

The Chair
Independent Pricing & Regulatory Tribunal
PO Box Q2920
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Dear Dr Keating

REVIEW OF STATE WATER BULK WATER PRICES TO APPLY FROM 1 JULY 2010

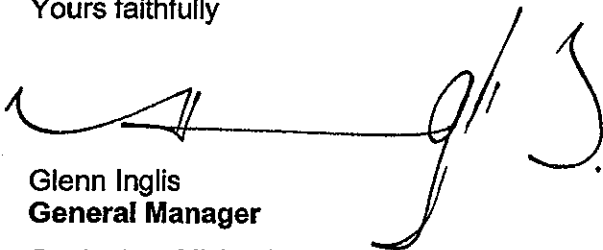
Ref: MB/SF2229

I refer to your letter of 20 July 2009 advising that IPART has commenced the review of bulk water prices proposed by State Water Corporation (SW) and NSW Office of Water (NOW) to apply from July 2010, and inviting input from interested parties on the draft determination.

Council has considered the SW submission of September 2009 to IPART and appreciates the opportunity to comment before the Tribunal brings down its draft determination.

Please find Council's submission attached.

Yours faithfully



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Tamworth Regional Council

Response to IPART

**State Water Corporation's Submission Regarding the
2010 Pricing Determination**

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1 Introduction

Tamworth Regional Council would like to thank the Independent Pricing and Regulatory Tribunal (IPART) for the opportunity to provide comments in relation to State Water Corporation's (SW) Submission on the 2010 Pricing Determination

Council does not propose to address every issue; however comments on key concerns identified in the SW submission are presented below.

2 SW Proposed Price Increases

Council has concerns about the exceptionally high entitlement and usage charges proposed by SW, particularly for the Peel Valley.

The Table below shows the current prices and proposed increases to Namoi and Peel regulated river entitlement High Security (HS) and General Security (GS) and usage charge prices over the four year period from 2009/10 to 2013/14.

The proposed increases are significant particularly in the Peel Valley (source of Tamworth water supply) where there is no transition with all the proposed increases taking place in the first year 2010/11. The prices in the Peel continue to rise from 2010/11 to peak in the third year 2012/13 and then drop by around 4%. The prices at the peak in 2012/13 represent a 149% increase from 2009/10 for usage rising from \$25.72 to \$64.02/ML. HS entitlement charges will more than double in the first year while GS entitlement charges will increase by 22% by the third year.

The proposed HS and usage price increases in the Namoi are about half as steep as the prices proposed for the Peel, however with increases of around 60% they remain very high and will impact on the price of raw water sourced from Split Rock Dam for the town of Manilla.

Proposed SW Prices for Regulated Rivers

| Year | Namoi Charges (\$/ML) | | | Peel Charges (\$/ML) | | |
|--------------------------|-----------------------|------------|------------|----------------------|------------|-------------|
| | H/S Ent. | G/S Ent. | Usage | H/S Ent. | G/S Ent. | Usage |
| 2009/10 | 9.31 | 7.44 | 12.56 | 11.50 | 1.71 | 25.72 |
| 2010/11 | 12.37 | 7.41 | 17.62 | 23.72 | 2.03 | 62.36 |
| 2011/12 | 13.53 | 8.1 | 19.29 | 24.22 | 2.08 | 63.68 |
| 2012/13 | 14.01 | 8.39 | 19.96 | 24.34 | 2.09 | 64.02 |
| 2013/14 | 14.68 | 8.79 | 20.92 | 23.37 | 2.00 | 61.47 |
| Inc. over 4 years | 58% | 18% | 67% | 103% | 17% | 139% |

3 Impact of Proposed SW Price Increases in Peel

The Table below summarises the impact of the proposed price increases on Tamworth water supply in the first year 2010/11 based on Council's Chaffey Dam HS water entitlement of 16,400ML and annual bulk water consumption from Chaffey Dam of an average 5,400ML per year.

| Charge | 2009/10 | 2010/11 | Increase in Charges | %age Increase |
|--------------------------|------------------|------------------|---------------------|---------------|
| Entitlement 16,400ML | \$188,600 | \$389,008 | \$200,408 | 106.3% |
| Chaffey usage 5,400ML pa | \$138,888 | \$336,744 | \$197,856 | 142.5% |
| Total | \$327,488 | \$725,752 | \$398,264 | 121.6% |

If approved by IPART the proposed SW price increases for supply of Peel bulk water for Tamworth on average would increase in the first year from \$327,488 to \$725,752, an increase of \$398,264 or 122% which would be a significant impost on town water supply users.

In dry and drought years when Council draws nearly all of Tamworth's water from Chaffey Dam the SW bulk water charges for Tamworth could increase to as high as \$900,000 per year which equates to a 274 % increase.

Also in addition to the above SW price increases NOW will also be applying to IPART for price increases for regulated and unregulated surface water plus ground water which will increase the cost of bulk water.

The price increases proposed by SW for the Peel are mainly driven by reduced water consumption forecasts, and for HS water a proposed premium (conversion factor) to reflect the level of security, plus full cost recovery.

4 Projected Reduced Water Consumption by Customers

In the 2006 IPART determination the consumption forecast for the Peel of 14,675ML per year was developed using the Long Run Average (LRA) approach based on the Integrated Quantity and Quality Model (IQQM) of the NOW. SW now proposes a 15 year rolling average based on actual extractions as the basis for forecasting consumption in the new determination, which for the Peel results in a 22.2% reduction in annual extraction to 11,422 per year. SW costs applied over a smaller volume of water significantly increase the consumption charge.

This is a new initiative by SW and Council considers that it is not in the best interest of bulk water customers as the charges for water delivered would be far too high should a run of wetter seasons (and more runoff into SW dams) be experienced and larger volumes of bulk water sold to customers (mainly for irrigation).

It should also be noted that when the storage capacity for Chaffey Dam is increased from 62GL to 100GL the current LRA extraction figure for the Peel of 14,675ML per year may be a reasonable figure to use instead of the 11,422ML per year proposed by SW.

Therefore IPART should adopt the current LRA figure of 14,675ML per year for the Peel and not the 15 year rolling average proposed by SW.

5 Conversion Factors

SW defines the conversion factor as representing the quantity of GS units needed to secure one unit of HS water. SW reason that in theory, the conversion factor incorporates an "unders" and "overs" system so that in dry times, HS licence holders benefit from greater water security and in wet times HS pay more than necessary. If the conversion factor is correct, the net effect of converting from a GS licence to a HS licence should be more or less equal. If it is incorrect, this will influence licence holder behaviour. If there is a large net benefit, more licence holders will seek to convert their licences to capture the benefit. Similarly, if there is a large net cost conversion from HS to GS licences would occur to avoid the cost.

Under the 2006 Determination, HS licence holders pay a higher entitlement charge than GS licence holders, known as the HS premium which is based on the Water Sharing Plan (WSP) conversion factors. SW and IPART believe that HS licence holders do receive a higher standard of service, therefore a differentiated price, including a HS premium is deemed appropriate. Given that there is no WSP for the Peel Valley it is considered that the 2006 Determination used conversion factors based on assumptions which are questionable.

SW believe the current conversion factors (based on previous assumptions for the Peel Valley) do not accurately reflect the benefit of holding a HS licence over a GS licence and propose that the HS premium be adjusted by a scarcity premium based on allocations over the last 15 years. This approach is a concern for Council. SW proposes that in the 2010 Determination IPART adopt an alternative methodology which incorporates existing conversion factors, adjusted for recent changes in reliability. SW proposes that the HS premium incorporate two elements, an access premium and a scarcity premium. The access premium to reflect the greater security of supply enjoyed by HS licence holders, which is reflected in the 2006 Determination premium via the WSP conversion factors. The scarcity premium to reflect the value of this supply under changing seasonal conditions which is not currently reflected in the 2006 Determination.

The ratios of current and proposed GS to HS conversion factors for various Valleys across NSW are shown in the Table below;

SW Proposed Conversion Factors

| Valley | Existing Ratios | 15 Year Average Allocation | Inverse Average Allocations | Proposed Ratio (Existing Ratio multiplied by Inv Av Alloc) |
|-----------|-----------------|----------------------------|-----------------------------|--|
| Border | 1.28 | 39% | 2.56 | 3.28 |
| Gwydir | 1.81 | 55% | 1.81 | 3.28 |
| Hunter | 3.0 | 93% | 1.07 | 3.22 |
| Lachlan | 2.45 | 43% | 2.34 | 5.73 |
| Macquarie | 1.88 | 36% | 2.74 | 5.16 |

| Valley | Existing Ratios | 15 Year Average Allocation | Inverse Average Allocations | Proposed Ratio (Existing Ratio multiplied by Inv Av Alloc) |
|--------------|-----------------|----------------------------|-----------------------------|--|
| Murray | 1.25 | 50% | 1.99 | 2.49 |
| Murrumbidgee | 1.63 | 54% | 1.85 | 3.01 |
| Namoi | 1.25 | 75% | 1.34 | 1.67 |
| North Coast | 1.25 | 81% | 1.23 | 1.54 |
| Peel | 6.73 | 58% | 1.73 | 11.66 |
| South Coast | 1.7 | 67% | 1.49 | 2.53 |

The proposed ratios would result in large increases in the proposed HS premium in Valleys where the security of GS licences has been deemed to have deteriorated relative to HS licences.

The Peel conversion factor would increase from an already very high 6.73 to an exceptionally high 11.66, more than double the second highest proposed conversion factor of 5.73 being the Lachlan Valley. As Tamworth Regional Council holds the majority of HS water in the Peel, this constitutes a major shift in charges from GS users to Council.

In the submission SW propose that HS licence holders generally receive near or full allocations every year and therefore they also have a greater capacity to meet higher water charges than GS licence holders. This may be the situation in some Valleys across NSW however is definitely not the case in the Peel Valley. Chaffey Dam currently has limited storage capacity and until such time as the dam is augmented to increase capacity from 62GL to 100GL capacity Tamworth water supply will not have access to water with the high level of security described by SW.

In June 2007 Tamworth was facing a very grave situation with its water supply where the city was forced onto Level 5 Emergency water restrictions as Chaffey Dam fell below 15% capacity. Under Level 5 Emergency restrictions water is rationed with no outdoor use, no use of evaporative air conditioners and severe restrictions on business consumers including schools, motels and other institutions. The city had reached a stage where there was only 12 months emergency water supply for essential purposes only remaining from all known sources. It is clear that under the current water sharing arrangements Tamworth does not enjoy a high level of security on its Peel HS water licences.

The Peel Valley is considered unique in that it does not have the ratio of HS and GS licences like other larger Valleys and the whole theory on conversion factors is not really relevant, particularly as Council does not trade its HS town water supply licence which is about 95% of the HS licence volume in the Peel Valley.

There is a significant equity issue raised by the proposed changes. There is no doubt that as proposed SW intends to unfairly shift costs to Tamworth Regional Council.

Clearly the conversion factors proposed in the Peel Valley are unrealistic, can not be justified and should not be approved by IPART particularly when there is no WSP for the Peel Valley and overall security in the Valley is very low, including security of water for town water supply.

6 Full Cost Recovery

The "percentage" increases in the cost of Peel regulated water may not sound so high when compared with some other proposed "percentage" price increases, however what the Tribunal needs to be aware of and address is the quantum of the current high prices for Peel regulated water, and if the proposed 111% increase for HS entitlement and 149% increase in usage price is added to the SW price, the additional cost of water becomes massively high. For example the proposed increase in Peel regulated usage from the current \$25.72 per ML to \$64.02 per ML represents an increase of \$38.30 per ML, which is far in excess of the increase in usage costs of other inland regulated river catchments. The proposed increase would see Peel regulated usage prices being over three times higher than the Namoi, around seven times higher than the Border Rivers, and 17 times higher than the Murrumbidgee Valley.

What is of concern to Council and other regulated water users in the Peel Valley is that Peel water users are paying usage charges up to 17 times more than most other inland regulated water users. While being forced to pay such high prices for water, the security of regulated water in the Peel Valley needs improving by increasing the storage capacity of Chaffey Dam. Therefore any increase in prices beyond the current level is considered untenable.

Under the National Water Initiative the bulk water supplier is generally to achieve full cost recovery for water services to ensure business viability and avoid monopoly rents. SW notes that a further NWI principle is transparency of operating subsidies when full cost recovery is not likely to be achieved in the long term.

SW received a transitional operating subsidy from the NSW Government over the 2006 IPART determination period. This operating subsidy resulted from IPART's decision to exercise its discretion not to pursue full cost recovery in the Peel, North Coast, South Coast and Hunter due to impacts on customers.

The principle of full cost recovery may be acceptable in Valleys with large storages, but the Peel Valley and Chaffey Dam are too small to apply full cost recovery principles and therefore it is Council's view that similar subsidies should remain in place at least until Chaffey Dam is augmented and a more reliable supply is provided to all users.

7 Other Related Issues

Some other related issues are listed below

7.1 Ability to Pay

The report titled "Ability to Pay – State Water Customers", prepared by RMCG August 2009 as part of SW's submission to IPART concluded that regions facing the most significant impact due to the proposed price changes are relatively small in terms of business numbers and total water usage. The high impact regions being the Peel Valley, North Coast and South Coast will face a significant increase in the cost/affordability of water should full cost recovery be implemented.

Council has grave concerns about the capacity for general security users to meet the significant cost increases foreshadowed in the SW submission.

7.2 Council Contribution to Chaffey Dam Construction 62GL Capacity

Council contributed 25% toward the estimated cost of constructing Chaffey Dam when it was constructed in 1979. This needs to be taken into consideration by the State Government when determining user charges that return income on investment to the government.

Council is of the view that it too should be receiving a return on the investment in Chaffey Dam, or alternatively a discount on bulk water charges.

Council would like IPART to determine its position on this very important issue. Such determination will enable Council to examine its legal position going forward.

7.3 Future Augmentation of Chaffey Dam to 100GL Capacity

The State Government has recognised for many years now that Chaffey Dam with a capacity of 62GL was undersized to provide adequate reliability for town water supply, other HS users and GS users.

Planning for upgrading the dam to 100GL capacity was well advanced by 1990, however the government of the day decided not to proceed with the project. This decision by the government to delay the project has now severely disadvantaged regulated water users in the Peel Valley.

An additional concern for regulated water users in the Peel Valley is that should Chaffey Dam be augmented to increase capacity to provide greater reliability for water users, under the current arrangements regulated water users in the Peel Valley would be required to contribute to the cost of these works. The price of this backlog capital works is presently estimated at \$36 Million to increase the dam capacity. So on one hand, the Government is asking users to contribute to the cost of an augmentation that increases the reliability of supply, yet whilst those users are waiting, unfairly charges existing users because of this very unreliability. This may be acceptable if there was some prospect that users charges will fall for those who contribute to the cost of the augmentation but on evidence to date this will not happen.

7.4 A State Wide Price for Water

Council has previously raised the need for a single price for each category of water across all Valleys in the State. This would even out the costs of access and delivery of water on a state wide basis, and introduce a level playing field for all water users. The present system unfairly discriminates against towns and cities that, through no fault of their own, happen to be receiving water from a state owned storage/source that is, relatively speaking, expensive to operate. In Council's view the cost of water should not be a primary consideration for industry wishing to relocate to particular regional areas, but repeated significant price rises by the State Government are contributing to the cost of water becoming just such a consideration.

7.5 Peel Valley to become part of the Namoi

If a state wide price for raw water is not able to be introduced then SW should consider merging the Peel Valley with the Namoi Valley. The Peel River runs into the Namoi system and is a much smaller system relative to the Namoi. The existing Namoi Water Sharing Plan links the 2 Valleys by stating that any increase in Tamworth City's water requirements will be accommodated 95 % from the Namoi and only 5 % from the Peel.

Further, the absence of off stream storages in the Peel Valley means that off stream allocation pumping and storage of water in the Peel is virtually non existent. Therefore significant flows in the Peel, capable of providing off allocation pumping, pass virtually untouched to the Namoi system where users with off stream storages can pump water that originated in the Peel Valley just up stream.

Despite these obvious links a high security user in Gunnedah, 75 kilometres West of Tamworth on the Namoi River will pay in 2010/11, under the SW proposal, a total of \$29.99 per Megalitre compared to \$86.08 per Megalitre for a high security user in Tamworth.

7.6 Pricing to encourage sale of inactive licenses

The Peel Valley is significantly over allocated. However a large proportion of the licenses issued for the Peel are inactive. One mechanism to reduce the number of inactive licenses is to look at the ratio of entitlement to usage charges for general security users and increasing the entitlement charges relative to usage charges. In this way an inactive license holder will pay more for water even if it is not used and therefore be encouraged to sell/relinquish the license on financial grounds. The present ratio of \$2.03 per Megalitre for general security users compared to \$62.36 for usage (proposed 2010/11) does not provide the correct financial incentive.

8 Summary

The proposed SW price increases for bulk water on regulated streams if applied will have a significant impact on Tamworth Regional Council town water supplies (Tamworth and Manilla) plus other water users in the Peel and Namoi Valleys, and Council is gravely concerned about the consequences of price increases, particularly in the Peel Valley where the current prices are already exceptionally high.

The State Government is effectively disadvantaging business production in the Tamworth region by distorting the competitive process. Inaccurate resource allocations in this way, necessitate decisions on production and consumption, for example, where to purchase goods and services, being gravely distorted. Trade practices legislation is being examined to determine conformity or otherwise.

Council trusts that the above comments provide constructive input to the Tribunal when considering the SW submission and urges IPART to consider the effect on users of the proposed price charges and to recommend more appropriate charging regimes that more equitably share the burden of cost recovery across the State.