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Dr M Keating
Chairman
Independent Pricing and Regulatory Tribunal of NSW
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Dear Dr Keating

Please find attached the Sydney Catchment Authority's (SCA) submission to the Independent Pricing and Regulatory Tribunal's review of Bulk Water Prices from 2006/07.

The SCA's response addresses charges to the SCA from the Department of Natural Resources, and the State Water Corporation's Fish River Water Supply Scheme.

Please contact Mr Kumar Rasiah on 4725 4718 if you have any queries arising from the submission.

~~Yours~~ sincerely

GRAEME HEAD
Managing Director



**Submission to
IPART's
Review of Bulk Water Prices
from 2006/07**

November 2005

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1 Summary

The SCA reiterates the principle put forward in its April 2005 submission to the Independent Pricing & Regulatory Tribunal (IPART) on bulk water charging, that it is important for the community and, in particular for water extractors, that there is an ongoing, independent and transparent process for setting bulk water charges. Such a process is particularly important to the SCA, as it must necessarily pass the charges through to Sydney Water's 1.6 million customers.

Based on this principle, the following key issues are relevant to the SCA:

- the Department of Natural Resource's (DNR) multiple charging mechanisms, some of which are regulated and others not
- inadequate reporting of the costs that DNR claims it incurs due to SCA activities
- repeated long-term delays in delivering cost based pricing on metered volumetric sales in unregulated rivers.

We need to see transparency by DNR on its costs of running the South Coast Region (which includes the SCA's area of operations). In the past, it has not been possible to establish the bases of either DNR's bulk water charge or its water management licence charge that SCA pays to DNR.

IPART could assist this substantially by undertaking detailed analysis of DNR's costs and efficiency using similar techniques to those applied for setting prices for metropolitan water utilities.

The SCA submits that IPART needs to take account of the licence fees (and costs met by the licence fees) in establishing the bulk water charges.

The SCA considers that the impact of any substantial price increases granted to DNR, and prices increases for the SCA's bulk water purchases from State Water's Fish River Water Supply Scheme (FRWSS), should be taken into consideration by IPART in assessing the SCA's performance against its current price path targets at the SCA's next price review. These additional costs should then be recoverable by the SCA in its next price path.

2 DNR Water Resource Management

The SCA is charged for water resource management (WRM) services provided by DNR in two ways.

1. **Bulk water charges:** water resource management services provided by DNR in relation to the SCA's catchment are charged for on a usage basis. This charge is regulated by IPART and is set per megalitre of water extracted. In theory this charge is to cover DNR's costs incurred due to SCA activities.
2. **Licence charges:** Schedule 7 of the SCA's Water Management Licence states that "Part 9, of the *Water Act 1912* contains provisions for the Ministerial Corporation to recover costs in managing this Licence". Costs recovered by DNR (as the Ministerial Corporation's agent) from the SCA in this manner are not, at this stage, regulated by IPART¹. This cost recovery occurs through two mechanisms:
 - **Direct recovery** through *Licence Fees* for establishing (and renewing) the SCA's licence followed by an annual *Water Management Charge* to cover DNR's costs

¹ IPART, *Bulk Water Price Determination 01-3, December 2001*, pg 54 "Following consideration of information about the nature of the [Water Management] charges and the steps taken by DLWC to disclose costs to these agencies, the Tribunal will not be determining these charges."

of administering the SCA's licence. This is billed semi-annually to the SCA via itemised invoices.

- o **Indirect recovery** for other works and services required for DNR's WRM. This includes such things as water monitoring and telemetry equipment. These items are recovered individually as they occur (eg. by SCA purchasing a telemetry device and transferring it to DNR) or are incorporated into SCA's cost structure (eg. water monitoring).

The SCA finds it difficult to ascertain that costs recovered under DNR's bulk water charges regulated by IPART, are not also recovered through licence cost recovery, which IPART does not currently regulate. This lack of transparency in DNR's cost structure could lead to a perception that there is double charging.

The following sections provide more detail on the nature of DNR's services and charges to the SCA

2.1 DNR bulk water charges

In its September 2004 issues paper, IPART describes WRM as activities to ensure the long-term sustainability of the resource to allow continued water extraction and maintain the health of the natural ecosystem (page 6).

IPART classifies activities undertaken by DNR with this aim as:

- **collecting data** to gain a better understanding of the levels of extractions as well as the potential implications of this extraction for the river system. This also includes the activities involved in managing the database
- **developing policies** to manage the resource which could involve broader Government policy development to manage the interstate sharing of resources
- **developing plans/strategies to allocate water** amongst users and the environment and to remediate problems such as salinity or blue green algae
- **Implementing these plans and monitoring compliance** against the plans.

SCA is charged bulk water prices for WRM services provided by DNR. This charge is totally volumetric-based, and is regulated by IPART based on efficient delivery of water resource management services. The SCA is currently charged \$3.00 per megalitre (2005-06).

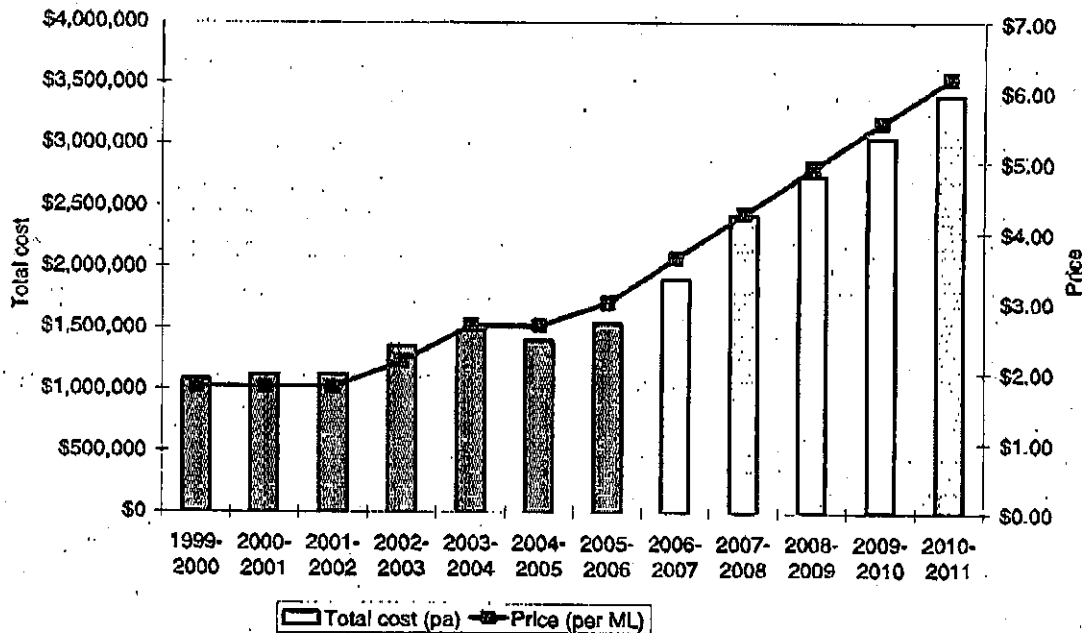
Other water users in the South Coast region pay a 'two-part' charge, comprising a fixed and usage component, which, added together, are equal to SCA's charge. However, these users, unlike SCA, do not have their usage metered, so that it is possible that their actual charge per megalitre is greater or less than that of SCA. As metering is rolled out in the region, this anomaly should disappear.

The following table shows the trends in price, and consequently total cost (price times usage) for the SCA's bulk water charge from 2000-01 to the end of 2005-06. In short, total costs of bulk water have risen by 40% in that period, despite falling usage due to restrictions, because of the greater than 60% increase in prices.

	2000-01	20001-02	2002-03	2003-04	2004-05	2005-06**
Applicable charge (\$/ML)	1.80	1.80	2.16	2.67	2.67	3.00
SCA usage* (ML pa)	626,915	625,387	631,625	556,565	525,533	516,000
Total cost (\$ pa)	1,128,550	1,125,697	1,363,552	1,486,028	1,403,173	1,548,000

* net of SCA's purchases of approximately 4GL pa from the Fish River Water Supply Scheme².
 ** estimated.

DNR's submission does not propose prices for 2006-07 onwards. However, it does provide some unit and total cost information, plus DNR's stated assumptions on cost recovery. Based on this information the SCA has inferred the possible level of future charges to the SCA. The chart below illustrates the possible sharp increase in estimated charges to the SCA over DNR's next price path.



Of particular interest to the SCA are the very high cost of DNR services in the South Coast region, and the lack of evidence of regulatory and catchment outcomes in SCA areas of activity that equates with this indicated level of expenditure.

DNR proposes that cost recovery targets for unregulated water should move from 59% to 89% but provides no justification. The cost information contained in Appendix 2 of the DNR submission does not provide water resource management cost information for the metropolitan water utilities. Thus, it is not possible to determine those costs associated with SCA's water use.

However, based on the costs provided in DNR's submission, it is clear that the South Coast region (containing the SCA's operating area) bears a high share of water resource management for unregulated water use in NSW. The SCA estimates this share to be about

² See separate Section 3 below on FRWSS pricing.

33%. Revenue from the SCA represents 34% of DNR's stated costs for the South Coast and 39% of the total revenue from NSW unregulated rivers.

IPART normally allows DNR's charges to the SCA to be passed through in the SCA's charges to Sydney Water. However, IPART has recently determined a new four-year price path for the SCA (in September 2005). IPART's price determination imposes substantial operating expenditure efficiencies on the SCA. Therefore, any large increase in DNR's charges to the SCA will place even more pressure on the SCA's ability to meet its operating expenditure targets.

The SCA considers that the impact of any price increases granted in DNR's water resource management charges should be taken into consideration by IPART in assessing the SCA's performance against its current price path targets, at the next price review. These additional costs should then be recoverable by the SCA in its next price path.

2.2 DNR Licence charges

The Water Management Licence fee and Water Management Charge paid by the SCA are intended to cover the actual costs incurred by the Ministerial Corporation in dealing with the application for, and on-going management of the Licence respectively.

Schedule 7 of the SCA's Water Management Licence states:

Part 9, of the Water Act 1912 contains provisions for the Ministerial Corporation to recover costs in managing the Licence....

Water Management Charges are the ongoing costs incurred by the Ministerial Corporation in managing the Licence. The costs associated with management activities are likely to vary from year to year, with higher costs being incurred in years when reviews and/or special studies or investigations are being carried out.

Cost recoverable activities relating to managing the SCA's licence are likely to include (but are not limited to):

- statutory reviews (initial six month review and then every five years;) and other reviews if required;
- monitoring and studies including audit and compliance monitoring; biophysical monitoring and special studies/investigations (if required);
- administration including annual reporting, auditing, general day to day administration of the licence; other water management functions and determining water management charges.

The SCA was initially charged \$420,000 by the DNR as a licence fee, at its commencement in 2001. The SCA is also charged an ongoing Water Management Charge in the order of \$250,000 per year. The following table shows the actual costs incurred to date:

	2000-01*	2001-02	2002-03	2003-04	2004-05	2005-06**
Licence charges	\$420,000	\$147,000	\$228,967	\$267,468	\$139,412	\$207,026

* Licence Fee at commencement of licence

** DNR's estimate

While the water management charge may be valid where licensing costs are recovered, there is a lack of evidence within the DNR submission to illustrate the cost basis of these charges. Following representations by SCA as part of the 2000 IPART Bulk Water Price Review, DNR made a commitment to provide data on the costs of managing SCA's Water

Management Licence. IPART noted this commitment in its determination³ as a basis for not regulating the Water Management Charge.

Unfortunately, in the past, DNR has provided cost data of varying detail. For example in 2003-04, DNR staff appear to have provided around 1.8 Equivalent Full Time (EFT) staff for SCA specific licence management activities under the Water Management Charge. This was charged at around \$90 per hour, including indirect and head office overheads of around \$35 per hour. At the time DNR provided some details of costings to enable this to be calculated. However, DNR no longer provides EFT or cost breakdowns, but provides line item invoices only. This detail does not enable the SCA to ascertain that it is being correctly charged.

In addition, the SCA's own operations also defray DNR's costs in the following ways:

- **Monitoring** – all SCA extractive usage is metered and SCA provides considerable monitoring data collected for business and other regulatory purposes to DNR. Where extra monitoring specific to DNR's processes is required (eg. inflow monitoring to storages) SCA has directly funded the capital augmentation required.
- **Review** – SCA provides reports and professional staff time for review meetings with DNR. This keeps DNR costs low.
- **Administration** – because of its larger scale consumption, administration costs for the SCA are proportionately much lower than those for other licensees.

The information provided by DNR does not reveal what the SCA is being charged for in the bulk water usage charge, which conceivably could contain the same items as charged for in Licence Fees. For instance, in DNR's current price path, SCA paid for some water monitoring capital equipment, which it subsequently transferred to DNR. However, DNR includes capital items in its bulk water usage pricing. Therefore the SCA again requests that IPART consider regulating the SCA's licence fees along with the SCA's bulk water usage charges

2.2.1 Regulatory Outcomes

DNR's regulatory effectiveness could be a greater indirect driver of SCA's underlying costs than DNR's direct charges. Therefore, the SCA considers that DNR needs to provide greater information on the level and effectiveness of its regulatory efforts. This information should include the results or benefits associated with the proposed expenditure. In particular, DNR should provide:

- data on *actual* and licensed extraction in the region, transparently showing trends over the price path in extraction in excess of licence.
- information on compliance rates with its legislation (eg. volume of unlicensed extraction/area of illegal irrigation/number of licence breaches detected) and where this is not possible, at a minimum should provide data on enforcement effort (volume of unlicensed extraction subject to prosecution action/ licensees prosecuted)

In this context, in its September 2004 Issues Paper, IPART asks two specific questions⁴ relevant to DNR's regulatory outcomes:

- the progress of converting to volumetric licences and applying the two part tariffs on unregulated rivers

³ IPART, *Bulk Water Price Determination 01-3, December 2001*, pg 54 "Following consideration of information about the nature of the [Water Management] charges and the steps taken by DLWC to disclose costs to these agencies, the Tribunal will not be determining these charges."

⁴ IPART raises a number of issues regarding DNR pricing in unregulated valleys. However, most of those relate to irrigation pricing.

- how prices for extractive users on unregulated rivers should be set if volumetric licences have not been established and metering is not in place

The progress within SCA river systems is slow. Apart from SCA, there appears to be little metering of extractions on the Shoalhaven and Hawkesbury-Nepean Rivers. According to DNR's submission, currently only 1% of unregulated river licences are metered in NSW. DNR should increase surveillance of areas irrigated to ensure that licence conditions are met. An estimate of the water efficiency loss each year due to the lack of metering is in the order of 30GL per annum⁵, which at current prices has a value of around \$4.5 million.

3 Fish River Water Supply Scheme

Almost all of the SCA's water is accessed directly under licence from the Water Ministerial Corporation, which is administered and charged for by DNR as described above. However, the SCA also buys around 4GL per annum of bulk raw water from the Fish River Water Supply Scheme (FRWSS) for Sydney Water's customers in the Blue Mountains.

State Water took over the operation of the FRWSS on 1 January 2005. Consequently, this is the first time that IPART is determining charges for FRWSS, as previously prices were set by FRWSS.

In its submission State Water is proposing that FRWSS charges should increase by 4% per annum, ie. 22% over the next five-year price path from 2006-07, as shown in the table below.

S/ML	2003-04 Actual	2004-05 Actual	2005-06 Actual	2006-07	2007-08	2010-09	2009-10	2010-11
Fixed charge	405	200	208	216	225	234	243	253
Usage charge	N/A	225	234	243	253	263	274	285
Total charge*	405	425	442	460	478	497	517	538

*assuming use of full allocation

Price increases of this magnitude will add to the difficulties faced by the SCA in meeting the operating expenditure efficiencies imposed on it by IPART in its new price path. The SCA considers that the impact of any price increases granted to FRWSS should be taken into consideration in assessing the SCA's performance against its current price path targets at the next price review, and be recoverable by the SCA in its next price path.

⁵ Water Balance for the Hawkesbury Nepean River System, Independent Expert Panel on Environmental Flows for The Hawkesbury Nepean, Shoalhaven and Woronora Catchments (2002), page 5.