs of an annual price setting approach vs a price cap.

**Recommendation 4:**

**NSWIC recommends that IPART conducts a Cost Benefit Analysis of both an annual price setting approach and a four-year price path, should the WCIR be amended until 2020/21.**

NSWIC also notes that IPART's decision not to undertake annual reviews of WaterNSW's regulated water charges in the NSW coastal valleys is irrelevant, given that IPART has decided to introduce a price freeze in the NSW North Coast and a once off upward adjustment in prices for the NSW South Coast.

Operating Licence Review

NSWIC has participated in IPART's concurrent review of WaterNSW's operating licence. We have made a submission to IPART's Issues Paper and attended the recent public hearing in Sydney on April 4. Based on the draft operating licence package and the discussions at the public hearing, we are concerned that the proposed amendments to WaterNSW's operating licence could impose future regulatory burdens on WaterNSW which will ultimately lead to higher costs for water licence holders in NSW. In particular, NSWIC is concerned about the proposed 'level of water conservation methodology and the 'water quality conditions' that are proposed for WaterNSW. We understand that both requirements originate from the Sydney Water operating licence, however we consider it totally inappropriate to impose equivalent conditions on WaterNSW for its provision of rural customers given the very significant differences in operating environments.

**Recommendation 5:**

**NSWIC recommends that IPART consider (in the context of future WaterNSW costs) NSWIC's submission to IPART on the review of WaterNSW's operating licence, which is appended to this submission (APPENDIX B).**

NSWIC reiterates that the Council has urged IPART to exercise caution in amending WaterNSW's operating licence before further discussions with stakeholders and water licence holders are conducted and there is a collective understanding on what the costs and benefits of the proposed changes may be. NSWIC is concerned that the current dual review process could lead to unintended flow on effects on WaterNSW's future service delivery and ultimately on regulated water charges. As per our submission to IPART on WaterNSW's draft operating licence, NSWIC is concerned that the proposed changes could trigger further cost increases to licence holders.

# Chapter 2: Revenue Requirement

Given the amalgamation and transfer of functions between water agencies in NSW, NSWIC is concerned that IPART suggests only a $5.1 million reduction in WaterNSW's NRR even though the water reform process was meant to lead to further efficiency savings and better value for customers. Focusing on only the user share of WaterNSW's draft NRR, it can be noted that IPART's draft proposal suggests a user target revenue that is greater than the entire NRR for WaterNSW in the 2014 final Determination ($279.9 million vs $257.8 million respectively).

NSWIC continues to be most concerned that water licence holders in NSW have experienced little or no benefit from the water reform process and to the contrary are now facing significant cost increases.

**Recommendation 6:**

**NSWIC recommends that IPART take the view in its final Determination that water licence holders in NSW must remain the focal point of the water reform process and must be the direct beneficiaries of any efficiency savings achieved by WaterNSW in this upcoming regulatory period.**

<u>Additional Costs</u>

It appears to be a remarkable coincidence that the average annual increase in WaterNSW's NRR is nearly equivalent to the 'additional costs' that IPART proposes to impose on licence holders through the volatility allowance, the payback of the Unders and Overs Mechanism and the MDBA/BRC charges, which equates to $73.4 million over the 2017 Determination period. While NSWIC has provided detailed responses to each of these additional costs, the Council would like to stress that it is absolutely unacceptable that a quarter of WaterNSW's NRR results from 'external costs' that are either unnecessary (volatility allowance and UOM) or not transparent and contestable (MDBA/BRC costs). The incorporation of these additional costs makes it impossible for water licence holders to reconcile the IPART pricing

Determination with their actual water bills. Such an outcome is deeply unsatisfactory and completely contrary to stakeholders' expectation for transparency of water charges.

**Recommendation 7:**

**NSWIC recommends that IPART adopt NSWIC's detailed submission recommendations on the UOM, the volatility allowance and the MDBA/BRC charges, and adjust regulated water charges accordingly.**

<u>WaterNSW Financial Viability</u>

NSWIC reiterates an excerpt of our previous submission to the ACCC on SWC's (now WaterNSW) financial position, to highlight the fact that WaterNSW is financially stable and more than capable of achieving further efficiency savings:

*"State Water Corporation (SWC) suggests to the ACCC that they will fully recover their allowed revenue requirements for the first time since corporatisation in (2012-13) and that under-recovery of revenue amounted to $79.1milllion over the previous regulatory period. SWC uses this argument as evidence that a change in tariff structure is warranted.*

*NSWIC notes that SWC used exactly the same argument at the last Determination before IPART to request that it dramatically alter its demand forecasting model. The request was allowed, the model was changed, and the revenue forecast was met. SWC now wants to double dip by using the same (now solved) problem to shift risk to its customers.*

*NSWIC submits that the focus should not be on whether SWC has met its allowed revenue requirement but whether SWC was able to generate a net profit from its operations. We note that SWC has returned a positive net profit before tax over the current and previous Determination periods based solely on actual revenue, despite the fact that the previous Determination included the worst drought on record. In 2012-13 alone, SWC was able to generate a $50 million net profit before tax and it is forecast that this situation will continue over the entire next Determination period, albeit at a slightly lower level.*

*In addition, NSWIC emphasises that 2011/12 – 2012/13 have been marked by significant increases in water availability across NSW which has led to record water releases by SWC in 2012-13. This has generated revenue in excess of the IPART allowed revenue allowance - in the order of $6.2 million.*
*NSWIC is particularly disappointed that SWC attempts to claim a shortfall in revenue of $79.1 million when only a comparison between allowed and actual revenue is being presented. We submit that such an analysis is misleading and does not show the full picture of profitability of SWC. In order to assess the profitability of SWC, a full analysis between actual costs and revenues must be presented.*

***NSWIC submits that SWC attempts to provide an indication of business performance in the current regulatory period that is significantly different from reality."***

NSWIC is of the view that the above-mentioned points are as relevant now as they were in the last Determination of State Water Corporation's regulated water charges. NSWIC believes they should be considered in the context of IPART's draft NRR Determination and IPART's proposal to reintroduce a volatility allowance.

# Chapter 3: Operating Expenditure Allowance

As outlined in NSWIC's submission to the IPART Issues Paper, the Council acknowledges the decrease in WaterNSW's proposed operating expenditure for the NSW MDB valleys over the next Determination.

As Operating Expenditure (OPEX) constitutes approximately half of WaterNSW's proposed Notional Revenue Requirement (NRR), NSWIC has called for an independent assessment of WaterNSW's proposed OPEX categories to ensure that it is prudent and efficient. NSWIC acknowledges that IPART engaged consultants Aither to conduct this assessment and is proposing further minor efficiency savings for WaterNSW.

<u>Amalgamation of Sydney Catchment Authority and State Water Corporation</u>

In respect to past OPEX expenditure, NSWIC noted with interest the differences in WaterNSW's actual and allowed operating expenditure over the current regulatory period.

As outlined on pages 47 and 48 of IPART's draft report, total *actual user share* OPEX was $20.5 million lower than the *allowed user share OPEX* determined by the ACCC in its 2014 final Determination. While NSWIC and its members had expected an efficiency dividend to result from the amalgamation of the Sydney Catchment Authority with State Water Corporation in 2014, we were surprised to see such a large discrepancy between actual and allowed OPEX.

Irrespective of the achieved OPEX efficiency savings, NSWIC would like to voice its frustration that WaterNSW's customers <u>have once again</u> not received a financial benefit from these (already achieved) savings, since regulated water charges over the current Determination are dependent on the ACCC's final Determination in 2014 (and not the actual expenditure values throughout the Determination). This outcome is particularly unsatisfactory since the ACCC (and now IPART) are required to conduct annual reviews of WaterNSW's regulated water charges in line with the Water Charge (Infrastructure) Rules 2010. This regulatory constraint again shows that the regulator has effectively extended a 'risk protection mechanism' to WaterNSW - as a monopoly operator - by adjusting regulated water charges **inversely with annual consumption volumes** BUT not in accordance with any OPEX efficiency savings over the Determination. NSWIC considers this a double standard which needs to be addressed by IPART in this current Determination.

Furthermore, NSWIC would like to raise questions as to whether any of the OPEX savings have been achieved as a result reduced levels of service and whether there have been discussions with customers about the required minimum level of service that should be provided under the existing pricing arrangements.

In addition, NSWIC stresses that water licence holders are particularly frustrated with this limited approach since IPART has proposed to phase out and repay the balance of the 'Overs and Unders Mechanism' over the next Determination, which equates to $11.8 million.

**Recommendation 8:**

**NSWIC recommends that IPART offset WaterNSW's OPEX efficiency savings with the balance of the 'Overs and Unders Mechanism.**

Transfer of Functions between DPI Water and WaterNSW

Following from the previous comments, WaterNSW's customers are expecting a further efficiency dividend from the transfer of functions and responsibilities from DPI Water to WaterNSW.

NSWIC expects further OPEX savings in the medium and long term. As outlined in our response to the IPART Issues Paper, it appears that the savings from the amalgamation of the Sydney Catchment Authority and State Water Corporation became obvious two years into the merger between the two organisations, and as such NSWIC suggests that this is a reasonable guide as to when the transfer of functions and responsibilities from DPI Water to WaterNSW should yield material OPEX savings. Such an efficiency dividend should be incorporated into the final Determination of WaterNSW's regulated water charges.

**Recommendation 9:**

**NSWIC recommends that IPART impose a further significant efficiency dividend on WaterNSW - in line with the State Water Corporation and Sydney Catchment Authority merger savings - to ensure that WaterNSW is incentivised to expedite the integration of DPI Water staff and regulatory responsibilities into their business and find additional efficiencies.**

NSWIC believes such a step is very necessary because water licence holders have, to date, enjoyed little benefit from the restructure of water management activities and functions between DPI Water and WaterNSW, despite the fact that 'better customer services and efficiencies' was at the heart of the reasoning behind the reform process. NSWIC is of the view that IPART must ensure that customers are the beneficiaries of the reform process – not only expressed in better service delivery, but also in the form of lower regulated water charges.

OPEX in the NSW Coastal Valleys

NSWIC continues to question the proposed OPEX increases in the North Coast and South Coast valleys. NSWIC believes WaterNSW has not provided sufficient justification for such an increase even though the draft decision will not have a material impact on coastal water licence holders' regulated water charges.

As outlined in Chapter 15 of this submission, there are significant structural problems in the NSW coastal valleys and NSWIC is deeply concerned that the current 'hold and wait' or 'once off increase' approach in the coastal valleys will drive even more licence holders into surrendering their water entitlements, with the result that the burden of costs for WaterNSW's infrastructure will have to be shared amongst a shrinking pool of customers. Given the recent preliminary proposals put forward by WaterNSW in the North Coast, significant concerns remain as to the future viability of irrigation in the coastal valleys – in particular if there is a serious consideration of WaterNSW divesting its current dam infrastructure.

## Chapter 4: Capital Expenditure

NSWIC welcomes IPART's decision to engage an external consultant to review WaterNSW's capital expenditure (CAPEX) program. The Council and its members expressed serious concerns about WaterNSW's proposed new CAPEX approach (i.e. using a 'theoretical upper limit benchmark' derived through the Modern Engineering Equivalent Replacement Asset model (MEERA) instead of a detailed CAPEX program for each valley).

Given the content of the IPART Draft Report, NSWIC believes its concerns were justified. As IPART's expenditure consultant *Aither* found, most of WaterNSW's proposed CAPEX projects had 'not undergone significant investigation and design assessment' or were 'immature in their development'. In addition, *Aither* outlined that there was 'little certainty over the need for the expenditure'.

It is NSWIC's view that IPART must only approve WaterNSW's prudent and efficient CAPEX. IPART can only do so if WaterNSW's CAPEX program is supported by detailed business cases or other cost / benefit assessment reports. It is therefore completely unacceptable that so little detail on WaterNSW's CAPEX was available to IPART, its customers or Aither; in particular given the significant increases that have been proposed by WaterNSW.

Irrespective of Aither's assessment on the adequacy of WaterNSW's proposed past and future expenditure, it deeply concerns NSWIC that IPART suggests that WaterNSW should 'justify its expenditure' in the next Determination. The basis of a bulk water pricing review must be for the regulator to assess the prudency and efficiency of the monopoly operators' expenditure – at the time of every Determination. It is therefore unreasonable that IPART could contemplate that WaterNSW should only justify its expenditure in the next Determination. It is NSWIC's view that WaterNSW should have ALWAYS provide a comprehensive assessment of why and how it intends to roll out its CAPEX program and IPART should be able to assess whether past and future CAPEX is prudent and efficient.

In addition, NSWIC is puzzled that IPART states in its draft report that at the next Determination of rural water prices (scheduled to commence in 2020), the regulator will review WaterNSW's *actual historical expenditure*. This should be a matter for the regulator at each and every pricing Determination. Nevertheless, NSWIC understands that this process is constrained by the Water Charge (Infrastructure) Rules 2010 which do not allow IPART to review WaterNSW's past CAPEX in the NSW MDB valleys – a regulatory constraint that the Council has continuously found frustrating.

**Recommendation 10:**

**NSWIC recommends that IPART requests WaterNSW to provide detailed CAPEX program and background information for the 2017 price Determination.**

Level of CAPEX

NSWIC is deeply concerned by IPART's proposed CAPEX allowance over the next Determination. As IPART outlines on pages 52 and 53 of the draft report, WaterNSW has again significantly under-spent on CAPEX in the NSW Murray-Darling Basin valleys over the 2014-17 regulatory period ($120.05 million allowed vs $90.27 million actual).

Similar outcomes have occurred in the last three Determinations of the State Water Corporation (as the immediate predecessor of WaterNSW). It therefore is no surprise to NSWIC that WaterNSW has **again** under-spent on its allowed CAPEX by $29.79 million or 24.8%. Given that WaterNSW's customers are paying a **holding cost** on any under-spend of capital expenditure, this outcome is deeply unsatisfactory.

NSWIC also notes that WaterNSW's under-spend mainly concerns its G*overnment share*. This outcome is interesting since the Government share of CAPEX in the next Determination is proposed to decrease to only $1.6 million in 2019-2021. NSWIC asks IPART as to how the under-spend of CAPEX can be reconciled with the low CAPEX proposal in the 2017 Determination.

**Recommendation 11:**

**NSWIC recommends that IPART address the holding cost paid by WaterNSW's customers on any under-spent CAPEX by WaterNSW. Preferably, IPART should include a 'penalty' for the past under-spent CAPEX and return the holding costs to customers. In addition, IPART should review the pre-1997 capital expenditure cost share framework as it appears to significantly shift CAPEX to WaterNSW's customers in the 2017 Determination.**

In addition, NSWIC points out that IPART's proposal would see WaterNSW's CAPEX allowance increase by $40 million – despite the poor track-record of WaterNSW in delivering on its previously approved capital expenditure programs and customers continue to pay the holding costs on unused capital funding. As most CAPEX in the next Determination is attributed to 'users', this outcome is particular concerning.

In the previous Determination, IPART's user share of CAPEX used to be approximately $44 million. In the IPART draft report, but this share is proposed to increase to $118 million – a near threefold increase in proposed CAPEX. Whilst NSWIC understands that WaterNSW's customers do not pay for the capital expenditure of WaterNSW, it will still be the case that any 'user share' CAPEX will ultimately reflect in WaterNSW's RAB and hence lead to future cost pressures on NSW water licence holders and users.

<u>CAPEX Reductions</u>

As IPART outlined in its draft report, WaterNSW's original CAPEX proposal suggested that the majority (60 per cent) of its future capital expenditure relates to 'maintaining capability', followed by 25 per cent for 'regulatory compliance'.

We reiterate that since WaterNSW's regulated water charges are reviewed on a **regular** basis (either every three or four years), NSWIC is deeply concerned by WaterNSW's proposed CAPEX for 'maintaining capability'. NSWIC is of the view that 'maintaining assets' should be part of WaterNSW's normal business activity and reviewed by the regulator on a regular basis. It is our understanding that the ACCC did so in 2014 when it last reviewed SWC's regulated water charges. WaterNSW argued that the current ACCC average annual allowance for replacement and renewals is far below the rate required to maintain capability, and is therefore arguing that previous pricing Determinations have resulted in significant under-investment in maintaining assets.

As such, NSWIC must presume that the significant increase in proposed CAPEX for 'maintaining capability' is either a result of a change in Government policy, an internal direction from WaterNSW's Board, or a result of WaterNSW's decision to apply the MEERA model. In all instances, NSWIC notes that the decision is completely outside customers' control, with customers being asked to bear the greatest proportion of the costs (page 84 of WaterNSW's pricing proposal). NSWIC considers this as inequitable and rejects it. For that reason, NSWIC applauds IPART's proposal to reduce WaterNSW's CAPEX by $44 million and in particular the $21 million in 'per valley renewals expenditure'.

In line with this, NSWIC also welcomes IPART's decision to remove the approved fishway offset in the Namoi from WaterNSW's past CAPEX.

## Chapter 5: Regulated Asset Base

NSWIC considers Chapter 5 to be the foundation that underpins this regulatory Determination. The calculations and proposals put forward in this chapter not only influence WaterNSW's notional revenue allowance but it also directly impacts on customers' regulated water charges.

Growth in RAB

As NSWIC outlined in its submission to the IPART Issues Paper, the Council is deeply concerned about the accelerated growth in WaterNSW's Regulated Asset Base (RAB). As outlined on page 64 of the IPART draft report, the opening RAB in 2013-14 was set at $611.8 million (nominal) in the NSW MDB valleys and $35.5 million in the NSW coastal valleys. The total RAB for WaterNSW was therefore $647.3 million ($2013 -14).

In the current review, IPART proposes an opening RAB for WaterNSW of $783.8 million and a closing RAB of $867.2 million in 2020-21. This will constitute a $219.9 million (nominal) or 33% increase in the RAB over two Determinations! Irrespective of IPART's reduction in allowed capital expenditure and a lower rate of return, NSWIC is deeply concerned that the growth in WaterNSW's RAB will continue to drive irrigators' regulated water charges higher into the future.

**Recommendation 12:**

**Given the central importance of the RAB for future regulated water charges, NSWIC recommends that IPART reviews its approach to setting WaterNSW's RAB for this price Determination to reduce the rate of increase in cost over the Determination period.**
**NSWIC also recommends that WaterNSW's past CAPEX should be heavily scrutinised for efficiency and prudency to ensure that the future cost burden on WaterNSW's customers is minimised.**

Roll Forward RAB

NSWIC considers the practice of rolling forward the RAB in order to create an opening value for the next regulatory period is deeply flawed, given that the process is based on forecasts in the last year of the current Determination. As NSWIC has highlighted in previous submissions, WaterNSW (and previously State Water Corporation) has significantly under-spent on its CAPEX in previous years, and while it typically weights the CAPEX in the early years of a Determination for planning purposes, the actual spend is frequently deferred to the final year of the Determination.

**Recommendation 13:**

**As WaterNSW's customers' pay a return on capital on all under-spent CAPEX, NSWIC recommends that IPART conduct a thorough investigation of WaterNSW's past CAPEX and the associated aggregate holding costs to customers**.

Furthermore, IPART noted in its draft report (page 52) that WaterNSW's CAPEX in 2016-17 is supposed to be $49.44 million, even though the last year of the current regulatory period is not complete. Not only is the heavy weighting of actual CAPEX in the last year of the current Determination typical practice for WaterNSW (as mentioned earlier), but it is also of concern as it would be approximately $3 million more than the amount allowed under the ACCC Determination. As the WCIR requires IPART to include <u>all actual CAPEX</u> into WaterNSW's RAB regardless of its prudence and efficiency (i.e. for NSW MDB valleys), NSWIC is most concerned that the RAB is unnecessarily inflated.

**Recommendation 14:**

**NSWIC recommends that the WaterNSW RAB value must be based on actual expenditure figures rather than forecasts, given the intrinsic link to regulated water charges.**

**Recommendation 15:**

**NSWIC recommends that the opening RAB value be set at the end of the third quarter, based on updated information from WaterNSW which should includes actual CAPEX figures together with an update on forecast expenditure for the remaining quarter.**

NSWIC also requests that IPART explore WaterNSW progress with its capital expenditure in 2016/17, noting some valleys have significant expenditure proposed for that year. Where expenditure is substantially less than forecast this should be taken into account when setting the valley-based RAB.

In this way, IPART will have a better understanding on the actual capital expenditures made by WaterNSW over the last year of the current Determination and should be better placed to determine an appropriate opening RAB value.

NSWIC believes such a proposal is not only appropriate but also supported by the ACCC Pricing Principles;

*"The RAB should represent the value of all assets that <u>have been funded</u> directly by the operator and which are required for the provision of infrastructure services for which regulated charges are payable."* (emphasis added)

We consider that this ACCC statement clearly outlines that the RAB value should represent the value of the assets that have <u>actually</u> been built, not the value of the assets that <u>might</u> be funded. Given WaterNSW's proposed changes to its CAPEX, this key principle contained in the ACCC Pricing Principle, is more important than ever – in particular since WaterNSW's

CAPEX proposal makes it significantly more difficult to determine what WaterNSW has actually spent on CAPEX.

## Chapter 6: Weighted Average Cost of Capital

As NSWIC outlined in its submission to the IPART Issues Paper, it seems peculiar that IPART is considering the introduction of *two* different Weighted Average Cost of Capital (WACC) figures for WaterNSW's coastal and inland valleys – with a deviation 1.5%. The approach is particularly puzzling since IPART has proposed a 'new approach to setting prices' in those valleys that do not generate sufficient revenue to achieve full cost recovery. It seems that under the new approach the WACC calculation in the coastal valleys will bear little relevance on the actual charges paid by water licence holders.

Irrespective of this fact, NSWIC cannot see how such a dual WACC calculation approach is sensible or appropriate – except to satisfy the bureaucratic process of IPART's pricing Determination. Based on the broad definition of the WACC as the rate of return a business is expected to pay on average to its shareholder (the NSW Government in this instance) to finance its assets, there is no reason to have two WACC values - unless there is a good reason why the cost of financing assets in the NSW coastal valleys is different to the NSW MDB.

NSWIC believes that IPART's discussions around two different WACC calculation approaches clearly highlights the arbitrary nature of setting a rate of return for a regulated monopoly business in the context of a regulated water charge review. While NSWIC understands the rules IPART has to abide by, common sense suggests that this outcome is nonsensical.

Since IPART now regulates all of WaterNSW's regulated water charges, it seems sensible to derive one WACC value for WaterNSW. In considering an appropriate WACC value for WaterNSW, NSWIC points to IPART's discussion on pages 53 and 54 of its Issues Paper, in which it was stated:

*"[IPART] <u>will comply</u> with the ACCC Pricing Principles in setting the WACC for the MDB valleys, while [IPART] is subject to the WCIR."*

Whilst uncertainty continues around the review of the WCIR (please see Chapter 1), IPART's current lack of flexibility around the WACC calculation for NSW MDB valleys appears to provide the guiding principle around which IPART should consider a WACC for WaterNSW's entire business.

NSWIC reiterates its preference that IPART should apply the WCIR calculated WACC value for the coastal valleys – in particular as the NSW South Coast valley appears to be penalised by IPART's standard approach at this regulatory review.

**Recommendation 16:**

**NSWIC recommends that IPART use the WACC methodology in the NSW MDB valleys as a WACC for the NSW coastal valleys.**

WACC Beta and Risk Premium

Leading from the previous discussion, the Council queries the WaterNSW proposed beta value used to calculate the weighted average cost of capital.

In its last pricing proposal, State Water Corporation (SWC) asked for a 0.9 beta based on a consulting report by Strategic Finance Group (SFG) who undertook a comparison study of 'equivalent businesses in the US and UK'. As SWC was not a listed company, NSWIC raised its concern that there was no methodology that would allow for a direct estimation of beta. NSWIC noted that a comparison with UK and US water networks is flawed given the significant difference in market conditions, operating conditions, and regulatory environments in the respective countries.

NSWIC acknowledges that in this Determination, WaterNSW has proposed a beta of 0.7 - in line with the ACCC Pricing Principles. However, NSWIC also notes the ACCC statement in the 2014 Determination of SWC's regulated water charges, that the Essential Service Commission chose a beta value of 0.65 for the Victorian bulk water supplier. As such, NSWIC believes there is the capacity for IPART to consider a lower beta value for WaterNSW than 0.7.

In addition, given that IPART is proposing to reintroduce a volatility allowance, it seems even more nonsensical to have such a high beta value or a risk premium for WaterNSW. IPART should seriously consider whether this approach duplicates the risk premium for WaterNSW.

**Recommendation 17:**

**NSWIC recommends that a further review of the beta value is justified for WaterNSW's WACC calculation. In addition, NSWIC recommends that IPART should consider removing either the risk premium from the WACC calculations or the volatility allowance, as one duplicates the other as a risk premium for WaterNSW.**

## Chapter 7: MDBA Pass-Through Charges

NSWIC remains deeply concerned and frustrated by the preliminary Murray Darling Basin Authority (MDBA) and Border River Commission (BRC) costs that are proposed to be passed through to WaterNSW's customers (as per WaterNSW's pricing proposal). The Council has held these concerns for many pricing Determinations for both SWC (now WaterNSW) and for the Water Administration Ministerial Corporation (DPI Water).

Despite IPART's decision to commission *Aither* to prepare an independent expenditure review report on the MDBA cost, NSWIC and its members' concerns have not been alleviated – to the contrary, our concerns have expanded after review of the consultant report. The report is confusing in that it seemingly confuses MDBA charges imposed on water licence holders through WAMC and WaterNSW charges (including the process of sharing costs).

**Recommendation 18:**

**NSWIC recommends that IPART make a clear distinction between the MDBA charges that are imposed on regulated water licence holders in the NSW Murray and Murrumbidgee valleys vs those that are imposed through the Water Administration Ministerial Corporation.**

Without this clear differentiation, water licence holders quite rightfully have grounds for serious concern that there could be 'cross-subsidisation' or 'duplication' between these two different MDBA costs.

<u>MDBA Cost Transparency</u>

Similar to stakeholders' ongoing frustration with the MDBA costs, it appears that *Aither* had equal difficulties to ascertain the basis of the MDBA costs and assess whether the MDBA programs were prudent and efficient – due to a lack of data and information on how the programs and service levels are derived and incorporated in the context of planned expenditure.

Overall, the consultant report was disappointing in that it did not provide substantive new information which was not already available to stakeholders. NSWIC and its members are aware of the process by which MDBA costs are passed on to WaterNSW's customers; we are aware that some of the costs are shared between the NSW Government and water licences holders; and that these costs are split between various groups in individual NSW valleys. What NSWIC and its members are not privy to, is a detailed capital expenditure efficiency assessment around WaterNSW's bids put forward to the MDBA in line with the MDBA's asset management plans or the internal processes that ensure the actual expenditure is prudent and efficient.

NSWIC considers it absurd that IPART's expenditure consultant simply has accepted that:

- There are internal (MDBA) processes to ensure efficiency and prudency of expenditure.
- Discrepancies between actual and budgeted expenditure are acceptable based on conversations with the MDBA.
- Other (past) assessment found the cost to be prudent and efficient.

Concerns of stakeholders have stemmed from this exact lack of detail and regulatory oversight over these three issues. NSWIC remains deeply dissatisfied that no further light could be shed by IPART or its cost review consultant on how the MDBA cost assessment process is conducted.

NSWIC acknowledges that Aither has provided a range of recommendations that could (partially) improve the transparency of the MDBA charges, however most of these are **'aspirational'** as they will require the cooperation and willingness of the NSW Government – who by the nature of how the MDBA charges are derived and passed on to customers, have little incentive to push for this additional oversight.

NSWIC submits that based on Aither's report:

- IPART must determine whether a mechanism could be put in place that would incentivise the State Constructing Authority (WaterNSW) to seek out further efficiencies.
- Impose a larger efficiency dividend on WaterNSW to ensure WaterNSW and MDBA jointly seek the lowest cost solutions.
- Deducts the amount of unspent CAPEX from future MDBA cost commitments in the next regulatory period.

NSWIC emphasises that the $5 million per annum CAPEX under-spent for the MDBA costs would have already been paid by WaterNSW's customers in the NSW Murray and Murrumbidgee valleys or have been allocated to the 'Overs and Unders' mechanism. It is simply not acceptable to NSWIC or its members that WaterNSW as the state constructing authority is able to retain 'under-spend' funding while at the same time asking for a change in the tariff structure for MDBA costs.

NSWIC urges IPART to reduce the recovery of MDBA costs from irrigators on the basis of the poor data, lack of transparency and the significant CAPEX under-spend.
NSWIC is not asking WaterNSW to absorb any under-recovery by the NSW Government. However, it is the NSW Government which agrees to fund the MDBA, with irrigators excluded from all cost pass-through processes and with no opportunity for input on the efficiency of the services paid for.

To highlight these points, in the case of the Murrumbidgee Valley River Murray Water costs, these costs are not even designated for the regulated water supply.

**Recommendation 19:**

**NSWIC recommends a further deduction to MDBA charges to reflect the lack of transparency and clarity around their prudence and efficiency.**

NSWIC hopes such cost deductions will send a signal to the NSW Government that further action must be initiated at Ministerial Council level that allows for a review of these charges to take place in line with all regulated, unregulated and groundwater charge reviews in NSW.

Finally, NSWIC notes that the proposed MDBA charges in the next Determination will dwarf any costs to customers actually resulting from WaterNSW's normal business activities which are reviewed by IPART as part of this review.

Given the disproportionate cost impact of MDBA charges in the Murray and Murrumbidgee valleys, it defies belief that neither IPART nor the ACCC have the regulatory capacity to review the cost basis of the MDBA and BRC charges (please see Appendix B of this submission for a possible proposal to amend this situation). To not be able to provide scrutiny of these costs in the two largest NSW water utilising valleys is a very serious shortfall in the price Determination process, and as such it seriously undermines the Government's approach to price regulation.

**Recommendation 20:**

**NSWIC recommends that IPART – as far as possible – conduct an efficiency review of MDBA and BRC related costs and apply its previous cost sharing approach to these charges.**

NSWIC also urges IPART to consider – in detail – the submissions made by NSWIC members for the NSW Murray and Murrumbidgee valleys for a detailed outline of their concerns. In addition, NSWIC refers IPART to the detail of its previous submission to IPART's Issues Paper.

## Chapter 8: Overs and Unders Mechanism vs Revenue Volatility

<u>Overs and Unders Mechanism</u>

While NSWIC expressed some concerns with the *Overs and Unders Mechanism* (OUM) in the 2014 Determination of State Water Corporation's regulated water charges, the Council and its Members consider this mechanism to be preferable to the previous (and now proposed) Volatility Allowance approach that has been suggested by IPART. This is because the UOM (in its current design) allows WaterNSW to adjust its regulated water charges each year (i.e. responsive) to ensure it is able to **recover its notional revenue allowance** rather than creating artificially inflated prices in each year of the regulatory Determination, irrespective of actual consumption figures. While the UOM has the capacity to cause significant price shocks between years and across Determinations (as has been proposed by IPART) and hence can – at the extreme – have substantial impacts on the medium and long term planning and investment decisions of irrigators, it is a <u>transparent</u> mechanism that adjusts regulated water charges according to actual consumption figures against forecast consumption (instead of basing everything on an allowed volume approach). By comparison the volatility allowance is not transparent and unnecessarily inflates regulated water charges without justification. As outlined elsewhere in this submission, WaterNSW is under significantly less revenue risk than all of its customers, due to both the cost share framework and the current tariff structure combined.

In addition, NSWIC is concerned that IPART's draft proposal suggests that the balance of the UOM mechanism (approximately $20 million) should be repaid (with interest) over the 2017-2021 Determination. Such a change in approach is completely contrary to the original intent of the UOM which was designed to enable the recovery of WaterNSW's notional revenue allowance **over the long term**. IPART's proposal to phase out the UOM and recover the remaining UOM balance over the 2017-2021 Determination will significantly distort prices and will lead to less cost transparency for WaterNSW customers.

Finally, NSWIC questions IPART's proposed approach to recover the balance of the UOM in proportion to the 'respective contributions that High Security (HS) and General Security (GS) sales made to the balance of the UOM over the 2014-15 and 2015-16 period'. Such a proposal is quite ludicrous, as it effectively suggests that GS entitlement holders should pay a 'penalty' on their lower water supply reliability - or to say it differently, GS licence holders should pay for the supply side risk of WaterNSW. As IPART outlined, there is a justifiable case for sharing of supply side risk between WaterNSW and its customers but NSWIC does not accept that IPART should shift all risk to GS entitlement holders but none to WaterNSW, as GS entitlement holders are not responsible for their annual levels of water allocation.

**Recommendation 21:**

**NSWIC recommends the continuation of the UOM mechanism as originally proposed by the ACCC, and in addition, that the balance of the UOM be recovered over the longer term and not be fully 'repaid' over the course of the next Determination.**

Revenue Volatility Allowance

As outlined in the previous section, NSWIC rejects WaterNSW and IPART's proposal to introduce a volatility allowance – irrespective of the value.

NSWIC finds it puzzling that IPART suggests phasing out the UOM and reintroducing a volatility allowance - at a value of $0.675million a year – on the basis that the UOM does not 'materially reduce the volatility risk faced by WaterNSW'. At a value of $0.675 million a year, NSWIC argues that the value is so negligible that there clearly is no need for further risk protection.

As a matter of principle, NSWIC sees absolutely no need for another Risk Protection Mechanism for WaterNSW which is paid for by water licence holders and users. As a monopoly operator, WaterNSW already enjoys significant risk protection mechanisms through the cost share framework, the current fixed to variable tariff structure and the fact that its customers are welded to it. As such, WaterNSW and its shareholder – the NSW Government – are able to achieve a rate of return remarkably higher than comparative monopoly operators.

**Recommendation 22:**

**NSWIC recommends that IPART reject the volatility allowance as an inappropriate approach to risk shifting by WaterNSW, and that IPART explicitly not determine for any reintroduction of a revenue Volatility Allowance on the grounds that WaterNSW is sufficiently protected from supply side risk through the cost share framework, the current fixed to variable tariff structure and the fact that it is a monopoly service provider.**

Arising from this NSWIC asks again, is it the purpose of regulation to allow the monopoly provider to be guaranteed nearly 100 percent of their notional revenue requirement? WaterNSW claims that the introduction of a Volatility Allowance is necessary and inevitable in order to ensure the commercial viability of WaterNSW and to guard against WaterNSW's business risk that arises due to a mismatch between variability in WaterNSW's actual and allowed revenue. NSWIC notes that a mismatch between revenue and costs is also present for any of WaterNSW's customers with the additional constraint that the latter do not have access to the insurance that is afforded to WaterNSW by its **base level revenue mechanism**.

## Chapter 9: Cost Sharing Framework

NSWIC welcomes IPART's draft proposal to maintain a current cost share arrangement between the NSW Government and WaterNSW's customers. The continuation of a cost share framework will ensure an equitable sharing of costs between the NSW Government and WaterNSW customers based on the 'impactor pays' approach.

Despite this endorsement, NSWIC is deeply disappointed that IPART has not addressed the fundamental issues of the current cost share framework even though the IPART draft report outlines on page 91 that the *'cost shares have not be revised for some time*' and that the *'changes in WaterNSW's operating environment mean there may be a number of users of WaterNSW's services (beyond billed customers) that are not currently taken into account in setting the customer share'*.

These two statements are crucial and warrant a fundamental review of the cost shares framework.

**NSWIC understands that a range of detailed information will be required to conduct this review and that there may also be flow-on effects on other policies or regulatory instruments. NSWIC is most interested to gain a better understanding of what will be required to conduct this review.**

The Council has – on many occasions – pointed out the shortfalls in the current cost share framework and urged IPART to address these issues in the regulated water charge reviews – a point that has evidently been shared by IPART's consultant Frontier Economics. In particular, NSWIC has been deeply frustrated by the lack of willingness to address the issue of 'free riders' in the context of WaterNSW's bulk water service delivery. We note that there are many more 'impactors' and 'beneficiaries' of WaterNSW's infrastructure who currently do not pay for WaterNSW's services.

Furthermore, NSWIC notes that under the current cost share approach, an increasing proportion of WaterNSW's notional revenue allowance is allocated towards WaterNSW's customers (i.e. water access licence holders). This is despite the fact that the demands of water licence holders to WaterNSW have not materially changed. On the contrary, NSWIC maintains that the only customers who have imposed further demands on WaterNSW has been the environment (i.e. through Basin Plan requirements and State held and planned environmental water storage and flows) and from increased community expectations (i.e. recreational, amenity and environmental services). NSWIC submits that there is increasing evidence that the delivery of environmental water, both planned and licensed, requires WaterNSW to incur additional operational and administrative costs that are not required when delivering to other licensed customers.  NSWIC maintains that this fact must be recognised in the cost share framework.

NSWIC acknowledges that Frontier Economics has recommended a new approach/methodology for cost shares that takes into consideration the valley specific context of WaterNSW's service provision. While NSWIC and its members have currently insufficient information on what the impact of such an approach may be, we are keen to gain a better understanding of it. We can see some benefits around greater transparency and a mechanism to include customer groups who receive benefits from WaterNSW but are not currently billed. Furthermore, we are interested to explore Frontier Economics approach to clearly outline the costs borne by the environmental licence holders, as we believe they impose significant costs on WaterNSW's operations that are, by default, being borne by other water access licence holders.

**Recommendation 23:**

**NSWIC recommends that IPART:**

- **Conduct a separate review of the cost share framework on the basis of Frontier Economics Report;**
- **That improvements be made to the current cost share framework in recognition of the additional demands imposed on WaterNSW from its environmental customers (through both rules based planned and held environmental water);**
- **That improvements to the current cost share framework also be made around the category of 'legacy issues';**
- **That provisions be made to capture all beneficiaries of WaterNSW's infrastructure and services who currently do not pay for the operation or maintenance of the infrastructure.**

NSW Government Commitment

NSWIC would like to emphasise that the NSW Government has still not officially committed to a continuation of a cost sharing framework as per the 2012 Review of Rural Water Charging System. In that Review, the NSW Government agreed to continue the current cost sharing framework until the explicit date of July 2017 and requested IPART to conduct a review of the cost share framework ahead of the next Determination. Whilst IPART has decided to propose a continuation of the current cost share framework, NSWIC points out that the NSW Government has still not made a formal commitment to sharing costs – leaving uncertainty over the recovery of over $146 million in WaterNSW's NRR. This uncertainty is a significant risk to WaterNSW's customers, who could be faced with a very significant increase in costs should the NSW Government decide not to continue with the current cost sharing framework.

The Council has sought a confirmation from the NSW Government that a cost sharing approach between the Government and WaterNSW's customers will continue. NSWIC has stated this request in a letter to the NSW Minister for Primary Industries, Lands and Water and will continue to follow up in discussions on this vital issue until a satisfactory response is received. However NSWIC reiterates the concerns of its Members over the uncertainty around the lack of a formal commitment to the cost shares framework by the Government.

## Chapter 10: Forecast Entitlements & Usage Volumes

NSWIC reiterates that creating a forecast for consumption has been - and must continue to be - a task for the regulator. Nevertheless, NSWIC acknowledges that climate variability and unpredictable rainfall patterns make this task difficult. In order to assess and determine consumption forecast values, IPART has – in the past - relied upon the Long Run Average (LRA) from the IQQM model for the Determination of SWC's regulated water charges (or a similar approach in valleys where IQQM is not used).

Whilst NSWIC also acknowledges that IPART has deviated from this approach in the 2010 Determination, we continue to support the use of the full IQQM (or equivalent) datasets and submit that the 20-year weighted average approach is not necessarily superior to the full IQQM model.

NSWIC believes that the 20-year rolling average approach benefits WaterNSW in this price Determination, as it currently understates the long term average consumption figures in NSW through the inclusion of the period of 1996/97 to 2016/17 incorporating the worst years of the Millennium Drought. As a result, WaterNSW's regulated water charges are higher than (possibly) necessary and will likely lead to an actual revenue collection that is greater than IPART's Notional Revenue allowance

As the last Determination showed, the yearly consumption updates, in accordance with Part 6 Division 3 of the WCIR, has caused some significant shifts in regulated water charges in some valleys, when a year of higher than average consumption was replaced with a year of lower than average consumption.

In addition, as this year has clearly highlighted, there is sometimes no correlation between weather conditions from one year to another, and hence the move towards a 20-year moving average does not add any significant benefits to the analysis, but rather decreases the transparency for customers.

Finally, to support our position on this issue, NSWIC advises that Murray-Darling Basin Authority has discarded the 20-year average demand forecasting model in favour of the full IQQM dataset for the Murray-Darling Basin Plan.

**Recommendation 24: NSWIC recommends that a consumption forecasting model that takes into consideration the full IQQM data is the most valid method available and should be applied in this Determination.**

## Chapter 11: Tariff Structure and High Security Premium

Fixed to Variable Tariff Structure

NSWIC cautiously welcomes IPART's draft decision to continue the existing pricing structure for WaterNSW's regulated water charges.

NSWIC policy supports valley-based pricing in the NSW Murray-Darling Basin valleys and the current fixed to variable tariff structure for WaterNSW's regulated water charges. We have reiterated this policy positon to IPART and the ACCC in previous Determinations and water charge reviews. NSWIC is therefore concerned that with the proposed volatility allowance and the repayment of the UOM, IPART effectively proposes to move GS entitlement holders to a 80:20 tariff structure.

Based on WaterNSW's original proposal and our own analysis, the Council currently considers there to be little or no benefit from moving to a higher fixed charge tariff structure (not considering any further 'risk protection mechanism' which are discussed in other Chapters of NSWIC's submission). It continues to be our position that the current tariff structure and the cost share framework eliminate most of WaterNSW's volume-related risk because a large percentage of WaterNSW's allowed revenue is recovered independently from actual water availability. Comparing WaterNSW's position with that of its customers, it must be stressed that such revenue guarantee is not available to WaterNSW's customers.

Related to the previous paragraph, NSWIC rejects IPART's analysis that 'given that WaterNSW's costs are largely fixed, we do not consider its current tariff structure to recover the customer share of costs, which is mostly 40:60 fixed to variable (…) a higher fixed proportion would be appropriate'. To the contrary, NSWIC has supported its position for the fixed to variable tariff structure on the basis that it has provided a fair sharing of risk between WaterNSW and its customers and provides a degree of protection for customers against supply side risk (i.e. of low or no water availability). WaterNSW is a State owned monopoly business across a number of valleys, which by default helps to offset some of the risk around revenue volatility. Clearly WaterNSW continues to exaggerate their real risk, and as outlined earlier, despite this risk has managed to secure a pre-tax profit throughout the last two Determination periods.

As outlined in our last submission to the IPART Issues Paper, NSWIC has evidence that in cases of low water availability and a high fixed to variable tariff ratio for WaterNSW's regulated water charges, the cost impost on WaterNSW customers could be significant in some valleys. In the absence of a comprehensive 'fixed charges relief trigger' policy offered by the NSW Government under its hardship provisions, NSWIC considers the current tariff structure equitable and appropriate.

**Recommendation 25:**

**NSWIC welcomes IPART's draft decision to continue the current 40:60 fixed to variable tariff structures for the NSW Murray-Darling Basin Valleys.**

NSWIC would like to refer IPART to our previous submission to the Issues Paper for a detailed outline of our views on tariff structures.

In conclusion, NSWIC would like to emphasise that individual valleys may wish to continue the discussions around tariff ratios, and NSWIC urges IPART to liaise with our Members on this issue. However, NSWIC does not accept that if members of the Customer Service Committees (or potentially Customer Advisory Groups) accept a different tariff structure that IPART should accept this as necessarily representative of the views of customers across the entire valley.

High Security Premium

In line with NSWIC's submission on its preferred demand forecast approach, the Council reiterates its concerns that the proposed adjustment to the reliability ratio is shifting costs to high security licence holders. NSWIC suggests that basing the reliability ratio on a 20-year dataset (1996-97 to 2015-16) may not accurately reflect long term conditions which should form the basis of the High Security Premium. As High Security and General Security Water Access Licenses are issued in perpetuity, we consider it appropriate to take a similar long term view on the calculations for the reliability ratio.

**Recommendation 26:**

**NSWIC rejects IPART's approach to the calculation of the reliability ratio and recommends that a longer dataset should form the basis of the High Security Premium calculations.**

## Chapter 12: Metering Charges

In line with NSWIC submission to the ACCC in 2013 on the review of SWC's regulated water charges, NSWIC disagrees vehemently with the cost build up and assumptions underlying WaterNSW's metering charges. NSWIC has still not seen any justification for the level of charges WaterNSW proposes according to meter size or the proposed increases in metering costs throughout the next Determination.

In addition, IPART and WaterNSW have not provided any justification for the equalisation of meter charges for both telemetered and non-telemetered meters. As a principle, telemetry – where it is feasible to be installed – should lead to lower costs for WaterNSW and hence lower charges. NSWIC questions IPART's statement in the draft report that the difference in Meter Service Charges between telemetered and non-telemetered is only 2% to 4%. If this is the case, NSWIC seriously questions the additional benefits of telemetered meters.

**Recommendation 27:**

**NSWIC rejects WaterNSW's proposed meter service charges and recommends that IPART revise costs down for small size meters (both telemetered and non-telemetered).**

Meter Reading Charges

NSWIC points out that DPI Water is currently in the process of developing a Water Take Measurement Strategy. As this strategy is not yet finalised, and could have significant impact on the cost of reading meters, NSWIC urges caution in IPART prematurely approving WaterNSW's proposed Meter Reading Charges. NSWIC reiterates its position that the Council and its members are not supportive of the introduction of new Meter Reading Charges at this point in time.

**Recommendation 28:**

**NSWIC recommends that IPART not approve WaterNSW's proposed Meter Reading charges prior to the completion of DPI Water's Water Take Measurement Strategy.**

## Chapter 13: ICD Rebates

NSWIC welcomes IPART's draft decision to continue the ICD rebates.

Despite our support for the draft decision, NSWIC reiterates that we consider the scale of reduction in rebates to be unjustified.

NSWIC submits that the calculation of the rebates must be a transparent process and that any reduction in the level of rebate must be justified by WaterNSW providing information to substantiate that there has been a reduction in their expenditure for metering, compliance and billing. NSWIC is of the view that the economies of scale and system-wide benefits persist and significant cost savings, including avoided costs, continue to be enjoyed by

WaterNSW through the aggregation of many irrigators under the auspices of a single WaterNSW customer as is the case with the ICDs.

**Recommendation 29:**

**NSWIC recommends that the current ICD rebates be maintained.**

NSWIC urges IPART to consult closely with the irrigation corporations on this issue as their knowledge and expertise on costs and service provision around this matter is invaluable.

## Chapter 14 Trade Processing Charges

NSWIC welcomes the proposed amendments to the *Trade Processing Charge* approach which the Council believes reflects WaterNSW's workload and costs for providing this service. NSWIC has considered it inadequate that Trade Processing Charges have been structured around a fixed and variable charge, despite insufficient evidence that the workload for WaterNSW varies by trade volumes.

Despite NSWIC's support for the proposed approach, we question the need to have minimal differences in charges for each year of the next Determination. For ease of application, NSWIC proposes a consistent charge for the next four years.

**Recommendation 30:**

**NSWIC recommends that the proposed approach to the Trade Processing Charge should be adopted, and that the Trade Processing Charge should be fixed for the entire Determination**.

## Chapter 15: Coastal Valleys

NSWIC welcomes IPART's acknowledgement that some valleys may never be able to achieve full cost recovery. This situation is pertinent to the NSW North and South Coast Valleys (as well as the Peel Valley) and could also be a likely scenario for the Hunter Valley once the large water users (i.e. the coal mining businesses and the power stations) cease to operate in the valley.

NSWIC acknowledges that IPART dedicated a whole chapter to the NSW coastal valleys in its Issues Paper and has commissioned two separate studies to ascertain the willingness to pay by licence holders in these valleys. We applaud IPART for the dedication of significant resources to the coastal valley pricing issue and in organising separate meetings to discuss licence holders' concerns around costs.

Despite this endorsement, NSWIC is disappointed that IPART has chosen to take such little action in its draft Determination to address the underlying pricing issues in the NSW coastal valleys. Coastal valley members had placed great hopes on IPART's preliminary proposals, which NSWIC would have liked to explore in more detail. As we mentioned previously, without a significant 're-think' of the coastal valley prices, irrigation on the NSW coast will unlikely be sustainable into the near future.

NSWIC is particularly disappointed that IPART has chosen the least ‘onerous’ outcome by simply freezing prices in the North Coast but increasing prices in the South Coast further. NSWIC states again that this approach – to not fundamentally review the current cost and pricing situation – does nothing to address the current lack of irrigation cost sustainability for the coast. In particular, the North Coast will experience 6 years of constant prices if IPART’s draft Determination becomes final. As the Council and its North Coast members have highlighted on multiple occasions, the current pricing structure and level of prices has already driven WaterNSW’s customers away from utilising their entitlements. What is needed is an incentive to increase usage – which equally will decrease the required CSO by the NSW Government – and an incentive to attract other customers or businesses to share the costs. This points to the urgent need for cost reductions to make water use more affordable and attractive to new customers. IPART’s draft decision is a significant disappointment and will not lead to a change in the current trend away from water utilisation. The same situation – if not more so – applies to the NSW South Coast where irrigators are faced with even higher prices. Despite our original support for IPART to conduct a separate analysis and deriving a viable solution for WaterNSW’s coastal valley customers, we are disappointed that IPART has not delivered this in its draft Determination.

NSWIC understands that such a change project will take time - which we and our coastal valleys Members, in the context of a rigid timeframe for a regulated water charge Determination – do not have. As such, NSWIC considers it critical that IPART considers amending the timeframe around the coastal valley pricing review in order to truly find a long term sustainable cost/services solution for WaterNSW.

NSWIC reiterates that WaterNSW is currently conducting a North Coast pilot in recognition of the ongoing cost challenges in the NSW coastal valleys. Given the complexities and the need for a fundamental re-think on how water pricing is applied in the coastal valleys, NSWIC believes that IPART needs to engage with WaterNSW on the pilot in order to understand the proposed options WaterNSW has discussed with the North Coast valleys and to understand the potential impacts. NSWIC is aware that WaterNSW is considering divesting itself of the Toonumbar Dam – a result that will fundamentally impact on this pricing Determination and could severely impact the security of supply of irrigators. IPART’s involvement in the North Coast pilot and the potential of a similar study in the NSW south Coast is critical to find a sustainable solution for both.

Further, NSWIC maintains that it is imperative that WaterNSW and IPART have sufficient time to thoroughly consult with stakeholders in the NSW coastal valleys on the options outlined in IPART’s Issues Paper.

**Recommendation 31:**

**NSWIC recommends that IPART initiate a separate review on the preliminary options for NSW Coastal Valleys as outlined in its Issues Paper, which sit outside WaterNSW’s regulated water charge review.**

## Chapter 16: Efficiency Carryover Mechanism

NSWIC notes that IPART has reaffirmed its position for the introduction of an Efficiency Carryover Mechanism (OPEX) for WaterNSW.

While NSWIC does not conceptually object to a mechanism that would incentivise WaterNSW to expedite possible efficiency savings, the Council considers the proposal ill-timed since the State Government continues to undergo a significant water reform process. With the recent transfer of functions between DPI Water and WaterNSW, customers are expecting operational efficiencies and cost reductions for both organisations (WaterNSW and DPI Water) that flow through to NSW water licence holders in the form of lower water charges. As outlined earlier, NSWIC is requesting that IPART pass on parts of WaterNSW's already achieved efficiency savings from the amalgamation of the Sydney Catchment Authority and WaterNSW.

As NSWIC has outlined in its submission to IPART's Issues Paper, the Council does not consider it equitable for WaterNSW's customers, who already have seen little benefit from the current water reform process in NSW, to continue to pay regular water charges while NSW's monopoly service operator and DPI Water reap the benefits of any efficiency savings. Since the water reform process has started, water licence holders have had to endure a significant loss in corporate knowledge within WaterNSW and DPI Water, experienced a substantial delay in the delivery of critical projects and programs without any compensation in the form of lower costs. The Efficiency Carryover Mechanism again puts into serious doubt the validity of IPART's draft Determination which is supposed to determine WaterNSW's efficient revenue allowance. While NSWIC acknowledges that IPART proposes to apply the Efficiency Carryover mechanism in 2021, the Council considers the next pricing review to be the opportune time to discuss such a mechanism and its potential operation – for the benefit of both WaterNSW and its customers – as has been proposed by WaterNSW. It is particularly puzzling for NSWIC as to why IPART proposes such a mechanism at this point in time while equally stating that 'our expression of intent to adopt an ECM (…) does not bind a future IPART Tribunal to adopt such a mechanism'.

Furthermore, NSWIC is concerned that there may be further auditing requirements imposed on WaterNSW in order to determine when the 'permanent OPEX savings' have occurred.

In addition, and in line with our previous comments, NSWIC does not understand why IPART wishes to provide further benefits to a monopoly service operator at the expense of customers who are unable to enjoy in the benefits of any OPEX savings. The Council objects in the strongest terms to the notion that all of the efficiency savings should be attributed to and retained by WaterNSW for four years. If IPART insists on introducing such a mechanism, NSWIC submits that IPART must consider the 'sharing of benefits' between customers and WaterNSW.

**Recommendation 32:**

**NSWIC rejects IPART's proposal to introduce an Efficiency Carryover Mechanism in this pricing Determination and recommends further consultation with stakeholders around such a mechanism for future Determinations. In addition, NSWIC recommends that any future form of efficiency mechanism must consider the 'sharing of benefits' between customers and WaterNSW.**

## Further Information

For further information on this submission and its recommendations please contact:

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Policy Manager
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or

Mark McKenzie
CEO
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# APPENDIX A

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|---|---|---|
| | NSWIC<br>NEW SOUTH WALES IRRIGATORS' COUNCIL | PO Box R1437<br>Royal Exchange NSW 1225<br>Tel: 02 9251 8466<br>Fax: 02 9251 8477<br>info@nswic.org.au<br>www.nswic.org.au<br>ABN: 49 087 281 746 |

**7 March 2017**

Helen Thai
Department of Agriculture and Water Resources
Water Market Policy Section
Water Acquisition and Markets Branch | Water Division

Via electronic mail: Helen.Thai@agriculture.gov.au

Dear Ms Thai,

**Re: NSWIC submission on the Final Advice on the review of the Water Charge Rules**

The NSW Irrigators' Council (NSWIC) appreciates the opportunity to provide further comments to the Department of Agriculture and Water Resources on the Australian Competition and Consumer Commission's (ACCC) final advice on the Water Charge Rules.

We understand that the Deputy Prime Minister and Minister for Agriculture and Water Resources, Barnaby Joyce, has made amendments to the Water Charges Rules via the *Water Charge (Infrastructure) Amendment Rules 2017* in order to repeal the Network Service Plan requirement on Part 5 operators, a decision that is welcomed by NSWIC. We are also aware that the Minister is currently considering the remaining advice and recommendations provided by the ACCC.

In broad, the NSW Irrigators' Council (NSWIC) would like to express its ongoing concerns with the remaining ACCC final advice and proposed recommendations. After careful evaluation, NSWIC recommends that the Federal Government reject the remaining ACCC advice on the grounds that it imposes further regulatory burden and compliance costs on NSW irrigators, irrigation infrastructure operators and NSW's bulk water service operator, WaterNSW. In addition, the proposed amendments are likely to lead to further regulatory uncertainty for water licence holders in NSW.

NSWIC fails to see how the ACCC's final advice and proposed rules have:

- Captured the intent of the Independent Expert Panel's recommendation for the review of the Water Act 2007 (as per recommendation 11 of the Report of the Independent Review of the Water Act 2007); and

- Fulfilled their primary objective of "improving the regulatory clarity or efficiency, or reduce regulatory burdens, while maintaining effective standards" as outlined in the Terms of Reference (ToR) for the review of the Water Charge Rules; and

- Resulted in a materially preferable regulatory outcome, despite the removal of the requirements for Irrigation Infrastructure Operators (IIOs) to prepare Network Services Plans.

It is evident to NSWIC that the ACCC has simply shifted the regulatory obligations within the Water Charge Rules whilst expanding the existing regulatory obligation on NSW bulk water service provider, WaterNSW. In respect to WaterNSW, NSWIC is concerned that the ACCC's final advice still leaves many questions unanswered, including which regulatory obligations will apply to WaterNSW if the Water Charge Rules are amended. As this question is relevant for the current review of WaterNSW's regulated water charges in 2017, NSWIC stresses the importance of resolving this issue.

NSWIC has inquired with the Independent Pricing and Regulatory Tribunal (IPART) whether there are any risks to the review of WaterNSW's regulated water charges if the Water Charges Rules are amended. We are yet to receive a response.

NSWIC has also inquired with the ACCC on the recommended changes to Part 3, 6 and 9 of the Water Charge (Infrastructure) Rules 2010; all of which are relevant for the next Determination of WaterNSW's regulated water charges. In particular, we sought clarification from the ACCC as to the possible implications on any amendments to the Water Charge (Infrastructure) Rules 2010 at various times of the current review of WaterNSW's regulated water charges. Unfortunately, the responses we received from the ACCC are not entirely transparent or conclusive.

It is our understanding that if there are further amendments to the Water Charge (Infrastructure) Rules 2010 and the amendments commence *after* IPART has made its decision on WaterNSW's regulated water charges (scheduled on 6th June), the amended PART 6 rules would apply for the remainder of that regulatory period – i.e. until the end of June 2021 as per rule 82(3) and (5).

However, Rule 5-R, 5-Q, 5-N and 5-A would apply prior to that date. Rule 5-R in particular would enable WaterNSW to ask for a re-opening of the Determination if there are significant variances between actual and allowed revenue during the Determination, which could constitute a significant risk to irrigators, as the threshold was lowered.

In addition, while the non-discrimination requirements have a 12-monthtransitional provision, it could still mean that the new 'non-discrimination' rules would apply by 2019. Whether IPART has already accounted for that in its draft Determination will remain unanswered until the draft report is released on 14th February 2017.

In broad, NSWIC believes that many of the ACCC proposals will add greater complexity when there was little call for such amendments. NSWIC stresses that our members did not request such wholesale changes to the Water Charge Rules, and rather hoped that the review would lead to regulatory streamlining and reduced regulatory burden as is reflected in the *Water Charge (Infrastructure) Amendment Rules 2017*. NSWIC and its members are extremely concerned that the remaining amendments constitute a very significant shift in the regulatory framework which could have adverse and unintended consequences and costs to the irrigation sector. In addition, NSWIC would like to highlight that many of the smaller irrigation infrastructure operators in the Murray-Darling Basin, who have not been involved in the development of the draft and final advice by the ACCC, may be unaware of what is being contemplated and its implications for their operations and compliance. On the contrary, those irrigation infrastructure operators outside of the Murray-Darling Basin will not be captured by any amendments to the Water Charge Rules.

In conclusion, and to reiterate, NSWIC is recommending to Minister Joyce that the Federal Government reject the ACCC final advice and proposed rules.

Yours Sincerely,

[redacted]

Stefanie Schulte
Policy Manager
NSW Irrigators' Council

# APPENDIX B

NSWIC
NEW SOUTH WALES IRRIGATORS' COUNCIL

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**7 March 2017**

Review of the Operating Licence for WaterNSW
C/o Jessica Hanna
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Dear Ms Hanna,

**RE: NSWIC SUBMISSION TO THE DRAFT WATERNSW OPERATING LICENCE REVIEW PACKAGE**

The NSW Irrigators' Council (NSWIC) appreciates the opportunity to provide additional comments to the Independent Pricing and Regulatory Tribunal (IPART) on the Draft WaterNSW Operating Licence package. As the Council outlined in its previous submission to IPART, we acknowledge that the NSW bulk water supplier, WaterNSW, has undergone significant operational and legislative changes over the last two years as a result of the merger between the Sydney Catchment Authority and State Water Corporation, as well as the more recent transfer of functions between DPI Water and WaterNSW.

**OVERVIEW**

NSWIC appreciates that a review of WaterNSW's two operating licences is essential to enable WaterNSW to fulfil its licence obligations and to conduct its operations under its legislative provisions, and to an equivalent service level prior to the NSW water reform process. importantly, NSWIC would like to emphasise that this water reform journey is not complete and further adjustments to the operating licence and/or other legislative instruments governing WaterNSW operations may be required. For that reason, NSWIC reiterates its call for caution before embarking on wide-scale amendments to WaterNSW operating licence before the reform process is complete, and there is a common understanding of the potential impacts from the proposed amendments. In broad, NSWIC continues to hold the view that significant uncertainty and confusion remains as to which direction WaterNSW should take under the provisions of a new operating licence.

Reviewing IPART's draft recommendations for WaterNSW's Operating Licence package, NSWIC is concerned that IPART is unnecessarily pushing for a standardisation of the two operating licences (including the functions and obligations imposed on WaterNSW's urban and rural water supply) without acknowledging and accounting for the obvious differences in the two operating environments. NSWIC considers it highly inappropriate that IPART has apparently chosen the more *onerous* urban water supply standards and obligations for WaterNSW's draft operating licence without an adequate assessment of any unintended consequences and the likely costs (i.e. audit costs) that will result from the proposed changes, which NSWIC believes will ultimately be passed on to WaterNSW customers in the form of higher water charges.

As outlined in our previous submissions to IPART and in light of the WaterNSW submission to the operating licence review, it appears to NSWIC that WaterNSW intends to fundamentally change the operation of its business, its interaction with customers, and its approach to future service delivery. While NSWIC continues to support customer choice and the intent of WaterNSW to transform into an efficient and customer-centric business, there is still no clarity around the exact detail of what the WaterNSW proposed approach is, and what it will mean for irrigator customers and Irrigation Infrastructure Operators. NSWIC is also unclear what legislative amendments and executive directions will be necessary to achieve WaterNSW's proposed new operating model. The lack of information and data about WaterNSW's proposed approach makes it extremely difficult for NSWIC to adequately review and respond to IPART's Draft Operating Licence package, which raises concerns within NSWIC and its membership about potential future impacts - including unintended reductions in service provision and/or greater costs to customers.

As highlighted in our previous submission, WaterNSW and its customers have only had preliminary discussions about tailored service delivery and, as such, it is premature to consider major amendments to the current operating licences until discussions have progressed further and stakeholders are clear and comfortable about the future WaterNSW direction and its implications. Having said this, NSWIC welcomes WaterNSW's efforts to provide greater choice to customers and better service delivery, and we look forward to further engagement with WaterNSW and IPART on these issues.

**KEY PRINCIPLES**

By way of broad response, NSWIC supports the following key principles around the setting of WaterNSW revised Operating Licence provisions:

- The amalgamation of the two operations licences (i.e. for the Sydney Catchment Authority and State Water Corporation) and an emphasis on the need to avoid duplication between the two licence obligations.

- The continuation of State Water's operating licence obligation to deliver water to its customers - recognising the important role WaterNSW plays in NSW's food and fibre production.

- The removal of regulatory overlap between legislation, WaterNSW's operating licence, and its work approvals.

- The closing of a regulatory gap in the operating licence where the services required by the environment are not captured adequately and consequently the cost of these services are being inappropriately paid by all water access licence holders. NSWIC believes this is a significant oversight and it should be addressed in the operating licence review.

- IPART ensuring that WaterNSW is legally enabled to conduct the expanded functions due to the transfer of management responsibilities from DPI Water to WaterNSW.

**SPECIFIC RECOMMENDATIONS**

NSWIC provides the following specific comments and recommendations on IPART's Draft Operating Licence package:

**Water Charge Review**

NSWIC welcomes IPART's acknowledgement of the concurrent IPART review of WaterNSW's regulated water charges. While NSWIC insists that parallel pricing and operating licence reviews are less than ideal, the Council is pleased that IPART has proposed the inclusion of a specific requirement on WaterNSW to comply with the pricing Determination. However, NSWIC reiterates that a staggered approach to the licence review and the price Determination is preferable to ensure that future regulated water charges reflect WaterNSW's operating licence requirements and obligations.

Despite our support for its inclusion, NSWIC seeks clarity around s.1.6.1 of the draft operating licence which states that 'WaterNSW must ensure that the level of fees, charges and other amounts payable for its services are applied subject to the terms of this Licence, the Act and any maximum prices or methodologies for fixing maximum prices determined from time to time by IPART under the IPART Act or under any other lawful Determination or instrument'. As NSWIC outlined in its previous submission to IPART, it is critical that extra care is taken when amending WaterNSW's operating licence as it could trigger changes in WaterNSW's obligations, functions and service delivery to customers, which would ultimately flow through to changes in regulated water charges. This is NSWIC's overriding concern with the outcomes of the WaterNSW Operating Licence review.

The interaction between the WaterNSW Operating Licence review and the regulated water charge review must be carefully assessed and further information must be provided to stakeholders to understand the implications of any change to WaterNSW's operating licence. NSWIC urges IPART to be especially diligent in ensuring that changes in the WaterNSW Operating Licence do not result in unintended price shifts for WaterNSW customers or reductions in service level delivery.

Transparency around WaterNSW's obligations under its operating licence is critical so that WaterNSW customers can clearly assess the link between WaterNSW functions and service level delivery and valley specific bulk water charges. As the most recent water reform process has shown, the transfer of functions between DPI Water and WaterNSW has complicated the issue of cost transparency further, as the price Determination for the Water Administration Ministerial Corporation no longer reflects the current operating environment for the Department.

**Recommendation 1:**

**NSWIC submits that IPART must provide clarity on whether amendments to WaterNSW's operating licence would trigger amendments to WaterNSW's regulated water charge Determination.**

**Economic Level of Water Conservation**

NSWIC is deeply concerned about IPART's proposed obligation for WaterNSW to develop an Economic Level of Water Conservation methodology and associated reporting obligations.

The Council understands that the previous State Water Corporation operating licence included an explicit water conservation obligation, requiring WaterNSW to take all reasonable steps to conserve water and minimise losses that result from undertaking its operation under the licence. We also understand that in most recent review of Sydney Water and Hunter Water's operating licences, IPART has introduced the concept of an Economic Level of Water Conservation requirement. While NSWIC understands the rationale for the introduction of an economic assessment of water conservation in a highly engineered (piped) operating environment (i.e. Sydney Water and Hunter Water), such an approach is inappropriate in a rural water supply operating environment that covers vast distances and open river channels.

In addition, the proposed methodology could carry significant risk for irrigators in rural NSW in the context of the NSW Government's obligations under the Water Act 2007 (Cth) and the Murray-Darling Basin Plan 2012. From a practical perspective, NSWIC is not confident that WaterNSW could (or should) develop a methodology that seeks to accurately 'measure' the level of water conservation, as it is far from clear whether this is feasible under the operating vagaries of rural water distribution. Nor do we understand how IPART intends to audit WaterNSW's compliance with this new approach. NSWIC seeks WaterNSW's input on the feasibility and costs associated with developing such a methodology.

From a risk assessment viewpoint, NSWIC urges extreme caution, as such an approach could potentially obligate NSW to utilise this approach for other assessments related to the progress of NSW environmental water recovery targets under the Murray-Darling Basin Plan 2012 and the offsets against the Sustainable Diversion Limit Adjustment Mechanism within the Plan. It is critical that IPART does not insist on new methodologies that contradict these key components of the Murray-Darling Basin Plan and the Water Act 2007.

**Recommendation 2:**

**NSWIC recommends the removal of the draft obligation to develop and implement an Economic Level of Water Conservation methodology in regard to WaterNSW rural water management.**

## Definitions – Supply, Capture, Store and Release

NSWIC is seeking further detail from IPART on its concerns around 'ambiguity between the terms 'supply water' and 'capture, store and release' water.

It is NSWIC's understanding that under the previous State Water Corporation operating licence (s.1.1.1 (b)), the bulk water operator was required to "provide, construct, operate, manage and maintain efficient, coordinated and commercially viable systems and services to capture, store and release water". As such, a supply function was only relevant in the context of 'water utilities'. The inclusion of a 'supply' function in the rural water context could therefore lead to confusion. A definition that clearly articulates the differences and differentiates urban water supply from rural water supply is required.

NSWIC is also concerned that IPART seems to be proposing the removal of Part 3.1 from the previous State Water Corporation operating licence (delivery of water to customers). It has always been NSWIC's understanding that the State Water Corporation operating licence is the only regulatory instrument that obligated State Water Corporation to operate its infrastructure in a way that its customers can access water made available under their water entitlement. As NSWIC outlined to IPART in 2012, the State Water Corporation was and WaterNSW is now the most crucial component in the water delivery process through the releasing of water from its storage infrastructure. The connection between State Water Corporation's activities and its function was, in the opinion of NSWIC, accurately reflected in the previous operating licence obligations and the associated definition of 'water delivery'. The amalgamation of two operating licences could create unnecessary ambiguity over WaterNSW's functions and responsibilities, and it is NSWIC's view that these functions should be clearly defined.

**Recommendation 3:**

**NSWIC recommends that IPART clarify the apparent ambiguity in the terms 'supply' and 'capture, store, and release'.**

## Water Quality Provisions

NSWIC is concerned about IPART's proposed push for a 'water quality' assessment in 'non-declared catchments' in WaterNSW's operating licence. We understand from IPART's draft report and the recent Public Hearing in Sydney, that IPART considers it adequate that WaterNSW should be authorised to 'protect and enhance the quality and quantity of water in declared catchments'. In 'non-declared' catchments, it is NSWIC's understanding that IPART proposes to impose 'Water Quality Management Systems' in relation to 'water supply activities in rural areas'.

Without a clear understanding of how IPART defines 'supply' in the proposed new operating licence, it is not clear to NSWIC whether this additional requirement could impose an additional 'obligation' on WaterNSW in their rural water service functions. In particular, NSWIC is unclear about IPART's assessment that 'In relation to managing water quality in non-declared catchments we consider a water quality management system is not appropriate unless water is also suppled within the area.' If 'supply' is not a function for WaterNSW's rural water services, NSWIC questions why it is needed as a licence requirement. If there are 'supply' functions in regional NSW, NSWIC and its members need to understand the extent of this proposed obligation and whether the new Water Quality Management System could obligate WaterNSW to fulfil a function it has ultimately no real control over (i.e. due to its operating environment in rural NSW). There is a real risk that under the second scenario, WaterNSW could find itself in a situation where it is in breach of its legislative requirements under the Operating Licence. In addition, the potential cost of enforcing the obligation could be unacceptably high for water access licence holders.

**Recommendation 4:**

**NSWIC recommends that IPART clarifies and provides an assurance that any requirement for water quality assessment does not impose an unattainable obligation on WaterNSW or additional costs to water access licence holders. Should any risk remain after a further assessment of the clause 2.1.2, NSWIC recommends the removal of this requirement from WaterNSW's Operating Licence.**

## Education and Research

NSWIC acknowledges IPART's preferred approach to authorise WaterNSW to undertake research and education programs in all of WaterNSW managed catchments. While NSWIC does not, in principle, object to this approach, we are concerned that the cost of these programs could be passed back to irrigators in form of higher regulated water charges. However, should the cost for these programs be funded through the NSW Government – for the benefit of the wider community – NSWIC would be supportive of IPART's proposed amendment.

**Recommendation 5:**

**NSWIC recommends that IPART's proposal to authorise WaterNSW to conduct research and educational programs also includes a provision that clarifies that these programs are funded exclusively through the NSW Government on behalf of the wider community and not through higher charges on water access licence holders.**

## Terms and Conditions

After careful assessment of the IPART draft report, NSWIC concurs with WaterNSW that the operating licence should authorise WaterNSW to operate outside NSW in order to allow WaterNSW to continue its interaction with the Commonwealth and other States when undertaking certain functions and activities under the Murray-Darling Basin Agreement.

**Recommendation 6:**

**NSWIC recommends that IPART impose reporting and public disclosure requirements on WaterNSW around its functions and activities under the Murray Darling Basin Agreement, including WaterNSW's functions as a State Constructing Authority for River Murray Operations and its Joint Functions under the Agreement - assisting irrigators in the NSW Murray and Murrumbidgee Valleys to gain greater clarity around proposed Murray Darling Basin Authority costs that are currently passed on to water access licence holders through WaterNSW regulated water charges.**

## Transparency

In light of WaterNSW's ongoing consultation with customers around its 'level of service' provisions, NSWIC still considers it critical that stakeholders are provided with greater transparency and clarity around WaterNSW's legislative requirements, including how much of WaterNSW services are negotiable and hence can be tailored. Previous discussions between NSWIC and WaterNSW suggest that the majority of WaterNSW operations are non-negotiable due to WaterNSW's complex legislative requirements. Should this be the case, NSWIC raises its concern as to the real or perceived benefits of IPART's proposal to make the operating licence even more prescriptive.

**Recommendation 7:**

**NSWIC recommends that IPART provide clarity around all of WaterNSW's legislative requirements to allow an assessment of how much of WaterNSW services could potentially be tailored.**

## Metering Functions

NSWIC continues to urge caution with regard to the introduction of proposed amendments to WaterNSW's operating licence (and with WaterNSW's proposal) to authorise the operation, replacement, repair, maintenance, removal, connection and disconnection, and modification of any metering equipment it does not own. NSWIC reiterates that such functions should apply to government funded meters only, but not to customer-owned meters.

**Recommendation 8:**

**NSWIC recommends that WaterNSW's operating licence should only authorise WaterNSW to operate, replace, repair, maintain, remove, connect, disconnect and modify Government owned water meters. A blanket meter management function over all meters (including customer owned meters) should not be permitted.**

## Planned Environmental Water

As mentioned in NSWIC's submission to the Issues Paper, the Council and its members seek greater transparency around WaterNSW's time, effort and cost of delivering planned environmental water. This not only includes the physical storage and delivery of planned environmental water but also the additional time spent attending and participating in water management committees and calculating planned environmental deliveries. NSWIC and its members have for a long time been extremely concerned that licence holders have paid more than their fair share of these costs. As the Government 'held environmental water' portfolio increases, the complexity of delivering this water for the environment and associated increased costs are becoming more apparent and reasonably should lie with Government – not with other water access licence holders.

**Recommendation 9:**

**NSWIC recommends that WaterNSW must be obligated under its operating licence to report on the time, effort and cost of delivering planned environmental water, to ensure that in future price Determinations the cost impact can be allocated to the 'impactor' and not be cross subsidised by water access licence holders.**

## Customer Advisory Groups

NSWIC reiterates the importance of the current Customer Service Committees as a highly valuable vehicle for discussion, provision of irrigation sector feedback, and information distribution around bulk water delivery in NSW.

Given the increased functions and responsibilities WaterNSW has acquired since the WaterNSW Amendment (Staff Transfer) Bill 2016, these local forums are an even more important cornerstone for interaction between the NSW bulk water operator and its customers. As such, NSWIC stresses the need to maintain these forums and to ensure that all types of WaterNSW customers are adequately represented.

NSWIC acknowledges that IPART has aimed to capture the wide variety of WaterNSW 'customers' (under s.6.5.3 (b)) however we are concerned that IPART suggests a specific 'environmental user or groups' as a separate category - in particular since 'environmental water holder' is already a specified group under section v. NSWIC is concerned that this will leave the door open for 'non-customers' , including environmental advocacy groups (who are not paying customers of WaterNSW), to be included in the proposed Customer Advisory Groups while other representative groups are not represented.

In addition, NSWIC seeks assurance from IPART that the important functions of the existing Customer Service Committees are not diluted and that the function of the CAGs should be 'advisory' only. NSWIC is concerned that the proposal around CAG structure and membership will act to dilute and diminish irrigation sector input to WaterNSW at catchment level, and NSWIC believes it is not acceptable that WaterNSW should use the CAGs as a proxy to reflect the sentiment of the entire valley (for example in relation to the question of tariff structures for regulated water charges).

**Recommendation 10:**

- **NSWIC recommends the removal of the 'environmental users or groups' in the proposed CAG structure and suggests that the environmental licence holders are adequately represented through point 6.5.3(b)(v).**

- **NSWIC recommends that IPART provide assurance that an adequate cross section of customers will be represented through the individual Customer Advisory Groups (for instance to take account of the large number of groundwater customers in the coastal valleys).**

- **NSWIC recommends that the current Coastal Valley CSC not be broken into a North and South Coast Customer Advisory Group, with the Hunter Valley separately amalgamated with the Greater Sydney area.**

- **NSWIC recommends that the proposed CAGs have an advisory function only.**

**DEFERRAL OF FULL OPERATING LICENCE REVIEW**

**Murray Darling Basin Plan Operational Implications**

As highlighted in our last submission to IPART, NSWIC notes with concern that WaterNSW is highly likely to be subject to further operational changes through the implementation of the Murray-Darling Basin Plan and/or the development of NSW Water Resource Plans. Examples include implementation of the Pre-Requisite Policy Measures and the Constraints Management Strategies relating to the management of environmental water flows in the Southern Basin. These proposed measures and management changes are far from resolved and, as such, IPART should consider whether the benefits of amending the WaterNSW operating licence at this stage is appropriately timed rather than waiting until the Basin Plan operational implications are fully known.

**North Coast Pilot**

NSWIC believes that the current WaterNSW North Coast Pilot is an ideal opportunity to gauge potential changes to WaterNSW's service delivery and to assess the feasibility around proposed changes to its range of services. As this pilot has still not progressed substantially, NSWIC urges IPART to consider shifting the final Determination of WaterNSW's operating licence review to a later date to enable this North Coast Pilot to be completed and its implications for WaterNSW service delivery fully assessed.

Therefore, NSWIC holds the view that a full review of the WaterNSW Operating Licence would be better deferred, and the current review be limited to the minimum licence changes required to give legislative effect to WaterNSW operations.

**Recommendation 11:**

**In view of the potentially significant impacts that WaterNSW's proposals may have for many customers, NSWIC recommends that IPART review the WaterNSW Operating Licence but consider only minimal changes at this time.**

In conclusion, NSWIC is open to further discussions with WaterNSW and IPART on WaterNSW's proposed operating licence framework – particularly in regard to whether the proposed changes are feasible and likely to lead to a positive impact on WaterNSW customers.

If you have any questions or require clarification on the issues we have raised or the Recommendations made to IPART in this Letter of Submission, please do not hesitate to contact us.

Yours Sincerely

[redacted]

**Mark McKenzie**
Chief Executive Officer