

# Macquarie Generation

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Chairman  
Independent Pricing and Regulatory Tribunal of New South Wales  
PO Box Q290  
SYDNEY NSW 2000

Dear Mr. Cox

## BULK WATER PRICES FROM 2006/07

Reference is made to the Tribunal's general invitation for submissions from interested parties for pricing reviews. Macquarie Generation appreciates this opportunity to comment on Bulk Water Pricing in advance of the Bulk Water Prices Determination from 2006/07 and to contribute to price determination process.

From the submissions of the two principle entities, the Department of Natural Resources (DNR) and the State Water Corporation (SWC), it is evident that the aim is progression to full cost recovery. In reviewing the respective submissions an assessment of pricing transparency was undertaken that allows considerations to be given to the question of equity within the proposed cost allocations.

### *Department of Natural Resources Submission*

Macquarie Generation as a major utility is exposed to a dual fee structure that shall continue under the current proposal. The DNR proposes to recover Water Resource Management costs through an access charge on based on entitlement volume and charges shall be independent of entitlement category. DNR also propose to continue to levy licence management fees for Major Utilities in addition to charges for water resource management. Appendix 4 of the DNR submission summarises how major utility costs are recovered through:

- Water Resource Management Charge - paid by all water users and based on total volume entitlement;
- Major utility licence management fees charged in accordance with the WA 1912 (ss 188 and 194) and in future shall be recovered through the WMA 2000 (s114). These fees are negotiated individually with the major utility; and
- Other charges based on direct negotiation between DNR and the major utility.

The proposal to set WRM charges based on volumetric entitlement raises a potential equity issue. The relationship between volumetric entitlement and actual costs incurred by the DNR for resource management is unclear. Macquarie Generation has significant water entitlements and only a limited number of licences. Under DNR's proposal it would incur significant resource management fees. It is not clear that the charges reflect the resource management costs, which may be attributable to Macquarie Generation licences.

An issue that requires clarification with regard to WRM charges is whether Supplementary Water is included in the entitlement base. Macquarie Generation is a major consumer of this category of entitlement. Its inclusion in the entitlement base for WRM charges has significant implications for costs to Macquarie generation

As a Major Utility Macquarie Generation is also required to pay licence management fees. The combination of a volumetric based water resource management charge and licence management fees may result in Macquarie Generation paying a disproportionate amount of DNR's total costs.

The other significant change is the restructuring of unregulated water management. DNR shall be responsible for cost recovery. From the limited information within the DNR submission, estimates from bar graphs and other tabulated data suggest that the price can be expected to double or treble. The two paramount issues with such a rise are transparency and equity of distribution.

The DNR has not provided any details of any proposed future charges. Estimates may be made from the information provided however without clarification with respect to issues such as supplementary water, it is impossible to formulate an accurate cost profile. From Macquarie Generation's perspective until such time as the detail relating to entitlement charges are clarified, along with the relative interrelationship to specific major utility licence fees, the impact cannot be accurately assessed.

#### ***State Water Corporation Submission***

The State Water Corporation submission enables an overview of their proposed strategy defining the framework for establishing revenue requirements, operating and capital expenditure, and return of investment for the shareholder. The presentation of the "unconstrained" price projections enables assessment of the potential impacts of full cost recovery. SW indicate that full cost recovery will lead to significant and unsustainable price increases in some valleys.

The adoption by the SW of the Council of Australian Governments (CoAG) requirement that 50% of revenue must be obtained from usage charges by 1 July 2006 and 60% by 1 July 2008 is included within the submission projections.

The SWC propose to set prices based on the following formulas:

Entitlement Charges:

$$\text{Price} = \frac{\text{Proportion of Costs to be Recovered through Fixed Charges}}{\text{Total Entitlement (ML)}}$$

Usage Charges:

$$\text{Price} = \frac{\text{Proportion of Costs to be Recovered through Usage Charges}}{\text{Forecast Usage (ML)}}$$

SW are concerned about the vulnerability of revenue streams to variable usage and propose to reduce this variability by utilising a forecast usage one standard deviation below the average.

SWC contend this will reduce the risk to revenue from variations in usage. However it raises two significant issues:

1. It adversely impacts Macquarie Generation's ability to accurately budget for bulk water costs. With its high dependency on the variable availability of Supplementary Water and given that 60% of charges shall be levied against usage, this has the potential to result in variations in budget versus expenditure of as much as \$1 million dollars per annum, assuming all SW's proposals are adopted.
2. SW's proposed forecast usage calculation, which it introduced to mitigate the risk to revenue from variable usage, requires careful scrutiny. It may result the potential for the SWC to receive win fall revenues, well in excess of full cost recovery. From data provided in SW's submission

the usage component of water in the Hunter would be inflated by 20% in excess of the charges that would result from average usage. This is potentially an excessive risk factor and appears inconsistent with SW stated goal of full cost recovery.

The combined effect of these proposals transfers significant financial uncertainties to the user.

### High Security to General Security Conversion

The SW proposal for different entitlement charges with respect to high security and general security entitlements in the Hunter requires clarification. Within the Hunter the factor is quoted as 1.3 (p120). In Table 10.3 of SW's submission indicate the Hunter Water Sharing Plan Ratio is 2.25 and propose to a price-weighting factor of 4.5 for the Hunter.

The Hunter Water Sharing Plan states that the volumetric conversion factor for high security to general security is 1/3. It is understood the conversion factor takes into account all relevant parameters for determining the respective benefits of high security to general security entitlements that would also be relevant to price. The reason for the difference in the conversion factor for volume and price requires clear justification.

### Supplementary Water Charges

The SW's submission fails to make reference to supplementary water charges. The proposed management and costing relating to supplementary water requires full explanation with appropriate justifications. Macquarie Generation is required to obtain on average 36,000 ML/year or half its water from this category of entitlement. To date Macquarie Generation has been charged at the variable usage rate for the supplementary water extracted.

The proposal to obtain 60% of revenue from usage charges in line with CoAG guidelines will result in significant cost increases for Supplementary Water.

SW does not incur any capital costs associated with the supply Supplementary Water. The capital costs associated with capturing Supplementary Water are borne by the user. The costs incurred by SW are limited administrative operating costs. SW has expressed concern about the potential inequitable price relationship between high security and general security water. This should logically be extended to Supplementary Water pricing. Without a comprehensive analysis of the costs associated with the administration of Supplementary Water, inequities may exist between the proposed charges of Supplementary Water and other entitlement categories.

### Full Cost Recovery

The SW proposed unconstrained pricing structure if implemented would result in increases in the total costs to Macquarie Generation for High Security entitlements of approximately 420% and an increase of 300% for General Security from 2005/06 to 2006/07. The impact on Macquarie Generation, assuming it were able to access its full annual entitlement of 72GL, 36GL of high security (major utility) water and 36GL of general security (supplementary) the cost would be approximately \$1.7 million and \$1 million respectively, or \$2.7m total. This is considered to be an excessive price jump. As a consequence Macquarie Generation supports a staged approach to full cost recovery.

Thank you for the opportunity to provide these comments.

Yours Sincerely,

JOHN NEEDS  
MANAGER / BAYSWATER