Submission to IPART

on DPI Water Charges 2016 - 2020

by Lachlan Valley Water Inc

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EXECUTIVE SUMMARY

- Monopoly service activities - LVW recommends that the extra services required to implement the Basin Plan must be identified to ensure there is no cost shifting onto licence holders, in view of the Federal Government commitment that implementation of the Basin Plan was to be at no net cost to States.

- LVW agrees that 4 years is an acceptable pricing period

- LVW considers that there is scope for further efficiency gains in DPI Water's operating costs in the 2016 determination. DPI Water has consistently underperformed on the development and review of water sharing plans, both in this determination and in the previous determination from 2006 – 2010. In both determination periods there has been significant over-expenditure in the water sharing plan development activity code and major under-delivery of WSPs.

- LVW recommends that a judgement on the prudency of the capital expenditure program cannot be made until DPI Water provides further detail on what the $13,780,000 capital expenditure on the groundwater monitoring network is expected to achieve.

- LVW believes it is important that reporting requirements are included in the 2016 determination.

- LVW submits that the original cost shares from the 2011 determination be retained for the 2016 determination.

- LVW supports transparent, valley-specific pricing and does not believe consolidation of valleys into wider regions for pricing purposes is appropriate.

- LVW believes that it is now appropriate to review the basis for setting groundwater tariffs and reinstate valley-based charges for the Inland subdivision.

- LVW supports the retention of two part tariffs. We believe this is consistent with cost-reflective pricing and that it is appropriate that some part of the risk associated with variation in usage is borne by DPI Water.

- LVW supports the existing 70:30 fixed to variable price ratio

- LVW considers DPI Water forecast entitlement volumes are reasonable, but that the 20 year average usage volume for the Lachlan regulated river is likely to understate actual usage.

- LVW supports DPI Water's proposal to increase the minimum annual charge to $150

SUBMISSION ON DPI WATER CHARGES - 2015 DETERMINATION

1. Introduction

Lachlan Valley Water (LVW) is the peak valley-based organisation representing 550 surface water and groundwater irrigator members in the Lachlan Valley, including irrigators within Jemalong Irrigation Limited (JIL). We welcome the opportunity to provide a submission on the DPI Water charges for 2016 – 2020. This submission has been prepared on behalf of all members, however, our members also reserve their right to make individual submissions.

Our organisation is a member of NSW Irrigators Council (NSWIC). We support the NSWIC submission in general, and provide additional comment on issues relevant to the Lachlan valley in this submission.

2. Overview

DPI Water's performance in terms of overall expenditure and revenue during the current determination period has been very close to the IPART allowed levels. Operating costs for water management services were within 1% of IPART's allowed efficient operating expenditure, and revenue received for the first 4 years of the determination was $3 million less than forecast, or 1.7% below budget. It is less clear whether the outcomes have represented an efficient level of service across all areas. In some areas changes in the activity codes have made it difficult to assess performance against the indicators, and in the key areas of water sharing plan development and water management modelling, it is clear that performance has lagged behind the expected level of output.

In addition, LVW does not believe that the groundwater costs represent an efficient level of operation. During the 2011 determination the overall operating costs for Inland groundwater were underspent by $3 million, or 5%. C02-01 Groundwater quantity monitoring, was $6.5 million, or 26%, underspent due to reduced staff availability[1] and costs moved to other codes. As discussed later in this submission, LVW believes that the amalgamation of all inland groundwater sources into one region for tariff purposes has not led to efficient cost allocation or cost-reflective pricing.

We endorse DPI Water's forecast efficiency savings of 1.5% per year over the 2016 determination, and the proposed reductions in charges for the Lachlan regulated and Central West unregulated rivers.

LVW also supports DPI Water's proposal to increase the minimum annual charge to $150 to more equitably recover the licence specific charges, which the Department has calculated at $235 per licence per year.

We welcome DPI Water's move to increase their engagement with customers on the pricing process. While this is a good start we believe it would be improved by the provision of more timely and comprehensive valley-specific information to customers on DPI Water's annual expenditure

[1] p59, DPI Water submission

and revenue performance and the outcomes achieved as a result of that expenditure. This is critical information that customers have requested during numerous previous pricing determinations and that would allow customers to assess whether DPI Water's charges are efficient and are providing the expected outcomes.

3. Response to IPART issues

(Numbering relates to IPART Issues paper)

Monopoly Service Activities
1. Are DPI Water's proposed monopoly services for the 2016 Determination period appropriate.

LVW agrees the monopoly services are appropriate, however, there is a significant overlap between the existing monopoly services and the activities related to the implementation of the Basin Plan. This includes surface water modelling, environmental water planning, water resource plans and water quality plans. DPI Water should not seek additional revenue from licence holders to undertake work that it is already part of the normal work program. Where additional work is required in these activity groups to implement the Basin Plan it must be identified and funded out of the $80 million allocated to NSW to implement the Plan. The Federal Government committed to deliver the Basin Plan at no net cost to states, so the associated costs should not be borne by licence holders.

LVW recommends identification of the extra services required to implement the Basin Plan to ensure there is no cost shifting onto licence holders.

Length of determination period
2. Appropriate length of determination period.

LVW agrees with DPI Water that 4 years is an acceptable pricing period in view of the work required by all parties to prepare submissions and taking into account the benefit of price stability over a period.

DPI Water's Operating Expenditure
3. Are DPI Water's proposed operating costs over the 2016 Determination period efficient, taking into account drivers of this expenditure and water management outcomes achieved.

Our judgement on whether the proposed operating costs are efficient is guided to a large degree by DPI Water's performance over the previous determination period. While we acknowledge that DPI Water has achieved reductions in operating costs over that period, and that total operating expenditure over the 2011 determination period was the same as the extended IPART forecast, at $303 million, there were significant variations between actual and forecast expenditure in a number of categories.

This leads us to question how efficient the service delivery has been, whether the expected outcomes were achieved when funds were redirected from one activity to another and whether DPI Water is now proposing to charge water users again to complete work that has already been funded in previous determinations.

A key activity area for DPI Water is water management planning, covered by the C07 codes in the 2011 determination. During this period there was an overall overspend across these codes of $6.9 million. This was not matched by the outcomes. The performance measure established by IPART for this activity area was to have 83 WSPs gazetted by 2014 and to review and remake 31 existing WSPs before 2014. DPI Water has not achieved either measure, having completed 70 WSPs, with 12 additional plans scheduled for completion during 2015/16, and not having completed the reviews of any of the 31 existing WSPs.

DPI Water has consistently underperformed on the development and review of water sharing plans, both in this determination and in the previous determination from 2006 – 2010. In both determination periods there has been significant over-expenditure in the water sharing plan development activity code and major under-delivery of WSPs.

This indicates that DPI's processes and allocation of resources has not been efficient, with the result that large additional resources have been diverted to water sharing plan development, and outcomes for other activity codes have consequently not been achieved. For example, under C06-03 Plan performance and monitoring, the target output for the 2011 determination was that 100% of regulated WSPs would have an ecological monitoring plan in place, whereas the achievement is that 5 ecological monitoring plans have been developed, and results from these are being extrapolated to other WSPs.

DPI Water's performance in this core business area has not been efficient, which indicates that their proposed operating costs in the 2016 determination period are also not likely to be efficient.

We also consider that the current level of costs for groundwater does not represent an efficient level of operation. The allocation of costs and charging of tariffs on a regional basis, and the fact that some activity codes include both groundwater and surface services, makes it difficult to accurately analyse the costs and water management outcomes.

4. IPART has asked what scope there is scope for efficiency gains over the 2016 determination period.

DPI Water has included a 1.5% efficiency saving per year in their forecast costs. This is welcome, but as noted in (3) above, we believe there is scope for further gains in ensuring the required service levels are achieved.

Capital Expenditure

7. IPART has asked whether DPI Water's forecast capital expenditure over the 2016 determination period is prudent.

It is difficult to comment on whether the capital expenditure is prudent without seeing a strategy for the expenditure. The DPI Water submission states that the organisation has a high level asset strategy and that they are developing a comprehensive asset management strategy, however, no detail has been provided.

According to the DPI Water submission[2] 89% of the net capital expenditure is for the groundwater monitoring network, but there is no explanation behind the expenditure other than that the driver is asset and service reliability. Elsewhere in their submission[3] DPI Water states that an additional 28 groundwater pipes have been commissioned in the coal basin areas of the state to address community concern. We suggest that where the purpose of the expenditure is to address community concern the cost of the expenditure should be borne by Government on behalf of the community, or by the impactor who causes the requirement for this monitoring. In any case, it should not be borne by groundwater licence holders as a whole.

We believe that in view of the size of the net capital expenditure DPI Water should be able to provide the assumptions and justification for the expenditure in the submission.

LVW recommends that a judgement on the prudency of the capital expenditure program cannot be made until DPI Water provides further detail on what the $13,780,000 capital expenditure on the groundwater monitoring network is expected to achieve.

9. What is a suitable rate of return on DPI Water's regulatory assets.

DPI Water proposes a real post-tax WACC of 4.6%, on the basis that this is the WACC proposed by other water businesses such as Sydney Water Corporation or Water NSW. DPI is a government department, not a state owned enterprise similar to Water NSW or Sydney Water Corporation. DPI is not subject to normal commercial disciplines and we reject the proposal that it should have a rate of return of 4.6%.

Performance and Reporting Requirements

11. Should reporting measures be included in the 2016 determination period.

LVW strongly believes reporting measures should be included. DPI Water has previously had a poor track record in meeting IPART's reporting requirements and in providing useful cost data on a valley basis to their customers.

We acknowledge that DPI Water has made a significant effort in this determination to provide responses to the reporting requirements, including the financial reports and the cost drivers, but we doubt whether this level of detail would have been provided were it not for the reporting measures. We therefore believe reporting measures are an important part of the pricing determination.

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[2] Table 7.7 and 7.8, DPI Water submission

[3] p132 DPI Water submission

LVW supports the inclusion of reporting requirements in the 2016 determination.

User Shares and Cost Recovery

12. Do the cost shares in the 2011 determination remain appropriate, and if not, what adjustments are required.

IPART has decided that charging domestic and stock rights holders is outside the scope of this review of prices.

However, it is clear that DPI Water provides services which benefit domestic and stock rights holders, who are able to extract water as high priority users ahead of both high security and general security licence holders. LVW believes it is inconsistent with the impactor pays principle that these costs are borne by licence holders.

LVW recommends that IPART identify the costs of servicing basic landholder rights, and that these costs are removed from the revenue requirement for licence holders.

13. DPI Water's proposed cost shares for the 2016 determination period.

Many cost shares have not altered from the 2011 determination. The inclusion of C04-01 in W02-02 Groundwater quality monitoring, has increased the user share from 50% to 100% for this component. The inclusion of C07-05 Water industry regulation, in the water plan development cods W06-01, W06-02 and W06-06, has increased the cost share from 30% to 70% or 75% for this component. There is no clear justification for these changes and we submit that the original cost shares from the 2011 determination be retained.

DPI Water's Water Management Charges

14. Is the current geographic split of water management charges is appropriate, or should valleys be consolidated into wider regions.

LVW supports valley specific pricing, transparency and minimisation of cross-subsidisation. On that basis we do not believe that valleys should be consolidated into wider regions for pricing purposes, particularly at the state-wide level when there are significant differences between valleys in terms of the inputs required and costs incurred to deal with localised water management issues. We believe that any gains from administrative simplicity and consistency in pricing between adjacent or connected valleys are minor compared with the lack of transparency in allocation of costs and the potential for cross-subsidisation leading to inequitable pricing outcomes for users and inefficient decision making by resource managers.

LVW supports transparent, valley-specific pricing and does not believe consolidation of valleys into wider regions for pricing purposes is appropriate.

Groundwater

LVW does not consider the existing split into Inland and Coastal is equitable or accurate in the case of groundwater charges. Having now seen the results of this charging regime in action over the last 4 years we believe that setting tariffs on a regional basis has demonstrated a complete lack of transparency and accountability for service delivery.

For example, DPI Water will collect approximately $1.8 million revenue from groundwater charges in the Lachlan Valley for the 2014/15 water year, but we cannot see where services to the value of $1.8 million have been provided in the field.

On reviewing the activity codes responsible for two thirds of the cost of water management services for groundwater over the determination period, it is clear that the cost drivers allow most of the groundwater costs to be allocated on a valley basis:

	Activity	**Cost driver**
W02-01	Groundwater monitoring	Groundwater bore pipes monitored
W04-03	Water resource accounting	Total water take
W05-01	Systems operation, water availability	Operations complexity
W06-01, 02	Water plan development	Total water take
W08-03	Compliance management	Compliance risk profile no. licences

The DPI submission indicates that there is 1,184,000 ML of entitlement in the Inland groundwater category, excluding Murrumbidgee, and notes that groundwater processes are highly variable. We submit that it is inaccurate to charge the same tariff for all inland groundwater when there are major differences between groundwater sources in terms of the level of utilisation, risks faced and management required.

LVW believes that it is now appropriate to review the basis for setting groundwater tariffs and reinstate the valley-based charges for the Inland subdivision.

16. IPART has asked whether two part tariffs should be retained.

LVW supports the retention of two part tariffs. We believe this is consistent with cost-reflective pricing and that it is appropriate that some part of the risk associated with variation in usage is borne by DPI Water.

18. Do two part tariffs promote greater metering and enhanced water management outcomes.

The DPI Water data shows the main user groups who would benefit from installing a meter and gaining access to 2 part tariffs are unregulated and coastal groundwater users. We expect that the cost of installing a meter compliant with the National Standards currently outweighs the benefit of gaining access to the two part tariff for many of these licence holders.

If the NSW Water Take Measurement Strategy authorises a measurement method that is cost-effective for smaller users then we anticipate greater uptake of the two part tariff and enhanced water management outcomes.

19. If two part tariffs are maintained, what is the appropriate balance between fixed and usage charges.

DPI proposes to maintain the current 70:30 fixed to variable ratio and LVW supports this. We believe the revenue performance in the 2011 determination indicates that the risk to DPI Water's revenue of maintaining this ratio is relatively low. In the first 4 years of the determination the revenue billed by DPI Water is only $3 million, or 1.7% below the forecast revenue.

<u>Forecasting entitlement volumes and usage</u>

20. Are DPI Water's forecast water entitlement and usage volumes reasonable.

We believe the entitlement volumes are reasonable.

Regulated river usage has been highly variable over the last 20 years, ranging from 10,000 ML/year to 440,000 ML/year. With the inclusion of the Millenium drought in the 20 year average for the regulated Lachlan we believe that actual usage may tend to be higher than the average, resulting in over-recovery by DPI Water. A possible risk management mechanism would be to set a range of, say 20%, variation around the average, and if actual usage moves outside the range then the estimate could be reviewed and adjusted for the following year.

<u>Price Path and Impact of Pricing Decisions</u>

23. What is the appropriate level for the minimum bill, and what types of users, if any, should be exempt.

As noted on page 3 of our submission, LVW supports the DPI Water proposal to increase the minimum bill to $150 per licence per annum. DPI Water estimates the licence specific charges at $235 per licence but we believe that it would be a significant price shock to increase prices to that level in one move.

On the basis of user pays, we do not believe any users should be exempt, but if the NSW Government is prepared to bear the cost of allowing some licence holders to be exempt from the minimum charge, then in our view it is a decision for Government as to what types of users would be exempt.

<u>DPI Water's Metering Charges</u>

25. Appropriateness of meter types, meter charges and the metering target.

LVW considers the Water Take Measurement Strategy is a sensible way to develop a policy on cost-effective metering. We agree that all licensed water extraction should be measured but that it would be appropriate to allow lower cost equipment, with lower levels of reliability of accuracy, at sites where there is smaller capacity to use water. We believe that meter ownership is the responsibility of the licence holder.

DPI Water proposes to pass on the cost it is charged by Water NSW for reading private meters, as an assessment charge of $198/meter for private meters.

While the charge seems high at $97/visit, we understand that is the cost negotiated between DPI Water and Water NSW. However, in situations where there is a charge for meter reading but the service is not provided, eg, where the licence holder is contacted and asked by Water NSW to provide his own meter reading, then we propose that DPI Water provide a rebate of $97 per meter reading.

26. IPART has asked whether the potential to trade water allocations provides an incentive for unregulated and groundwater users to install a meter.

We note that the majority of groundwater licences in the Inland groundwater already have a meter and able to access the two part tariff[4] . We believe the potential to trade water allocations provides only limited incentive for unregulated users in the Lachlan to install a meter because the cost of installing a compliant meter may outweigh the benefit of being able to trade, and there are limited opportunities to temporary trade water allocation in most unregulated rivers and streams.

27. *IPART has asked whether the potential to switch from a one-part to a two-part tariff provides an incentive for unregulated and groundwater users to install a meter.*

Refer to our answer to (26) above.

[4] p201 DPI Water submission