

Macquarie Submission to IPART

On

**State Water & DIPNR
Bulk Water Pricing Proposals**

2005 – 2008

**Macquarie Customer Service Committee &
Macquarie River Food & Fibre**

April 2005

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1 Executive Summary

The following points are a summary of the key messages MRFF and the Macquarie Customer Service Committee has for IPART with regard to the 2005 – 2008 pricing determination:

1. IPART needs to revisit its cost sharing principles, based on the NWI requirement for a user pays approach. Then it must require State Water & DIPNR to fully adopt the concept of user / beneficiary pays across the complete (consumptive and non-consumptive) “customer” base. Currently State Water and DIPNR have adopted an inconsistent approach, blending user and impactor pays and neither body has suggested including users other than bulk water customers in the cost sharing arrangements.
2. The ‘user responsibility’ or ‘user share’ portion of costs needs to be broken down into ‘relative use values’ between ALL consumptive users, as identified in Water Sharing Plans as having access rights to one of the classes of water.
3. State Water needs to focus on efficiency (i.e.: customers want to see evidence of research into competitive tendering to outsource in comparison to costings on in-house or DIPNR service provision) and both State Water and DIPNR pricing must be transparent and cost-reflective, with no cross-subsidisation or arbitrary pricing.
4. A line needs to be drawn at July 2005 and a DIPNR debt identified, (including cost for works and standards that are not compliant with 2005 requirements, with-holding of maintenance and upgrade budget from State Water post 1997 and any other DIPNR under-funding). This debt needs to appear as a line item in State Water’s financial statements and should have interest charged (equivalent to the rate of return being charged to customers) until repaid.
5. Scarcity pricing and demand management are not appropriate pricing tools, creating market externalities, conflicting with State Water’s purpose of optimising its water delivery business and having no factual basis of being able to deliver the outcomes sought in applying such pricing tools.
6. Water Resource Management (WRM) costs need a complete review. This includes a review of the definition of cost-recoverable WRM costs (to ensure items such as policy, planning and general Government functions are excluded). In addition, an independent cost-benefit analysis needs to be undertaken for the complete range of DIPNR’s WRM costs and a method (which includes customer input) determined prior to DIPNR’s second submission in late 2005 for prioritising, budgeting and limiting WRM expenditure, based on relevant factors (such as scale of resource, relative ‘user value’ i.e.: cost of WRM relative to volumes of use).
7. There should be no increase in Macquarie water prices for the current determination, as cost recovery was achieved at the last determination and State Water and DIPNR must be required to focus on increasing operating efficiencies and transparent pricing.
8. The RAB and building blocks approach to financing State Water’s business provides a zero risk investment opportunity to Government for which it will yield a 6% return on its investment. This is not commensurate with private public sector risk : return ratios and IPART should request an independent comparative analysis of several alternative financing options in order to determine the most appropriate model for State Water AND its customers.

2 Introduction

Macquarie River Food & Fibre (MRFF) and the Macquarie Customer Service Committee (CSC) welcome the opportunity to respond to State Water and the Department of Infrastructure, Planning & natural Resources (DIPNR) submissions to IPART on bulk water prices for 2005 – 2008.

We acknowledge the significant progress made in State Water making its own submission and commencing operation as a separate entity to DIPNR. We have outlined the major concerns we still have regarding the next pricing round and look forward to the opportunity to elaborate on these concerns and our alternative solutions with IPART prior to the final determination.

The following document has been prepared by Macquarie River Food & Fibre in consultation with the Macquarie Customer Service Committee. The Macquarie Customer Service Committee has endorsed the submission (refer to Appendix A: Macquarie Customer Service Committee letter). As there are two separate submissions (from State Water and DIPNR) proposing water prices for 2005 – 2008, separate responses to each submission have been made in this document, with State Water's submission addressed first.

In relation to the two separate submissions from State Water and DIPNR, we believe that while the submissions should be separate, they both impact on water prices and from a customer's perspective, there should be some consideration made by each organisation of the total price if economic impacts on customers and ability to pay is to have any bearing on prices. It is difficult to see how State Water & DIPNR could work closely or efficiently in partnership to deliver services to customers if they have not had regard for each other's proposals to IPART or made prior agreements on exactly what services would be provided by each organisation (we note that it is impossible for State Water to have considered DIPNR's proposal as it was not completed for months after State Water had made its submission).

3 Response to State Water Submission

3.1 *Implications of the National Water Initiative*

The State Water submission refers to the possibility of reductions in volumes of water available for consumptive use. MRFF strongly supports State Water's position that 'if water is actively required to be delivered using its assets (to non-consumptive users) then the beneficiaries of State Water's services will be required to share the full costs.' To take the alternative of increasing fixed and usage charges to make up for any decreases in water delivered is contrary to the beneficiary pays principle and creates a double impact on water users.

It is disappointing, given State Water's position, that it recommends an alternative solution if the cost of delivering environmental water is not recoverable, based on bulk-water user customers being the easy, captive target; 'a reduction in the water entitlement base of 2% resulting from transfer of water to the non-chargeable environmental licences should cause an automatic or progressive adjustment of per-unit prices within the relevant valley, to maintain the revenue base.'

It seems that State Water's focus on maintaining adequate revenue comes before considering the impacts on its customers of this monopolistic approach to pricing. It could also be argued that deviating from its own views (documented above) on what water user customers should be charged, conflicts with its principle objective of delivering its services in a financially responsible manner. There are also its other objectives of social responsibility and its responsibility towards regional development which are surely compromised by opting to create the 'double whammy' effect of less consumptive water, combined with increased prices for remaining water rather than the transparent, equitable alternative of proposing to IPART and to Government that costs are recovered from non-consumptive users.

MRFF adds that to be consistent, State Water's principle of user/beneficiary pays applying to non-consumptive users should apply right now, not just in the event of further provisions of water for the environment. Refer to Sections 3.2.2 & 3.2.10 discussing cost shares and stock & domestic access for further comment on this issue.

3.2 Pricing Objectives

3.2.1 The Building Block Approach:

MRFF realises the critical need of State Water to ensure financial stability into the medium and longer term and the need for equitable and transparent pricing with regard to the funding of major infrastructure maintenance requirements. However we are not convinced that the building block approach is the best option from customers' perspective as no other alternatives have been offered for comparison and only minimal price impact information (Figure 3, page 29 of State Water's submission) has been provided. Research has indicated there are other alternatives, such as the previous Annuities approach, or the Asset Management System adopted in the Goulburn-Murray in Victoria. Reproduction Replacement Costs (current total cost of replacement) are combined with Renewals Replacement Costs (current total cost of the asset), as well as Unit costs, to reflect the many similar components within the asset base. Goulburn-Murray's managers are complimentary towards this system and it would certainly be worth comparing with the RAB approach.

In addition to the above concerns regarding a lack of comparative analysis, there are no other commercial businesses to our knowledge where the customer base is forced to act as the 'bank' for the business, as State Water customers will be. The RAB approach combined with a 6% rate of return is essentially delivering a return of 6% to Government on a risk free investment, which is certainly better than any alternative in the private sector.

The issues that are of concern to MRFF are those related to how much of the burden of funding State Water and its profits is asked of customers verses Government when compared with other businesses and the rate of return being asked of the business:

- Re the 35:65 split between customers and Government: Is it appropriate to base this ratio on the current ratio of capital annuities between Government and customers?
- Re the RAB value for the purposes of generating a rate of return: IPART found the RAB value after writing down pre-1997 assets to zero was \$75 million at July 2004. We understand that this RAB value is insufficient to generate the required revenue stream; however it may be the appropriate number to use in calculating the rate of return required by Government. In calculating a \$75 million RAB, the Tribunal found in 1997 that Government investment prior to 1997 was 'sunk costs' i.e. "this was consistent with the view that much of the infrastructure was constructed for non-commercial objectives and a commercial return on this historical expenditure was therefore, not justified".

Recommendation: IPART needs to request an independent comparative analysis of the options available for financing State Water's business, with a view to protecting the rights of customers, given the monopoly nature of the service provider.

3.2.2 Cost Shares

Two issues MRFF raises upfront prior to discussing cost shares are listed following:

- 1) **DIPNR under-funding maintenance pre and post 1997 and sub-standard asset conditions.** The basis of any cost shares and the split between treatment of assets as sunk costs or 'legacy costs' and future works is based on agreement that assets were handed over by DIPNR in a condition that satisfied OH&S and other compliance standards. Since 1997, State Water has relied on DIPNR (or DLWC) to distribute funding and to our knowledge, has not ever received the budget it required to fulfil all the listed maintenance requirements and upgrade works. (Refer to comments on State Water's efficient costs, where State Water indicates that it has not received required funding to complete its maintenance program for the 3 years of the most recent pricing determination.)

Recommendation: MRFF proposes that July 2005 be set as the new date for handover of water storage and delivery infrastructure and that NSW Government is responsible for fulfilling all maintenance requirements to meet compliance standards up to this date. There will have to be an independent audit of asset conditions and quantification of DIPNR's funding responsibilities that have not yet been met. These responsibilities must then be met by DIPNR.

- 2) **The second issue is the combined issue of Community Service Obligations & fully defining ‘User share’:** CSO’s go hand-in-hand with the issue of identifying and including ALL customers and beneficiaries in the distribution of costs. State Water should be consistent in applying CoAG principles to cost shares:
- a. The full cost of providing water services to specific beneficiaries or impactors should be recovered through charges to these parties.
 - b. The costs of public benefits / impacts management, which cannot be attributed to specific beneficiaries should be treated as a Government funded CSO.

IPART’s terms of reference also specifies the role of identifying and charging other beneficiaries apart from bulk water users:

Item 3: ‘A proposed sharing of costs between different users and other beneficiaries of services’.

There are conflicting interests in the current approach, where it seems to be the Government’s responsibility to identify CSO’s as well as a Government responsibility to fund them. Not surprisingly there has been no progress towards identifying and accounting for CSO’s under this system where bulk water customers are a convenient and captive target.

State Water flags (p. 15) that it will “require cost recovery from non-consumptive users and/or increased prices from consumptive users” to ensure adequate revenue in the event of reductions in water. MRFF believes that regardless of changes to current entitlements, the inclusion of other customers is clearly an IPART issue that needs addressing, due to the monopolistic nature of pricing on bulk water users.

State Water is in a strong position to identify all its customers, including all non-paying users and beneficiaries of its services, without having a conflicting agenda regarding how these services are funded. In addition there has been research undertaken for the Australian Conservation Foundation in 2004 “Quantifying the Economic Value of River Dependent Industries in the Southern Murray-Darling Basin”. This research identifies many more beneficiaries of State Water’s business activities than IPART currently includes in its pricing determinations.

Recommendation: MRFF requests IPART to seek all available information (e.g. from State Water or other external research) and commission any extra research required to determine the breakdown of use / benefit derived by each of its ‘customers’ and that these proportions are applied to the relevant cost items prior to setting the bulk water user prices for 2005-2008.

Dam Safety Compliance Upgrades

MRFF supports the Tribunal Determination that the funding of dam safety compliance would be 100% borne by Government based on the legacy nature of the large cost, public safety concerns and imposed societal risk standards. MRFF adds that any maintenance required to bring dams up to 2005 compliance standards must be the Government’s responsibility due to under-funding of this maintenance in recent years.

State Water proposes in its submission that any further *compliance upgrade costs* will not be legacy costs and should be shared between Government and customers based on the level of flood mitigation benefit (nb: State Water lists downstream population, property and public works such as rails, roads and buildings as major beneficiaries).

State Water also says (p31) that ‘any further *upgrade program costs* should be shared by the beneficiaries, however it recommends a 50: 50 split between customers and Government, where the storage has the ability to actively mitigate floods. This takes us back to the core issue of this submission – identification and distribution of costs amongst ALL customers and beneficiaries, not just bulk water users.

Some preliminary work has been undertaken by DIPNR's predecessor, DLWC, investigating the consequences of Burrendong Dam failure, under an extreme flood event. The figures provided in Table 1 (earlier version provided in MRFF's 2001 submission to IPART) are quite generalised, but serve to illustrate the relativities between economic impacts across beneficiaries.

Table 1: Estimated Impacts of Burrendong Dam failure

Impacted Category	Impact in \$ Millions	Impact as % of Total Cost
Residential	933	11%
Commercial	2,911	34%
Industrial	1,827	22%
Public Assets	2,212	26%
Replace Dam	308	3%
Total Indirect Impacts	53	1%
Agricultural	257	3%
Total	8,501	100%

Source: Pers comm. (Glenn Tully, DLWC, Sydney), 2001

Table 1 demonstrates that a 50:50 split in cost distribution between bulk waters and Government is completely inappropriate based on a misrepresentation of the users/ beneficiaries of flood mitigation services.

Recommendation: MRFF repeats previous requests for dam safety and flood mitigation expenses to be identified as a CSO. An alternative is for methods of recouping costs of flood mitigation from urban and commercial beneficiaries to be explored, such as through rates. Once the CSO or charging mechanism is identified, there needs to be a standard set of ratios applied across the state (based on an independent estimation of the relative benefit gained from flood mitigation between bulk water users and other sectors of the community.)

Occupational Health & Safety Compliance & Other Costs associated with Storage & Delivery

State Water has proposed that once infrastructure is compliant with July 1997 OH&S standards, users should pay 100% of future OH&S costs as they are a normal cost of business. MRFF's recommendation regarding shifting the cut-off date in Government responsibilities from July 1997 to July 2005 applies to OH&S, again due to Government under-funding of its commitments up to the present time.

With respect to OH&S costs beyond July 2005, MRFF understands that OH&S and other operating expenses associated with delivery of water are largely for the benefit of users and so should be funded by users rather than Government. However MRFF firmly disputes State Water's '100% user responsibility' proposal, given the current exclusion of all other customers and users apart from bulk water customers in the calculation of cost sharing ratios.

Two suggested alternatives for calculating relative use values include:

- 1) Base cost shares amongst users on each group's *proportion of total valley entitlement* (adjusted to reflect higher storage & delivery costs for some users); or
- 2) Base cost shares amongst users on each group's *proportion of long term average annual use*.

Relative use values based on entitlement, as outlined in Table 2, show that bulk water users should pay no more than 69% of cost items provided by State Water that are users' responsibility.

Table 2: Distribution of Entitlement across all Macquarie Users (from the WSP)

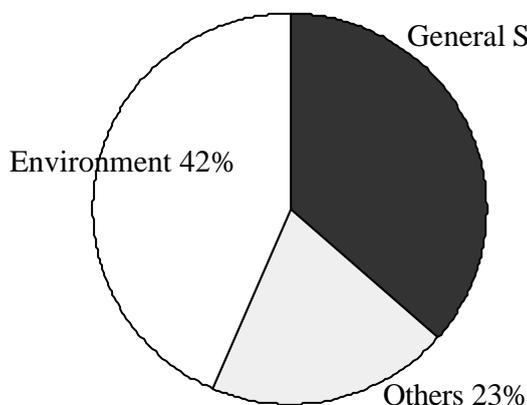
User Group	Base Entitlement	Adjusted Entitlement & % of Total
Bulk Water Users–high security	19,419 ML	38,838 ML (1) 4%
Bulk Water Users–gen security	632,428 ML	632,428 ML 69%
Environmental Water	160,000 ML	160,000 ML 17%
Town Water Supply	22,681 ML	45,362 ML (2) 5%
Industrial / Commercial Licences	(combined with TWS)	
Stock & Domestic Users	14,265 ML	42,795 ML (3) 5%

- (1) High Security entitlement has been doubled to reflect the requirement to maintain two years full allocation in storage.
- (2) Town Water Supply entitlement has been doubled to reflect the requirement to maintain two years full allocation in storage.
- (3) Stock and Domestic entitlement has been tripled to reflect the high transmission losses incurred in delivering stock and domestic water throughout the tributaries of the system.

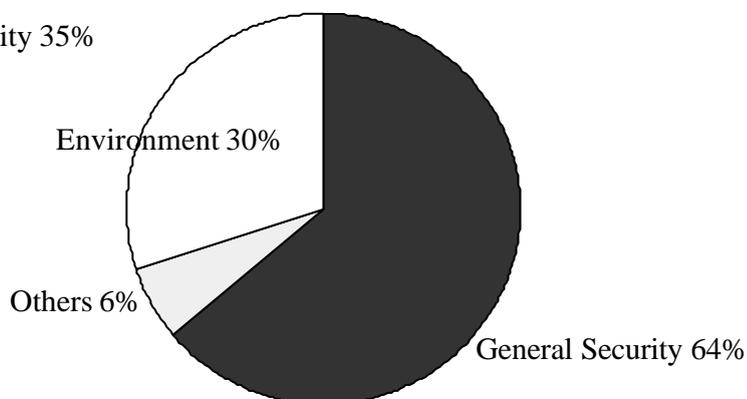
If we use Option 2 and base relative use value on long term average usage there are still problems in accurately reflecting the actual cost incurred by State Water of storing and delivering water to the various users. However considering the results of the second method helps in gaining confidence in estimating relativities between use values and actual costs.

The long-term average availability for general security is around 60% in the Macquarie. This equates to a long term average annual use of about 380,000 ML (which is 45% of total entitlement and is anticipated to be a slightly higher percentage of total average annual use). There is obviously significant variability in usage proportions from year to year, as is demonstrated in the pie charts below. (For simplicity other smaller users are not separately categorised).

Pie chart 1: Distribution of Water (99/2000) Pie chart 2: Distribution of Water (2002/03)



Source: State Water Macquarie Newsletter: April 2000



Source: State Water Annual Report 2002/03

In addition to the users identified in Table 2 and the above pie charts, The Australian Conservation Foundation report (Sep 04) lists a much larger potential list of users and beneficiaries to be considered. Some of the non-consumptive industries listed in the report that are applicable to the Macquarie and derive direct benefit from the river include:

- Grazing on floodplains (reliant on flooding);
- Caravan and camping grounds;
- Birdwatching;
- Restaurants on the river;
- River cruises;
- Recreational fishing; and
- Special events (skiing, fishing competitions etc).

Recommendation: MRFF recommends that for all State Water costs associated with delivery of water, a valley-based 'relative use value' is calculated for each user group (i.e.: bulk water users, town water supply, stock and domestic and environment) and reflected in water prices. State Water has indicated similar logic in its proposed value based pricing between high and general security entitlements (see comments in Section 3.2.3). For the Macquarie, the general security licence holders' proportion of total use (and therefore cost responsibility) is estimated to be between 45% and 69% (not the 100% of user/customer share they are currently being charged).

Environmental Compliance Costs

State Water proposes to leave the current cost share of 50: 50 between users and Government. However State Water is proposing to distinguish the costs of environmental compliance as those being triggered by legislative requirements. For instance if State Water is modifying a weir for users' benefit and a legislative fishway requirement is triggered, the cost should be shared 50:50 between users and Government. However if a third party wanted to modify the weir (either for consumptive or environmental reasons) the proponent would be required to pay 100% of the fishway cost. State Water also proposes that once modifications are completed, the new asset would be added to the asset base and be treated like any other asset, whereby the operating and maintenance costs as well as remaining lifecycle costs would be borne by water users.

Recommendations: There are three parts to MRFF's position on the above proposal:

- 1) Government must be responsible for 100% of the cost of bringing infrastructure up to environmental compliance with July 2005 standards (rather than the previous date of July 1997, due to under-funding of its compliance responsibilities since 1997).
- 2) For any future legislative environmental compliance requirements, MRFF proposes a 100% Government funded CSO, where the specific beneficiary is unable to be identified or charged. This is based on new legislation being a result of changing community standards and therefore a community responsibility as per the National Water Initiative principles. If the above proposal is not accepted and users are required to fund part of the cost, MRFF requests consistent application of the beneficiary/user pays principle: in the instance of a 50:50 split between users and Government, the 50% of cost responsibility that is users' share needs to be apportioned across all the identified users (consistent with MRFF proposal re: OH&S and other operational costs).
- 3) Regarding third party requests for environmental works that are not legislative requirements, MRFF supports the proposal that the third party is responsible for 100% of the cost of the work. However MRFF does not support State Water's proposal that once completed the new asset be treated the same as other State Water assets, with maintenance and other costs being the responsibility of water users. This distorts State Water's core business principles of efficient and financially responsible delivery of water, as the asset is not adding to State Water's ability to deliver water. Instead we suggest an ongoing service agreement with the third party where the third party is charged for any maintenance costs.

A parallel example arises in the case of electricity network companies whereby parties can request extensions or modifications to the network for their specific purposes. In some cases the network company will fund the work and then establish an agreement to charge a rental to the third party to recover the capital costs (using a regulated rate of return) and the O&M costs associated with the asset over its economic life. Conversely the third party can make a capital contribution up-front and will be charged a rental to cover ongoing O&M costs under an agreement. Either way the asset remains in the ownership of the network company and other customers are not required to meet any of the initial or ongoing costs.

Cost of Hydrometric/Hydrographic Services

Under Determinations 2 and 3 IPART allowed State Water to recover 70% of the full cost of the entire DIPNR hydrometric services (818 gauging stations). The two issues at hand are a) the efficient delivery of the service and b) the level of service required to meet State Water's core objective of efficient, effective, safe and financially responsible capture, storage and delivery of water. State Water has indicated that it only requires 399 gauging stations to meet its objectives.

Recommendation: MRFF supports that users (includes ALL users, with responsibilities allocated based on relative use value as per OH&S cost sharing recommendations) pay for 100% of the cost of hydrometric services for those gauging stations required by State Water specifically for the delivery of bulk water to customers. This means that bulk water users should not pay any part of the cost of hydrometric and hydrographic services that are not necessary in the delivery of water. In addition MRFF recommends that State Water focuses on issues such as its current methods for making supplementary flow announcements and assesses the additional value to customers of more accurate and timely gauging of supplementary flows.

3.2.3 High Security and General Security Charges

State Water has proposed that the differential price between high and low security entitlements be based on the conversion rate in the water sharing plans adjusted to account for the opportunity cost and increased evaporation from holding the water for longer.

Recommendation: MRFF supports the removal of cross subsidies between different water users within the same valley and believes that it is equitable to all users to take the Water Sharing Plan conversion rate from general to high security as an appropriate ratio to reflect the increased costs associated with delivering increased security on the latter class of water. The increased evaporation from holding the water longer should be added to the high security entitlement charge only if it has not already been factored into the WSP conversion rate. Any variation in charges should be revenue neutral.

We add that the above rationale for increasing high security charges should be applied across State Water's customer base. Therefore town water supply licences, being of higher security (with higher storage costs) than high security bulk water, should attract proportionately higher entitlement charges.

3.2.4 Entitlement and Usage charges in Regulated Rivers

State Water argues that most of its costs are fixed in nature and that there should be a standardised ratio applied across the state of 60:40 entitlement to usage (variable) costs in order to reduce financial volatility through droughts and low water use periods.

Recommendation: MRFF does not support State Water's proposal. The ratios between entitlement and usage charges should remain valley based and should be weighted according to average availability of water (the lower the average availability, the higher the use charge should be in relation to the entitlement charge). State Water could address its revenue volatility by considering more customer-friendly solutions to the issue of financial volatility in times of low water availability.

Examples include risk management and insurance products to de-volatilise earnings, or, if entitlement charges have to be increased, introduce CSO's for part of customer's entitlement fee in zero allocation years (see following paragraph for more detail). The hydro-electricity industry provides a useful example where insurance is taken to protect against volatility in its revenue generating potential ie. lower than average rainfall and higher than average temperatures (pers comm, Graham Ebbett, Meridian Energy, 2004).

Apart from the issue of low allocations causing shortfalls in State Water revenue, it is not reasonable or affordable for customers to have to pay significant entitlement charges during repeated periods of very low allocations. Therefore MRFF also recommends a CSO is established to be triggered if allocations remain less than 10% for two consecutive years. The second year would trigger the 'exceptional circumstances' style CSO, where Government would then be responsible for meeting 90% of entitlement charges in the affected valley until the allocation announcement exceeds 10%.

3.2.5 Wholesale discounts

Historically there have been 'wholesale discounts' for some of the irrigation companies, based on the old DLWC arrangements that saw irrigation companies providing information to DLWC after irrigation districts became privatised. State Water is proposing to eliminate wholesale discounts over the next three years and where irrigation companies are providing additional information or services required by State Water, the costs will be negotiated and managed via a contract rather than through discounts.

MRFF supports the removal of any arrangements where the cost of services is not reflected in pricing, however we are concerned that it is not apparent from State Water's submission that it is focussing on optimising the efficiency of its business.

Recommendation: On the basis of equity for all customers and removal of hidden cross subsidies, MRFF supports the removal of wholesale discounts to irrigation companies. Just as important as the removal of wholesale discounts, MRFF requests that State Water focuses on optimising the efficiency of its services. We would expect to see evidence of competitive tendering and transparent research findings that indicate the most cost effective way of providing various services. Where outsourcing of required services occurs (whether to irrigation companies or other providers) there must be full transparency via clear contract arrangements, invoicing and pricing.

3.2.6 Price Path to full cost recovery

State Water is proposing a price path from 2005 to 2008 towards full cost recovery. Based on all the recommendations outlined, this means an increase in the Macquarie as outlined in Table 3 below:

Table 3: Proposed Price Increases in the Macquarie

Valley	2005/06			2006/07			2007/08		
	H/S	G/S	Use	H/S	G/S	Use	H/S	G/S	Use
Macquarie	4.90	3.04	4.63	6.73	3.38	5.79	9.24	3.76	7.24

State Water expects that the long-term price path involves annual price increases in the order of 10% per year for ten years, followed by lower annual increases thereafter.

MRFF has several concerns regarding the proposed further price increases:

- For the 2001-2004 pricing Determination the Macquarie was found to have virtually reached full cost recovery (especially for General Security charges). This raises the question of exploitation of monopoly powers by State Water as MRFF would expect a period of stability once full cost recovery is reached;
- With the full range of 'customers' being identified and apportioned their share of costs, either directly or via CSO's as outlined in this proposal MRFF would expect a decrease in prices, as bulk water users have been fully subsidising other users up to the current time;

- A justification for the price increases could be that State Water has been left short by DIPNR and is trying to recoup the under-funding of recent years. This is obviously inappropriate and would raise concerns with the ACCC's anti-competitive behaviour guidelines;
- The price increases are based on an estimated annual increase in costs of 10%, which is certainly not transparent pricing and would indicate State Water is failing to improve on its operational efficiency.

Recommendation: Based on the above concerns, MRFF does not support State Water's proposed price increases in the Macquarie and requires transparency in costings and clarification of the above concerns prior to any consideration of a price increase.

3.2.7 State Water's Efficient Costs

State Water documents that it 'reduced its maintenance program and other expenditure by around \$3 to \$4 million per year from 2001 – 2004 because access to funds have been limited and water sales have been below estimates. This shortfall is referring to the most recent Determination and MRFF assumes that the same or more extreme under-funding would have occurred in the period from 1997 to 2004. This assumption is supported by the Price Waterhouse Coopers Review of Capital & Operating Expenditure undertaken for IPART at the last Determination findings that "State Water's intensive renewals and rehabilitation program results from the identification, through independent audit, of a material level of deterioration of water infrastructure, resulting from inadequate maintenance over a long period of time."

MRFF has proposed a new transfer date for assets of July 2005 because of Government not meeting its maintenance commitments prior to and since 1997. This means that Government is responsible for meeting costs of ensuring infrastructure is compliant with 2005 dam safety, OH&S and environmental standards.

In addition to the above comments, MRFF raises two concerns related to the lack of incentives for State Water to increase business or environmental efficiencies:

1. At present the environment does not operate as a 'buyer' of water, although it is a non-consumptive user of State Water products and services. Apart from the inequities and cross subsidies this causes, it also means that State Water has no incentive to invest in infrastructure works to save water for environmental purposes, as it cannot sell surplus water to the environment.
2. We understand the corporatisation of State Water and the current tax and dividend arrangements mean that any extra revenue generated from additional sales due to efficiency gains goes in dividends rather than in improving the business (either by discounting prices or offering better customer service etc).

Recommendation: The environment must be given the rights to trade and purchase water that other access licence holders have, and it must also be given cost-sharing responsibilities commensurate with the water it uses. There must also be a cap on dividends, above which State Water can invest surpluses back into its business through price reductions or improved service provision, based on customer preferences.

3.2.8 Implications of Corporatisation

MRFF has concerns regarding the costs associated with the onerous operating licence State Water must comply with. This operating licence and the requirements it places on State Water do not appear to have regard to cost, or the competitive environment's requirements and so abuses the monopoly position in requiring several different method of crosschecks on State Water. For instance a private sector public company may need to satisfy internal and external audits as well as report to shareholders annually; however State Water has reporting requirements to many different Government scrutineers – IPART, DIPNR, Treasury as well as customers. IPART and Government must be mindful of the costs of many different reporting requirements and should either subsidise or streamline requirements where possible, in order to bring State Water back to the level playing field in terms of its reporting requirements.

A further implication of corporatisation which has been raised earlier in our submission is the need to address DIPNR's under-funding and failure to meet asset compliance standards prior to handover. MRFF is concerned that there has been subsidisation between the OPEX and CAPEX budgets due to DIPNR's under-funding and that prices are now being set to recoup funds from customers in order to catch up on the Capital program. As outlined earlier, the only solution to this problem is for IPART to commission an independent audit of assets and funding against the CAPEX and OPEX program since 1997 and specify the shortfall as DIPNR's responsibility in the corporatised State Water financial reports.

3.2.9 The Application of Cost-Reflectivity

The Tribunal issues paper raised the question of state-wide versus valley prices, which could result in a move away from reflecting all costs at the valley level. MRFF supports cost reflectivity being applied to each valley in which the services are provided. This removes potential for cross –valley subsidisation and ensures costs are relevant to customers. This position means that where costs are under-recovered in a specific valley, these costs must either be recovered from users or from Government via a subsidy, but not transferred to users in other valleys.

Cost reflectivity by service product

State Water indicates in its submission that the proportions of fixed and variable charges do not reflect cost patterns, but are decided by balancing the need to maintain a significant variable component for water conservation reasons and the competing need of State Water for revenue stability. MRFF assumes that 'water conservation reasons' means demand management for environmental outcomes and is concerned that demand management is a factor in State Water's pricing, rather than consideration of customer value via available water allocations.

MRFF questions State Water's logic in seeking to achieve undefined water conservation outcomes as part of its justification for setting the ratio between fixed and variable prices. This is in direct conflict with State Water's revenue driver of optimising water sales and contradicts logic used in Section 3.7.2 Water Users Capacity to Pay, where State Water suggests that demand for water for irrigation is known to be remarkably inelastic. Therefore demand pricing or pricing to achieve water conservation introduces an externality to water pricing that is neither transparent nor able to be justified in terms of its effectiveness in delivering the desired outcome.

MRFF suggests that the proportion of fixed and variable should reflect the valley's average water availability, so that the lower the security of supply, the lower the entitlement charge in proportion to the variable use charge (refer to MRFF's recommendations regarding a fixed ratio between fixed and variable costs in Section 3.2.4).

3.2.10 Asset Management & Capital Program

As stated earlier, Price Waterhouse Cooper's report found that "State Water's intensive renewals and rehabilitation program results from the identification, through independent audit, of a material level of deterioration of water infrastructure, resulting from inadequate maintenance over a long period of time." This again raises one of the core issues of this submission, being Government under-funding of maintenance responsibilities on infrastructure. It is critical for customers that Government fully funds all legislative asset compliance requirements and that these costs are not passed on through the TAMP.

In the last Determination, IPART found that the Macquarie was virtually achieving full cost recovery. However State Water has proposed an increase in prices. This is not acceptable, especially if maintenance costs are being shifted from Government to customers.

Recommendation: IPART must urgently undertake an assessment of Government's under-funding of responsibilities re asset compliance prior to and post 1997. Once a final figure is known State Water should then itemise the figure as a separate item listed as a loan to the Government, attracting interest from when funding should have occurred in its accounts.

State Water's Estimates of Capital Costs - Stock and Domestic Water Access

State Water notes that there is considerable cost in meeting the regulatory requirement of WSPS to deliver stock and domestic water to non-customers, particularly in drought times. From the National Water Initiative Agreement (p16) "Full cost recovery for all rural surface and groundwater based systems (needs to occur), recognising that there will be some small community services that will never be economically viable but need to be maintained to meet social and public health obligations."

Recommendation: IPART needs to request that State Water investigate more efficient methods of delivering stock and domestic water and develop proposals for feasible investments. For the 2005-2008 Determination, Stock and Domestic users need to be classified as one of State Water's 'customers' and State Water needs to work with Government to determine a means of funding the cost of delivering Stock and Domestic water, whether via subsidies, direct charges to licence holders or CSO's.

3.3 Costs Not included in the Determination

Lease and royalty payments for Hydropower facilities

State Water charges hydropower operators for the right to install their facilities on its dams and use water in its storages for power generation. These amounts are not subject to determination for bulk water services, although they provide revenue to the Government as a return for the expenditure on the assets that make the hydropower stations possible.

Recommendation: MRFF proposes that the transparent accounting of hydropower station revenue as part of 'customers' share of costs is appropriate. This has applicability for calculating bulk water user's share of costs as well as in determining the charges to raise the customer's share of the RAB requirement.

3.4 State Water & DIPNR Responsibilities

Separation of functions still being negotiated between DIPNR and State Water. State Water is now responsible for water supply to regulated river water users only. It has been agreed to date that DIPNR is responsible for all water resource management responsibilities as well as for supplying water / managing water users on unregulated and groundwater systems. State Water will be contracted to undertake some water quality monitoring for DIPNR, as well as the following activities for unregulated rivers and groundwater:

- Metering water use;
- Maintaining records of water use and databases;
- Billing for water use and other charges;
- Monitoring compliance with water use rules; and
- Administering temporary transfers.

MRFF raises the following concerns regarding the separation of DIPNR & State Water responsibilities:

- We assume DIPNR's pricing submission will propose water prices on top of State Water's charges. Therefore consideration of capacity to pay by either organisation is meaningless without reference to the total cost being charged;
- With reference to the surface water quality monitoring tasks that State Water is proposing that it will undertake, a service agreement must be established, where DIPNR is charged for any water resource management monitoring.
- MRFF is concerned that there is no improvement in transparency and no ability for customer input to review or change the level of service from the above listed water delivery activities that DIPNR will be undertaking for unregulated and groundwater customers. Hence all the positive outcomes of separation that are consistent with CoAG and National Water Initiative principles (transparent pricing, increasing efficiency, customer consultation, appropriate service levels) are only going to be enjoyed by one bulk

water customer – regulated licence holders, leaving unregulated and groundwater users in a potentially worse situation unless specific measures are required of DIPNR by IPART.

- There is no improvement in the transparency of, or customer input into DIPNR's water resource management costs, despite massive improvements in State Water's transparency of accounting over a reasonably short period of time. This issue has received mention in every submission made to IPART by MRFF and we question what intention or will IPART has to raise the priority of this issue with Government, given its reoccurrence over numerous years.

Recommendation: MRFF proposes that IPART sets a timeframe and requires DIPNR to liaise with unregulated and groundwater customers to develop an appropriate, ongoing mechanism for their input into service levels and pricing. In addition a framework for prioritising and quantifying appropriate WRM expenditure needs to be developed in consultation with all customers (perhaps via the Customer Service Committees).

3.5 Stakeholder Consultation

MRFF reports that State Water's consultation in the lead-up to its submission has been moderate, with good intentions and processes in place, but the financial reporting system proving to be a limitation to the interrogation of costs by customers. MRFF understands that State Water is limited by the SAP system, (or at least in the components of SAP it currently has access to) in generating cost reports in a useful format for customer review.

MRFF is concerned to report zero consultation from DIPNR in the preparation of its submission. In fact due to the lateness of DIPNR's submission to IPART, there has been increased difficulty and expense to customers in analysing and responding to DIPNR's completed submission. Some effort or intent to consult would require minimal financial resources in order to demonstrate some improvement over time, yet IPART, the National Competition Council nor the Government has enforced the requirement to consult on DIPNR. MRFF asks IPART to clarify who is going to enforce requirements.

3.6 Comments on Appendix 1: Progress with 2001 Issues

3.6.1 Separate Valley Accounts

While there has been some improvement in the State Water response to separate valley accounts, there is still no progress in identifying natural resource management costs at a valley level. We refer IPART to our comments in Section 3.5 regarding Stakeholder Consultation, regarding its intent and capacity to enforce requirements on DIPNR. We seek a resolution to this ongoing issue, including documentation of consequences and the degree to which the requirements are enforceable in IPART's determination of prices for 2005-2008.

At least if IPART can explicitly acknowledge shortcomings or a failure in the system in terms of its lack of capacity to enforce requirements, the issue can be raised with the National Competition Council or directly with Government.

3.6.2 Unregulated and Groundwater Services Provided to DIPNR

State Water highlights the requirement of DIPNR to seek cost recovery on these systems. As noted above, there is currently a complete absence of transparency, cost reflectivity or consideration of efficient costs by DIPNR in its pricing. At present, customers have no input (apart from through submissions to IPART) into DIPNR services and costs and there is no requirement for DIPNR to prioritise activities or consider the provision of various services based on the outcomes of cost-benefit analysis.

This is a particularly critical issue for unregulated and groundwater users, where Water Sharing Plans and consequent DIPNR resource management and water delivery expenditure is not likely to have consideration for the relatively small volumes of water used, and hence capacity to pay by water users, especially if there are no checks and balances in place in the expenditure planning process (Refer to Section 3.4 for MRFF's recommendation on this issue).

3.7 Comments on Appendix 2: - IPART Issues paper responses

3.7.1 Further Efficiency Gains

MRFF urges IPART to require DIPNR to finalise negotiations with State Water on sharing of responsibilities and services. IPART needs to set a timeframe and guidelines for these negotiations that stipulates that where a DIPNR service can be more efficiently provided by State Water (and doesn't conflict with the over-riding principle that State Water should have no regulatory functions or powers) or by outsourcing, that the more efficient option is taken.

MRFF welcomes State Water's development of performance indicators to enable it to deliver services, monitor and improve its performance.

3.8 Comments on Appendix 3: Externalities & Other Issues

3.8.1 Scarcity Pricing

MRFF supports State Water's position that it is not appropriate to apply scarcity pricing in NSW – and extends the principles raised to cover DIPNR's WRM responsibilities as well as State Water's bulk water delivery responsibilities. It is the same set of customers and the same water market, regardless of whether WRM or bulk water delivery is being considered and scarcity pricing within WRM charges would have the same distorting effects as outlined by State Water for the scenario of adding scarcity prices to bulk water delivery charges.

Apart from State Water's arguments, MRFF would question the monopolistic nature of this kind of pricing and whether it would achieve desired outcomes. The Government already extracts its dividend from the investment and if some resource management outcome is sought, there are much more direct and appropriate ways of achieving water resource management outcomes, such as through the valley based Water Sharing Plans.

From a recent paper by Martin van Buren & Darla Hatton MacDonald 'the purpose of a scarcity charge is to signal resource opportunity costs to users in situations where water is scarce and water trading is inhibited'. Due to difficulties in estimating scarcity rents and the risks associated with inappropriate charges, van Buren and MacDonald suggest 'the first-best solution is to remove the impediments to water trade' (van Buren & MacDonald, 2004). MRFF understands that there are minimal impediments to water trade in the Macquarie which means the market is able to respond to scarcity through the trading price of water, making scarcity pricing inappropriate and unnecessary.

3.8.2 Demand Management

State Water's revenue is directly related to maximising the volume of water supplied to water users within the regulatory framework of the WSP (as well as to deliver water to the environment and other basic rights as specified in the WSP). This demonstrates that the concept of demand management in pricing is directly in conflict with the fundamental purpose of State Water's business. Again there are much more direct and appropriate means of achieving water resource management outcomes than through water pricing, where the desired outcome is not defined and the chances of achieving a response through pricing are unlikely, aside from the adverse impacts on State Water's business objectives (Refer to comments in Section 3.2.9: The Application of Cost Reflectivity for further discussion on using pricing as a demand management tool).

3.8.3 Externalities

MRFF supports the concluding findings of a paper recently completed for a Water Policy Workshop, titled “Addressing water-related externalities: Issue for consideration” by Martin van Buren and Darla Hatton MacDonald (Feb 2004). The paper found that there is a need to address the following key issues in progressing policy and guidelines for addressing externalities in the water market:

- “Clarifying property rights in water and the provision of environmental services – which is important for determining who should bear the cost of environmental improvements and lowering the costs of meeting targets;
- Establishing a robust set of ‘cause and effect’ relationships to assist policy makers in assessing the environmental impact of alternative water management options; and
- Greater scrutiny needs to be applied to the cost-benefit of environmental targets, which will involve techniques such as threshold analysis (the minimum size of environmental benefit required to offset the cost of delivering the target – including full implementation and opportunity costs).

3.8.4 Temporary Transfer Fees:

State Water is proposing to increase the maximum charge per transfer from \$75 to \$275. This is based on a fixed fee of \$25 plus a variable fee of \$1/ML (as in the last Determination).

Recommendations: MRFF supports users being charged the full cost of temporary transfers, however all charges to users need to be based on *transparently identified or estimated* costs of service delivery. MRFF requests that State Water provides justification for the proposed price increase by documenting / estimating the actual cost of undertaking temporary transfers. MRFF does not support a price increase without information about cost reflectivity as pricing that is not transparent perpetuates hidden cross subsidies and provides no efficiency incentives in service provision.

In addition, MRFF states that where there is a change in method of costing or charging for any service or product, that the change should lead to a revenue neutral outcome, with the sole purpose of recovering costs.

3.8.5 Adjustments for Water Ordering Errors

State Water is proposing that a charge equal to the usage charge in the particular valley be levied against all customers who placed incorrect orders. The total charge will be equal to the net loss of water incurred and will be shown as a separate line item.

Recommendation: MRFF supports pricing that is equitable, transparent and encourages efficiency in the system. Therefore we support State Water’s proposal, with ‘incorrect water orders’ being defined as per Customer Service Charters. For instance, the Macquarie CSC has specified that orders not adjusted by customers within a specified timeframe (to enable State Water to re-sell) should be classified as incorrect, incurring a use charge for the full amount ordered.

4 Response to DIPNR Submission

MRFF raises one fundamental concern, prior to addressing the specific details of the DIPNR submission; the lack of capacity of DIPNR to undertake any services related to bulk water in a way that is satisfactory, delivers required outcomes or is cost efficient. The poor standard and extremely delayed timing of DIPNR's submission to IPART is just another symptom of the fundamental problems DIPNR is having in defining and undertaking its role. There are no easy solutions to DIPNR's problems, but from a customer perspective we state upfront that we have no confidence in the costings or the services DIPNR is proposing for the next determination. We believe it is highly inappropriate to force DIPNR's inherent inefficiencies onto customers through water prices for any period of time. The following sections address issues in the same order as they are raised in DIPNR's submission.

4.1 Overview

DIPNR states in its submission that bulk water services include water resource management and regulatory activities. MRFF opposes the inclusion of regulatory activities in the DIPNR component of IPART's pricing Determination. DIPNR is the only Government department to our knowledge seeking to pass on such costs to customers (Refer to Diagram 1, p21). In addition, DIPNR is incapable of providing transparent and cost-reflective pricing or operating in a cost efficient or timely manner, all of which are responsibilities of service providers seeking full cost recovery.

DIPNR also announces in its overview that 'in order to maintain prices in real terms, legislative amendments will be made to increase 2003/04 bulk water charges by 2% from 1 July 2004.' MRFF is extremely concerned that such a claim can be assumed by DIPNR to be proceeding, without an IPART recommendation. This assumption is even more inappropriate given DIPNR's own quoting of IPART's 2001 Determination (DIPNR submission, p4), which stated:

'Given the probability of significant developments within the industry IPART is likely to review in detail the operating costs of DLWC and the next Determination. It notes that the costs used for this (2001) Determination should not be regarded as the benchmark efficient costs'.

As stated above, we have no confidence in the legitimacy of DIPNR's current prices, based on a complete lack of costing information or ability to demonstrate adequate capability to meet service provision requirements. Therefore to take the last Determination's prices and simply add inflation, let alone to back-date the price rise to July 2004, without meeting requirements set out by IPART and COAG is intolerable to customers.

DIPNR refers in its overview to a 'medium term pricing proposal in the second half of 2005'. Again it seems DIPNR is running to its own agenda, with its own timeframes, with no regard of the expense to customers and others of adjusting to its program. Perhaps DIPNR should be covering all the costs associated with customers having to respond to an additional submission, based on its own inability to meet the given timelines.

4.2 Part A: The Water Resource Management Pricing Framework

4.2.1 WRM Pricing Policy Context

DIPNR refers to the water resource data gathering and planning activities due for completion in June 2006 in this section of its submission. MRFF suggests DIPNR needs to reconsider its timeframe for commitments urgently, given that no progress has been made (to our knowledge) on plans for water sources that have not yet been completed (and June 2006 is only 14 months away). In addition DIPNR should not be claiming responsibility and hence costs for WRM activities (as per its 2001 submission and Determination) that are being delegated to the Catchment Management Authorities (CMA) to undertake. CMA Chairs have recently been informed by the Minister for Infrastructure and Natural Resources that they will be required to take on some water resource planning responsibilities as well as consultation components of water sharing plans in the near future.

4.2.2 WRM Services Undertaken by DIPNR

DIPNR quotes IPART's definition of water resource management in this section of its submission;

“activities that arise out of the need to manage a resource that is being consumed by a wide range of user groups... (with) with overriding aim of... ensuring the long term sustainability of the resource which will allow continued water extraction while maintaining the health of the natural ecosystem”.

MRFF is concerned that this definition provides no boundaries or methods for prioritising or limiting WRM expenditure. There is no requirement from this definition for DIPNR to consider the cost benefit ratio of undertaking WRM activities and no consideration of whether all activities are affordable or worthwhile in terms of value for money.

MRFF also notes IPART's reference to a 'wide range of user groups' in the above definition.

DIPNR also quotes several regulatory activities as being defined as WRM activities by IPART in the 2001 Determination. The list of WRM defined activities includes:

- Development of policies to manage water resources;
- Development of plans and strategies to allocate water and to address water management problems;
- Implementation and monitoring of compliance with these plans.

We refer to our comments under Section 4.1 Overview, with regard to regulatory activities. Regulatory activities must not be categorised as WRM activities, as activities such as policies and planning do not fit within the beneficiary or impactor pays framework as appropriate activities from which Government should seek full cost recovery. This is because these activities are the responsibility of present-day Governments, regardless of bulk water users' existence. There is a community expectation that our water resources will be managed now and into the future (regulated or pristine) and therefore these activities and expenses are not being incurred by Government solely for the benefit of, or due to, the impacts of bulk water users.

Recommendations :

- (a) MRFF requests IPART to revisit its definition of WRM expenditure to incorporate the concept of cost effectiveness into the definition.
- (b) In addition MRFF requests that IPART seeks input to determine an appropriate framework for guiding WRM expenditure decisions by DIPNR.
- (c) To repeat the core issues of our response to State Water's submission, MRFF requests an overhaul of IPART's approach to apportioning costs that are deemed to be 'users' responsibility, so as to include ALL users. At present these costs are covered by just one user group – bulk water users.
- (d) IPART removes regulatory activities from the definition of bulk water related WRM activities (see Diagram 1, p21).

The Nexus Between Water Service Provision and WRM Activities

DIPNR makes the assumption in this section of its submission that 'the most significant threatening process for most water sources in NSW is the regulation of flows and the extraction of water'. MRFF questions this assumption – given the known (and unrelated to regulation or extraction) catastrophic impacts of increasing salinity on water sources, and some other water quality issues, not to mention potential climate change impacts on floodplains and wetlands.

DIPNR also states that “most catchment management, floodplain and coastal activities are excluded (from bulk water related WRM) as they have a broader WRM role and cannot be identified with the impacts of water extraction.” However the WRM activities listed by DIPNR (p3) as being bulk water related include floodplain management plans, blue-green algae and wetland strategies and other water quality strategies.

MRFF would argue that these activities are not bulk water related, that they derive benefits for users other than bulk water users and would be required of DIPNR regardless of bulk water users’ existence. For example, the floods of 1956 (prior to river regulation) caused severe damage in the Macquarie valley and present-day community expectations would be to have protection against severe flood events. Therefore bulk water users cannot be classified as the impactor or the beneficiary.

Water quality is another obvious example to support our argument, with many water quality issues being related to salinity and upper-catchment management practices. Therefore bulk water users cannot be classified as the impactors and could only be considered as secondary beneficiaries, behind other ‘users’ more dependent on high water quality (i.e.: environment, towns etc).

MRFF notes that DIPNR refers to ‘very detailed levels’ of identification and reporting of attributable bulk water WRM activities (DIPNR submission, p3). However DIPNR is unable to provide requested information on costings to Customer Service Committees and is incapable of reporting expenditure monthly, quarterly or even annually.

Recommendations :

- a) MRFF requests that IPART reviews all the activities that DIPNR currently classifies as bulk water related WRM activities and removes those activities (such as flood operations and water quality activities) that are not directly related to bulk water delivery.
- b) MRFF requests that IPART places cost data information provision and reporting requirements on DIPNR as a minimum service standard that is auditable and enforceable.

Service Level Agreements

We refer IPART to our comments in Section 3.4: State Water & DIPNR Responsibilities. We note in addition that again DIPNR’s language and assumptions in this section reveal its opinion of its authority over State Water’s business decisions i.e.: DIPNR states (P3) ‘contestable tendering arrangements will be put in place *where DIPNR is satisfied* that cost efficiencies and standards of service can be maintained.

Recommendation: MRFF requests that IPART instructs DIPNR with regard to State Water’s control over all of its business decisions, including the allocation of competitive tendering arrangements.

4.2.3 WRM Costs

WRM Operating Costs

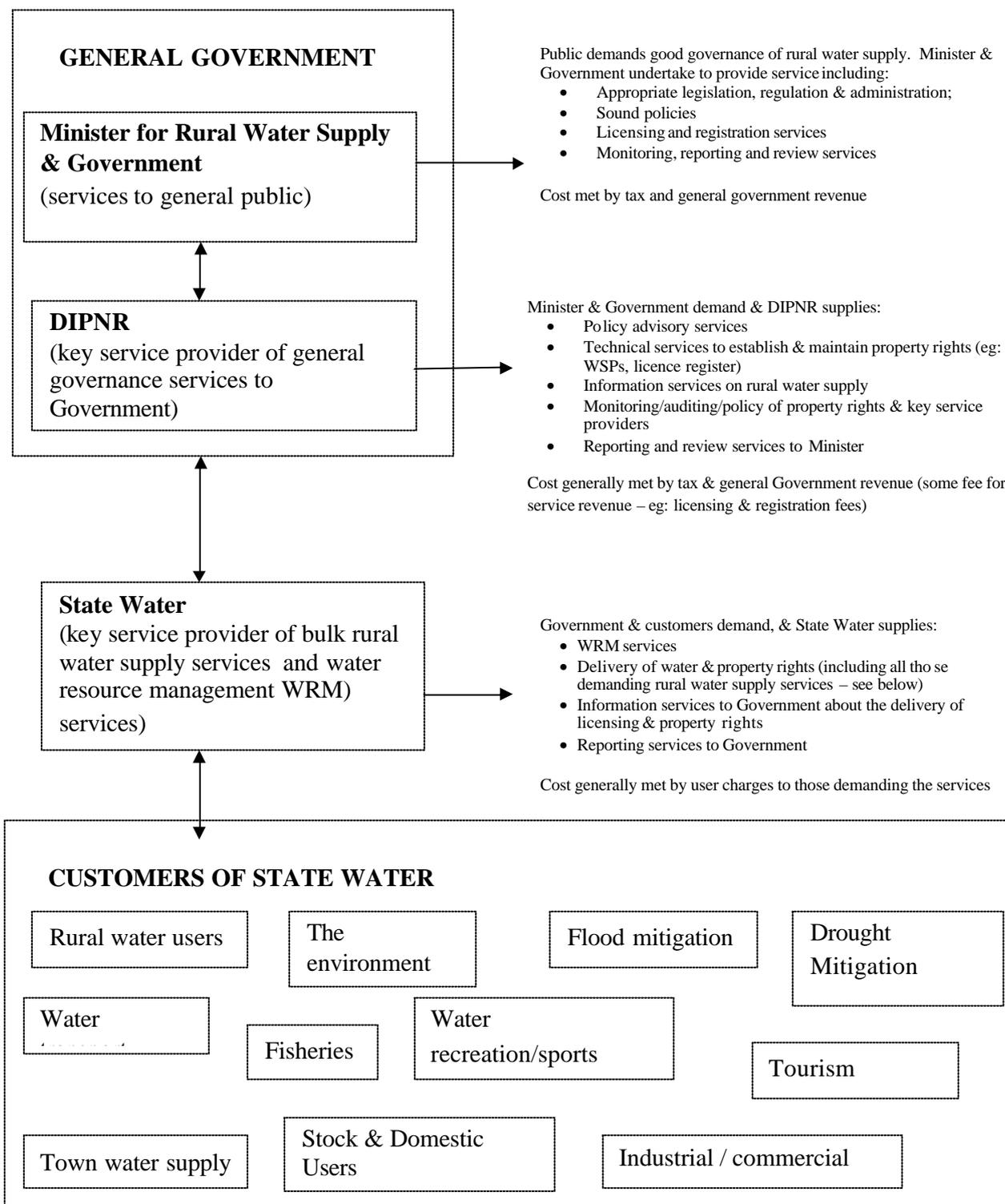
DIPNR refers to 2003/04 costs as ‘indicative’ rather than actual in this section and provides some justification as to why it has not undertaken a detailed review of costing information. It is now ten months since June 2004 and MRFF believes it is completely unacceptable for DIPNR to be incapable of reporting expenditure and cost information in a timely manner and in line with previous IPART Determination requirements.

DIPNR refers to the proposed increase in unregulated river WRM costs, with the justification that this ‘in part reflects the additional costs of the metering and billing... and also reflects increased WRM costs associated with implementation of the planning provisions of the WMA.’ MRFF has raised the issue earlier (Sections 3.4 and 3.6.2) of DIPNR’s lack of framework for prioritising and quantifying appropriate WRM expenditure.

Recommendation: MRFF requests that IPART seeks up to date information on all DIPNR's WRM activity costings, including a detailed report of expenditure in 2003/04 and a budget for 2005/06 prior to considering any pricing proposals by DIPNR. In addition DIPNR must specify for each activity or product, what proportion of costs are being charged to bulk water user customers, as there are currently many and varied types of expenditure that DIPNR is lumping under the general heading of WRM expenditure.

In addition, we propose the following structure in Diagram 1 for financing of rural bulk water supply, reflecting the principles outlined throughout this report.

Diagram 1: Principles for Financing and Cost Sharing for DIPNR & State Water



This diagram has been developed based on a diagram in Murrumbidgee Irrigation's current submission to IPART.

Licensing Administration Costs

DIPNR states that licensing administration costs, including administration of the licensing and approvals regime, licensing surveillance, compliance and enforcement with licensing conditions and WSPs, are spread over all licensed water users and are included with WRM costs.

DIPNR is also proposing that individual licence holder transactions related to water management consents will be charged directly to the individual, based on uniform, state-wide fees.

Recommendation: MRFF supports individual licence holder transaction fees to be charged to the individual rather than included as part of the WRM licensing administration activities. However we request that IPART seeks (and provides to customers) detailed costing information from DIPNR on the calculation of state-wide, uniform fees for water management consent activities.

WRM Capital Expenditure

DIPNR states that river gauging stations are a major item of equipment used for WRM (with ongoing expenses included as part of operating costs). Refer to comments in Section 3.2.2 Cost Sharing, under the sub heading Cost of Hydrometric / Hydrographic Services with regard to State Water's proposal for customers' funding responsibilities of gauging stations.

DIPNR also refers to minor items of WRM CAPEX including office equipment and motor vehicles, which are 'added to direct salaries to determine the full absorption cost of all external services, including WRM services, provided by DIPNR'. MRFF is concerned that DIPNR is passing overhead costs onto bulk-water customers by including them with WRM activity costs.

Recommendations:

- a) MRFF requests that IPART seeks clarification from DIPNR on exactly what proportion of overheads such as office equipment and motor vehicles) are being included in WRM costs.
- b) In addition, MRFF requests that IPART rejects DIPNR's proposal to include general business overheads in its WRM costs on the basis that the nature of overheads means that they cannot be attributed specifically to bulk-water related WRM service provision.
- c) With regard to WRM capital projects and maintenance of unregulated river infrastructure, MRFF requests that IPART requires such expenditure to be assessed via the framework proposed, to prioritise and quantify appropriate WRM expenditure levels.

Return on Capital

DIPNR states its intention in the medium term, to make provision for a return on capital if it is decided to include CAPEX on unregulated river structures in the WRM cost base. MRFF raises concerns with this concept, given the lack of relevance of such infrastructure to bulk water users, especially in the absence of appropriate CSO arrangements from which to fund a rate of return.

4.3 Part B: Water Resource Management User Costs & Tariff Restructuring Proposals

4.3.1 Establishing the Level of WRM Costs from 1 July 2005

DIPNR states (p7) that 'WRM user costs published in the 2001 Determination are adequate for setting WRM charges from 1 July 2005'. We refer to IPART's 2001 Determination, as quoted earlier, where IPART stated that:

'Given the probability of significant developments within the industry IPART is likely to review in detail the operating costs of DLWC and the next Determination. It notes that the costs used for this (2001) Determination should not be regarded as the benchmark efficient costs.'

MRFF notes the stark lack of detail provided or effort made by DIPNR to justify its current pricing proposal. Refer to the recommendation under Section 4.2.3 WRM Operating Costs.

4.3.2 Security Premiums

DIPNR is proposing a single WRM access charge that will ‘effectively average high and lower security premiums...’(DIPNR submission, p8). DIPNR expects that this approach will ‘result in marginally increased access charges for general security water users, but correspondingly lower charges for high security water users’.

MRFF disputes DIPNR’s claim that this approach will improve pricing transparency and cost reflectivity in pricing. In fact it seems obvious that one access charge for two different user groups is explicitly imposing a subsidy between general and high security users, and hence cannot be considered cost reflective or transparent. The proposal also seems to be contradictory to State Water’s logic and approach in proposing a higher entitlement charge for high security users, to reflect the higher cost of storage.

Recommendation: MRFF rejects this proposal on the grounds that it is not cost reflective and perpetuates cross-subsidies between users within each valley. We refer IPART to our earlier comments regarding entitlement and use charges in Section 3.2.3 of our response to State Water’s submission.

4.3.3 Wholesale Discounts

DIPNR is proposing the removal of wholesale discounts and the introduction of fee for service arrangements where Irrigation Corporations provide assistance for the WRM function in the future.

Recommendation: Refer to our comments under Section 3.2.5 regarding wholesale discounts. We add that it is important that the principle that guides this issue is that where a DIPNR or State Water need arises or a service of value is offered, by irrigation corporations or any other external party, that the service is costed, and where the most efficient provision of the service is via outsourcing, that contractual fee for service arrangements are implemented.

4.3.4 Two part Tariff on Unregulated Rivers

DIPNR is proposing that ‘when the metering and monitoring program is completed and water usage can be reliably measured to DIPNR standards, it is intended that a two-part tariff structure be introduced.

Recommendation: MRFF queries the cost effectiveness of the level of metering required to enable the implementation of a two-part tariff structure. Without any information of the scale and cost of such a program, compared with the small volumes of unregulated water used in most valleys, it is impossible to know whether this is a financially prudent direction for DIPNR to be taking. We request that IPART requires some cost-benefit analysis from DIPNR prior to proceeding in this direction, with consideration of the volumes of water being used and whether there are alternatives that are more suited to the scale of use.

4.3.5 Transaction Fees on Water Management Consents

DIPNR states that it is continuing to use the fees charged under the Water Act 1912 in most cases. MRFF is sceptical about how DIPNR can make the statement that ‘costs represent a reduction in cost recovery levels’, yet it has not established the full cost of transactions on WMA consents. The costs provided in Appendix 5 do not give us any indication of cost reflectivity.

Recommendation: MRFF requests that IPART requires DIPNR to calculate and report on the full cost of transactions on WMA consents prior to the consideration of any price increases for transaction fees on WMA consents.

4.4 Part C: Future Directions in Water Resource Management Pricing

4.4.1 Institutional Changes in WRM

DIPNR states that many of the new institutional arrangements and structures are ‘yet to be fully established and currently have only limited operational capacity’. We dispute this, particularly with CMAs, the NRC and NRAC having been in place now since mid 2004, being fully operational and with specific reference to the CMAs only limited by difficulties in extracting service agreements and the delegation of authority for functions from DIPNR.

DIPNR also suggests that a review of participation of all Government agencies in providing WRM services would be desirable, with a view to seeking recovery of these costs. DIPNR states that ‘in the interim it will continue to undertake many of its ongoing WRM activities and seek recovery of the cost concerned’.

Recommendation: MRFF repeats its concerns that DIPNR, and potentially other government agencies have developed a philosophy that the cost of ‘usual Government functions’ should be recovered from customers. It is imperative that IPART provides much tighter principles, guidelines and boundaries for agencies to operate within when considering what are appropriate activities with respect to services being charged to customers (see Diagram 1, p21).

4.4.2 WRM Entities

DIPNR states that CMA water management functions include monitoring the impacts of WSPs. MRFF has three concerns at present with respect to monitoring the impacts of WSPs:

- No service agreement exists to remove responsibility for WSP monitoring from DIPNR to the CMA’s;
- DIPNR is not undertaking the essential monitoring programs that are still its responsibility, which means environmental outcomes and all the other impacts of the WSPs are not being measured; and
- Despite the fact that DIPNR has somehow ceased this critical monitoring role, it is still charging the same monitoring WRM charges to customers

Supporting our above concerns is a quote from the NSW Auditor General’s recent report:

“There are significant gaps in the monitoring and evaluation of water quality. Based on the information currently available, it is not possible for anyone to gauge in a comprehensive way the health of NSW rivers; the main risks to those rivers and the sources of risk; and the strategies to manage those risks (NSW Auditor General, 2003).”

Recommendation: MRFF requests that IPART seeks clarification from DIPNR regarding the detailed breakdown of exactly what monitoring activities it is undertaking as part of its WRM activities, whether these are core regulatory functions (such as WSP monitoring), separate to water user-specific activities and how much it is proposing to charge water users. Obviously DIPNR should only charge customers for the activities it is undertaking that are specifically related to water delivery and bulk water use.

4.4.3 Impact of the NWI on WRM

DIPNR claims that an ‘increase in security will be accompanied by an increased in recoverable WRM costs in providing that security’. DIPNR has extended its interpretation of the definition of WRM to include: “increased monitoring and compliance costs and the extension of compensation provisions”. MRFF strongly believes that WRM costs (as defined by IPART) are completely unrelated to the issue of security of access and it is legislative and Government policy changes, not changes in bulk water use that have altered security of access, allowed for compensation provisions and specified monitoring requirements. Therefore water users cannot be the impactors creating any additional costs resulting from increased security of access – and it is arguable that there would be any increase in costs anyway.

Recommendation: MRFF requests IPART to review its definition of WRM costs, (as recommended earlier in this submission) to ensure Government policy decisions, planning and functions are not lumped in with WRM costs to be recovered from water users (See Diagram 1, p21)

Specific NWI Commitments

DIPNR's submission (p13) quote from the NWI outlining some principles for best practice in water pricing, including:

- 'giving effect to the principles of user pays and achieving pricing transparency...'
- 'identification of the proportion of (water management and planning) costs that can be attributed to water access entitlement holders', based on excluding activities undertaken for the Government; and linking charges as closely as possible to the costs of activities or products.

MRFF raises the question to IPART of the difference between user pays and the IPART endorsed position of impactor pays. In addition, we highlight the inconsistencies in both State Water and DIPNR's submissions in applying one pricing principle. Both organisations have made pricing submissions using a mixture of user and impactor pays, in addition to inappropriate application of the pricing principles in order to optimise revenue from customers.

MRFF also raises the question to IPART about how DIPNR's NWI commitments will be enforced in the area of reporting and pricing transparency. The obvious and effective solution to this issue would be to make price increases dependent on meeting all their responsibilities to the customers.

DIPNR lists other NWI requirements that will mean increased WRM costs. Most of these are not appropriate WRM 'cost recoverable' charges on either user or impactor pays basis. For instance the costs of achieving 'integrated management of environmental water commitments' should not be covered by water user customers.

Recommendation: MRFF requests that IPART review its pricing principles set for the 2001 determining to guide water pricing methods, to ensure that prices charged are in line with the NWI user-pays principles.

4.4.4 Medium Term Submissions on WRM Charges

DIPNR has requested a medium term pricing determination on WRM charges to apply from July 2006, with the current determination process classified as interim, to cover the period up to July 2006. MRFF accepts that there are continuing water management reforms and recent changes to institutional arrangements. However it is wasteful of resources and impractical to change the current determination to an interim arrangement. The only sensible solution would have been to delay the current determination by a year, and with DIPNR's failure to meet deadlines, the current submission is at least four months behind already.

MRFF adds that there has been and will be a continuing period of water management reforms for at least another two to four years, so for DIPNR to use the reforms as justification for failing to meet its pricing submission requirements highlights its underlying failures in the areas of reporting of costs by activity and pricing transparency.

Recommendations:

- a) MRFF recommends that IPART freezes consideration of the current submission from DIPNR pending its provision of up to date, detailed cost reporting that has been absent in recent history. This includes a detailed report, by activity of 03/04 expenditure, as well as a budget for the determination period. (Refer to recommendation under Section 4.2.3).
- b) With respect to DIPNR's medium term submission proposal, MRFF recommends that the above freeze continues until DIPNR addresses its reporting requirements, as well as the issues listed for the medium term submission.
- c) With respect to interim prices, MRFF recommends that DIPNR's charges remain unchanged, pending the achievement of recommendations a) and b) above.

Specific IPART Issues

The Balance between Entitlement and Usage Charges

DIPNR raises a number of issues to be taken into account when developing an appropriate balance between the fixed and usage components of the two-part tariff. Issues include the mix of fixed and variable costs in providing WRM services, the implications for financial viability and revenue stability for DIPNR, the significance of WRM charges in affecting consumptive behaviour patterns and the fact that bulk water charges do not provide an effective demand management signal.

MRFF supports DIPNR in seeking to make WRM tariffs cost reflective. It also seems logical that as most WRM costs are fixed, that these should be incorporated in a fixed, valley based tariff structure. We note that in order to be cost reflective, the tariff would have to be valley based, rather than uniform across the state. However customers would not be confident in a single valley-based tariff or in any DIPNR prices being cost reflective or transparent until DIPNR addresses its completely inadequate and out of date reporting standards.

MRFF adds that DIPNR seems to have forgotten two things:

- 1) that it is a Government department and is instead relying on passing as many of its expenses onto customers as IPART allows. We believe it is inappropriate for DIPNR to make pricing recommendations on the balance between entitlement and usage charges on the basis of its own need for financial viability and revenue stability; and
- 2) the implications of the ratio between entitlement and use charges on customers as a driving factor in determining the appropriate balance. (Refer to Section 3.2.4 for further comments).

Separate Valley Accounts

DIPNR states that it 'will review the need for developing special purpose WRM valley financial reports as part of the medium term submission'. MRFF is alarmed by DIPNR's anticipated reduction in reporting of WRM. Its current reporting is dismal and it cannot demonstrate cost reflectivity or pricing transparency, therefore to consider uniform state-wide tariffs and reductions in reporting appears to be completely contradictory to its NWI and IPART pricing and reporting requirements.

Recommendation: MRFF requests that IPART clarifies the correct interpretation of its own and the NWI reporting standards and requirements and instructs DIPNR and customers on clear and detailed guidelines for reporting guidelines into the future. This will include outlining the regularity of reporting, appropriate time lags, detail in terms of activities and cost sharing ratios and cost reflectivity guidelines.

MDBC Cost Allocation

DIPNR quotes IPART's last determination (p16) 'To ensure that MDBC costs are appropriately assigned on an impactor pays basis for the next Determination and thus ensure that Murray valley users do not pay more than their fair share of these costs, IPART requires DIPNR to develop a robust and transparent method of allocating MDBC costs for the next Determination.' DIPNR states that it will 'include an appropriate basis for allocating WRM costs across valleys in the medium term submission.

It is concerning that DIPNR appears to be focussing on including more bulk water users in other valleys in the cost sharing arrangements, rather than looking at other 'impactors' (and users as per NWI directives) within the Murray. For instance, the operation of river and storage infrastructure in the Murray by MDBC is not a result of the impact of bulk water use across the basin, or even bulk water use alone within the Murray (we refer IPART to the methodology suggested in Section 3.2.2 for apportioning costs of OH&S and other storage and delivery costs).

Therefore any efforts to spread costs across valleys cannot contradict the limited scale of impact that the Darling system and its tributaries has on the Murray.

Recommendation: MRFF recommends to IPART that any exercise to separate and apportion MDBC costs across a broader group of 'consumers' on an impactor pays basis must be reflective of true costs and 'impacts' by different consumptive and non-consumptive customers. A robust and transparent methodology for apportioning any generic MDBC costs that do not specifically apply to the Murray would be on the basis of contribution of flows to the Murray. For instance the long term statistics indicate that the Darling and its tributaries contribute around 12% of total Murray flows.

4.5 Comments on Appendices

4.5.1 Comments on Appendix 1: Water Resource Management Products & Pricing Valleys Bulk Water Products

The NWI specifies that related costs are not appropriate costs to recover from water users. However most of the products listed in Appendix 1 have policy-specific components e.g. from within one of the Product areas PA1 (the Surface water database) PA110, PA130, PA210, PA230 and PA 330 all include setting policy and corporate standards for assessment, including customer plans, quality assurance standards for collecting and management.

Other examples include the products PB1 – Surface Water Allocation Strategies, PB3 – Groundwater Allocation Strategies, PD1 – River Quality/flow reforms, PD2 – Blue-Green Algae Strategies, PD3 – River Salinity Strategies, PD4 – Bacterial, Chemical & other Regional Plans, PD5 – Groundwater Management Strategies, PD6 – Wetland Strategies, PD7 – Water Industry Strategies. All of these products contain sub-product categories mostly related to the development of state-wide policies and associated plans. In addition many of these products are not related to or resulting from bulk water use.

Recommendation: MRFF seeks a review of the detailed list of sub-products and associated cost sharing ratios, as per recommendations in Sections 4.2.2, 4.2.3 and 4.4.3. Activities included as the 'recoverable WRM costs' must be directly as a result of bulk water use and must be apportioned across all 'users' - consumptive and non-consumptive (see Diagram 1, p21).

4.5.2 Comments on Appendix 6: Service Level Agreements for Bulk Water Service Provision

DIPNR refers to the Service Level Agreements between State Water and itself, including the Hydrometric service agreement and the metering and billing agreement. With respect to gauging stations, DIPNR states (DIPNR submission, p33) 'A management plan has been developed to optimise the allocation and utilisation of gauging stations. The plan will also provide the necessary data to monitor and control the distribution of equipment and allow for inclusion in DIPNR's assets register.'

MRFF has serious concerns with DIPNR's 'Management Plan' and its associated costs. The philosophy behind a service level agreement is as we understand, to provide a *required* service at an efficient cost. We refer to State Water's submission and our response in Section 3.2.2, where State Water indicates it requires only 399 of DIPNR's 818 gauging stations for the purpose of water delivery. DIPNR is clearly focussed on how to 'optimise the allocation and utilisation' and hence claim all the costs of its gauging stations, rather than focussing on meeting the service level agreement with State Water in a cost efficient manner.

Recommendation: MRFF requests that IPART seeks urgent clarification from DIPNR and State Water regarding service level agreements and requests itemisation of the break-up of costs from DIPNR, from those activities and services that apply to Service Level Agreements with State Water and the remainder of costs not to be charged to State Water or bulk water users.

5 Appendix A: Macquarie Customer Service Committee's Letter of Support

Macquarie-Cudgegong Customer Service Committee

4 April 2005

Mr Jim Cox
Independent Pricing and Regulatory Tribunal of NSW
P O Box Q290
QVB Post Office NSW 1230

Dear Mr Cox,

5.1.1 Re: Macquarie Cudgegong Customer Service Committee Submission on State Water and DIPNR submissions for Bulk Water pricing from 2004/05.

Please find following a submission from the Macquarie Cudgegong Customer Service Committee.

The following points are a summary of the key messages MRFF and the Macquarie Cudgegong Customer Service Committee has for IPART with regard to the 2005 – 2008 pricing determination:

- IPART needs to revisit its cost sharing principles, based on the NWI requirement for a user pays approach
- State Water needs to focus on efficiency
- Scarcity pricing and demand management are not appropriate pricing tools, creating market externalities, conflicting with State Water's purpose of optimising its water delivery business and having no factual basis of being able to deliver the outcomes sought in applying such pricing tools
- Water Resource Management (WRM) Costs need a complete review.

There should be no increase in Macquarie water prices for the current determination, as cost recovery was achieved at the last determination and State Water and DIPNR must be required to focus on increasing operating efficiencies and transparent pricing.

We acknowledge the crucial role of IPART in overseeing Government monopolies such as the bulk water market and cannot stress enough the importance of IPART's role in this regard. We look forward to the opportunity to make a presentation at your public hearing.

Yours sincerely,

Mike Bennett
Chairman
Macquarie Cudgegong Customer Service Committee