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Friday 18th November 2005

Mr Jim Cox
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
Level 2, 44 Market St
SYDNEY NSW 2000

Re: 2006-2009 Bulk Water Pricing Determination for the Macquarie Valley

Dear Mr Cox,

Macquarie River Food & Fibre (supported by the Macquarie Cudgegong Customer Service Committee) is pleased to have the opportunity to make a submission on Bulk Water Prices in the Macquarie Valley for 2006 – 2009.

We believe it is appropriate that we are given an opportunity to make an additional submission, following the completion of consultancies that IPART has commissioned in relation to the next bulk water prices determination.

You will note that our submission has been separated into two documents; the first being the main submission and the second, being Appendix 2: MRFF's 2004 submission to IPART.

We look forward to the opportunity to expand on the issues raised in our submission at a public hearing in Dubbo.

Yours sincerely

Chris Hogendyk
Chairman
Macquarie River Food & Fibre



Macquarie River Food & Fibre & Macquarie Customer
Service Committees' Joint Submission

to

IPART

On

State Water Corporation
and
Department of Natural Resources'
Proposals for Bulk Water Prices
for 2006 to 2009

November 2005

Prepared by Michelle Ward

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1 Executive Summary

Macquarie River Food & Fibre (MRFF) fully understands the nature of water pricing reforms, with the 1994 CoAG Agreement spelling out the desired endpoint. Despite the overall soundness of this agreement MRFF continues to have major concerns with its implementation. It can only appear one-sided to an onlooker to consider that we now face exponential cost increases under constantly redefined ‘full cost recovery’ targets along with a private sector rate of return, while on the other side there has been zero progress towards cost sharing between ALL customers and linked with this, zero mention of community service obligations. MRFF urges IPART to redress this imbalance in implementation of the CoAG water pricing principles and lists the following issues of concern from the State Water Corporation and Department of Natural Resources pricing proposals. MRFF also requests that IPART respects the effort and resources that have gone into this and previous submissions by providing a response to MRFF on the core issues we have summarised below.

1. **Use estimated at 1 standard deviation below Average Use:** SWC’s risk management proposal to calculate usage costs assuming use at 1 standard deviation below average use is an exorbitantly expensive and ineffective means of managing variations in annual use. The implications for the Macquarie are that SWC will be charging a 53% risk premium. A sensible alternative would be debt funding of shortfalls in income and investment of surpluses with the difference in interest rates and hence appropriate risk premium of about 1%.
2. **Cost Sharing Principles:** With CoAG 1994, followed by the NSW WMA 2002 and the recent National Water Initiative (NWI), bulk water is clearly defined as a valuable product to be used efficiently, with users paying full cost recovery for access. However IPART (to date), SWC and DNR have defined a list of users that aren’t also recognised as customers. We remind IPART that the officially acknowledged purpose of Burrendong Dam when it was expanded in the 1950’s was for flood mitigation, in addition to irrigation and provision of stock and domestic supplies. In 2005, there are now numerous higher priority customers than irrigators in the Macquarie, with the environment having a general security entitlement, with trading rights just like irrigators. MRFF urges IPART to revisit cost sharing principles so all beneficiaries and users are included as customers.
3. **Return on Investment:** MRFF acknowledges the CoAG 1994 Agreement’s intent that full cost recovery should include a return on investment. MRFF suggests a rate of between 2-3% would be appropriate, based on suggestions of up to 4% from CoAG (1994), and considering the annual dividend that capital growth shares deliver on the stock market. NSW’s Treasury’s demand of 7% return on investment is inappropriate because:
 - It is substantially higher than CoAG’s intent,
 - 7% is equivalent with private sector, higher risk, higher yielding investments that do not have long term capital growth potential. The bulk water infrastructure asset base will be appreciating in value delivering a capital gain to Treasury over time. This should be factored into any annual “dividend” and as is the norm in the share market, assets with longer term capital growth do not also generate strong annual dividends.
 - Customers should not have to pay commercial rates for use of substandard assets that cannot guarantee delivery to Macquarie customers during peak irrigation season demand.
 - Customers should not have to pay commercial rates for being classified as low priority in terms of delivery service, after other users who have more rights as determined by the Water Management Act 2002.

4. **Full cost recovery:** MRFF acknowledges the CoAG 1994 Agreement's intent that water prices must achieve full cost recovery. However we strongly oppose the constant widening of 'goal posts' that define full cost recovery for the Macquarie Valley. According to IPART's 2001-2004 determination the Macquarie reached full cost recovery in 2004. In addition, SWC's own earlier submission for this pricing round forecast prices half and one-third of the current proposals. How could it possibly be then, that we could be 150% below full cost recovery?
5. **Upper bound or unconstrained prices** are not akin to a commercial approach to pricing, where the focus would be to drive costs down, based on constantly improving efficiencies. Unconstrained prices contradict the 1994 CoAG Agreement, have distorted the application of full cost recovery principles, are excessive and demonstrate abuse of monopoly pricing powers and non-compliance with SWC's objectives related to regional development.
6. **Regulatory Asset Base:** MRFF supports the philosophy of debt funding as an efficient means of raising capital for SWC. However our concerns with the RAB proposal relate to shifting the 1997 'line in the sand' with respect to asset value but not carrying this through for legacy costs. There is inconsistency in SWC's proposed approach at present and MRFF requests that if IPART is to adopt a higher asset value (hence condition), then it must be accounted for transparently via a higher Government contribution into the legacy component of asset condition.
7. **Service Level Agreements:** MRFF has concerns with the SLA's regarding the accountability mechanisms on DNR and the method of costing specific information outputs and products that DNR is being paid to provide. In addition we believe the services requested by SWC should have gone through a public tender process as we are not convinced that DNR can provide the required service at the lowest cost. Also very concerning is DNR's a proposal to charge customers for the capital costs of obtaining the groundwater monitoring network required to provide information services to SWC, which will also be charged to customers (If customers fund the capital investment customers should own the information).
8. **Efficient Costs:** MRFF can see no evidence of a focus on cost efficiency for SWC or DNR. We expect to see examples of measures being taken to reduce costs and find efficiencies. MRFF requests that IPART requires both DNR and SWC to also demonstrate cost effectiveness (via cost benefit analysis) of any costs being passed on to customers. It is not adequate for IPART to be satisfied that costs are efficient, if the nature of the expenditure is questionable. In addition to SWC's general and high security price increase, we refer to the astronomical costs being proposed for groundwater and unregulated users due to the implementation of the monitoring requirements of the Water Sharing Plans. The costs are completely out of proportion with the resource base and small number of customers in the Macquarie.
9. **Government Cost Shifting of Regulatory Role:** As mentioned under cost-sharing principles, DNR is attempting to charge customers for the bulk of its WRM expenditure. This is asking individuals to pay for the general costs of Government bureaucracy and policy; what other Government Department does this? For instance NSW Agriculture doesn't pass its costs onto farmers. Again it is a case of irrigator customers being captives through the billing system. MRFF strongly believes that there are no grounds for DNR to seek to recoup costs from customers, as the only expenditure it incurs that is relevant to customers is captured in SLA's with SWC and accordingly paid for by customers through SWC. DNR does not have the same accountability requirements as SWC – it doesn't have an operating licence, with annual reviews and a requirement to demonstrate transparency and cost effectiveness. This means there is no consultative mechanism or operating license to be monitored against.

2 Introduction

Macquarie River Food & Fibre (MRFF) and the Macquarie Cudgegong Customer Service Committee welcome the opportunity to respond to State Water and the Department Natural Resources (DNR) submissions to IPART on bulk water prices for 2006 – 2009. The following document has been prepared by Macquarie River Food & Fibre in consultation with the Macquarie Cudgegong Customer Service Committee. The Macquarie Cudgegong Customer Service Committee has endorsed the submission (refer to Appendix 1: Macquarie Cudgegong Customer Service Committee letter).

The approach taken in this submission is to highlight major issues of concern, rather than responding to each of the points raised in DNR and SWC's submissions in chronological order. Sections 2 to 7 provide more detail on the issues summarised in the Executive Summary as well as listing some additional issues.

All issues listed in MRFF's submission to IPART in November 2004 are still pertinent to the upcoming pricing round, so this submission has been attached in full in Appendix 2 (separate file). MRFF has sought clarification and requested information from DNR and SWC on issues specific to their submissions and we have attached these questions and the status of responses in Appendix 3.

3 Cost Sharing

3.1 Cost Shares Based on Identifying All Customers

Table 1 below provides the analysis of the distribution of flows between customers in the Macquarie, based on 110 years modelled data from SWC. MRFF is proposing that these numbers should form the basis of the new cost sharing ratios, provided the flood mitigation purpose can be accounted for being classified as a surrogate customer.

Using these numbers, and not accounting for flood mitigation, all types of extraction for irrigation equate to 391 GL (or about 25% of the total distributions). MRFF has argued for some factual substance to support the principles behind cost sharing arrangements in recent submissions and puts this proposal forward for IPART to consider. We have requested in our previous two submissions that IPART revisits the cost sharing principles. We state again that we would welcome the opportunity to work with IPART and SWC to develop a robust and dynamic cost sharing calculator that reflects the actual benefit derived by different customers and the expense SWC incurs in servicing its different customers.

To provide some further justification of this approach we refer to environmental water, as one of the Macquarie's non-paying users. With the recent Water Sharing Plan, some environmental water is classified as general security (with the same access rules as irrigation general security water). A proportion of the environmental water is also able to be traded, and it is all able to be stored, carried over etc and is accessible on demand, incurring the same costs to SWC as irrigators' general security water. These points emphasise why environmental water belongs in the 'paying customers' category (See Appendix 2 for more discussion on cost sharing with respect to environmental water).

In addition to the above 'use' based rationale for sharing costs, SWC has stated that it has had increased costs due to requirements of the new Water Sharing Plans. The Water Sharing Plans are statutory plans for the benefit of the whole community, not just irrigators, and in most cases the

Water Sharing Plans are to the detriment of irrigators. Therefore, this is another argument for including a community service obligation element to the cost sharing ratios.

Table 1: Average Annual Water Sources and Distributions for the Macquarie

Run number: macwsp06.sqq

Averages are for the period 1/7/1890-30/6/2001

	Water Source of Distribution Category	Annual Average (GL)	Comment
Sources	Windamere Inflow	59	
	Burrendong Inflow	1061	
	Tribs inflow d/s Burrendong Dam	487	Includes gauged and ungauged inflows
Distribution	Windamere Storage net evaporati	14	
	Burrendong Storage net evaporati	42	
	Cudgegong Extraction GS	7	
	Macquarie Extraction GS	325	
	Cudgegong Extraction HS	3	Includes High Security irrigation and TWS
	Macquarie Extraction HS	23	Includes High Security irrigation and TWS d/s Burrendong Dam
	Cudgegong Extraction (Suppleme	0	
	Macquarie Extraction (Supplemen	33	
	Transmission and overbank losses - d/s Burrendong Dam	321	Main River Transmission Losses: Burrendong Dam to Macq Marshes
	Flows into effluent creeks - d/s Bu	351	Marshes) + (5% of Reddenville outflows) - (extractions from effluents: Burrendong Dam to
	Flows into Marsh	437	(Modelled flow upstream Marebone Break) - (total irrigation diversions d/s Marebone Break)

Unaccounted difference:sources n 51

Mass Balance check

Burrendong Inflows + Sources d/s Burrendong Dam - Distribution d/s Burrendong Dam	453
Burrendong Inflows + Sources d/s Burrendong Dam - Distribution d/s Burrendong Dam - Flows	16

3.2 Burrendong Dam – Flood Mitigation Role

A large part of the Macquarie’s infrastructure, storage and delivery costs are related to Burrendong Dam. MRFF has referred to the inequity of cost sharing arrangements in the Macquarie in each of its submissions to IPART, especially with regard to the beneficiaries of Burrendong dam. We note the reference to dam costs in SWC’s submission (P65) “many of SWC’s assets are not just for provision of water; they also provide flood protection to rural communities. Structures that provide both services are, in general more complex and expensive to operate and maintain eg: the flood warning systems require maintenance and testing”.

Some preliminary work has been undertaken by DNR’s predecessor, DLWC, investigating the consequences of Burrendong Dam failure, under an extreme flood event. The figures provided in Table 2 (earlier version provided in MRFF’s 2001 submission to IPART) are quite generalised, but serve to illustrate the relativities between economic impacts across beneficiaries.

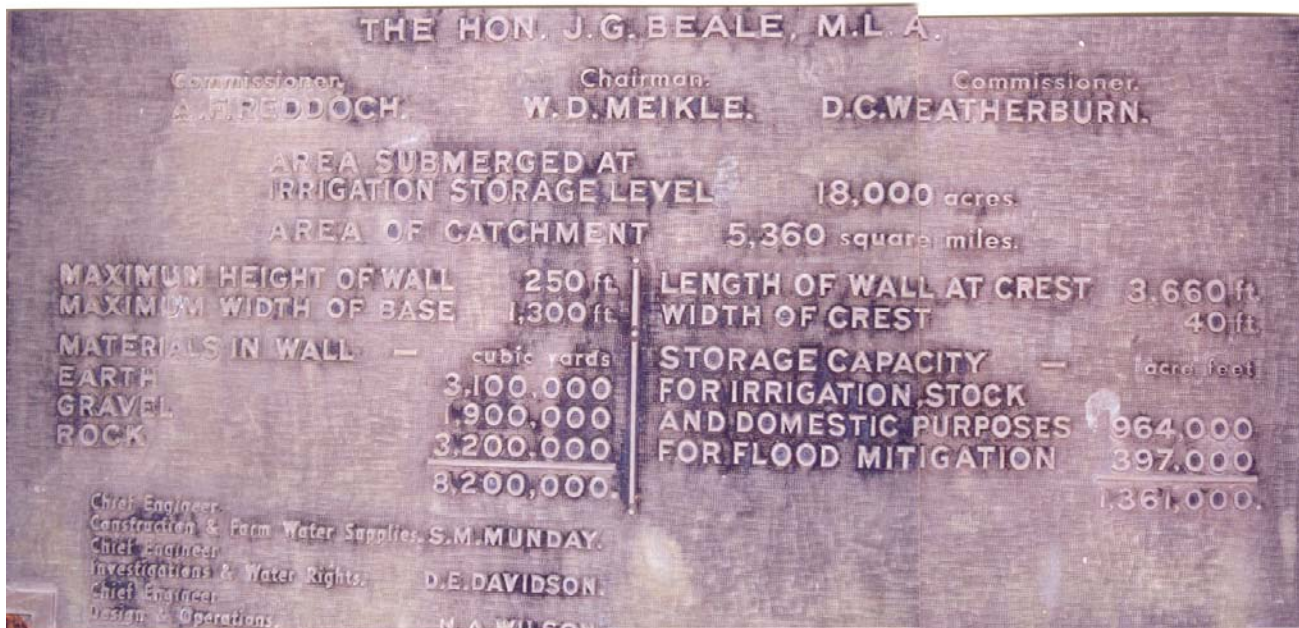
Table 2: Estimated Impacts of Burrendong Dam failure

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 2 demonstrates that flood mitigation is a very valuable role for Burrendong Dam to perform, with irrigation customers low on the list of beneficiaries. We understand that the Government is responsible for all OH&S upgrade work to reach 1997 standards and that SWC proposes that future costs be shared amongst beneficiaries. We support this, provided the intent is to recognise the major beneficiaries as outlined in Table 2. However all operating costs are currently being passed to irrigation customers despite the formally defined purpose of Burrendong, as per the obelisk that was unveiled at the Dam’s opening. Refer to the Picture below, to see that of the storage capacity of 1,361,000 acre feet (or 1,678,000 ML) which equates to 489,000 ML designated and operated solely for flood mitigation, with 1,189,000 ML designated for irrigation, stock and domestic (and more recently environmental) purposes. In addition to this significant volume of water storage designated specifically for flood mitigation, the low priority of general security irrigation water, below all other users (as discussed earlier) makes it all the more unjust to expect us to pay all costs. Hence IPART’s current position, (the dam is solely for the purpose and therefore benefit of irrigation) is not correct.

Picture 1: Obelisk at Burrendong Dam Unveiled at its Official Opening



3.3 Government Interference in Cost Sharing Ratios

Water Sharing Plans and the WMA 2002 have changed the priority of water. This needs to be reflected by IPART updating cost shares. All users are customers in MRFF’s view, however we note the contradictions in SWC’s recent submissions on this subject. In its 2004 submission SWC proposed an 80:20 split between irrigation customers and government on user’s share of costs. However in this submission the ratio has changed to 100% users pay, despite SWC on p21 classifying irrigation, industry and town water supplies as ‘customers’, while it lists environmental flows in 10 valleys and stock and domestic use to 15,000 licences as part of its primary role in delivering bulk water.

MRFF can make a confident assumption that there has been interference by SWC’s new owners (Treasury) in changing SWC’s position on cost sharing between its 2004 and 2005 submissions, so as to remove Treasury’s own cost sharing obligations. We believe this is one of the core reasons why IPART exists, to protect customers from monopoly abuse by Government, in setting prices and sharing costs.

3.4 Representation on CSCs

To strengthen our argument that all users need to be identified as customers, we refer IPART to the make-up of the new Macquarie Customer Service Committee. The representation demonstrates that all users are given rights to be consulted by SWC and have input into SWC’s business planning, TAMP and other fundamental operations (see Table 3 below). To exacerbate the inequity with the current cost sharing arrangements, there is a cost to running the customer service committees and this is paid for by only one of the customer groups – irrigators.

Table 3: Macquarie-Cudgegong Customer Service Committee Representation 2005 – 2008

Groups with CSC Representation
Riparian irrigators from regulated streams (upper Macquarie)
Riparian irrigators from regulated streams (mid Macquarie)
Riparian irrigators from regulated streams (lower Macquarie)
Riparian irrigators from regulated streams (Cudgegong)
Riparian irrigators and S&D from unregulated streams
Irrigators from Irrigation schemes & corporations
Stock & domestic water users - Macquarie
Stock & domestic water users – Macquarie
Stock & domestic water users – Cudgegong
Local Government
Industry
Groundwater irrigators
Environmental Flow management
Catchment Management Authorities

3.5 The Community Consultative Committee

SWC’s operating licence requires it establish a Community Consultative Committee to “enable community involvement in issues relevant to the performance of SWC’s obligations under this Licence.” The membership of the Community Consultative Committee is even broader than the Customer Service Committees, requiring representation from irrigation customers, environment groups, basic water right holders, regional business and consumer groups, Catchment Management Authorities and local government.

MRFF has raised concerns during consultation regarding the Operating Licence of the onerous reporting and consultation requirements being placed on SWC. These requirements are much greater than a public, commercial business and of course incur significant expense to SWC. Now that SWC is faced with these onerous requirements MRFF raises with IPART the issue of cost sharing arrangements for functions such as the Community Consultative Committee. Clearly this committee is not established for the benefit of irrigation customers, but to meet a Government requirement to provide the broader community with opportunities for input into SWC’s business. This will not only be an expensive Committee for SWC to operate but is likely to result in resource hungry and contentious outcomes, given its nature.

The Community Consultative Committee should be funded by Government through a Community Service Obligation, as it has only come into existence due to Government requirements and is for the benefit of the whole community.

Recommendations: MRFF requests that IPART revisits cost sharing principles and ratios with regard to incorporating the significant flood mitigation beneficiary in the Macquarie as well as adding the entire list of users to the SWC’s customer profile (as per the proposal above). We note the increased need for this review, given SWC’s new owner and consequent changes we’ve seen in SWC’s approach to cost shares. In addition MRFF requests that IPART recognises the need for Community Service obligations to fund those areas of SWC’s activity that are meeting Government requirements to provide public (whole of community) benefit, such as the Community Consultative Committee.

4 Water Prices

The water prices proposed for the Macquarie are listed in Table 4 below. We note the inability of DNR to provide valley-based costs to us for use in our submission despite written requests.

Table 4: State Water and Department of Natural Resources Pricing Proposals to IPART for Cudgegong Macquarie

REGULATED	CURRENT PRICES (\$/ML)			PROPOSED 2006/07 (\$/ML)		
	Fixed HS	Fixed GS	Usage	Fixed HS	Fixed GS	Usage
State Water	3.66	2.81	3.79	12.96	3.45	13.08
DNR	.90	0.70	0.94	2.96 *	2.96 *	
TOTAL	4.56	3.51	4.73	15.92	6.41	13.08

* Note: DNR price per ML to be confirmed - DNR has only quoted total cost, so we have estimated price/ML.

GROUNDWATER	CURRENT PRICE (\$/ML)	PROPOSED 2006/07 (\$/ML)
Entitlement	1.37	10.53 *
Usage	0.71	

Note: Price per ML to be confirmed - DNR has only quoted total cost, so price/ML has been estimated.

4.1 Full Cost Recovery

MRFF acknowledges the CoAG 1994 Agreement's intent that water prices must achieve full cost recovery. However we strongly oppose the constant widening of 'goal posts' that define full cost recovery for the Macquarie Valley. According to the 2001 – 2004 Pricing Determination, the Macquarie had reached full cost recovery in 2004. How could it possibly be then, that we are facing increases in the order of 150% for the next round of pricing? If there are indeed substantial cost increases due to the new corporatised structure, we need to be convinced that the extra costs that are driving prices up so rapidly are efficient and cost effective.

We are sceptical about the grounds for the cost increases especially because of the differences between SWC's 2004 submission and its 2005 submission, both the 2005-2008 pricing period. The forecast costs for 2006/7 for High Security entitlements have doubled and have almost tripled for usage between the two submissions, despite SWC presumably having the same cost data available for both submissions. Therefore unconstrained prices and the move to full cost recovery cannot explain the difference between 2004 and 2005 on their own. Our own analysis indicates that the '1 standard deviation below average use' approach is a significant driver of costs in the Macquarie - refer to comments under this section regarding the inefficiency of this approach.

The MJA –Cardno report reinforces our concerns, with the following extract demonstrating the problems with SWC's cost forecasts:

20. *“State Water’s integration of experience from four previous IPART reviews of bulk water delivery, should have resulted in an expenditure proposal from State Water that provided reliable information on the cost of executing robust, defined business strategies that would enable efficient discharge of legal, regulatory and social obligations, and the efficient delivery of services to customers.*
21. *However, the proposal that State Water submitted to IPART in November 2004 did not comprehensively identify specific obligations, nor define business strategies that would meet those obligations, nor provide robust information on the cost of doing so, nor comprehensively address impacts on service standards. Nor did State Water’s submission adequately explain why forecast costs should rise substantially compared to outcomes of the current regulatory period when there was o equivalent substantial change in obligation or service standard.”*

A final quote which captures our concerns regarding DNR and SWC pricing proposals perfectly and relates to sections below on Efficient Costs and DNR 'Services' to Users, is from the NSW Government Pricing Tribunal's (now IPART) December 1995 Issues Paper on the Pricing of Bulk Water Services in NSW, (p2)

“Consumers should be able to choose the level of service they want. They should not have to pay for services that are neither necessary nor wanted. In the absence of market forces, the Tribunal must scrutinise levels of service and investment decisions to ensure water agencies work to make productivity gains and pass these on to irrigator customers”.

Recommendation: We request that IPART adheres to its 2001-2004 determination defining actual full cost recovery for the Macquarie unless it can demonstrate the factors that have added to costs to such an extent that the Macquarie prices need to be doubled and tripled to reach the new full cost recovery bar. Once IPART has made a determination on actual cost recovery levels, these must be the levels that SWC works from in future.

4.2 Unconstrained Pricing

The following tables show the increases faced in the Macquarie due to unconstrained pricing.

Table 5: Percentage Change in Customer Bills due to Unconstrained Prices

Percentage change from previous year						
TOTAL BILL	2006/07		2007/08		2008/09	
	HS	GS	HS	GS	HS	GS
Macquarie	249.7%	117.0%	1.9%	1.9%	0.0%	6.9%

Source: SWC submission to IPART

Table 6: Change in Amount of Customer Bills due to Unconstrained Prices

change in dollars from previous year						
TOTAL BILL	2006/07		2007/08		2008/09	
	HS	GS	HS	GS	HS	GS
Macquarie	2,446	3,383	65	118	1	440

Source: SWC Submission to IPART

From Tables 5 and 6 it is clear that there are massive increases with the unconstrained pricing approach. MRFF has the following concerns with Upper bound (unconstrained) pricing:

- Upper bound pricing is in conflict with the 1994 CoAG agreement and takes a much more aggressive stance than recommended in the NWI.
- SWC’s principle objectives include concern for regional development and a sense of social responsibility (SWC p18); “to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates, and to exhibit a sense of responsibility towards regional development...”. Such an aggressive and blatantly excessive approach to a pricing proposal indicates little concern for impacts at the regional economy level which may be a case for non-compliance with SWC’s objectives.
- To take such a pricing approach demonstrates abuse of monopoly powers, especially when is in contrast to the expected focus on driving costs down and when it is applied in combination with revenue smoothing strategies such as higher fixed price ratios and calculation of higher usage unit by estimating annual use is 1 standard deviation below average use.
- SWC is attempting to shift customer and IPART focus onto options for affordability of their upper bound pricing. MRFF sees this as an attempt to divert our attention away from justifying the actual pricing levels and rationale driving them. As previously stated MRFF does not argue with full cost recovery as a principle but clearly opposes ambit claims for increases in prices.

Recommendation: MRFF requests that IPART considers affordability options as secondary to the issue of being convinced the actual prices proposed are legitimate, efficient and effective. MRFF also requests that IPART instructs SWC that lower bound pricing is most appropriate especially if SWC is able to justify price increases on the basis that prices are still under full cost recovery.

4.3 One Standard Deviation below Average Use:

SWC's risk management proposal to calculate usage costs assuming use at 1 standard deviation below average use is an exorbitantly expensive and ineffective means of managing variations in annual use, simply because it is far too conservative. SWC is presumably operating in a competitive environment, as per its principle objectives which include (SWC p18) "to be a successful business and, to that end: operate at least as efficiently as any comparable business...", the focus of which should be driving costs down, yet MRFF is able to come up with more cost effective options for managing variability in use.

In applying the '1 standard deviation below average use' approach across the state, SWC has omitted consideration of the drastic differences in reliability of water between valleys. SWC's approach hits the Macquarie extra hard, given the variability in use, explaining almost 50% of the increases in costs. This is because total usage costs are recovered across 208,117 ML, almost 180,000 ML less than the average annual use for the valley and with the impact of placing a 53% risk premium impact on usage charges. One alternative MRFF suggested in the Executive Summary is for SWC to base usage unit costs on average use estimates, debt fund any shortfalls (for example the cost might be 5% interest on borrowings), invest any surpluses (at a return of 4.5%) and charge customers any cost resulting from a net shortfall (more likely to be around 1% risk premium). This is in line with all SWC's logic regarding the benefits of the RAB (debt funding) approach to covering the capital costs of running its business.

In addition to our concerns about the expense to customers of this proposal, SWC provided no information in its submission about what it will do with the thousands of dollars in surplus usage charges it collects in years when use is average or above. In fact SWC refers to the potential to become inefficient if it had excess cash in store as one of its arguments in criticism of annuities rather than debt funding through the Regulatory Asset Base approach (SWC p57):

"The annuity can result in excess cash that itself can driver the business to inefficiencies".

When we questioned SWC (pers comm. 14 Nov 05) regarding surplus funds their response was

"SW invests money in T Corp. So surplus funds would be invested in T Corp for years when water sales resulted in under-recovery. SW is proposing to IPART that either under recovery or over recovery would be adjusted in the next round of pricing."

Recommendation: This issue is one of the most important for the Macquarie and MRFF requests that IPART rejects the '1 standard deviation below average use' proposal (in the Macquarie if not across the whole state) as too conservative and expensive and instructs SWC to calculate usage unit costs based on average use, with debt funding as the means of covering shortfalls.

4.4 Return on Investment

As stated in the Executive Summary, MRFF acknowledges the CoAG 1994 Agreement's intent that full cost recovery should include a return on investment with suggestions of 4% return. NSW's Treasury's demand of 7% return on investment is unrealistic and is excessive even from the most competitive Australian business's perspective. Further detail on the justification for MRFF's position is provided below:

- If CoAG suggested 4% may be appropriate and customers are facing a period of step price increases in order to reach full cost recovery, this would be strong justification for Treasury not attempting to be too greedy in the current pricing determination.
- 7% is equivalent with private sector, higher risk, higher yielding stocks that do not provide long term capital growth opportunities. Bulk water infrastructure does not fit this category of investment. The asset base will be appreciating in value delivering a capital gain to Treasury. This should be factored into any annual "dividend" and as is the norm in the share market, assets with longer term capital growth do not also generate strong annual dividends.
- Macquarie customers can currently expect the likelihood of a shortfall in their water requirements being met at critical, peak demand periods of the cropping season due to substandard infrastructure and valve capacity limitations on the volumes able to be released from Burrendong Dam. (we note SWC plans to upgrade valve capacity at the cost of customers) Again if this scenario is likened to the private sector, an underperforming company does not generate competitive returns. The difference with SWC is that the customers are captive and so Treasury is still able to demand a higher rate of return than the condition and value of the assets commands.
- Despite the rhetoric in DNR and SWC submissions interpreting the National Water Initiative as giving irrigators rights and therefore the full responsibility for charges, there has been changes in prioritisation of SWC's customers in the opposite direction. Irrigation customers are now classified as lower priority in terms of delivery service, than all other customers and beneficiaries (flood mitigation, town water supply, stock and domestic and environment), as determined by the Water Management Act 2002 and implemented in the Macquarie Cudgegong Water Sharing Plan. Therefore it seems inappropriate for Treasury to charge the lowest priority customer group the entire cost of a very high rate of return.
- Not to be ignored is the huge task ahead of SWC in shifting its business to a position of being competitive and efficient, especially given its own admissions of the run-down nature of infrastructure and the completely inadequate information and business management systems that it has taken on as a newly formed State Owned Corporation. It would therefore seem reasonable for Treasury to provide for a decent transitional period where a rate of return requirement may even be waived, until SWC gets 'onto its feet'. We note that SWC still hasn't issued the 04-05 accounts which indicates some major internal issues in terms of its efficiency in reporting.
- A rate of return of 7% disregards the severe opportunity cost for Government (and community) of not investing in rural water supply infrastructure such as Burrendong Dam which was also built with the purpose of flood mitigation (refer to quote provided below).

In its December 1995 Issues Paper on the Pricing of Bulk Water Services in NSW, the Government Pricing Tribunal (now IPART) recommended on p19, that:

"the target rate of return will depend on whether/how public goods and CSOs are valued and paid for by Government", and stated that "Where investments in the water industry have been made for other than economic reasons, and a positive rate of return is unlikely to be achieved, the Expert Group says that if those currently benefiting from services provided by the investment are prepared to meet the costs of supplying these services in the future, but without a rate of return on assets, the minimum financial viability test adopted by COAG would be satisfied".

In this submission MRFF has stated that customers are willing to pay full cost recovery and if necessary a conservative rate of return, but as we have reminded IPART in numerous submissions, our major asset, namely Burrendong Dam, was not built solely for 'economic reasons' given its purpose of flood mitigation, so therefore the above logic should apply.

Recommendation: MRFF requests that IPART makes comment on an appropriate rate of return for NSW Treasury to expect to earn on its assets. We suggest between 2-3% is appropriate with the rate of return requirement not commencing until 2008/09, to give State Water a realistic period in which to pull the business into an efficient position.

4.5 Efficient and Effective Costs

With regard to SWC's costs MRFF has already raised concerns regarding the actual grounds for any increase in costs for the Macquarie, given that we had reached full cost recovery in 2004. In contrast to the increases, we would have expected to see examples of measures taken to achieve cost savings and efficiency gains. Understandably there will be some additional costs related to corporatisation that may mean a slightly higher new cost recovery level has to be set. However doubling entitlement fees and tripling usage fees cannot be efficient in our view. In addition MRFF stated previously that SWC still hasn't issued the 04-05 audited accounts, which raises concerns about its ongoing ability to review actual and forecast costs and indeed make accurate forecasts without knowledge of actuals.

4.5.1 Staff Numbers

In addition MRFF has concerns about the extra staff being proposed, both by DNR and SWC. Customers have not been consulted in regard to whether they require the extra service that extra staff would presumably deliver and in the Macquarie no extra staff have been requested by customers. Increasing our concerns about the efficiency of the proposed increases is the fact that neither DNR nor SWC have demonstrated where the extra service would be delivered as a result of extra staff.

With respect to DNR staff increases, from its submission:

"Most of the increase in WRM costs is associated with redirecting 71 equivalent full time positions within DNR to its WRM function based on 2004/05 levels." "Human resources account for approximately half of the WRM cost based (54%). Proposed direct full time staff requirements for 06/07 are regulated rivers: 133, unregulated rivers 103, groundwater 75."

We note that this increase is proposed at the same time as DNR is shifting much of its remaining Water Sharing Planning responsibilities onto CMAs. We know DNR has had its budget drastically cut by NSW Treasury and so what we are seeing is a desperate attempt to find salaries for its existing staff. This is not the responsibility of irrigation customers.

These numbers show the complete absence of cost effective analysis, or cost reflectivity of the vastly different value to extractive users of the different water sources. They also demonstrate that irrigation customers are being charged for DNR's operating overheads.

In summary we believe staff should be considered variable costs in SWC's business and DNR should not be seeking to make customers pay the salaries of existing staff that have not and will not ever be working to deliver benefits to customers whilst employed by a regulatory government agency.

4.5.2 DNR Changes in Product Coding

DNR is proposing what can only be a shift away from accountability with regard to service provision as they have changed from product / output codes to a system of ‘activities’ or inputs. DNR argues that input based coding more closely matches costs. MRFF is concerned about the lack of ability for SWC, customers or IPART to assess any measure of performance or value for money with this change in coding. An analogy is a consultant (or lawyer) who is given free rein to accrue hours worked on a project till the project is complete, charging for the total hours. This is also called ‘do and charge’ and is usually more expensive than the alternative of being required to quote up-front for the final outcome or product to be delivered. We attempted to research how the change in coding affects DNR’s SLA’s with SWC, given that State Water (hence customers) will pay for an outcome and DNR is charging based on activities. However the SLA’s are commercial in confidence and DNR has not provided any answers to our questions, so we are unable to investigate the accountability and performance assessment mechanisms in the SLA.

In addition to our concerns about further shifts away from accountability with the change in coding, there is the issue of the product coding that has been used to date. We have requested from DNR and have not been given audited proof that money collected from customers to date has been spent on the codes that it was collected under. We anticipate that given the under-expenditure in 2004/05 by DNR there will be surpluses collected against codes that will no longer exist, which in our view, should be returned to customers

Other concerns with DNR’s proposal are related to the break-up of the proposed activities. There is no logical basis as to how costs are to be built up, there is poor justification of cost increases and many of the activity groups don’t fit within their allocated categories.

The fundamental problem with DNR’s pricing proposals is that DNR is not about service to customers, it does not have customer service officers and it does not have a role in providing benefits to one sector of the community over another. Its role is one of regulation and bureaucracy, for the benefit of the entire community and this should make it clear that it is Government’s responsibility to fund DNR activities.

Recommendation: There is a fundamental, unresolved issue that IPART needs to address and that is to make a ruling on the role of Government in the context of water prices. DNR will continue to change definitions and invent activity codes so complex that efficient costs are impossible to determine, unless there is a determination which defines clearly what DNR’s role is (and hence right to charge customers). In addition to these comments MRFF notes that it is opposed to the change in coding due to our concerns regarding transparency and accountability. We request that any surpluses collected against product codes be returned to customers and repeat our requests for access to audited statements itemising expenditure to date against product codes.

4.5.3 Customer Service:

MRFF has noted previously in this submission (and has also quoted MJA-Cardno’s review) in raising its concerns regarding the absence of demonstration of increases in customer service where there are increased costs proposed. For instance in SWC’s submission (P52): despite the headings in the Service Delivery Framework: “Industry & Government Opportunities & Threats” and “Customer and Broader Societal Expectations”, there is nothing about industry opportunities and threats and customer expectations in the areas of focus under the headings.

So despite it being referred to as ‘service delivery’ there is nothing about customers or industry in the drivers behind the strategy that we can find in SWC’s submission. In essence the words aren’t enough to deliver a customer service focus if the intent is not there.

Please refer to issues raised under DNR Services to Customers for our DNR related comments.

4.5.4 SWC Actual to Forecast Costings

MRFF is concerned with the findings of MHA-Cardno review May 2005 and cannot see evidence of improvement in SWC’s recent submission regarding cost forecasting. MJA-Cardno’s review states:

“key findings included a number of instances where State Water’s actual approach to cost forecasting for Opex, business evaluations, customer service, cost or timing differed significantly to its stated business processes and the approach documented in IPART submissions...”

- *State Water is not able to track, control or manage actual expenditure against forecasts or project costs against budget, which is very likely to lead to inefficient outcomes. (again we note that the 04/05 financial report is still not available)*
- *Nor did State Water demonstrate that it linked forecast expenditure to coherent business evaluations based on robust estimates of asset condition, customer service, cost or timing – despite this being a stated feature of State Water’s business processes.*
- *State Water has not provided sufficiently detailed explanations to defend the forecast levels of (increased) expenditure. Nor has State Water identified or taken into account benefits flowing from corporatisation that should result from clearer commercial focus by managers and its newly appointed skills-based board.*

The information and explanations provided by State Water failed, IN MJA-Cardo’s view, to adequately link increased costs with actions that were necessary to improve generally satisfactory service delivery or actions to address outstanding or new obligations.”

In addition the MJA-CARDno review concluded that

“the variation in State Water’s estimated construction cost of options for major projects listed in TAMP2004 is too great for the estimated costs to be considered ‘efficient’.”

MRFF is concerned to know how IPART is pursuing the issues raised in MJA-Cardno’s review. SWC addressed some of the concerns raised, but there are many outstanding issues that need to be addressed in our view.

5 Regulatory Asset Base

Firstly MRFF acknowledges that it supports the philosophy of debt funding as an efficient means of raising capital (and in fact we strongly urge SWC to adopt a debt funding approach to variations in annual use – see earlier comments on the 1 standard deviation below average use approach.)

From SWC’s fact sheet on the Regulatory Asset Base, it states: “IPART adopted an annuity approach in determining capital costs in previous determinations for the former Department of Land and Water Conservation. This led to an asset annuity of \$18 million as at 30 June 2004.

The annuity approach calculates an annual capital return (ie capital annuity charge), based on the net present value of a 30-year projected capital expenditure program. It is likely that the adoption of the annuity approach contributed to the decision to write off pre-1997 assets for pricing purposes.”

This statement touches on an issue of concern to MRFF is altering the RAB from the IPART written-down 1997 value. MRFF believes there is an inconsistency in having a ‘line in the sand’ in terms asset values for determining Government’s responsibility for legacy costs, but having a different (much higher) line in the same in terms of asset value for calculating the Regulatory Asset Base required to cover the capital costs of the new corporatised business.

MRFF does not claim to understand the detailed workings behind either of the asset values, but believes that there must be a transparent process of accounting for the increased RAB asset value by adding to the value that the assets are considered to be in 1997 (via an increased legacy responsibility from Government).

We defer our final opinion on the RAB until we have had a chance to review the consultancy work that we understand NSWIC is arranging to have undertaken on the RAB.

5.1 Thermal Pollution & Other Legacy Costs

MRFF is concerned that DNR will continue to attempt to shift costs to SWC (and ultimately onto customers) by reducing its exposure to legacy costs. IPART has made a ruling that Government is responsible for 100% of the costs of bringing assets up to the condition required to meet 1997 community standards of environmental compliance, OH&S and other relevant compliance standards.

Thermal pollution is one such area of environmental compliance where DNR is attempting to shift responsibility for required upgrades of Burrendong Dam. However thermal pollution was a known flaw and recognized problem in the design of these dams in 1997 and so should be a legacy cost.

Recommendation: MRFF recommends that IPART requires DNR to fund an independent study reviewing the actual 1997 condition verses the required condition for asset handover. This study would then form the basis of clarifying DNR’s responsibilities and remove the expense and time required in customers having to continually provide arguments against DNR in its attempts to shift legacy cost responsibilities.

6 Service Level Agreements

We believe that those services SWC is accessing at a fee from DNR, such as hydrometric information, are not being provided efficiently or cost effectively, as DNR is a sole supplier with no efficiency drivers and no opportunity for SWC to query costs. We note that there has been no justification provided to customers of details such as why the number of gauging stations determined is required (we note from the MJA-Cardno review that Sunwater operates Queensland’s water delivery with less than half the number of gauging stations that DNR and SWC are proposing.) From the MJA-Cardno report:

49. *“MJA-Cardno also found that “State Water had not established an ‘efficient’ basis for these services (stream-gauging services). It is MJA- Cardno’s view that State Water should have*

sought preliminary service offers from private service providers or determining its own internal costs to undertake this activity.”

MRFF also supports the continuing requests of SWC that it is much more suited to having all hydrometric assets and responsibilities transferred to its ownership, given that hydrometric information is part of SWC’s core business and it has the imperative to be efficient in its collection where DNR doesn’t. SWC could then charge DNR for any hydrometric information DNR requires rather than vica versa.

MRFF requests that all the issues raised by MJA-Cardno in relation to the SLA’s are addressed prior to their approval into the next pricing determination. These issues include:

- a) The number of DNR gauging stations that will be transferred to State Water;
- b) The number of gauging points that are duplicated by State Water and DNR (given that it is not efficient to duplicate investment in stream gauging capability);
- c) And the number of gauging points that have been, can be, or will be incorporated into State Water’s SCADA system (given that it is not efficient to invest in SCADA capability if it does not yield reliable and useful information that will improve operational efficiency).

MRFF has some major concerns regarding groundwater monitoring that are relevant to the SLA, but are discussed under DNR Services to Users below.

Recommendation: As stated above, MRFF requests that IPART reviews the efficiency gains to be offered by transferring hydrometric assets to SWC. In addition we request evidence that the MJA-Cardno concerns have been addressed adequately, given that we have requested access to the SLA’s and this has not been permitted due to their ‘commercial-in-confidence’ nature. MRFF also requests that IPART reviews the SLA’s and determines whether an open tender may lead to a more efficient means of meeting SWC’s information requirements.

7 DNR ‘Services’ to Users

7.1 The Definition of WRM

MRFF is extremely concerned about DNR’s attempts to change in definition of WRM costs. DNR’s submission states that it wants to replace the IPART definition of WRM services. IPART 2001:

“those where the benefits to extractive users are insufficient on their own to justify the costs of the activities”.

The proposed DNR submission spins the services to be largely for the benefit of extractive users.... With “implications for cost recovery and user shares.” This must appear to IPART as it does to customers; as just another attempt to use any means (including changing definitions) in order to shift cost responsibilities.

If there is any change in definition, it should be on the basis of fact, in this case the facts would have to demonstrate a significant change in the nature of Water Resource Management, that suddenly mean that there is a much greater level of service and benefit being extracted by customers. From

customer's perspective MRFF can assure IPART that this proposition by DNR is very creative to say the least, and a long way from accurate in our view.

Some relevant evidence from DNR's submission that strengthens our view that redefining WRM costs is just a 'cost-shifting' exercise is the noted lower WRM costs in 2004/05, which according to DNR was due to staff shortages. Macquarie customers certainly did not suffer due to any reduction in WRM activity – which is evidence that WRM activities are not required to be expanded by irrigation customers and are not for the benefit of irrigation customers. Our view is that WRM expenditure is about the implementation of Government policy and legislation, which is for the public benefit. Another concern regarding WRM costs is that they should remain valley-based, particularly if they are meant to be related in some way to actual costs being charged.

Recommendation: MRFF requests that IPART adopts the following position in the upcoming determination: SWC is a business operating to provide services and benefits to its customers (including irrigators). Whereas DNR is a regulatory body undertaking a policy implementation role for the benefit of the broader community, as is reflected in IPART's earlier definition of WRM costs.

7.2 Groundwater Monitoring

MRFF has several concerns regarding groundwater monitoring proposals by DNR and the SLA with SWC. Our first concern is related to DNR's submission, which states (p73) that 100% of Code C12-03: (Groundwater monitoring network for WSPs & extensions & surveillance & salinity networks) costs are being passed through to customers. We are clear on the fact the DNR's SLA with SWC relates to charging customers for the information that will be generated from this monitoring network. Therefore it would be inappropriate if our understanding is correct, that DNR is also planning on recouping the entire capital cost of the monitoring network from customers. This is the scenario that is plausible when SWC relies on DNR for the information provided in SLA's, without a competitive tendering process and when DNR has no checks and accountabilities placed on them to be efficient or competitive in their operations. (We note that we requested in writing to DNR, clarification on this issue and as expected, we have received no further reply apart from notification that we would be getting a corporate response).

A second concern is related to the same arguments MRFF has made many times before regarding DNR's mismanagement of groundwater resources in the Macquarie. The recent history of DNR (and its predecessor's management) clearly demonstrate that DNR is avoiding its own responsibilities and also avoiding being accountable for its own mistakes by passing monitoring costs onto customers. Monitoring to determine sustainable yield was conducted in the 1990's. This sustainable yield information has not been updated and it was irrigators who raised the alarm with the then DLWC in the mid 1990's that they were continuing to issue new licences beyond the sustainable yield of the aquifers. So DLWC over-allocated licences as recently as the mid 1990's despite knowledge of the CoAG 1994 agreement and sustainable yield information. In addition to this incompetence DLWC contradicted its own policy at the time by issuing new licences in sandstone aquifers.

It is up to IPART to recognise the inequity that groundwater customers face with DNR's pricing proposal. Not only have customer's had their security of access eroded due to DNR over-

allocations, but now DNR is charging customers for monitoring that is part of its own core responsibility as the department charged with regulating use of natural resources.

Recommendation: MRFF requests that IPART reviews the groundwater monitoring costs to determine if DNR is charging customers the full capital costs of networks it will then be using to generate information which it will sell to SWC. If this is the case, DNR's SLA with SWC should be cancelled with SWC going to a public tender for the information it requires.

8 Appendix 1: Macquarie Cudgegong CSC Letter of Support

Friday 18th November 2005

Mr Jim Cox
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
Level 2, 44 Market St
SYDNEY NSW 2000

Re: 2006-2009 Bulk Water Pricing Determination for the Macquarie Valley

The Macquarie Cudgegong Customer Service Committee writes to express our support for the submission prepared by Macquarie River Food & Fibre in consultation with our committee.

As raised in the submission we have concerns with the lack of evidence of a focus on efficiency for SWC. Also we express our concern at the proposed increases, given our role to have input into any decisions regarding increases in service delivery to customers and any associated increases in costs.

In previous submissions we have had to emphasise the lack of data and ability of SWC and DNR to provide detailed breakdowns of expenditure. We note that SWC is improving in this area, however it is not adequate that the Customer Service Committee is yet to be presented with the Audited 04/05 Financial Statements for the valley.

Despite these concerns we do acknowledge the value all customers gain from the Customer Service Committee process in the Macquarie and look forward to working with SWC to improve the business in the future especially through the valley business planning process which starts in December 05.

Yours sincerely,

Michael Bennett, Chairman
Macquarie Customer Service Committee

9 Appendix 2: MRFF 2004 Submission to IPART

(Appendix 2 is provided in a separate file)

10 Appendix 3: Information Requests to DNR & SWC

10.1 Questions to DNR from MRFF

Tues 1 November

Dear Axel

MRFF are currently working on our IPART submission in response to State Water and DNR's submissions.

It would be most helpful to have further information from DNR which I am hoping you are able to provide.

We have an MRFF IPART sub committee on Thursday morning this week. Would it be possible to provide us with some assistance on the following by Thursday morning for discussion at our meeting?

Initial questions:

- Has DNR done any cost benefit analysis on WRM activity?
- There are 71 extra positions across regulated, unregulated and groundwater. Why so many?
- Why is there so many staff on unregulated and groundwater given it is such a small component of irrigation value?
- With the shift from product to activity input code, how does the system activity based coding affect SLA's (Service Level Agreement)? How is it going to work? How will it be outcome driven?
- Is the number of gauging stations necessary? How did DNR arrive with the number of 800 gauging stations? Has DNR done an assessment on the number of gauging stations required?
- On page 13 of the DNR submission at the very top of the page it talks about the WRM costs falling in 04-05 by 'about \$4M from the previous year' and the reasons are given in two dots points? Do they apply to the Macquarie? What didn't happen then that requires more staff now? There is no evidence to suggest it was on processing licenses in the Macquarie.
- Are you able to give more details on the expenditure and staffing in the Macquarie?

Axel it is highly likely we will have further questions as we work through the DNR submission.

Many thanks
Cheers
Meg

Wed 2 November

Dear Axel

RE: DNR Macquarie IPART Submission.

Macquarie River Food & Fibre (MRFF) IPART Sub Committee has requested information on the following:

- An audited copy of reconciliation records relating to all WRM receipts against expenditure from 2001 forward. Our understanding is DNR are obliged to spend all the revenue generated from past determinations against product codes and we would like to see the audited evidence of this.
- To ensure the funds paid by entitlement holders will be effectively used what accountability mechanisms will be in place?

- Based on DNR's assumptions that WRM costs largely benefit users how will expenditure decisions be equitable? Do extractive users get a say?
- What is the justification in terms of increased output/service/productivity to customers driving the number of required additional staff? We would like to see the calculations driving the numbers of extra staff.

Many thanks
Meg

Wed 2 November

Dear Axel

Below is another request from the MRFF IPART Sub Committee for information on DNR's IPART submission.

Please provide the breakdown of DNR's WRM costs in terms of \$/ML for the Macquarie for

- Regulated
- Unregulated
- Groundwater

We would like to see the costs in terms of \$/ML for the Macquarie for 04/05 and also the proposed prices for 06/07 07/08 08/09

Macquarie:	Water Price \$/ML for WRM			
	05/06	06/07	07/08	08/09
Regulated				
Unregulated				
Groundwater				

Many thanks
Meg

Mon 7th November

Dear Axel

The following are more query on the DNR IPART Submission

Re Code: C12-03: Groundwater monitoring network for WSPs & extensions & surveillance & salinity networks.

- Are any costs related to this code being charged to the Macquarie in DNR's submission?
- If so what are the costs for the Macquarie and are these costs being passed through to customers?

The table on p73 of DNR's submission indicates that 100% of these costs are being passed through, if I understand correctly.

However I would have thought that if customers were being charged for the information being generated from the network through the SLA with State Water it would not be appropriate to also charge for the capital cost of the monitoring network? - any comment?

Cheers
Meg

10.2 DNR Response to MRFF

From: Jill Sands [mailto:Jill.Sands@dipnr.nsw.gov.au]
Sent: Friday, 4 November 2005 3:40 PM

To: meg.bennett@mrff.com.au
Subject: IPART Questions
Hi Meg,

Axel has asked me to be in touch with you in relation to the IPART Questions you forwarded to him last week. The Region has been advised by Head Office that given the number of questions being logged in relation to the IPART submission and the fact that the submission was compiled for the whole department, a decision has been made to answer all enquiries with a corporate response. Your query has been logged with Head office and will be responded to in the near future. Please give me a call if you require any further assistance.

Regards
Jill

Jill Sands
Executive Assistant for Regional Director
Central West Region
Department of Natural Resources
PO Box 53
Cnr Kite & Anson Streets
Orange 2800
Telephone: 02 6393 4316
Fax: 02 6361 3839
jill.sands@dipnr.nsw.gov.au

10.3 Questions to SWC from MRFF

7 November 2005
Email to Geoff Borneman, SWC

Dear Geoff,
as you know I am assisting MRFF with their IPART submission and following a meeting last week, have several questions for you. I would appreciate written responses if possible to enable me to keep MRFF in the correspondence loop (otherwise you can call me on 0746 535 163 or 0746 535 134).

1). I noticed that the forecast prices in State Water's earlier Submission to IPART for 2005 - 2008 prices were much lower than the Sep 05 submission forecasts eg: 2006/07 prices in the first submission were forecast to be: \$6.73 HS, \$3.38 GS and \$5.59 use, whereas in the recent submission the 06/07 forecasts are \$12.96 HS, \$3.45 GS, \$13.08 use. Can you explain the reasons for this Geoff - specifically what has changed to double to high security price and almost triple the use price?

2) In Volume 1 of State Water's revised submission, p77 there are some figures provided. Are you able to provide the data used for these figures? (when actuals and breakdowns have been requested previously State Water has not had the numbers available to provide to MRFF, so we are keen to see how the info on p77 has been generated.

3) In Volume 1: p 122 the data set only goes up to 1993 rather than 2004/05. Why has State Water dropped the last 12 years of this data?

4) Re the Burrendong capital upgrade works - how much of the safety upgrade work is considered pre-1997? ie: what safety work will be considered 'new work to be split amongst beneficiaries' and how much of the budgeted safety compliance work are customers paying for?

5.) What is State Water proposing to do with the surplus income collected in years when use is average or above (given the calculation of usage unit costs based on 1 standard deviation below average use)?

6) Is State Water aware that in order to meet its SLA on groundwater metering and billing DNR is incurring capital costs to upgrade its groundwater monitoring network and it will be passing 100% of these costs onto customers, as well as the information charge generated from the new network. This is a backdoor cost being passed through the customers that enables DNR to only quote an information provision cost in its SLA, despite it actually recouping the total cost of the capital investment as well as the income from the information it sells to state Water. If State Water is concerned about the competitiveness and efficiency of its service providers this should be ringing alarm bells. For eg: If I own the building that State Water rents, I charge rent, not the capital repayments I owe on the building....

7) Re State Water's SLA's with DNR on gauging station info as well as groundwater and unreg metering and billing can State Water provide MRFF with the details / specifics of the SLA's please. We believe the SLA's should be public documents and we are interested in the calculations, service responsibilities, DNR accountabilities and how the information specified SLA's is to be charged (we are concerned at reductions in accountability at DNR with their change in product coding from 'outputs' to activities).

8) MRFF is interested in developing a formula for allocating shares of costs across ALL users. (We note that State Water has a complete list of users in its submission (including stock and domestic and environment) but only lists irrigators as customers for cost-sharing purposes). Can State Water provide some average numbers for the last 10 years on the water delivered for different uses (with a breakdown of the actual volumes required to deliver water for different uses). We will also be listing flood mitigation as a 'customer' so if state Water can make any comment in terms of storage operations or costs to State Water from meeting flood mit commitments that would be useful. Geoff if you need clarification about this point please call me.

9) Can State Water explain why it doesn't list other users as customers and leave it to IPART / Government to have a debate about community service obligations. We would have thought it is in State Water's interests to avoid loading inappropriate costs onto its irrigator customers, so that they remain sustainable and profitable into the future and so that it spreads its income and hence risk base.

10) Finally (for now) what can and is State Water doing and what can customers / MRFF do to address the budgetary pressures that are clearly coming from treasury directives on State Water? If Treasury is setting excessive profit targets at the same time as limiting State Water's ability to flag CSO's and identify other customers apart from irrigators in order to keep its own cost responsibilities down, this is not a matter for IPART but it is a very serious matter for customers and this means it is ultimately a very serious matter for State Water.

Geoff I realise there is a bit of work in answering the above questions - so if you can get answers to me as you have them and keep me updated with your progress that would be great. I have a deadline for my MRFF report of Wednesday 16th November, so I would need any responses before then.

regards,
Michelle Ward

10.4 Responses from SWC to MRFF

SWC made a concerted effort to respond to MRFF's questions. Some email responses were received (copied below) in addition to tabular data (included in our submission), phone conversations and the fact sheets from its website.

From: [Geoff Borneman](#)
To: ramsays@bonshaw.com
Sent: Wednesday, November 09, 2005 10:03 AM
Subject: Re: questions re IPART submission

I have been out of the office since last Thursday so this is the first opportunity to read your e-mail.

I am seeking answers to all your questions but I will start with question 4.

There are three aspects to the work at Burrendong.

1. Dam safety upgrade that will be 100% Gov. All aspects regarded as pre 1997.
2. Cold Water pollution. Will be 50/50
3. Upgrade of outlet capacity that will be 100% user. Having said that I don't believe that upgrading the outlet capacity will not be cost effective. However we need to investigate further before consulting with customers/users on a final decision.

If you need to call me my new numbers are 02 6841 2061 or 0429 360 690.

We have provided all or cost data (CAPEX & OPEX) to Meg, I am assuming you have been given that information. If not and you want it let me know

Regards
Geoff

----- Original Message -----

From: [Geoff Borneman](#)
To: [The Ramsays](#)
Sent: Wednesday, November 09, 2005 3:54 PM
Subject: Answer to question 3

Answer from Dan Berry re question 3

3) In Volume 1: p 122 the data set only goes up to 1993 rather than 2004/05. Why has State Water dropped the last 12 years of this data?

We used the data provided by the DNR IQQM models. Each valley's IQQM has different start and end years. The period that is consistent for all models is 1898 to 1994. This period was used in the submission for consistency.

Regards
Geoff

From: Geoff Borneman [Geoff.Borneman@statewater.com.au]

Sent: Thursday, 10 November 2005 5:44 PM

To: bonshaw@bigpond.com.au

Subject: Questions - Some more part answers

I have attached some fact sheets prepared for staff to explain issues in the IPART submission. Hopefully they may be of use in answering some aspects of your questions.

1). I noticed that the forecast prices in State Water's earlier Submission to IPART for 2005 - 2008 prices were much lower than the Sep 05 submission forecasts eg: 2006/07 prices in the first submission were forecast to be: \$6.73 HS, \$3.38 GS and \$5.59 use, whereas in the recent submission the 06/07 forecasts are \$12.96 HS, \$3.45 GS, \$13.08 use. Can you explain the reasons for this Geoff - specifically what has changed to double to high security price and almost triple the use price?

There are two issues that cause the changes in price. Firstly we are now basing the price on one standard deviation below average. This has a large impact in the Macquarie. The second aspect is that the current costs are based on unconstrained prices.

I will send another fact sheet on the one standard deviation shortly

5.) What is State Water proposing to do with the surplus income collected in years when use is average or above (given the calculation of usage unit costs based on 1 standard deviation below average use)?

SW invests money in T Corp. So surplus funds would be invested in T Corp for years when water sales resulted in under-recovery. SW is proposing to IPART that either under recovery or over recovery would be adjusted in the next round of pricing.

6) Is State Water aware that in order to meet its SLA on groundwater metering and billing DNR is incurring capital costs to upgrade its groundwater monitoring network and it will be passing 100% of these costs onto customers, as well as the information charge generated from the new network. This is a backdoor cost being passed through the customers that enables DNR to only quote an information provision cost in its SLA, despite it actually recouping the total cost of the capital investment as well as the income from the information it sells to state Water. If State Water is concerned about the competitiveness and efficiency of its service providers this should be ringing alarm bells. For eg: If I own the building that State Water rents, I charge rent, not the capital repayments I owe on the building....

Not sure that I understand you on this issue. It appears a DNR issue. However if you are renting then generally you will be paying a 'return on assets' and a 'return of assets (depreciation)' as part of your rent. As I understand it that is part of the calculation of rent.

Sri will provide an answer to your question 8 tomorrow.

regards
Geoff

Macquarie Submission to IPART

On

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

2005 – 2008

Prepared by Michelle Ward for:

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

March 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 – ie: 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 – ie: cost of WRM relative to volumes of use etc).
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 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 organization 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 blocks 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 manager's are very 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 97 was sunk costs – “this was consistent with the view that much of the infrastructure was constructed for non-commercial objectives, & 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 & 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/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 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/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 (from State Water, other research etc) 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 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 of and distribution of costs amongst ALL customers / 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)

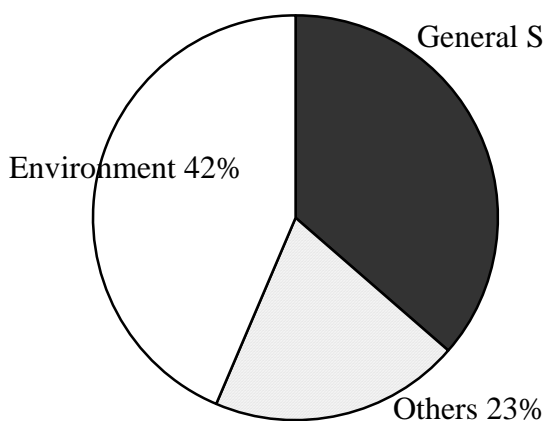
User Group	Base Entitlement	Adjusted Entitlement & % of Total
Bulk Water Users–high security	19,419 ML	38,838 ML (1) 4%
Bulk Water Users–gen security	632,428 ML	632,428 ML 69%
Environmental Water	160,000 ML	160,000 ML 17%
Town Water Supply	22,681 ML	45,362 ML (2) 5%
Industrial / Commercial Licences	(combined 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 2 year’s full allocation in storage.
- (2) Town Water Supply entitlement has been doubled to reflect the requirement to maintain 2 year’s 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.

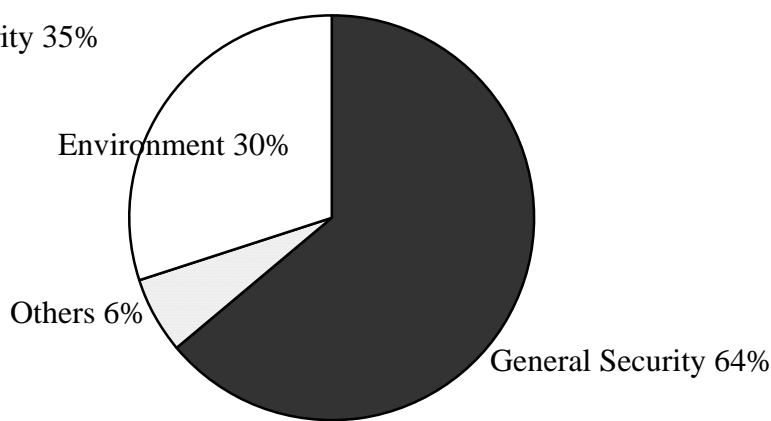
If we use Option 2 and base relative use value on long term average usage there are still problems in accurately reflecting the actual cost incurred by State Water of storing and delivering water to the various users. However considering the results of the 2nd method helps in gaining confidence in estimating 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/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 (ie: 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 user's benefit and a legislative fishway requirement is triggered, the cost should be shared 50:50 between user's and Government. However if a 3rd 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) Re 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 if 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 costs etc 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 3rd party where the 3rd 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 3rd 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 3rd party can make a capital contribution upfront 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 efficient delivery of the service and 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 standardized 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 has been 'wholesale discounts' for some of the irrigation companies, based on the old DLWC arrangements when the irrigation districts became privatized and the services the irrigation companies provided to DLWC. 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 and 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 increased 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 - \$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:

- 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.
- 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 Government 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 of 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 verses 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), recognizing 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 State Water to 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 Hydro-power 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 hydro power 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 unrig 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 re-occurrence 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. Otherwise what is the point of providing customers with expectations that requirements are meaningful, unless there is a mechanism and the will to make them happen?

3.6 Comments on Appendix 1: - Progress with 2001 Issues

3.6.1 Separate Valley Accounts

There has been substantial improvement in the State Water component, still no progress in natural resource management costs portion. 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 a complete absence currently 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 guideline 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 addresses 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 15 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 are could only be considered as secondary beneficiaries, behind other 'users' more dependent on high water quality (ie: 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. ie: 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

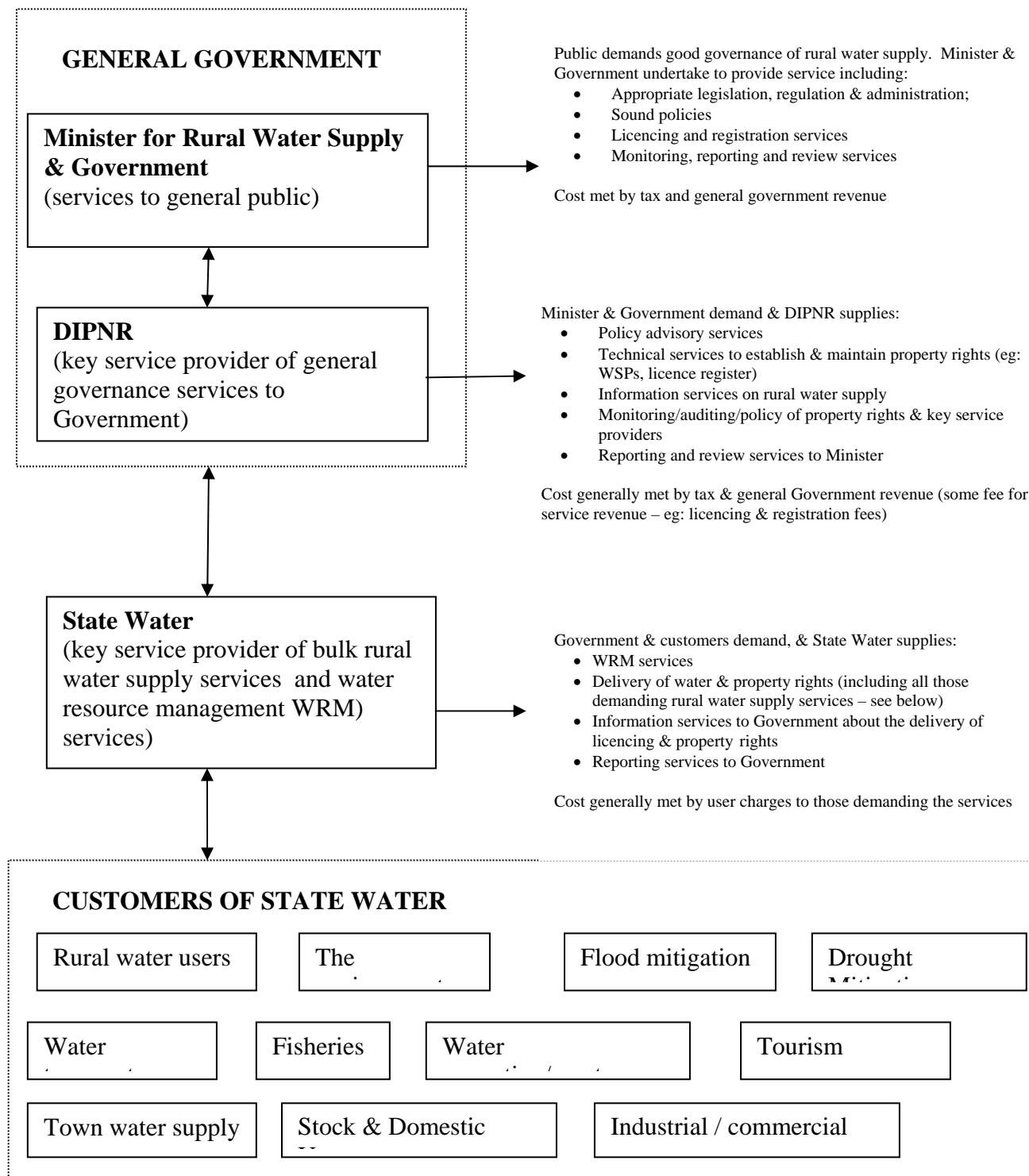
DIPNR refers to 2003/04 costs as 'indicative' rather than actual in this section and provides some justification as to why it has not undertaken a detailed review of costing information. It is now 9 months since June 2004 and MRFF believes it is completely unacceptable for DIPNR to be incapable of reporting 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 4 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, only 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).

MRFF refers IPART to 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 – for example: 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 so-called 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