



Our ref: R94/0155 Out-12245
Further contact: Shaun McBride
15 April 2005

Mr Richard Warner
Bulk Water Prices for 2004/05
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230



Dear Mr Warner

IPART Review of Bulk Water Prices from 2005/06

Thank you for the opportunity to comment on the IPART Issues Paper on Bulk Water Prices from 2005/06. The Local Government and Shires Associations of NSW have examined the issues papers and the submissions by State Water and the Department of Planning, Infrastructure and Natural Resources from a broad, state wide perspective. It is expected that IPART will be receiving individual submissions from councils affected by proposed changes in their bulk water prices to identify specifically the impact on the sustainability of their businesses.

The Local Government and Shires Associations of NSW (the Associations) represent all of the 152 general purpose councils in NSW. Of these 104 operate Council Owned Water Utilities (COWU), of which 40 receive bulk water services from State Water.

It needs to be noted that this submission is still to be endorsed by the LGSA Executives, so it should only be considered a draft. Final approval shall be determined in June 2005.

General comments

The primary concern of councils is the impact of increased bulk water prices on costs to local water utility customers. However, councils are also concerned with the broader social, economic and environmental implications of increased bulk water charges.

It is important to recognise that town water customers have already experienced significant increases in retail water costs over recent years. Councils have generally adopted two part tariffs and have gradually shifted to cost reflective pricing. This reflects the adoption of Council of Australian Governments (CoAG) and National Competition Council water pricing principles that have been promoted by the Department of Energy, Utilities and Sustainability (DEUS) through the Best Practice Management of Water Supply and Sewerage Guidelines. The increases are intended to recover COWU/council costs and in doing so would also have reflected bulk water price increases allowed under the 2001 Determination.

It should also be recognised that many of the communities served by COWUs and State Water have been gripped by drought over the past 7 years and have suffered severe economic and social set backs. It needs to be recognised that there are limitations to the extent of price increases that the community can absorb in relatively short time frames. Being close to the community, councils are acutely aware of these limitations and it is a factor in determining rating and pricing policies across the board. The commercial imperatives of the newly corporatised State Water need to be tempered by these realities.

That said the Associations are broadly supportive of cost reflective pricing and the water pricing principles adopted by the Tribunal.

In commenting on water pricing, the Associations maintain the position that high security town water supplies should be distinguished from high security irrigation and commercial supplies as a bulk water usage. This is based on the principle that domestic water supply is an essential service.

Comments on State Water Submission

General

The Associations have a number of concerns about the proposals contained in the State Water Submission to the Review of Bulk Water Prices from 2005/06. These include individual pricing proposals and general concerns about the direction State Water is taking since corporatisation of bulk water.

- The Associations do not accept State Water's assertion that additional regulatory compliance costs resulting from corporatisation should result in increased compliance costs to customers. Presumably corporatisation will produce efficiencies and economies that would more than offset these costs.
- We are concerned about the apparent emphasis being placed on the stated objective of State Water (objective 2(a) (ii)) "to maximise the State's investment in the Corporation". There are dangers in focussing on this objective given the monopoly status of State Water and that the public good aspects of water may be obscured. The Associations maintain that equal emphasis should also be given to other stated objectives such as:
 - 2(b) to exhibit a sense of social responsibility having regard to the interests of the community in which it operates;
 - 2(d) to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates.
- The Associations support the IPART principle of pricing to provide financial stability and sustainability not maximisation of revenues and returns.
- The Associations note the dilemma faced by all water utilities involving the conflicting objectives of water conservation and the need to maintain revenues. However, this is a broader issue that raises questions about the appropriateness of corporatised structures for water utilities.

Pricing

- We note that State Water has already achieved Lower Bound Pricing as defined under the National Water Initiative (NWI) in all but the North and South Coast, the Peel and the Hunter. This would suggest that future price increases in other valleys should only be small. While proposed increases for 2005/06 reflect this, proposed increases in 2006/07 and 2007/08 show significant increases. This presumably represents a transition to Upper Bound Pricing (UBP), even though State Water states that it will not seek to move towards UBP until the 2008 pricing review.
- The Associations do not accept the proposition that State Water needs to move to UBP, particularly in the short to medium term. The objective for doing so would seem to be none other than maximising returns in what is an artificial commercial environment. Lower Bound Pricing as defined, should be adequate to maintain the viability and sustainability of State Water. It would also satisfy NWI principles.
- The Associations are not entirely convinced of State Water's assertion that the annuity is no longer the best model for delivering the corporate objectives of State Water. However, we accept that it warrants consideration and agree there may be some merit in aligning with a traditional accounting treatment of assets.

- Further consideration of the above approach will be influenced by proposals in relation to the regulatory asset base (RAB). The Associations are concerned that State Water's proposal to increase the RAB to generate "realistic" revenues will underpin unnecessary and unjustified price increases.
- The Associations agree with the Tribunal's position that bulk water customers should not be required to pay commercial returns on the full historical value of State Water assets. Many of these assets were acquired and developed for non-commercial objectives by past governments and agencies. They are a legacy of days when public infrastructure was considered to be a social good and providing access to infrastructure and services was a state and national priority. It is inappropriate to go back and charge for these assets. In a simplistic sense, they have already been paid for. The Associations do not accept State Water's argument that this situation fails to strike an equitable balance for stakeholders' interests in any real sense.
- The Associations question the argument that low asset value will present difficulties in managing debt. While appreciating the argument, we would expect that given the status of State Water there would be other satisfactory means for overcoming this difficulty.
- The proposition that the long term price path should involve increases of 10% per annum for 10 years is clearly excessive and without justification. Particularly so in those valleys where State Water is already achieving cost recovery and Lower Bound Pricing. It is difficult to understand why increases beyond CPI would be warranted in those valleys. The Associations maintain the position that bulk water price increases should not be excessive or artificially maximised to deliver an unwarranted dividend.
- The Associations accept the need for a significant proportion of State Water's revenue to be derived from fixed charges in the interests of revenue stability. However, we note that this argument is at odds with the pricing principles applied by DEUS to COWUs which sets an objective of 25% fixed to 75% usage. We are not in a position to specify the appropriate ratio. However, we question the proposition that the ratio of entitlement revenue to usage revenue be standardised at 60:40 across State Water's operations. As with pricing, different ratios may be appropriate for different valleys.

Customer Service Obligations

- The Associations are of the view that there will be a need to maintain Community Service Obligations (CSO) for State Water. The social, economic and environmental implications associated with water supply are such that they will never be satisfied by pricing solutions. This is particularly so in an environment of unreliable rainfall, prolonged droughts, services having to cover long distances and small population centres away from the coast. We do not support progressive removal of CSOs. They may need to be refocussed over time but they will always be required.
- The Associations do agree that CSOs should be transparent.

Dam Upgrades

- The Associations agree that the cost of upgrading dams to required standards identified in 1997 should be met by the government. We further maintain that future upgrades beyond those identified in 1997 should be met by government, not shared by customers. This position is taken on the basis of the beneficiary pays principle and the beneficiaries of such measures are generally more widely dispersed than the customers.

High Security Charges

- As previously stated, the Associations are of the view that high security water for town water use should be distinguished from other high security applications such as irrigation. Town water supplies are an essential service. Further, while councils are increasingly moving towards cost recovery on their water utility operations, they are not seeking to maximise profit in a commercial sense. Town water supplies should attract a lower high security charge than commercial users. While acknowledging that there is a basis for a high

security premium for commercial water use, the Associations cannot accept the case for the large increases proposed by State Water.

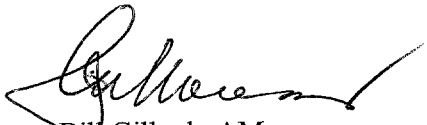
- The proposed increases for the Peel, Hunter, Lachlan, Macquarie, Gwydir and Paterson valleys, the South and North Coast, appear particularly excessive. The proposal to increase the ratio in the Peel Valley by a multiple of 8 from 1.7 to 13.46 appears excessive in the extreme. An increase of this order is unreasonable and is not acceptable.
- The State Water submission does not establish that the extent of cross subsidies in the valleys is so great as to warrant price increases of this extent. The methodology for establishing evaporation and opportunity costs is also questionable.

Other comments

- The Associations support the principle that state and federal governments should pay the costs of increased environmental flows where they are delivered from water utility assets. The benefits are of a public good nature and are of value to the broader community, not just the residents of a particular valley. Only state and national governments have to capacity to spread the cost over the range of beneficiaries.

We hope the above comments are of value to the review process and will be used in making a balanced determination on the costs of bulk water from 2005/06. If you require any further information in relation to the above comments please do not hesitate to contact Shaun McBride, Finance and Economic Development, on 9242 4072.

Yours sincerely



Bill Gillooly AM
Secretary General