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Ref: D2010/5559

Mr James Cox  
Chief Executive Officer  
Independent Pricing and Regulatory Tribunal of NSW  
PO Box Q290  
QUEEN VICTORIA BUILDING NSW 1230

Dear Mr Cox

I am writing regarding the Draft Price Determination for the NSW Office of Water (NOW).

I note that IPART has proposed that the SCA not be charged on the basis of its Long Term Average Annual Extraction Limit (LTAAEL), arguing that "the position of HWC and SCA is not sufficiently different from all other users to justify the inequities that would arise from acceptance of the utilities' proposals"<sup>1</sup>.

The SCA maintains that the entitlement arrangement is indeed substantially different. SCA provided estimates of the double counting of entitlement on 9<sup>th</sup> August 2010 and this is provided again at Attachment 1. In effect, 329GL of SCA's 974GL of chargeable entitlement is double counted.

This information is best understood in the context of the key regulatory test of the efficiency of pricing. This test is whether resulting costs are avoidable. If costs are not avoidable, any pricing has the form of a lump sum tax (which IPART is not empowered to levy). The question is whether the SCA can sell its entitlement if it is not required for water supply, either on a temporary or permanent basis. This is normally true for other entitlement holders such as irrigators and is required under national competition rules. In a year when SCA does not need to pump water from Shoalhaven the SCA should hypothetically, be able to sell the entitlement of 329GL to other users (regardless of whether there would actually be a buyer willing to pay for the water). Our understanding is that SCA does not hold this entitlement as a tradeable entitlement and on this basis should not be charged for it<sup>2</sup>.

IPART argues that if it were to accept "SCA's proposal then, for a given level of cost recovery the prices for other users would increase". This is incorrect, as SCA's proposal included a one third increase in the total entitlement for SCA from 482GL usage in 2009/10 to 636GL at the Long Term Annual Average Extraction Limit at commencement of the price path, which all things being equal, would result in a significant fall in prices for other users at a given level of cost.

IPART argues that since the cost impost caused by this arrangement is a small proportion of SCA's total costs and will be able in due course to be passed through to consumers that this does not create a significant impact on the SCA or consumers. However, a critical requirement of national competition policy and NSW Government policy is competitive neutrality, that competing entities are not treated differently. If SCA were to bear a lump sum impost not borne by other water users this would breach those requirements. IPART has

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<sup>1</sup> Pg. 110, IPART Review of prices for the Water Administration Ministerial Corporation, 2010.

<sup>2</sup> See John Patterson (2004) "Truth in Water Entitlements" Farmhand Foundation Pg. 12-13 for robust specifications for water entitlement.

made a significant contribution to price reform by removing similar cross-subsidy arrangements between commercial and residential water consumers, and it would be a retrograde step to institute cross-subsidies from urban consumers to irrigators.

IPART has chosen to note (but not comment) on the issue of double charging under SCA's Water Management Licence charges. The SCA's fixed charge in the later part of the price path will exceed 80% of its total water cost, a level which IPART argued was excessive in its 2008 Price Determination for the SCA.

The SCA maintains that pricing should reflect the water available for sale. Given that IPART has chosen not to accept SCA's proposal that entitlement charges be based on the Long Term Average Annual Extraction Limit of 636GL, we would propose that charging be based on the share component of 974GL less the double counted and untradeable 329 GL from Shoalhaven. This results in an increase in entitlement to 645GL, which should significantly lower prices for a given cost to other users.

If the Secretariat wishes to explore any of these matters further, kindly contact Rod McInnes, Acting Senior Manager Economics, on 4724 2426.

Yours sincerely



**MICHAEL BULLEN**  
**Chief Executive**

30.11.2010

## Attachment 1: Question on Notice Provided to IPART

### Transcript Pg 64, Line 20 ff.

20 MS CHADWICK: My last question relates to the  
 21 interaction of your storages. Hunter Water makes the point  
 22 that some of its entitlement is water that goes into  
 23 Grahamstown Dam and then it is counted again as it goes out.

24

25 MR BULLEN: We have a similar situation in particular  
 26 around Shoalhaven, where it is able to be transferred to  
 27 either Warragamba or to the metropolitan dams, so there is  
 28 that risk of double-counting as a result of that similar  
 29 arrangement.

30

31 MS CHADWICK: A question on notice.

Would you be able to provide us with information as to the potential of that double-count?

### Response:

**Entitlement** defined by NOW for pricing purposes as the “Share component” is based *on maximum historical extraction over last 10 years*. The **Long Term Average Annual Extraction Limit** (SCA extraction limit) is *based on average historical transfers to Sydney Water and system yield modelling*.

Water extracted at the Shoalhaven River access point is likely to be extracted again at a later date, from the Upper Nepean or Warragamba system in terms of both SCA entitlement and LTAAEL so the Shoalhaven extraction is counted twice.

This double counting is more critical with the entitlement because it is a maximum extraction, and necessarily gives an entitlement value that is substantially greater than water usage. Therefore, using the revised\* Draft Water Sharing plan Share Component as below, there is the potential for 329,000 ML from Shoalhaven to be also counted within the 620,000 ML pa in the Upper Nepean and Upstream Warragamba.

Water source	SCA share component (entitlement) in the draft Water Sharing Plan (cl.34) (ML/year)	Revised SCA share component (ML/year)*	SCA LTAAEL in the draft Water Sharing Plan (cl.40(3)) (ML/year)	Revised SCA LTAAEL (ML/year)*
Shoalhaven River	317,000	329,000	50,000	36,000
Upper Nepean and Upstream Warragamba	620,000	620,000	547,000	581,000
Hawkesbury and Lower Nepean Rivers (Blue Mountains)	6,000	6,000	5,000	6,000
Southern Sydney Rivers (Woronora)	32,000	19,000	18,000	13,000
TOTAL	975,000	974,000	620,000	636,000

\* Corrections as proposed by SCA in its submission to the Public Exhibition of the Draft Water Sharing Plan.