Namoi Water

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Initial submission pending PB Associates' report to IPART regarding Asset Planning, capital expenditure, operating expenditure of both State Water and DNR (water resource management activities).

Namoi Water

Namoi Water is the peak water users group in the Namoi Catchment area following a decision by unregulated water users, regulated water users, upper and lower groundwater users in the Namoi Catchment to combine under the umbrella of Namoi Water for the purposes of having full time representation on water issues.
This new structure does not prevent individuals and local water groups from making submissions. The intention of Namoi Water is to add to these efforts.

The bounds of this submission

This submission will not attempt to address at this time the many concerns Namoi Water holds over the apportioning of costs and responsibilities in the capital and operating expenditure budgets. It is inappropriate to examine these issues until we have had the opportunity to detail to IPART's consultant PB Associates the concerns that we hold in this area and then to view their findings in this area. As a generalisation we disagree with the apportionment of many of the costs and the lack of transparency and detail in many of the expenses put forward. These concerns are not new and we would note that despite a lack of resolution of many of these issues including the non-provision of information by DNR, the IPART process continues to move forward. By progressing with potentially unfair costs and not halting determinations until all information is provided, IPART potentially becomes the delivery mechanism for monopoly rent.

Threats to the IPART Process (politics the mother of intervention)

The Council Of Australian Governments (COAG) driven water reform process in NSW has at times been quite adversarial due to irrigator perceptions of preset agendas and a very real lack of credible information. It would be true to say that the pricing side of the reform process has largely escaped the poor perceptions associated with the Natural Resource Management (NRM) reforms due to the independence of IPART. Politics is however the mother of intervention and in this next determination we are seeing the insertion of what are effectively policy decisions that increase the capacity of government to impose costs and narrow the structure in which to establish fair pricing. The following are examples of the areas that need debate as policy decisions and not be automatically accepted into the IPART process.

- Upper bound pricing and treasury rates of return on capital
- Externalities
- Legacy policy decisions
- Legacy infrastructure decisions

The political process is skilfully using the IPART process to avoid public debates. Upper bound pricing is one example. Effectively if you want to move to upper bound pricing in NSW, your bureaucrats write the possibility into the National Water Initiative (NWI) Inter Governmental Agreement (IGA) and then you get the major shareholder in State Water (NSW Treasury) to insist on the inclusion of upper bound pricing in the current submission to IPART. IPART then rule on fair costs within the newly established paradigm. This, instead of irrigators arguing whether the 1994 COAG on water intended to move to upper bound pricing on legacy infrastructure and whether there is linkage to establish these new principles in the NWI IGA. We will instead argue over our capacity to pay within the new paradigm. Good politics, but disrespectful of the need for public debate on economically prejudicial policy for rural communities.

This is not to say that IPART has no role in ruling on fair costs in these areas, it should be noted however that our negotiating position is considerably weakened in these new paradigms established by dubious mechanism. These threats to IPART's independence need to be addressed. Treasury's role as regulator of State Owned Corporations (SOCs), shareholder of State Water (SOC) and balancer of the NSW budget need to be scrutinised.

Upper Bound Pricing and Rates of Return for Treasury

This current determination may cover the three years 2006/2009 and as such it is important that genuine concerns over the policy decision to seek an upper bound rate of return on capital are examined.

This policy change is in part driving the huge price increases being sought in the Namoi and Peel valleys in this determination.

Upper bound pricing allows, and in the current State Water submission to IPART, actually seeks commercial returns on capital.

The justification in moving to upper bound pricing is confused. The Inter Governmental Agreement (IGA) on the 2004 National Water Initiative (NWI) indicates in clause 66 V) b) that the NWI seeks "*continued movement towards upper bound pricing for all rural systems, where practical.*

This NWI statement needs to be questioned. The NWI states that it is built on the work and intentions of the 1994 COAG agreement on water reform.
In the preamble to the NWI clause six states;

"The parties acknowledge that the NWI builds on the 1994 strategic framework for the efficient and sustainable reform of the Australian water industry (the 1994 COAG framework)."

The 1994 paper is the strategic framework document that formed the basis for the 1995 COAG agreement on water reform. The1994 strategic framework document identifies cost recovery for rural water and irrigation schemes as-
(Clause 3.4 1994 COAG)
"In the case of many existing rural water and irrigation schemes application of the full cost definition will need to take account of operational and maintenance costs, any river delivery costs, the refurbishment costs of supply and reticulation assets, including headworks and the extent to which investments were intended to meet social as well as economic objectives".

There is no mention of returns on capital on pre-existing rural water infrastructure or in regard of cost recovery in the 1994 document. However, the current State Water submission builds a 7% rate of return on capital into the construction of the regulatory asset base (RAB).

This appears to be a policy decision by State Waters shareholders namely NSW treasury. This policy decision needs to be debated and the impacts assessed. Both NWI and the original 1994 COAG agreement stress the need to avoid monopoly pricing. Any treasury insertion of increased pricing needs serious scrutiny in the light of these concerns over monopoly pricing.

Page 9 of State Water Corporation's current submission calculates a return on assets of $20,199, 000 dollars per annum across NSW these are new costs driven by upper bound cost recovery.

Peel Valley Usage entitlement figures

Annual entitlement HS 17277 Ml GS 30,878 Ml
Average annual usage 14675 Ml HS / GS combined figure
Average annual usage less 1 standard deviation 12,925 Ml HS / GS combined figure

The increased annual cost of seeking a rate of return on capital in the Peel system

2006 / 2007	2007 / 2008	2008 / 2009	2009 / 2010	2010 / 2011
$331,000	$417,000	$587,000	$809,000	$933,000

Each year an average of 14675 ML of HS and GS water is used. The average cost of seeking a rate of return on capital in the Peel will be -
06-07 $331,000 raised as a rate of return on capital equates to an increase of $22.56 per ML attributable to seeking a rate of return on capital, averaged across HS and GS water.

The increased cost per megalitre of unconstrained prices on customer bills in the Peel system in the 2006/07 water year are as shown.

	Entitlement Charge Per annum		Usage Charge per delivered ML	Cost of Delivered Water/ML Total=Entitlement+Usage	
	HS	GS		HS	GS
05-06	$11.52	$5.05	$9.19	$20.71	$14.24

06-07	$42.86	$3.18	$64.89	$107.75	$68.07
% increase based on100% usage of entitlement				420%	378%
State Water's estimate of impact on average customer				377.5%	102%

Namoi Valley Usage / Entitlements figures

Annual entitlements HS 8,519 ML GS 255,936 ML
Average annual usage 181,000 HS / GS combined (disparity between this and SW figure)
Average annual usage less 1 standard deviation 171,036 HS / GS combined

The increased annual cost of seeking a rate of return on capital in the Namoi system

2006 / 2007	2007 / 2008	2008 / 2009	2009 / 2010	2010 / 2011
$1,012,000	$1,156,000	$1,305,000	$1,441,000	$1,531,000

Each year an average of 181,000 ML of HS and GS water is used. The average cost of seeking a rate of return on capital in the Namoi will be - 06-07 $1,012,000 raised as a rate of return on capital equates to an increase of $5.59 per ML attributable to seeking a rate of return on capital, averaged across HS and GS water.

The increased cost per megalitre of unconstrained prices on customer bills in the Namoi system in the 2006/07 water year are as shown.

	Entitlement Charge per annum		Usage Charge per delivered ML	Cost of Delivered Water/ML Total=Entitlement+Usage	
	HS	GS		HS	GS
05-06	$8.04	$5.36	$6.42	$14.46	$11.78
06-07	$20.48	$9.22	$14.82	$35.30	$24.04
% increase based on100% usage of entitlement				144.1%	1.04%
State Water's estimate of impact on average customer				144.1%	102.5%

The move to upper bound cost recovery needs public debate. It is a policy decision that ignores legacy decisions and appears to be enabled by the influence of the NSW treasury as shareholder over the monopoly operations of the State Water Corporation.

Legacy infrastructure and legacy policy decisions

Impacts on CAPEX and OPEX
Both the 1994 COAG strategic framework and the NWI IGA acknowledge that in many instances full recovery will not be possible due to previous legacy policy and legacy infrastructure decisions being made without consideration of possible future cost recovery or returns on capital. Both Keepit Dam and Chaffey Dam were built at a time when neither cost recovery or rates of return to treasury for capital were policies for consideration. Both storages are legacy policy infrastructures decisions. This will not change with time; they will always be legacy decisions due to individuals and corporations in the Namoi and Peel valleys being encouraged into investment and certain decisions with the knowledge that the storages were public infrastructure at that time. Government needs to recognise its role as the current 'owner' of these past decisions, perversely the reverse is true. Government adopts a moralistic approach to

the ‘tardy’ efforts to achieve full cost recovery from those lured into investment decisions under previous policy commitments.

The 1994 COAG strategic framework says of legacy decisions
“E.9 while the need for reform is recognised, the legacy of past investment and policy decisions, particularly in relation to irrigation schemes, means that there are very real constraints on the extent and pace of reform in some areas”.

Chaffey Dam
The Peel system is a prime example of legacy decisions making full cost recovery impossible. The Peel’s costs structures are extremely high due to the awkward size (too small for dedicated irrigation, too large for dedicated town water) of the Chaffey storage.

Formulating the Government’s share of the cost of legacy decisions
There is a need for IPART to acknowledge that legacy decisions are just that; permanent legacy decisions. Formulas need to be designed to take into account the Government’s permanent share of running the legacy portion of both Keepit and Chaffey dams. The NSW Government’s legacy share of running Chaffey Dam will be quite significant; it is an inefficient sized storage in terms of operational efficiency. Formulating the permanent costs to government should be a role that State Water can readily take up if its majority shareholder will allow it. These legacy costs to government should not be considered as public subsidies; these costs are the government’s permanent share of their decision to change policy that underpinned past investment. There is a role for public transparent subsidises as mitigation for a lack of capacity to pay in some circumstances, this role is acknowledged in both the 1994 COAG and the NWI.

Externalities
Namoi Water raises the issue of the use of externality policy as a means of achieving environmental outcomes. Externality is mentioned in the NWI and in the current IPART statement on this next price determination. Namoi Water opposes the use of Externalities, effectively establishing a notional market place to further distort the paradigm of what constitutes a fair cost. Externalities are producer levies by another name and Namoi Water suggests that IPART examine the definition and very negative rating given to producer levies in the Allen Consulting Group report into Funding Urban Public Infrastructure.

There are far more effective means of introducing positive environmental outcomes than the use of punitive taxes dressed up as market place corrections. Regional communities have very narrow economic drivers based chiefly on mining and agriculture. To target a producer levy at an already narrow economic base defies reason and should be vehemently opposed by regional communities.

Operational separation
The bundling of administrative, NRM and operational services by DNR as regulator and the seeking of cost recovery on these purported costs in the current determination deserves further comment.
The 1994 strategic framework says of operational separation;
6 (c)
That the COAG “endorse the principle that as far as possible, the roles of water resource management, standard setting, and regulatory enforcement and service provision be separated institutionally.

The need for full separation has become very clear with the current attempt by DNR to approach IPART with the roles of regulator, NRM, hydrometric service provider and provider of administrative roles re licensing all bundled together.

Namoi Water suggests that the non-regulatory services being provided be described in service contracts pending these contracts being opened up for market place tender.

Further Input
Namoi Water looks forward to being involved in public hearings in Sydney on the 25^{th} November and in Moree in the New Year. We also look forward to meeting with PB Associates to discuss our concerns over OPEX & CAPEX and Asset Planning. We look forward to further written submissions when PB Associate’s work is released.

Yours sincerely

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Namoi Water EO