INDEPENDENT PRICING AND REGULATORY TRIBUNAL

REVIEW OF PRICES FOR WATERNSW - RURAL BULK WATER SERVICES

Tribunal Members
Dr Peter Boxall AO, Chairman
Ms Catherine Jones, Member

Members of the Secretariat
Mr Matt Edgerton, Mr John Madden and Ms Jessica Forrest

The Max Centre, 1/30 Heber Street, Moree, NSW

Monday, 31 October 2016 at 10.00m

OPENING REMARKS

THE CHAIRMAN: Good morning. Welcome to this public forum and thank you very much for coming. We are conducting a review to determine the maximum prices that WaterNSW can charge for its monopoly bulk bill water services from 1 July 2017.

My name is Peter Boxall and I am Chair of the Independent Pricing and Regulatory Tribunal - IPART. I am joined today by one of my fellow tribunal members, Catherine Jones. Assisting the tribunal today are members of the IPART secretariat, Matt Edgerton, John Madden and Jess Forrest.

I would like to begin by acknowledging that this hearing is being held on the traditional lands of the Kamilaroi people.

Also I would like to thank those who provided a written submission in response to our issues paper for this review which was released in September. Our issues paper set out the key issues that will be considered as part of the review.

WaterNSW's pricing proposal was submitted to IPART on 13 June 2016. The pricing proposal, our issues paper and submissions to our issues paper are available to the public on our website.

This public hearing is an important part of our consultation process for this review. In addition to the views expressed in written submissions, we will consider the views you provide today in making our decision on WaterNSW's prices for rural bulk water services.

We are holding four public hearings for this review. Today's public hearing is the first of the three public hearings this year. We will hold further hearings this year in Sydney, on 8 November, and Coleambally, in southern New South Wales, on 14 November.

We will release the draft determination and report for public comment in March 2017. People will then have about four weeks to make further written submissions for consideration by IPART before we make our final decision on WaterNSW pricing. We will also be holding a public hearing in Sydney on 4 April 2017 following the release of our draft report. This will provide a further opportunity for stakeholders.

A final report and determination will be released in June 2017 which will set the maximum prices to apply from 1 July 2017.

In general terms, our price review will be seeking to determine:

What are WaterNSW's efficient costs of providing its rural bulk water services;
What is the user share of these costs; and
How should the user share of costs be recovered through prices.

Before we commence proceedings today I would like to say a few words about the process of the hearing. As set out in the agenda, we will commence today with a presentation by WaterNSW on its pricing proposal. The hearing will then be divided into four sessions.

The first session will consider WaterNSW's expenditure, including operating expenditure, capital expenditure and its proposed approach to allocating costs between users and government - that is, the user share of costs.

The second session will address WaterNSW's proposed price structures and approach to managing revenue volatility including water entitlement and sales forecasts.

The third session, which will occur after the tea break, will consider Border Rivers Commission costs as well as the issue of cost recovery.

Finally, the fourth session will address other prices and issues associated with the WaterNSW price review including meter service charges and other miscellaneous charges.

Following this fourth session, there will also be an opportunity to hear your views on any other issues you wish to raise that are relevant to this review of WaterNSW's rural bulk water services prices.

Within each session, we will discuss several topics. A member of the IPART secretariat will give a brief presentation introducing the topic. I will then invite participants at the table to provide comment on those topics. Following discussion by those around the table, I will invite comment from those in the general audience.

Today's hearing will be recorded and transcribed. To assist the transcriber, I ask that, on each occasion you speak, to please identify yourself and, where applicable, your organisation before speaking. I also ask that you speak clearly and loudly.

A copy of the transcript will be made available on our website.

We commence today with a presentation by WaterNSW on its pricing proposal and I ask David Harris, WaterNSW New South Wales chief executive officer, to make a presentation. David?

WATERNSW'S PRICING PROPOSAL

MR HARRIS: Thank you, very much, Mr Chair. Good morning one and all. Welcome to our customers and also can I welcome members of my team sitting up here and those in the crowd.

We are very pleased to present the great outcomes for our customers that are incorporated into this pricing proposal. Right at the outset, I would like to thank all of our customers who have invested a significant amount of time and effort in contributing to this pricing submission. A number of people here today who are on our CSC reference group, and so on, have invested a large amount of time and we would like to thank them for that.

In terms of the highlights of the submission itself, our submission incorporates reduced operating expenditure over the future period by 20 per cent as compared to the current allowance as at 30 June 2017. We have a reduced revenue requirement for customers of 11 per cent, again compared to that current regulatory allowance as at 30 June, and both of these things result in reduced bills for our customers.

Overall, our pricing proposal demonstrates operating expenditure of a lean and efficient organisation. This was achieved through our new management team implementing significant reforms within our business. I am proud to say and I am confident that the 2017-2021 proposal demonstrates a refreshed, responsive and efficient organisation in WaterNSW.

I will now hand over to our chief financial officer --

MR STOCKLER: I've just got a promotion.

MR HARRIS: Sorry, I will now hand over to our executive manager retail, David Stockler, who will deal with the high level overview.

MR STOCKLER: Good morning, everyone. For those of you who have not met me, my name is David Stockler. I am the executive manager for retail at WaterNSW.

This is a high level overview, just to make sure that we are all on the same page. We are seeking a four-year regulatory period from July 2017 through to June 2020. As David Harris mentioned, there is a lower revenue requirement overall. We are seeking a revenue requirement of $350.4 million in real terms over the four years, and our revenue requirement from customers will reduce by 11 per cent as compared to the current determination.

We are pleased with the improving transparency and knowledge sharing across the board. We have gone to great lengths and we are encouraged by the engagement with our customers and it is something we plan to continue for ever and a day.

We have gone through a number of information packs regarding education on the unders and overs mechanism, which is still relatively new, to broaden the understanding across the customer base overall.

The increased transparency also includes billing and pass-through charges which will be touched on later in the session through the BRC and such. These are charges over which New South Wales has no control but may have material impact to customer bills. We are absolutely committed to increasing customer transparency and you will see those changes progressively implemented on our billing and communications.

We have given a clear commitment to meet the customer requirements and continue to drive efficiencies across our business - so the proposed opex of $154.9 million will be 20 per cent lower compared to the previous.

Here are some headlines. Some of you will have seen this information in the packs we presented previously. Our total operating expenditure across the determination is $154.9 million. At the valley level, you can see a comparison compared to 2016-17 by valley. Overall, we are very, very pleased to present cumulative savings of 20 per cent across the board.

For general security customers, you will see an average of 3 per cent reduction compared to your 2016-17 bills, as illustrated by the dark blue series on that graph, again by valley.

For high security customers, you will see an average of a 9 per cent reduction compared to your 2016-17 bill. Again by valley, you can see those savings with the average shown there in the dark blue at 90 per cent.

This is a little bit of a refresher on our consultation approach, which we commenced late last year and have been committed to ever since. We have gone through a number of rounds including our CSC reference groups. Also there has been the establishment of a CSC reference group that sits above the individual CSCs at the valley - key customers including irrigation corporations and the environmental customers and the NSW Irrigator's Council itself.

We then progressively move through from February through to April/May, continuing to engage with those groups as well as broad customers committees, including our newsletters at the end of each quarterly bill cycle, and that touches some 6,500 customer at each bill run.

The green arrows indicate where we are at today, being the next period with ongoing consultation, including these public hearings. At the bottom of this slide I have presented a more detailed view of what is happening over the next couple of weeks.

Regarding the outcomes of that customer consultation, we agreed with our customers to continue engaging with them on issues that we are concerned about and issues that also arose during the preparation of our proposal. We ran an issues and insights register throughout that process. We recorded some 100 issues and we progressively worked through a number of these. We have also given our strong commitment to our customers with respect to dealing with a number of larger more material issues over the next four years leading up to the 2020-21 submission.

Those key issues are legacy asset shares; government water, the government user shares, which I know our colleagues in IPART will give some additional information on later in the session; our levels of service framework; and the capital underspend and the holding costs incurred by our customers on any such understanding.

For these issues and others, we did identify in our proposal a detailed analysis and review will be undertaken and the outcomes of those will be included in our next submission.

A key focus of the engagement over the past nine to 12 months has clearly been the tariff structure. We had a number of detailed sessions with customers over all valleys and provided far greater detail on the regulatory process and framework. We provided in-depth explanation on the unders and overs mechanism introduced by the ACCC back in 2014. We did some detailed scenario analysis looking at what might happen or what would happen potentially if the UOM were changed in terms of the timeframe that it runs over, and we also explored a range of fixed and variable pricing structures.

At the end of that, we also put out really a choice to customers as to whether or not they sought continuation of the UOM. With respect to that, customer groups in each valley through formal resolution, as is recorded in the customer service committee minutes, nominated their preferences for retaining the unders and overs mechanism with respect to the variable tariff component; and also a nomination by each valley customer group of a preferred tariff structure for this upcoming submission.

We believe we have pulled together a responsive or a customer responsive submission. We structured our pricing proposal on the basis of preference for continuation of existing fixed to variable tariff splits except for the Fish River, which is quite exceptional, with the closure of Wallerawang power station having a material impact on the 20-year averages there.

To mitigate the material risk of revenue volatility resulting from the selection or nomination by customers of a greater variable split, we have included the cost of purchasing a risk transfer product, which we may refer to as an RTP throughout this session.

With regard to the customer response, overall customers have responded positively to our refreshed approach. It has been a highly engaging approach. It has been a highly informative approach. I think both sides could say it has worked well but, at this stage, customers do not support the risk transfer product.

Noteworthy is that the Lachlan CSC has continued to undertake its own analysis and is still considering the move to an 80:20 fixed:variable split. I might hand over to Elli now, who is the CFO, to give you a bit of insight with respect to the RTP.

MS ELLI BAKER: Thanks, David. My name is Elli Baker, I have responsibility for finance and the pricing structure at WaterNSW. I joined a couple of years ago as part of the reform journey for this organisation.

As David has mentioned, my team did a lot of work this year on trying to move forward with customer choice with tariff structure and trying to give customers a lot more by helping them to understand the different options that are out there and understand in greater detail the result of different tariff structures on customers' bills.

One of the key things for us as a business obviously is managing our revenue against our cost structure. We have a very high fixed cost structure. It is part of the ACCC rules that we are able to - sorry, I was one slide ahead.

The cost of managing our revenue volatility is a specific item that the ACCC pricing principles refer to. In this submission, we have sought to essentially mitigate the risk of the high variable tariff structure that we have offered to customers as one of the options that they could choose.

Going back to the "Why" on the slide, essentially, we wanted to offer customers the ability to choose a tariff structure. For us that is part of a larger journey to actually looking at products and pricing and giving customers choice of different products and different pricing structures. This was a first step for us in looking at the different fixed:variable tariff structures.

Customers nominated a preference to keep the higher variable tariffs for the 2017-2021 period based on the correlation between their incomings and outgoings. However, for us, being a high fixed cost business, that does put increased risk and cost for our business and that is what we have sought to mitigate through the RTP product.

I will hand back to David to talk about capex.

MR STOCKLER: Thanks, Elli. I hope I'm not speaking at a million miles an hour. We only have 10 minutes with you today, so I am trying to get through a fair bit of material.

With respect to capital expenditure and a different approach, we also spent quite significant time on this with our customers at all the various forums and proposed approach to renewal and replacement - or R&R - capex is significantly different to previous periods.

That is primarily because approval is not being sought for individual R&R projects, or maintenance if you like; rather a prudent, efficient and sustainable level of expenditure for renewal is proposed for each valley based upon the predictive asset condition and the risks and operational concerns all using a robust engineering methodology.

The intent of this change is really that adequate level of funding is available to offset that asset consumption and also to provide the organisation the flexibility to really enact a risk-based approach throughout the pricing period and to reprioritise projects based on need and risk should the need occur. Currently we don't have that flexibility.

This new approach addresses issues which typically arise towards the end of a period where emergent needs have changed and operational needs might arise.

So what is happening on our capex approach? We recognise historically there has been under-investment in maintenance which has resulted in a running down of our assets. That simply can't continue and we must maintain the assets properly. As a result, greater investment in this area is required but we recognise customer concerns that the issue of historical underspend must be addressed because customers have been incurring those holding costs along the way.

You might recall this is one of the top four which we highlighted in the very early part of the presentation with respect to dealing throughout the period in time for the 2020-21 submission.

To address this, we have adopted a robust engineering methodology to determine the right level of spend. We spent quite a lot of time on this with customers with respect to looking at the upper limit, the lower limit, and establishing something reasonable in between. We are changing our approach and moving away from a project approach, and this is quite important to a program approach, but whilst we do that, we do recognise that customers require assurance about our priorities and that we are not gold-plating.

So next steps - it is really about a different way of determining projects, as we have touched on, a different way of tendering projects. As we have said, we are moving away from a project-by-project approach to a program approach where we may take bundles of projects to market to seek greater efficiencies in both the tender and delivery of those projects and, finally, as I said the delivery of those projects needs to be in a different way.

We will be engaging with customers regarding our proposed capital plan for each financial year before we submit to our board for final approval. For example, for the 2017-18 capex plan, it is currently being developed on the basis of our submission, so we will be discussing this with you circa March next year.

This is a little bit of insight with respect to touching on the concerns raised to us about underspend.

These two charts illustrate the user share capex spend to date in the current period versus the capex spend and government share. You can see on the top graph, blue is the ACCC target for the period. The green is committed, yellow being uncommitted. So in there, there are some unders, predominantly in Fish River and the Lachlan, and there are also some overspends with respect to user share. The bulk majority of underspend to date is on government share. I am sorry it is not uncommitted; the yellow is forecast to be spent. It is not yet committed but we plan to, within the period.

Ladies and gentlemen, in summary, we are committed to being a customer-responsive organisation and providing a range of choices to our customers to help meet your needs. We remain absolutely committed to maintaining real relationships with our customers that I hope you will also attest to through the effort we have put in over the past 12 months, an effort we plan to continue.

Our reduced operating expenditure is down by 20 per cent over the period. Our reduced revenue requirement from customers is down 11 per cent. Overall, our proposal provides customers, on average, a bill reduction of 4 per cent which is, as I said, the 9 per cent on high security, 3 per cent on general security.

Thank you very much for your attention. We appreciate the opportunity to speak to you today.

THE CHAIRMAN: Thank you very much, WaterNSW. We will now move into the first session of the agenda. In this session we propose to discuss some key elements of WaterNSW's proposal, commence discussion on their operating costs, followed by discussion on capital costs and proposed capital maintenance allowance and the share of these costs to be recovered from users through prices.

I will now call on John Madden from the IPART secretariat to introduce the discussion.

SESSION 1: Water NSW's expenditure including proposed user shares

MR MADDEN: I will go quickly through our slides because I want to maximise the time for discussion. If anyone wants a point of clarification at a slide, I would be happy, for them to just chime in.

WaterNSW's role - I have put this here to make the distinction between the WAMC review that we had last year, which is on water management charges. Obviously we are here focusing in on infrastructure charges mainly around bulk water service provision across New South Wales.

We actually set prices across 13 valleys and we have a distinction between the Murray-Darling Basin valleys and the coastal valleys in the sense that they operate under different legislative backgrounds. We have the Murray-Darling Basin valleys under the Water Act - the Commonwealth Water Act - and the coastal valleys - those in the North and South Coast and the Hunter region - are still actually regulated under the IPART Act.

As well as the prices for rural bulk water services, we also regulate meter servicing charges and other miscellaneous charges that WaterNSW provides.

This is just a little bit of background again. The current prices were set by the ACCC in 2014 to apply to 30 June 2017. So the prices in the coastal valleys have actually been set since the IPART determination in 2010. That has been kept constant in nominal terms since June 2014 so we then have alignment with these price reviews. In case you didn't know, IPART is accredited under the Water Act to actually apply water charge infrastructure rules.

The approach we take to setting prices has been mentioned a few times now. The scope of services is actually the first thing that we look at; then the efficient costs, which we will talk a lot about today; the user share; how to allocate, any overhead costs, et cetera, between valleys; then determining prices to recover that user share given a certain price structure that we have determined; and, finally, we evaluate along the way the impacts of various decisions on WaterNSW and users.

Here is some background in terms of the building block approach that we take to determine notional revenue requirement. In a sense, we go through those different building blocks or cost items for a regulated entity and build those up to determine a notional revenue requirement, and you might hear a bit about that. That is, in a sense, the costs that we allow under our decision and use to set prices for regulated entities.

There is a little bit of a distinction here between WaterNSW's proposal that talks about its notional revenue requirement and then also adding the Murray-Darling Basin and BRC charges to give an overall requirement across the state for bulk water services. So there are cost pass-throughs for the organisation of WaterNSW, but down in the south particularly, those MDBA charges are a significant proportion of their prices.

I will skip through these slides fairly quickly. WaterNSW has done a good job of outlining them. Basically, we have the average notional revenue requirement decreasing - so the total requirement is decreasing and the average user share is decreasing.

Just going through the process that we undertake, once we have that notional revenue requirement that is decreasing and the user share of that, we then look at forecast volume of water take or water usage and entitlements within a valley and use those to then determine the price per entitlement. That is one thing we will talk about in terms of the process used to estimate those forecasts for the next four years.

I have put this slide up here as it gives a bit of historical background. We have had the comment that opex is decreasing. On the left-hand side, we have some of the historical data for WaterNSW. That is since 2010 and we still have that because the coastal valleys are still actually under prices that were set way back in 2010. You can see there in terms of actuals and proposed, opex is actually decreasing since 2010 through to the proposed 2020-21.

Again this is just a bit of slide on the opex in terms of outlining that decrease of $8.5 million per year. There are actually specific costs. I think there is an increase in two valleys, which are the North and South Coast. I will let WaterNSW talk to that, but I am fairly sure it is a staffing issue that was actually in the last determination; it was, in a sense, overoptimistic about the amount of savings on staffing levels they could incur in those valleys where there is actually a very low level of service.

I will move on to the capex. Again I think the interesting thing is the chart that shows actual capex in terms of user share and government share - so the total capex spend historically from basically 2010 through to the forecasts for this year, 2016-17. You can actually see the allowed capex, and this is a chart showing, I guess, that underspend that David was talking to in terms of capex. It also puts the proposed capex in some context in terms of historical performance.

Turning to the capital maintenance allowance proposed by WaterNSW, it is greater than the building block allowance for deprecation of the RAB. Just to note that the RAB is lower than the value of the physical assets. The RAB is our regulatory asset base, which is what we use to determine an appropriate return of and on capital for WaterNSW. That is a construct for regulation purposes and prices. It is not the actual replacement value which I think is the MEERA value that they use in terms of the WaterNSW assets, ie, the dams and regulators, et cetera, that they use to deliver their services.

Moving on, a couple of times we have mentioned government share and user share. With each expenditure category for capex and for opex - I think it may have been way back in 2006, when this was first brought in to our determination process - we actually look at, under the impactor pays principle, what share of costs are appropriate to assign to the general community through the government and through water users directly and include that in their prices. So the user share has been the same for a long time now in terms of the categories, and in 2014, the ACCC left those user shares by category as they were previously used by IPART in 2010.

This is a bit of an overview here on the type of activities for operating and capital expenditure and the user share. For example, on customer support and billing, 100 per cent of the cost of that activity is included in prices. If we go to something which we might talk about later, namely, expenditure on fish ladders and environmental works, 50 per cent of that is borne by government and 50 per cent is included in prices to be recovered.

This is, I guess, a bit of a stocktake where we are up to in terms of the expenditure proposal from WaterNSW. We have engaged consultants to review the proposed expenditure. They are in the midst of that at the moment. I directed them towards the submissions a few weeks ago in terms of having read of what was of particular concern.

They actually look at the prudence and efficiency of proposed expenditure. We have asked them to look at the prudence of past operating and capital expenditure, so just to note under the Water Charge (Infrastructure) Rules, historic expenditure is included in the regulatory asset base if the money is spent. That's a little bit different from the IPART process and how we examine historic expenditure under the IPART Act.

We will also be looking at the cost shares framework, so that's the user government share. We are starting to look at that at the moment, with the process obviously taking into account feedback through these public hearings and from the submissions, and we are looking to outline some decisions or draft decisions in that area in our draft report in March.

We have some broad questions to start the discussion, if required.

Firstly, do you think the operating costs are efficient over the proposed period?
Is the forecast capital expenditure prudent and efficient?
What do people think of the approach in terms of the capital maintenance allowance, in addition to the building block allowance for depreciation?
Is WaterNSW's forecast user share of costs reasonable? That is in terms of applying the user shares that were determined in the last period, noting that WaterNSW proposed no change to those.

THE CHAIRMAN: Thank you, very much, John. Let's move to some comments around the table from the various irrigators. Would you like to start, Zara?

MS LOWIEN (Gwydir Valley Irrigators Association): Yes, thank you. May I can take a few minutes to do a broad overview on this section, then go into the first question and we might move between the groups.

First of all, thank you for coming to Moree. It is quite nice to have you in our hometown, and we turned the weather on for you.

I think the first point is that obviously Gwydir Valley Irrigators has made a formal submission of around about 18 recommendations. The important part of that submission is to remember always that users in this valley, and all valleys in the state, don't get a choice for their water operations deliverer. There is a lot of scrutiny and criticism, and that is our role as an irrigator representative body, to ensure that we can, on behalf of our users, make sure that prices are reflective of the services that are being received.

The general note is that most users in this valley are very much happy with the services they do get, but there are definitely issues with the financial management and the reporting systems of WaterNSW and its predecessor, and there continues to be some form of improvement required.

There are some additional complicating issues as part of this process, which was mentioned earlier, which is the ongoing reform of the organisation, both regulatory and organisational, as well as some other issues around the user share review and how that might impact the final determination.

All that does is provide reasons to reduce confidence in users that the price they are looking to pay is reflective of efficient and proven results.

Definitely from our point of view, the high level information provided in the pricing proposal by WaterNSW made our submission difficult. We feel that we have less information now than what we have had in the past to make an assessment, and we will go through the reasons for that in both the opex and capex.

A major headline, going to the operational expenditure component, is the continued pursuit of the benefits of the pricing proposal to customers. If you look at a number of those graphs, opex is the only case where we are receiving a decrease of 3.6 per cent, but in capital, our overall prices are increasing in this valley.

We will go through the discussion later about how

WaterNSW presents those impacts to customers. In our view, they have been quite deceptive on those impacts on members in this region - in the Namoi, Gwydir and the Peel in particular. I think there should be some changes in the ways that real impacts are presented. In terms of that, we want to ensure that any price determination going forward is a maximum and that WaterNSW should do the best they cam to achieve efficiencies under that.

Having said that, we do welcome the 3.6 per cent efficiency gain in our valley's operational expenditure. However, we believe there could be larger efficiencies primarily due to the continued organisational restructure, the change of strategic priority of WaterNSW to become a more modern and efficient organisation, as we have heard earlier, and also the previous underspend and the fact that WaterNSW have been continually improving their operational expenditure, much below their allowance. I think as that continues, as we saw earlier, that should be passed on to customers.

The point we raise is that on the issue of bill impacts, comparing allowances to forecasts really presents an inaccurate view of the actual impact because, in most cases, they underspend on their allowance consistently in both opex and capex.

I think, as any business should do - and I note we don't get a choice with our service provider here - they should find all opportunities to further drive efficiencies. Whilst we welcome the minor efficiency gain, we think there could be further investments provided services are not undermined.

THE CHAIRMAN: Thank you, Zara. Jon-Maree?

MS JON-MAREE BAKER (Namoi Water): I think Zara has provided a good overview on a lot of those questions. I will not restate some of these statements, but I will go on and build on what our concerns are.

Probably one of the concerns from stakeholders is that we are concerned that we are increasing the shift of notional revenue to the customer as a general theme. One of the things that we did specifically request is that WaterNSW actually provide us with their cash flow. We talk a lot around the volatility - and we will get into that in the next session - but we have actually asked for is income versus costs. That has yet to be provided.

We would ask that IPART really investigate quite thoroughly that issue. I think it's really important that we have a level of transparency about how that is reported back to customers. That is something that could actually be achieved differently as part of this determination process.

As Zara said, we have no choice but to use a monopoly service provider. One of the things I would say about the earlier statements from WaterNSW is that those risks are overinflated.

In terms of opex, I guess the notional revenue requirement and the proposed expenditure should be compared to the regulatory obligations and services, just checking that those are efficient and that they are actually indeed a requirement and needed.

The opex categories and descriptions of what sits behind them in each valley and in detail were not actually provided in this submission. I certainly couldn't find it. Given that I was on leave during most of this period, I did check with my colleagues and no-one seems to have seen that level of detail. That is something that we would request that IPART seek as part of that review.

The approach in particular in relation to capex is that it provides a maximum capex allowance and flexibility without corresponding engineering need and stakeholder support, and David will give a specific example from the Namoi.

We would request again further detail on the capex spend at the valley level. General information is provided in the pricing determination, but it is just not sufficient for us to actually go through in detail and work out whether or not with that capex, there has been a transfer of function as those categories have actually changed.

Renaming and amalgamating capex categories can result in cost shifting and we are not really sure that the information has been provided about whether or not that is a burden in this pricing determination.

The increase in capex in relation to maintaining capability must be accompanied with a report particularly at the CSC level. I see a shift generally to a different approach, which has been outlined today, but as David will talk to in a minute, that actually has significant risk to it and there is a really good example of why that can actually go wrong.

In relation to the question of whether we can actually determine here was the forecast capital expenditure prudent and efficient, I would actually say that we can't provide a relative answer to that because the level of detail has not been provided.

David, I might get you to go into the example of Gunidgera Weir, if that's all right.

THE CHAIRMAN: Yes, thank you, David.

MR PHELPS: David Phelps, Namoi-Peel Customer Service Committee. I don't know how much I'll talk on this now because it relates to the fishway discussion later. However, to do with capex, the specific issue relating to this is the capital works that was programmed which called for Gunidgera Weir to increase the height of the weir to improve flows down the Gunidgera-Pian system, which is a system that has capacity constraints that has 8 per cent of the general security water in the Namoi down that stream with only a capacity of 1,200 metres due a day.

The plan for Gunidgera Weir was to increase the flow rate by about 30 per cent, but it relied on the offset from the Keepit Dam safety upgrade up for the fishway to be put in place on Gunidgera Weir. This project goes back well over 10 years, and it was not until the opportunity for the offset from the fishway that the project was given its financial viability.

As everyone knows, with fishway projects across the state, there has been a blowout in budget by an enormous amount. In the case of Gunidgera, the project was put on hold when a state-wide review was put in place because of the cost blowouts on the fishways. We understand that was to be only a temporary measure until there was a reasonable outcome on the expenditure on the fishways.

I acknowledge WaterNSW's comment earlier that there has been extensive consultation between customers and WaterNSW over their pricing submission. Being chairman of the Namoi-Peel Customer Service Committee, I have been involved in all of that consultation.

In this particular item, which is item 1.1.1 in WaterNSW's response to the IPART issues paper, they have dropped the Gunidgera Weir upgrade to avoid using the fishway offset there at a cost stated here of $9 million - which I challenge under pricing given to us by WaterNSW, as State Water previously - and using that offset at Walgett Weir at a cost of $3.25 million. My comment on consultation is that this issue has arisen in this paper and it has only really been discovered by us in the recent month or so because there has been absolutely zero consultation on this issue - nothing. Also, at a local level, our local water users group, the Gunidgera Pian Water Users' Association, of which I am chairman too, has said that it has had no conversation about this issue.

There are several issues to do with this. There is the process about consultation, firstly, and whether Walgett Weir is an appropriate weir for this offset to be used because it is not actually in the Namoi; it's in the Barwon. The cost and increased costs to customers for that weir upgrade has no beneficial effect to the paying customers in the Namoi. For many years I've heard State Water claim that it is not an asset of theirs because it is in the Barwon. Obviously that asset has come across and some of it has transitioned between departments.

Having said that, it is not a Namoi asset as far as pricing, it should belong in those western unregulated streams, and there would have been MDBA funding for fishways, et cetera, in that neck of the woods.

This whole submission about switching the fishway from Gunidgera to Walgett as a price saving to customers is false. It does not reflect the significant advantage to customers of receiving their general security water in a more efficient manner. Thank you.

THE CHAIRMAN: Thank you, David. You're right; that is about the allocation of capex, so it is fine here and obviously we will get to it later in terms of offsets and what have you.

Sorry, Zara, and Jon-Maree, do you want to make a few more comments before we open to the floor?

MS LOWIEN: Yes, that would be good, thank you. Following on the discussion on capex, there is the introduction of the prioritised fishway program, which includes some preliminary work and discussions at the cost of round about $2 million which has been passed on to customers in our valley and others where there are already fishway projects.

We first heard about this as part of the issues paper submission - again not enough detail to really understand what the impact is. There is actually no price for the valley. There is an overall price that somehow has been handed down on a pro rata basis on which we are not clear.

The high level question is: $2 million in preliminary work, is that not an opex calculation? There is no capital program going in. At this stage this is just feasibility work. We really question the inclusion of that and how it has been determined.

Moving back to capital, we have been quite vocal throughout the consultation process on the new capital program, using MEERA, as a way of determining the renewal and replacement process. As I said earlier, and in our submission, users are fairly happy with the service they are receiving but then, of course, we want to make sure that our infrastructure can be maintained going forward also in a more efficient manner.

So we don't question capital expenditure; we question the way it has been determined and the process and the communication of that. I pose this question: if you were to ask members of this audience whether they would write a cheque for $11.498 million of capital investment with no understanding of what it is for, I don't think you would get many offers, but that is what you are asking as part of this determination process.

The significant increase in the revenue required for this valley is exceptional. With 155 per cent across all valleys, a 90 per cent increase of capital expenditure in the Gwydir is unacceptable without any transparency as to why.

There is the lack of information that Jon-Maree talked about, and clearly there is the past performance of WaterNSW and their predecessor where they seem to load the last year of the determination with capital expenditure as a means of meeting their expenses and there is continual underspend. We are looking at about 18 per cent over the last determination with the highest expenditure forecast in the final year.

We did see that graph before that John Madden provided, which was quite telling. The question is how much of that revenue has actually been acquired by WaterNSW and their predecessor and where has that underspend gone? That is a big question for us. We had hoped through the under and overs mechanism that we would have an opportunity to be able to recapture that revenue, but the significant amount of investment that has been requested with no detail is a big concern, and there is the impact on the regulatory asset base.

We are seeing now the regulatory asset base forming around about 50 per cent of the revenue required for WaterNSW going forward. That is a return on assets that the government invested and produced in this valley on behalf of the industry, on behalf of the community, to provide economic benefit. We are now seeing ourselves pay for that at a 50 per cent value of all of the investment for our region. I think the big question is whether or not that has been benchmarked against other similar organisations within Australia and internationally.

With the regulatory asset base, there is the question around actual expenditures being included and not the forecast, especially for the final year of the rollover calculation. We are assuming that the WACC is getting updated closer to the determination period. As always, there is the question of WaterNSW being a state-owned corporation most of whose assets were invested on behalf of the general community and how they are making a return off those assets in the future and the impact that is having on prices is quite considerable.

THE CHAIRMAN: Thank you. Jon-Maree?

MS JON-MAREE BAKER: Building on that, what we would actually ask is that there is further detail provided on the assumptions underlying WaterNSW's MEERA calculations to enable us to assess whether or not that is actually a prudent and efficient expenditure.

We would also ask that WaterNSW identify the major items of capital expenditure to implement the maintaining capability approach. I think the CSCs have in the past provided a really important function in relation to maintenance of existing infrastructure and proposed forward expenditure.

If that function has worked particularly well in the past, I am not necessarily sure why we would actually change that to a different modelled approach when you have built up considerable capacity within the CSC. I say that given because we actually don't have a significant number of assets necessarily, and I think there is a good level of understanding within the CSCs of the assets within the valley.

What David was highlighting particularly about Gunidgera is that it is a really good example of something that is a major mistake. You are talking about shifting a cost upstream to a different valley. You are talking about expending capital on something that was an offset and putting it downstream. I think that really requires much closer scrutiny in terms of the process. As a valley, given we are probably late in making our formal submissions in detail, we would have major concerns with that expenditure actually being spent at Walgett Weir.

Further probably to some of the things that Zara was talking about, as a customer base, we would actually be looking at where the operating expenditure and the level of detail of operating expenditure is provided to stakeholders.

I am not necessarily saying that every farmer in the room or every customer will read through that level of detail, but I certainly think that it should be available particularly for us to scrutinise and actually look at from a valley-specific process given that the Gwydir and the Namoi are the two valleys that are seeing a significant increase.

Obviously, the Namoi has a different set of circumstances than us being related to the Keepit Dam upgrade, but we would still like to have some visibility on where that costs has actually been generated from. Thank you.

THE CHAIRMAN: Thank you very much, Jon-Maree. Maybe I will give people from the floor an opportunity to make some comments at this stage. Would anybody like to make some comments? No, not just yet?

WaterNSW, would you like to give an interim response?

MR HARRIS: Certainly, Mr Chair. I would like to respond to three things generally. I think, first of all, we might want to be a bit careful about our language here. It is very disappointing to hear that WaterNSW has been "quite deceptive" in presenting bill impacts. That is completely untrue. We have always said that by reference to the Gwydir Valley submission, where your claim of deception is based on our comparison of our current allowance versus the allowance that we are seeking, that is a 20 per cent reduction.

I would have hoped customers might have come along here today and instead of calling us deceptive, they might have given us - my management team - some credit in achieving that outstanding result. As you saw from John's slide, there will be a continuing reduction over the next regulatory period in terms of our costs in opex.

My second point is more observation than anything else. I find it interesting, and it is just worth all of us reflecting on this fact, that our customers, both those here today and others, have referred to no choice; yet, in our language, we have referred to choice both in terms of tariff structure and also Elli spoke about future choice in terms of product. Now, clearly there is more work for us to do there, but you won't hear from any of our people anything about monopolies or no choice; it is not the mentality we bring to our business.

The third issue obviously is the capex issue. I want to tackle the specific issues first. There is Gunidgera Weir, which David raised at our CSC group meeting last week. We did acknowledge there was inadequate consultation on that. We also gave a commitment there last week to remedy that and I repeat that commitment here this morning.

The second point about that issue was we gave, in the slides that David Stockler talked to this morning, an acknowledgment that each year we would run our proposed capex plan through our CSC committees for consultation before putting these plans to the board. That is a commitment that we stand behind and we would be happy to put in writing.

I want to make two points on the capex issue: first of all, there are two issues here. One is, yes, governments, through user share and so on, have built assets in this valley, and in every other valley in the state. Those assets have to be maintained. They are intergenerational assets. In our view, they are being overconsumed at the moment.

Zara spoke about a "maintain assets according to a benchmark". That is exactly what we have done using the MEERA approach. That is not our approach; it is a universal engineering approach for estimating how much you should be spending on assets by category to maintain them.

First of all, that is where we got those numbers from. That is the benchmark, if you like, the external benchmark that we have used.

The second very separate point with capex is a point that is well made by our customers and unfortunately has been well made by IPART last year in our Greater Sydney determination, and that is that we have, as an organisation, historically not delivered on our capex.

By the way, to make the point clear, customers are not paying capex; they pay a return on capex. A number of numbers that have been the quoted here today is not what you would be paying; you pay the return on that capex.

Nonetheless, what we have done is we have changed our processes and, in particular, the way that we wish to put our maintenance capital out to market so that we are aggregating. Instead of dealing with these things on an individual project basis, the prices of most of those maintenance projects are in the order of $100,000 to $200,000. That is completely inefficient. It is a large part of the reason why we find ourselves towards the end of every pricing determination significantly below our capex.

We are going to bundle individual projects into programs. We are going to put those programs to market, for the very reason that our customers want to try and get through that capex and deliver fully on our capex allowance during each pricing determination. Thank you, Mr Chairman.

THE CHAIRMAN: Thank you very much, David. Maybe we could move on to the second session. We can always raise issues then.

The second session is price structure and managing volatility and it is to discuss WaterNSW's proposed price structures and approach to managing revenue volatility including water entitlement and sales forecasts.

Again I call on John from the secretariat to introduce the topic.

SESSION 2: Price structures and managing volatility

MR MADDEN: Thank you, Peter. Again, I will try to go fairly quickly. This session probably has a little bit more complexity with a few of the things like volatility. Again if anyone has a point of clarification on the way, I would be happy to take it.

The price structures that we set aim to recover 40 per cent of revenue from annual fixed charges and 60 per cent of revenue from variable charges. That will actually vary depending on the level of usage in terms of actual usage over the next four years. So when we set prices, we take those estimates of water usage and entitlement and, given those, set the two-part tariff on that basis.

We also have a high security premium which is based on a calculation of the reliability of different valleys - so the relatively reliability versus general and high security.

Under WaterNSW's proposal, those price structures are generally maintained. The difference is the BRC and MDBA prices where WaterNSW has proposed to move to a 100 per cent fixed charge moving from the current 40:60, which is probably not so relevant in this forum.

Turning to the forecast volumes and forecast entitlements, as we said before, we use those once we have determined the price structure we want to aim for to actually set prices with those assumptions. Currently, we have a 20-year rolling average of actual water sales. That is the way we actually estimate water usage.

This is some historical information in terms of actual and forecast volume since 2010-11 across the whole of the state. We can see the level of variability there within that period. Obviously, there are higher and lower periods than forecast of water sales.

The volatility or the RTP that has been mentioned by WaterNSW is, I guess, set within that context of the 40:60 price structure while costs are largely fixed. In our 2010 determination, we actually allowed, in our building block, a cost for the volatility allowance which was around $2.6 million per year across the state. This was based on calculations of variability of water sales.

In 2014, the ACCC introduced the unders and overs mechanism. It was their process that makes annual adjustments possible - annual adjustments to prices if WaterNSW request a review. Actually they can then factor that in to their prices and the updated sales forecasts.

WaterNSW has proposed to maintain the unders and overs mechanism and also to introduce a risk mitigation allowance based on, at this stage, the estimated price, I guess, of a risk transfer product from a third party.

In current prices, the cost of that is allocated across to general security users across valleys. Where there is full cost recovery, they are all based on an estimate of their contribution to the overall risk. In essence, a valley with higher water sales variability will pay a high higher proportion of that. It is weighted, of course, so if you are a large valley with large variability then you will pay a higher proportion of that overall cost. This is something that is proposed at the moment and with regard to the actual price, WaterNSW suggested they would provide that to us later in the review period.

For a little bit of context, we have provided there the RTP context as provided in WaterNSW's proposal - we note this is not a final estimate of costs - as a percentage of the user share of notional revenue requirement in those different valleys in terms of the basis that we set prices. That ranges for this part of the world for the Border valleys 3.5 per cent of the notional revenue requirement through to 8.9 in the Gwydir, 8.9 in the Namoi and 7.2 per cent in the Peel.

This is something we want feedback on, but also a couple of times, the move to an 80:20 split has been canvassed, in a sense, avoiding this RTP cost. That is something to get feedback on, not just whether that is something that should be entertained but what mechanism would be actually used for a valley to make a decision one way or the other on its price structure for a selection one way or the other.

Just to outline our preliminary position in our issues paper, we recognise that the risk WaterNSW actually faces in terms of its revenue volatility from the 40:60 fixed variable price structure is real. We did actually acknowledge that in the 2010 determination and the ACCC also acknowledged it.

We have compared it to other states. In Victoria they actually have a 90:10 price structure, for example, for the Goulburn-Murray. I know they are less volatile as well in terms of their sales, but it is getting more so.

We, in principle, allow the concept of allowing for some costs for managing risks, but, of course, we have to determine what is the efficient level of those costs. We will consider all elements of the proposal to mitigate risk and the distribution of the risks between WaterNSW and its customers and we will obviously entertain and consider alternative options.

These are some of the questions around price structures and volatility that we are examining at the moment and we would like some feedback on. Obviously what is the appropriate level of risk? I mentioned Victoria with that kind of 90:10 price structure. In the other part of WaterNSW's business in terms of the old SCA - the Sydney Catchment Authority - it was an 80:20 price structure and that is obviously what they have canvassed in terms of their discussions with people.

There are obviously the questions of:
What level of costs user should pay for managing volatility?
What are the implications and how would an RTP work with an unders and overs mechanism as proposed by WaterNSW?

What rate should be applied to an under and overs going forward, if it is retained?

I think this is the first time that an unders and overs would be brought in for the Peel Valley. Given it is at full cost recovery, WaterNSW has proposed to introduce that mechanism in the Peel.

Finally, as I mentioned before, would water users be willing to move to an 80:20 to avoid that cost and how would that selection actually be made in practice? Thank you.

THE CHAIRMAN: Thank you very much, John. Zara or Jon-Maree?

MS JON-MAREE BAKER: Thank you, John. The first question is really interesting - "What is the appropriate level of risk WaterNSW should bear?" To gauge that from a customer's perspective, we actually need to have information about what risk is.

I think Elli pointed out in the earlier presentation that a high fixed cost structure is incurred. We would actually say, probably as an argument to that, that 70 per cent of the allowed revenue is recovered before a single megalitre is actually sold, so in terms of the current process you have an unders and overs.

Plus, in the previous determination - I think, John, you said you were looking at it as part of a package of what is actually on the table for WaterNSW to manage their risk - they actually received a new demand forecasting model as part of the previous determination. I think we are looking at a couple of different options that have been provided historically for WaterNSW to manage their risk.

We completely reject the need for an RTP. I don't think there is a customer who supports this, and I think David could probably provide feedback as to whether or not any customer supports a volatility allowance for WaterNSW. I certainly would suggest from the CSC chairs meetings that I attended, there was not support for that.

On the question of determining what risk does WaterNSW actually bear, I don't believe the evidence has been provided to the customer to actually substantiate that there is a risk to the business, particularly in relation to how much revenue is actually recovered.

We would ask that the cash flow revenue return be provided and, in particular, that if that income over the determination period could actually be quantified, then we could better understand what risk the business actually faces.

I would ask a question of IPART, and that is: what percentage of notional revenue recovery is supported? So what is your benchmark in terms of actually assessing the business and will this be made transparent to customers as part of your decision?

In terms of the efficiency carryover mechanism, which I don't believe you talked about John --

MR MADDEN: No, we will deal with that later.

MS JON-MAREE BAKER: All right. In terms of the question that you have asked, "Should waters users pay for the costs of managing volatility", the answer is no, we think they actually recover enough revenue, and I don't think enough evidence has been provided on the up-front costs that are incurred.

I think the third question there actually assumes that RTP will be implemented and how that actually fits with an unders and overs mechanism and I guess we are considering that we don't believe that that is necessary.

"What rate should be applied to the UOM account, if continued?" We think the new existing mechanism has yet to be really proven as to how that works, so we would be looking for a continuation of the existing rate. I'll let the Peel Valley Water Users talk about whether or not it should be introduced for them.

"Would water users be willing to move to 80:20?" We actually think that that is occurring by stealth. We are continuing to see an increase in pushing the risks onto the customer continually. At the end of the day, whilst I acknowledge David's comment that they are operating within their cultural attitude as a business function, I think the fact remains that they are the only service provider and so, in actual fact, for the customer, we do see that risk is being transferred to the customer at that rate.

THE CHAIRMAN: Thanks Jon-Maree. Zara?

MS LOWIEN: Thank you. I think Jon-Maree has covered a lot of things. In the beginning in terms of the share and the revenue, we did say as part of our submission - David and David, there might be some more language that you don't appreciate here as well - that in fact there is a large proportion of the revenue fixed, as Jon-Maree pointed out between the government share and also the 40 per cent fixed coming from users.

We did see a lot of evidence throughout the consultation process on the premium which customers were paying for that. We feel that because of the unders and overs mechanism coming into play, we have not really seen it play out properly. It is a long-term tool and we are looking at it in a short time frame. I think we need to allow it time to progress.

I will give you an example from the Gwydir for why we believe that is the case. We, the users, had the information and we had the discussions with WaterNSW to really appreciate it and we still made the decision that we would stick 40:60. We did that knowing that that tariff structure provided the best match to water users' availability. When there is water available, they hopefully, make some money and they can afford to pay a higher variable charge.

That is why we choose a 40:60 because it matches the type of dynamic system in which we live in the Gwydir, in particular, where water availability can go from less than 8,000 megalitres at the start of the financial or the water year to what we have now, which is over 250,000 megalitres plus around about 150 on the farm.

That is the scenario that can change in a number of months here and that has opportunity for revenue payback for WaterNSW. That is why we want to see that unders and overs mechanism progress for a number of years more and its suitability tested as a long-term tool, the reason being we are sitting with quite a deficit in our account, which we are paying back. With supplementary water that has already been sold in the valley so far this year, we are almost at forecast. We are about 65 per cent of our forecast take and we have not even started to irrigate a crop yet. The reality is we are in one of the these years where we will pay back to that account and we will reduce that deficit quite significantly.

We know that that plays out. It is just unfortunate that unders and overs came into play at the start of the low water availability cycle. That's why we believe that that as a form of volatility is a good tool and a long-term basis for valleys that have that fluctuation.

Going back to the overall revenue, the current RTP system is, as Jon-Maree pointed out, 80:20 by stealth. I think everybody acknowledged that in the most of their applications and it is in the issues paper. It is about the risk to the business.

We had a lot of trouble, as we do often, finding the actual cash flow, as Jon-Maree pointed out, and what is the revenue that had not been recovered and how that is impacting WaterNSW's business. Whilst I am not as confident in the numbers that I have here as I was in the price impacts for our customers, I will say that we do believe that with the evidence in the back end of the report and some of the information up in the front, we can see that WaterNSW claimed a $20 million revenue deficit over the last determination period based on two years where forecasts were quite low and take was below forecast - I think it's 12 and 8, primarily driven by the north of the state.

Actual expenditure for that period is down $17 million; in fact, I believe there is about a $3 million risk to the business which we think would be more than adequately covered in the current season. For the final year of the determination, it is always a forecast and I think the actual figures from this year might tell the story of the minimal risk which has been to that business for the last four years.

With a cash flow analysis, and that is the only information we could find in here, I think you might be able to discover the actual true risk to the business. That is why many organisations like ourselves have asked for analysis on the actual versus the allowable and a comparison of that to really highlight that issue.

The problem here too is forecasting. I think we explained the variability in our valley. As is the case with some of the northern systems, there is clearly a time lag in the forecasting and the 20-year rolling average - that's just the way it comes into play. I don't think many people in this valley or others would not support moving to a longer term view of this, and that is using the updated IQQM outputs.

We have had a significant overhaul of the IQQM model in this valley, and other valleys will be going down that path in the coming years. It is important that we go to that best test case scenario of a long-term view rather than the 20-year rolling average. It does calculate that back over 114 years and it is a much better scenario than a 20-year snapshot that is brought in two years behind time. I think it would better account for volatility while providing a long-term certainty. Also, at the end of the day, it is still a forecast in a system which is highly variable, so we have to recognise that.

That generally summarises where we are up to. There are a number of recommendations in our report that we believe, if investigated further, we might get to the bottom of the risks to the business and of the overall revenue required.

I will say that customers did vote for a 40:60 tariff. We do support this choice, and I refer to David's comment that that is the only part of the monopoly that we may get in the future, which is on a valley-by-valley based tariff. Our vision is to move to a customer-choice situation where they may choose the tariff structure that suits their business better and we may see people take on different tariff structures.

In particular, I note that whilst both the environmental water holder - the Commonwealth and OEH - have not come out saying exactly what tariff they will move their customers to, there is a higher preference for them to go to a higher tariff structure to support their budgeting as they are moving forward. That would take nearly 30 per cent of the water out of the system on a higher tariff structure, then again reduce risk. That is a benefit to their business and potentially a benefit to the whole risk to the business, if there is such a risk as WaterNSW continue to claim.

THE CHAIRMAN: Thank you very much, Zara. David, do you want to say anything at this juncture?

MR PHELPS: No, thank you.

THE CHAIRMAN: Any questions or comments from the floor on this topic?

MR GEORGE: My name is Bernard George and I am from Auscott. I want to make an attempt to answer the second question up there - "Should water users pay for WaterNSW's costs of managing volatility" - and maybe the last question.

All businesses face risk. The cost of managing risk is the cost of doing business. As irrigators, we face not only risks of volatility in the water supply but seasonal conditions, world commodity markets and foreign exchange, just to mention a few. We accept these as a cost of doing business and we pay for them ourselves. We cannot pass them on and we do not, and I would offer the same suggestion to WaterNSW.

As a water user, would I be willing to move to an 80:20 fix to avoid the risk management costs? No, thank you.

THE CHAIRMAN: Thank you very much, Bernie. Ildu?

MR MONTICONE: My name is Ildu Monticone and I am representing the Peel Valley. We have some comments to make in session 3, but as the Peel Valley has been raised in this session, I would like to make a couple of comments here.

First of all, I would agree with what has been said here today and elsewhere. The government fixed share and the user entitlement fixed share that is guaranteed to WaterNSW is only the usage which is volatile. I think what WaterNSW need to do is manage their business within the constraints of the business in which they operate.

Regarding the Peel Valley, we would like to see some modelling indicating the impacts over the last 10 years on irrigators and the council and what would have happened in regard to prices. There is no carryover in the Peel, and we don't believe the Peel is big enough to make a material difference to WaterNSW's revenue, but again we would need to see the figures.

We don't think it is appropriate for the Peel Valley to be put to the decision to offer a comment on that, at this stage, until we have seen the figures. We really would need to see the figures before we would make a comment. Thank you.

THE CHAIRMAN: Thank you, Ildu. Would anybody else from the floor like to make a comment or ask a question at this stage? No?

WaterNSW, would you like to make a follow-up comment?

MR HARRIS: Thank you, Mr Chairman, four comments. I think when we opened our first CSC reference group meeting in November last year, we indicated our hope was that, with our customers, we would come to an agreement on every aspect around our pricing submission.

We did flag, right at that very first meeting, that the risk transfer product was unlikely to be in that category and we sit here today very simply with us having included that in our submission and our customers objecting to that. However, I want to reiterate Bernie's words - the cost of managing risk is the cost of doing business and that is what is underlying our claim for an RTP.

For those of you in the room who were not participants in the CSC reference group and may not have this information, I do, Mr Chairman, want to highlight that among us and our customers collectively in this regard, we all did look at quite a number of alternatives around the UOM and the RTP. We generated, for example, prices with the UOM, prices without the UOM. We also looked at reducing the UOM to a 10-year recovery period. That didn't work for our customers and it didn't really work for us either.

We also generated prices by valley - every valley - from 100 per cent fixed zero variable through to 100 per cent variable zero per cent fix. There was an enormous amount of information put on the table and put in front of our customers and discussed, but we have got to the position that I referred to before.

Thirdly, with regard to the comment that about 70 per cent, I think it was, of our revenue is fixed before we deliver one megalitre of water, Mr Chair, we need to be very careful about that. That is a comment across our entire revenue base, which includes our Greater Sydney pricing determination. Of course, those customers in Greater Sydney are paying an 80 per cent fixed charge and I don't think anyone in this room wants to get into cross-subsidies between those two customer bases. I don't think we should go there.

Finally, on the issue of 20-year average usage versus forecast, we are very open to having a look at that. From our perspective, we have to get from someone a reasonable demand number to put into our calculations.

Gwydir Valley have recommended the use of IQQM. We don't have access to that data or that model; we are not privy to it. We have argued that, within government, there should be a common data set and modelling for this. If we did have access to that, we would be more than happy to look at forecasts rather than backwards-looking 20-year averages.

THE CHAIRMAN: thank you very much, David. Catherine?

MS JONES: I have a question for WaterNSW. I am very confused as to how you would work the RTP with the unders and overs. Can you please elaborate how it would actually work.

MS ELLI BAKER: From our perspective, they are two quite different things. What the UOM does - we did an awful lot of analysis over the last six to nine months - is that it basically means that, over the longer term, we earn no more, no less than our revenue requirement because it reduces prices or increases prices under a formula to ensure that we recover our revenue requirement, but it does not address the volatility of that revenue from year to year.

The RTP addresses the risk of the business and gives us money to go to a third-party provider and essentially buy an insurance product to reduce that revenue volatility and therefore the mismatch between our revenue and our costs. The UOM really is something that purely and simply delivers the result that, over the long term, we are paid no more and no less than our revenue requirement.

For that reason really, we put the UOM to customers. We showed them prices with or without the UOM. From our perspective, the UOM is a customer choice. We, as a business, are happy to take the risk or some risk in whether we over or under-recover. However, it is the volatility of our revenues that we are seeking to back out to a third-party provider; therefore, the cost of that would be the cost of what that third party provides us, and it is really around that mismatch between our revenue volatility and our fixed cost base.

THE CHAIRMAN: So that mismatch goes to, in a sense, the time value of money, is that right, because if you have a UOM, you are going to get your notional revenue over time. It is just that, in some years, there will be a deficit and other years a surplus, and the RTP product is to basically insure you against the costs of having to carry those differences from year to year?

MS ELLI BAKER: So, the easiest way that I think to explain it is that for us to mitigate our revenue volatility, should customers wish to choose a 40:60 tariff structure, we then need to find a third party in the market to essentially do a swap with us so that we, as WaterNSW, essentially replicate as though we had an 80 per cent fixed tariff. The UOM does something different over the longer term. It, on an NPV basis, ensures that we receive our notional revenue no more, no less, but it doesn't pay us a cost for the volatility.

THE CHAIRMAN: Thanks, Elli. Are there any other questions. Yes?

MR ROBINSON: Joe Robinson, Gwydir Valley Irrigators Association. To be clear on that, it is either a UOM or the other mechanism. It is not both of them, so it is either. Then the timing difference that you are talking about, it could be that I over-recover early, so I don't think it's a time-money thing either.

The issue that we have had previously and the one that I see now is WaterNSW is a state government corporation.

The state government as a whole has a whole lot of different income sources. Therefore volatility in one area of their business - I am talking about New South Wales government business - could be offset by some other area. If you have multiple businesses, effectively, you have a risk mitigation across the board.

I have an issue with the fact that we tend to look at WaterNSW as though it is a stand-alone business. I think it should be looked at as a part of a New South Wales government suite of businesses.

It also goes down to individual valleys. It seems to me that the individual valleys are treated like they have to be recovering on their own, whereas, there are revenues coming from a whole bunch of different valleys. Unfortunately, there is a fair bit of correlation between water availability and usage across New South Wales, but if you look at, say, the Gwydir and the Namoi they are about 97 per cent correlated. If you look at the Gwydir and the Murrumbidgee, there is about a 40 per cent correlation. That sort of has a risk mitigation across the state for WaterNSW's business.

The problem for individual irrigators is that we are in one business and the irrigation business is totally reliability on water. That is the whole driver of the business. I think the point we are trying to make is that we feel that there is a better cheaper way of managing the risk than on the grower. It is our one revenue stream, whereas, WaterNSW has a bunch of valleys and the bigger picture then is the New South Wales government as a whole, with its state-owned corporations, has a much better chance of mitigating risk. However, to be paying an 8.9 per cent premium - I can't remember what it was - the premium to me is based on the individual valley and that is not the real risk.

I am supporting WaterNSW. I don't think they should have to be returning year on year when they are part of a suite of New South Wales government owned businesses. Thank you.

THE CHAIRMAN: Thank you very much, Joe. You have honed in on a couple of really important issues. Part of my question was to get to this issue about whether the UOM and the RTP are really just two ways of getting at the same thing. I think that WaterNSW is maintaining that they are actually dealing with different issues.

MS ELLI BAKER: That is correct. I can talk about that again, but essentially for us in mitigating our revenue risk from the high variable tariff structure backing that out to a third party is the only way we can truly mitigate that risk and that is what the RTP is about.

We are out in the market, as we speak, seeking a firm price from insurance companies and the like in the market that will look at providing that product to us and we do hope to be able to, therefore, put a firm price of the actual cost to us into the final determination number.

The UOM is an interesting one. We have had a lot of discussion on this during customer meetings, but it does still do a job for you should you as customers choose to continue with it. It does ensure that, over the long-term, what you pay is that revenue requirement, no more, no less, because it adds or subtracts to prices to make that adjustment. From our perspective, that really is at your choice. If there are very large years where we happen to over-recover because of a particular volume assumption that has been used in the price calculation, without the UOM, we would retain that revenue. With the UOM, you will essentially, as a customer get that money back over time because prices will be reduced.

We, as a business, feel that volume risk is something that businesses should take a certain amount of, and with regards to the UOM and what we see as its function, we really do think it is quite independent from running our business, the financial side of our business, and mitigating those risks. We are happy for customers to have that UOM product over the top if you wish.

As one of the Davids said before, during the consultation period with customers, we did show what prices looked like with or without the UOM. Interestingly, at the moment, that UOM balance is about $19 million that customers owe us because we have under-recovered. Without the UOM, you wouldn't owe us that money.

THE CHAIRMAN: Thanks, Elli. Just on the other point you have raised which gets to the issue about spreading risk across different government agencies or between different arms of WaterNSW's business and issues about valley to valley, this goes to another issue, which we always consider, and that is to what extent prices should be cost reflective of delivering a product within a valley or within a business? If WaterNSW or any other government corporation were to absorb more risk, that would, in effect, be cross-subsidised by other arms of the New South Wales government. These are really important issues and thanks for raising them.

We are coming close to morning tea, but Zara would like to make a point. I am happy to revisit any of these topics after morning tea. Zara --

MS ELLI BAKER: Can I go first before Zara goes?

THE CHAIRMAN: On what?

MS ELLI BAKER: Just on the valley question that Joe raised.

THE CHAIRMAN: Okay, why don't you go first, Elli, then Zara, and then we will have morning tea.

MS ELLI BAKER: I'll hopefully be quick, Joe, but what you raised absolutely is really core to where we, in managing this business, want to go. In this determination, we have talked about and consulted with customers about tariff structures. That was the beginning of our journey of really trying to put more choice with customers.

Where we are wanting to get to as a business is very much more related to that choice around products and services and David's team is doing a lot of work on trying to identify exactly what products and services customers value.

It is a bit of a longer term journey for us than we were able to do in this particular price determination, but definitely one of the things that we will be putting to the tribunal in the next determination is moving more towards a revenue cap rather than price cap.

One of the things we definitely want to look at - and we would love more ideas from you - and that David will continue to consult on, is this concept of products and services based pricing rather than strict valley based pricing and the ability for us, as a business, to manage to a revenue cap rather than specific prices. There's a whole stream of issues that people or customers currently have some frustration levels with that we think that will solve. I wanted to give that a quick plug given your question, but we absolutely are moving there for the next determination.

THE CHAIRMAN: Thank you, Elli. Zara?

MS LOWIEN: I think there has been some really good discussion on this. There are a couple of things we want to reiterate. The UOM, as Elli pointed out, is a long-term tool. The main reason customers are a big supporter of it is that there is that opportunity for the years when there is an over-recovery of revenue that we get a payback from that.

We have seen throughout the drought, when there has been low water availability in most of the valleys that we are talking about, WaterNSW and its predecessor still producing a profit and passing that on to the state government. That is the context which we are dealing with, when users did not get a benefit passed on to them in those cases, so when we do over-recover, as we are anticipating to do this year, the UOM provides an opportunity to top up that balance.

The UOM was brought in by the ACCC in place of a volatility allowance on that year-on basis on which they are pointing out that there is a cash-flow risk. As Joe adequately pointed out, I think we have to understand this on the scale of the business - valley by valley, across the state as part of the state government structure, that is really key.

It has been very difficult - to reiterate our point earlier - to even understand at a valley level that scale of risk. We have had some chance of underpinning that on a state-based level where we think there is very little risk in the last four years, even though we have had a number of years of low water availability. Because of the high nature of the fixed structure of the revenue they are receiving, we really need to see those cash flows and those actuals versus projected costs being analysed as opposed to allowances which are a maximum into the scheme of things.

To pick up on the user choice in the future, that is something that we are very much supportive of and we will continue to have discussion and dialogue with WaterNSW on it. It is key, though, that a price cap for users provides them some certainty going forward and allows them to know what the maximum is they will pay rather than providing an open slather on what that might be, and that is a real risk for us. We definitely support the UOM over a hybrid approach of the UOM with a volatility allowance or RTP, or whatever you call it, but we need some further analysis on the actual real risk to see whether either of them are actually required, and transparency.

THE CHAIRMAN: Thank you, Zara. John, just quickly.

MR MADDEN: I wanted to put a question out there, and maybe we can come back to it later rather than answer it now. A couple of times customer choice had been mentioned, which I can understand at a customer level, but the issue, I guess, IPART will face potentially in this determination is how does the valley actually make a choice?

Maybe we can come back to it, if people want to think about it. There's obviously the customer service committees, but what level of power or authority do they have to actually speak on behalf of customers in a valley? I am just wondering what people's views are on that and about how a choice would be made, say, whether there is unders and overs. It is of real interest to us in the short term, but I guess even in the longer term because I see a lot of risk given different valleys, even though we have customer service committees, in a sense, across valleys, for example. Maybe think about that and we can come back to it later.

THE CHAIRMAN: Thanks very much, we would be interested in coming back to that. Let's break. We are just a little bit behind schedule. Maybe we could break for 15 minutes and return at 5 past 12. Thank you.

SHORT ADJOURNMENT

THE CHAIRMAN: Thank you, let's resume. We had an interesting discussion just before the break and during morning tea. I think we will push ahead with the agenda and we should be able to cover some of these topics as well.

The third session is the Border Rivers Commission, costs and cost recovery and I will ask Jess Forrest from the IPART secretariat will introduce this.

SESSION 3: Border Rivers Commission (BRC) costs and cost recovery

MS FORREST: Thank you, Peter. To begin the session, we are going to look at the Border Rivers Commission (BRC) costs and the Murray-Darling Basin Association (MDBA) costs, but obviously we will focus more for today's discussion for this session on BRC costs as these are more relevant to the northern New South Wales valleys.

First of all, to give you a brief overview, BRC and MDBA contributions apply in three valleys, with BRC costs applying in the Border Valley.

BRC is a cross-jurisdictional body established by the New South Wales and Queensland governments to operate and maintain jointly owned water infrastructure and implement agreed border-sharing arrangements in that region.

The BRC's costs in performing this role are jointly paid for by New South Wales and Queensland and the costs are allocated based on an agreement between the states, with the New South Wales government paying the New South Wales share of these costs to the BRC.

During the 2014 ACCC decision, the New South Wales treasury issued a direction to WaterNSW, then known as State Water, to pay the BRC and MDBA costs. In its 2014 decision under the Water Charge (Infrastructure) Rules, the ACCC concluded that the recovery of BRC and MDBA costs was a regulatory obligation for what was then State Water. As such, WaterNSW categorises BRC and MDBA costs as uncontrollable costs and prefers that these costs be passed through to relevant customers.

DPI Water has provided written advice to WaterNSW on the amount that should be passed through to customers and WaterNSW have included this amount in their costs in their proposal.

WaterNSW forecasts BRC costs for Border Valley users at about $3 million over the 2017 determination period, which equates to costs of about $700,000 per year.

Compared to the 2014 ACCC decision, this represents around a 4.5 per cent reduction in the annual user share of costs.

WaterNSW proposes that 100 per cent of these costs be recovered by an annual fixed charge. This is an approach that differs substantially from the current arrangement, whereby 60 per cent of BRC costs are recovered through usage charges and 40 per cent of costs are recovered through entitlement charges.

WaterNSW is also proposing an adjusted high security premium so that the average bill of a high security customer does not rise substantially as a result of its proposal to recover BRC costs via an entitlement charge.

This slide depicts the user share of actual BRC costs incurred over the last three years as well as WaterNSW's proposed BRC costs for the proposed four-year determination period from 1 July 2017. It illustrates the increase in BRC costs that have been seen over previous years and the proposed decrease in costs for the next determination period.

The proposed BRC charges for the Border Valley for the 2017 determination period are summarised on this slide, which also shows the final charges comprising of the BRC charges and water charges.

As mentioned, WaterNSW is proposing that BRC costs are recovered through the 100 per cent fixed charge rather than through the current 40:60 fixed:variable split. The effect of this on BRC charges can be seen in the prices shown in the middle column of the table with the proposed change in structure resulting in an increase in fixed entitlement charges for general security entitlements. However, the impact of this change appears larger than it actually is as the increase in entitlement change is offset by a reduction in usage charges which falls by 100 per cent in 2017-18 compared to 2016-17. So in terms of bill impacts, this actually translates to a decrease in overall prices faced by a typical water user.

IPART's preliminary position on BRC and MDBA costs is that, in the absence of a direction from government to WaterNSW to fund these costs, we will review the prudency and the efficiency of the proposed BRC and MDBA costs and suggest only prudent and efficient costs and prices.

We will also examine DPI Water's application of the user shares' activities included in the BRC and MDBA costs, and we also intend to examine the proposed changes in the structure from the 40:60 split to a 100 per cent fixed charge, and this will include consideration of the proposed approach to sharing the charges between high security and general security entitlement holders.

This final slide for this issue shows the key questions that we would like to discuss. These questions include:

Is the proposed BRC user share of costs efficient?
How should BRC costs be recovered from water users?
Is WaterNSW's proposed adjustment to the higher premium reasonable?

Thank you.

THE CHAIRMAN: Thank you, Jess. Zara or Jon-Maree, would you like to make any comments on BRC?

MS LOWIEN: No, thank you.

MS JON-MAREE BAKER: It has been a long-standing concern in relation to MDBA costs that there is low visibility and transparency on those costs that are incurred and passed on to water users within the Border Rivers. Tim Napier, the executive officer, I'm sure will be contributing at further discussions, but I would note that the NSW Irrigators' Council submits two points in relation to this; namely, that IPART should conduct an efficiency review, and in previous pricing determinations there has been low visibility on the MDBA costs. Thank you.

THE CHAIRMAN: Thank you, Jon-Maree. Would anybody else like to speak on the BRC costs issues? No? Sorry, David?

MR HARRIS: Just two quick points. First of all, with regard to the change referred to there of 100 per cent payment, that is reflective of the requirement of the New South Wales government. They have asked us to pay that amount in full and that is why we have proposed that in our pricing submission. If they wanted 40:60, if they gave that to us, we would pass that through.

Secondly, to follow on from Jon-Maree, WaterNSW stands with its customers and it has publicly stated that there should be a prudency and efficiency review of particularly MDBA charges an also BRC charges. I am not quite sure how we would get that test done through the WaterNSW pricing determination given that the figures are not our numbers - they are not generated by us, they are generated by those other two bodies - but anyway, we are absolutely at one with our customers in terms of supporting greater transparency in that regard.

THE CHAIRMAN: Thank you, David.

We plan to looked at and review, to the best we can, the MDBA and BRC costs so that, in the event something is passed through, we would hope that it was prudent and efficient. Of course, if the government issues a direction to pass the whole lot through, that is what will end up happening. However, in the event that they don't issue a direction to pass the whole lot through, we would look at what we think is the most prudent and efficient and only that would be passed through. That is a general principle and the tribunal is yet to finalise its decision on that matter.

We will move on to the next introduction from John on cost recovery.

MR MADDEN: There is one small note to add on that and that is that, in the MDBA submission, they actually did welcome IPART to come to MDBA and actually look at their proposal, et cetera. That work, at this stage anyway, is being undertaken. As Peter said, that is then subject to what the New South Wales government says later in the piece.

With the issue of cost recovery, we aim to set prices that fully recover user share of WaterNSW's efficient costs. There are two valleys in particular, which are South Coast and North Coast, where prices at the moment are well below levels that would achieve full cost recovery.

In past determinations and in the ACCC decision, there has generally been an approach of a cap on prices in these valleys to actually attempt to mitigate bill shocks of any move to prices that would recover the full costs incurred in providing the service. That shortfall, in a sense, has been worn by government as a community service obligation.

Under WaterNSW's proposal, in the North Coast and South Coast, there is a cap on price increases of 10 per cent per year. Even under those price increases there is still under-recovery of costs in these valleys over the 2017 determination period.

Actually I think this slide might be wrong. The South Coast should be at 44 per cent and the North Coast would be at 12 per cent after that period. So the amount of revenue we are talking about is about $1.2 million per year in terms of the shortfall, in terms of the costs to WaterNSW.

We are looking at this issue, I guess, to try to establish a set of principles for setting prices in valleys where we can assess that full cost recovery is unattainable. The definition of that really is that if your prices are at full cost recovery, there would be zero pumping of water.

These are questions that we have:

How should the costs of providing bulk water services be recovered in valleys where full cost recovery has not been achieved?
What are the principles or approaches we could then use to assess efficient costs in these circumstances?
What are some principles that we should use to determine prices in valleys below full cost recovery?

THE CHAIRMAN: Thank you, John. So comments or questions on this topic? Ildu?

MR MONTICONE: We don't have any comments on the North Coast or South Coast, but if you are interested in comments on the Peel, I would certainly be happy to make some.

THE CHAIRMAN: We are indeed.

MR MONTICONE: Thank you, here's my opportunity. Peel Valley has been represented at every previous round of IPART and ACCC public hearings, including in Tamworth, Armidale, Sydney and Moree.

Unfortunately for us, IPART has ignored the comments made on behalf of the Peel Valley at every previous public hearing and contained in every submission that we have ever lodged. Therefore, the members of the Peel Valley Water Users Association have become disillusioned with the IPART process. But here we are, once again, trying achieve a fair go for the Peel Valley.

IPART is currently conducting a review on prices for New South Wales, but not much of today's discussion has so far been on the subject of the actual prices. WaterNSW has done a very good job of diverting attention away from pricing on to all of the other topics that have been discussed here today. A whole new bureaucracy has developed around the calculation of water prices, and an unnecessary level of complexity has been created. As a result, there is hardly any focus on the actual prices that are produced from that convoluted process.

Pricing should be the major focus of IPART's current review instead of too much attention being given to matters which are somewhat secondary in this review process. Therefore, we would like to bring the focus back to the core purpose of the review - that is, the actual prices that are being proposed for water over the next four years.

On the screen, we will put the prices up and, specifically, we would like to focus on the prices in the Peel Valley and the massive disparity between the prices in the Peel Valley and every other valley in the Murray-Darling Basin. Those are the figures.

We draw the attention of the tribunal to the prices in that table that are in bold print. We think those prices should be etched into the brain of each member of the tribunal because the first priority of the members of the tribunal should be adjudicating on those prices in that column.

If IPART approves the proposed prices as shown in that table then, by definition, IPART deems that they are fair, they are equitable and that they promote competition. We believe that in their final determination, the members of the tribunal owe it to the Peel Valley Irrigators to explain how the proposed prices can be regarded as fair or how they can be regarded as equitable or how the proposed prices actually promote competition. In our submission, we have also made a suggestion that those prices may actually be against the terms of the Commonwealth Water Act, but that's for IPART to determine.

If the members of the tribunal are unable to explain how the prices are fair, how they are equitable and how they promote competition, then we believe that there is no basis on which the members of the tribunal can approve the proposed prices.

All that the irrigators in the Peel Valley have ever sought from IPART is a fair go. IPART cannot submit that the proposed prices represent a fair go for the Peel Valley compared to other valleys in the Murray-Darling Basin. Therefore, we believe IPART should not grant approval to the proposed prices in the Peel Valley.

If members of the tribunal are to develop a list of action items from today's public hearing, then focusing their attention on the prices in bold print should be top of the list. A critical review of the actual prices being proposed should be the starting point for the regulator's current review of the proposed prices of a state-owned monopoly provider regardless of how those prices have been derived. Thank you.

THE CHAIRMAN: Thank you, Ildu. John, would you like to add anything?

MR BRIGDEN (Peel Valley Water Users Association): Yes, for the sake of having two bob's worth, I really think, as I've said before, that it is about time somebody started looking at why the Peel is treated separately to the Gwydir and the Border and the Namoi. We are all valleys. We are at the headwater of the whole Murray-Darling Basin. All the water that flows out of our valley, out of the Namoi and out of every other valley ends up in the Murray-Darling Basin; but somehow, because we are at the headwater, we end up paying the whole of the cost of maintaining the dam's infrastructure - whether it be Keepit or Chaffey, or whatever, or a percentage thereof - whereas everybody else is getting away with it.

As you can see, there is a bit of a discrepancy in price here. We have not put our entitlement charge on that; that is our usage charge. We are part of the Murray-Darling Basin Plan. When they brought it in, they brought in the water-sharing plan. Our irrigators have licences for 30,000 megs. The water sharing plan brought in a maximum consumption of 6,000 megs, so we are paying entitlement on 30,000 megs and we are paying the cost recovery on the dam, or our share of the cost recovery, on 6,000 megalitres of total usage. That's why we end up with a $57 or $58 usage charge and it is just beyond belief, so why should we have to pay? Namoi would agree too that they are probably paying too much.

Surely there has to be an average drawn or a rule made or a law changed that will allow a cost sharing across everybody in the basin to be competitive with each other. We can only sell a tonne of grain or a bail of hay or a bail of cotton - not that there is much cotton grown in our valley - for the same price that the guys in the Namoi get, and the guys in the Gwydir and the Border would argue the same.

We are off the mark by an enormous amount of money before we even put a seed in the ground. We are now becoming opportunity irrigators because we can't afford to irrigate or we can't afford to have a management plan 12 months in advance first because of unreliability of water.

Tamworth City Council take the majority of what was Chaffey Dam. We now have an enlargement so, hopefully, that will give us long-term security. It's now 100 per cent full, which is even more staggering, but long term, you just can't make a plan to plant an area of lucerne, cotton or anything else that requires regular watering to create an income.

We are being sucked by having to pay $58 a meg and we really can't afford to plant something that needs to be watered because we are in that market with everybody else. I don't think that the guys down the bottom - there has to be somewhere that everyone can share a little bit of the cost, and it is not just our costs, it is the Namoi's and it is every other valley that has a dam sitting in it.

We have been to Barnaby Joyce. He said, "Oh, yeah, that's not right. You should not be paying that." Niall Blair said, "Oh, no, I didn't realise you guys were paying as much as that." They all said, "That's not right", but none of them have done anything about fixing it. We have asked them. They have come back and said, "Yeah, we're working on it", but the "working on it" never happens.

IPART, I assume, has a problem because you can only determine what the rules are and apply those rules, but we need somebody with some guidance to say, "If you don't fix it, we won't have an industry in our valley anymore because no-one can afford to be a full-time irrigator."   It's as simple as that.

THE CHAIRMAN: Thank you very much. We have obviously taken that on board and we have read your submission. Thank you.

Are there other questions or comments on cost recovery?   Yes, Jon-Maree?

MS JON-MAREE BAKER: I would like IPART to consider a community service obligation for the Peel in view of the current pricing. Obviously there is some CSO that is applied but, generally speaking, given the recovery basically comes from usage and there is about 12,000 megalitres of usage annually on average, the community service obligation should really be considered.

That has been raised by Peel Valley Water Users and Namoi Water to the New South Wales government. Obviously that decision is outside your hands, but I think an increase in the CSO as proposed for the coastal valleys would provide some price relief. I would certainly encourage that as an option that IPART consider as part of setting prices and offsetting that increase in costs for the Peel irrigators.

THE CHAIRMAN: Thank you, Jon-Maree.

Do we want to continue the discussion before morning tea now or move on to the metering and other things?

MR MADDEN: I think we will finish this and then start on other business --

THE CHAIRMAN: Maybe we could move on to the final session, which deals with other issues, and that deals with such things as meter service charges, other miscellaneous charges and the efficiency carryover mechanism.

Jess will introduce this. We can discuss that and then move on to any other issues we want to pick up from the earlier discussion.

SESSION 4: Other issues (eg, meter services and miscellaneous charges)

MS FORREST: In this session, we will look at other charges proposed by WaterNSW. They have proposed a number of other charges such as the meter service charges which generally apply to new meters in the southern valleys.

WaterNSW proposes to continue to levy these charges, but to impose the same level of charging for both telemetered and non-telemetered meters. That is quite different from previous years, where they have had separate prices for the different types of meters. Under this new approach, prices will increase up to around 35 per cent over the determination period.

It should also be noted that currently WaterNSW does not levy a separate charge for meter reading and water use assessment costs as these costs are currently recovered through bulk water charges. WaterNSW currently requires a minimum of two meter reads for customers who use between 100 and 500 megalitres and four meter reads for customers above 500 megalitres.

WaterNSW have stated that they intend to restructure their approach to meter reading, so they will consider whether to apply a fixed minimum charge for small customers and a separate meter charge for larger customers and whether this might be appropriate. We will consider this approach over the course of our review as well and we are quite interested to know your views on whether meter-reading costs should be recovered through a separate charge.

Other charges that WaterNSW propose also include a number of charges for non-routine services. These include the trade processing charge, the environmental gauging station charge, meter accuracy in situ and lab meter accuracy deposits for verification and testing and the Fish River connection and disconnection charge.

In particular, it is worth noting that WaterNSW has proposed to increase the environmental gauging station charge significantly for 2017-18 by about 112 per cent. This charge is set to recover the incremental costs of operating the 21 gauging stations that are operated under a service agreement with DPI Water.

WaterNSW argues that the increase is necessary because the current ACCC determined charge is insufficient to recover the costs of upgrading the stations to achieve the level of accuracy that is required under the Commonwealth national measurement standards. The proposed charge includes the additional operational costs to maintain the gauging stations at the required level of accuracy.

We will consider the proposed charge and examine whether it reflects efficient costs as part of our review. Again we are interested in stakeholder views on whether the charge proposed by WaterNSW is reasonable.

WaterNSW is also proposing to introduce credit card payments as a new payment option. It proposes to pass on the costs for credit card payment fees through to the customers based on the normal cost of merchant interchange fees. Our view on this is to not regulate credit card payment fees levied by WaterNSW as customers can avoid credit card fees because there is still a choice of other payment methods that they can use instead.

I will now hand over to John, who will discuss the efficiency carryover mechanism.

MR MADDEN: Thanks, Jess.

I will try to be relatively quick again on this. This is something that may cause a little bit of confusion with people, so we thought that we should cover it. Some might argue that it is a fairly detailed mechanism about regulatory pricing which we have recently applied to Sydney Water. It is something that they proposed, but we are looking at it from a regulatory pricing point of view to apply across all the businesses that we regulate. It is actually about providing incentives and an appropriate incentive so that the business does not affect the timing of, for example, its opex savings, in a sense, to game the system and lock in a higher price and achieve a benefit for a period, so it actually reveals savings when they become apparent to the business.

Now, this may be something that, on the first examination of WaterNSW's proposal, they are obviously not hiding the opex savings they have identified. However, in regulatory practice, there is a concern that, because we don't know everything about a business, in a sense, they hide savings just before a determination and then make those savings the first year after, and they get a period of benefit, so they have an opportunity, in a sense, to make more money.

Really this mechanism would only apply to opex savings and it would apply just like we did for the Sydney Water example. It is really about incentives for the business to actually make savings as soon as it can or as soon as they become apparent.

This slide has a couple of examples. Really what we are talking about is in year one, for example, and year two, there is a permanent decrease in costs. This mechanism actually allows us to take into account in the next period that saving so that the business gets four years of that saving even though it goes into a new determination.

Basically in year three, it is indifferent to being in year one as to whether or not they make that saving. It is a relatively small thing, so I don't want to overplay it in terms of getting feedback, but we will describe more - after getting feedback from people - in the draft report on how this mechanism may work.

As I mentioned, it is similar to one that was used for the Greater Sydney business as well as Sydney Water, and the questions that we have are:

Should we look at regulatory measures such as this to enhance WaterNSW's incentives to pursue efficiency gains?
For this determination should we apply an ECM to WaterNSW's rural operations?

Thank you.

THE CHAIRMAN: Thank you very much, John. Are there any comments or questions from around the table on this section? Zara?

MS LOWIEN: Just on the meter reads and protocols, I would note that the Gwydir doesn't have any Commonwealth-owned meters so we won't pass comment on that.

My first point of call would be that DPI Water is undertaking the water take strategy. It is still in draft. We don't believe it is finalised yet. I do like the alignment of WaterNSW's approach to match that strategy, but, as it is not finalised, I am not sure whether that is an appropriate approach right at this point in time. I think we need to, in time, develop protocols over those that self-read meters at a lower risk basis, how that is entered in the iWAS, and how that is then reported on the water register.

There is a lot of confusion over the meter read as presented on the water register as to whether they are actual or otherwise, and in the sense that do they include self-read meters, they do, but that took a lot of digging in a time of crisis to find that out. I think it is very important that we establish those protocols and match that water take strategy quite efficiently when it is finalised.

On the changes to the water trade, we obviously agree with the slight change. We would suggest that you may consider a price cap or a fee cap in that process. I question the amount of time and effort involved in undertaking the water trade above a certain amount of megalitres and whether or not that should cost more on a per dollar basis. I think that should be capped at a certain amount on what it would cost to undertake that trade.

I appreciate that, in the groundwater sector, there can be some detailed analysis that is required by DPI, assuming they still undertake that role. That may have groundwater having different price caps to regulated, but I think that is a good way forward.

We would definitely support any decreases or price benefits for online transactions and encourage WaterNSW to continue to pursue that.

Efficiency carryover mechanism - thank you for the explanation. Not being aware of the decision that happened in Sydney Metro, I believe, we were quite confused at this type of process. We wondered how it would play out with the UOM, and whether there was any connectivity there or not, as chance to pass on efficiencies and other expenditure.

I think there are some possible opportunities for efficiency gain as the organisation continues to reform and improve. We said in our submission that moving to a higher presence online is obviously the way to go, but noting we have some internet issues in certain parts of the state, so that needs to be taken into account, and we do have some issues occasionally with iWAS.

I think we need to explore this mechanism as a way to make sure there is not any double accounting in the systems. If it is really to drive efficiencies with WaterNSW, that is great. We do question whether having an efficiency dividend as in finding savings to offset inflation over time is one way of doing this without having a carryover mechanism, but we look forward to IPART undertaking some analysis on some opportunities to drive efficiencies.

THE CHAIRMAN: Thank you. Jon?

MS JON-MAREE BAKER: My comments would be similar to what Zara has said. In relation to the meter reading, the water take strategy, I understand, is going to public exhibition in November, whether or not that has actually been delayed now. I think it would be worthwhile checking with DPI Water and if the water take measurement strategy is planned for public exhibition, the meter reading charge should actually be delayed until that information is released. Metering is obviously a popular topic for this part of the world.

I guess in relation to the efficiency carryover mechanism, I am not really sure why we would be providing a service provider with that option. I can't really see the benefit in doing that, and given that it looks like it is just creating another rule and another set of complexities, why can't we actually pass on that benefit to customers straight away?

With most other service providers who are able to buy goods at a cheaper cost, that is directly passed on to the customer straight away. In terms of that efficiency carryover mechanism, given our time frame for the determination is short - it is four years anyway - we should be annually resetting it.

I think that is really our only comment, without going into too much detail. Did you want to talk about anything, David?

MR PHELPS: No, thank you.

THE CHAIRMAN: Thanks, Jon-Maree. Are there any comments or questions around the table? Anybody from the audience or further discussion on this topic. Yes, Joe?

MR ROBINSON: I want some clarification. The efficiency carryover mechanism sounds like a UOM for expenses rather than income; is that right? Is that what it sort of is about?

THE CHAIRMAN: Not really, but it's actually not a bad description on the run. What it is is that, because you have a four-year regulatory period, once the price is set for the four years, there is an incentive on the regulated business to make the savings up-front because they can bank that, in a sense, for four years before IPART comes along in the next review or the other regulators come along in the next review. What this would say is that if they make a saving up-front, they would retain that for the four years, but afterwards it would be passed on to the customer for the next period.

MR ROBINSON: So is the saving passed on or the ongoing savings passed on?

THE CHAIRMAN: The ongoing savings, yes.

MR ROBINSON: So they would bank it?

THE CHAIRMAN: Yes. I think WaterNSW's proposal is rather tentative on this. Maybe WaterNSW can speak to it.

MR ROBINSON: You can come up and use this microphone; it's on.

MR HARRIS: We just wanted to make clarification. As has been said, the IPART allowed an ECM in our Greater Sydney determination. We did not propose one in our rural determination. What we proposed was that we could collect data; similar to Greater Sydney, we would collect data and we would have that conversation with our customers over the next four years and, if it was thought fit, seek an inclusion of that at that time, but there is no proposal in our pricing submission for this at this time.

THE CHAIRMAN: Thank you.

Are there other questions or comments? Just before the tea break, John Madden put a question about in the event that WaterNSW was consulting with customers on certain pricing options, or something like that, what sort of role is there in terms of individual customers being able to express their view and sign up on that and how does that fit in with the customer service groups at the moment?

I'll pass to John for further clarification.

MR MADDEN: Hopefully, people have thought a little bit more about this. Obviously there can't be a definitive answer. I guess the thought that comes to me is really what is the authority around a customer service committee? WaterNSW might want to talk about this as well. With that level of consultation, does it vary between valleys in terms of interaction between the customer service committee and user groups in terms of the membership levels? How do they actually communicate information downwards and upwards? It might be good to know, given that we have different valleys, does that in itself work differently but, more importantly, how would it actually have to work to have the authority to make the choice on behalf of the valley?

MR PHELPS: Being the chair of a customer service committee, I'll have first go. I would say that in the Northern valleys, we have embraced the customer service process pretty well. The current management of WaterNSW have embraced it. There have been times in the past where we have been a nuisance to their process, but they have an obligation to conduct the CSCs and to the current guys' credit they have embraced it. We think it is a good process.

With issues such as the volatility allowance, these guys have stated their view up-front. Our view is that we have always been against it, but from day one they have said, "That's our view. Look, we will come here and argue with you guys our view."

As to what obligation WaterNSW would put on a customer service committee's view, I think they don't have any obligation to do what we want, but they do listen. We have disagreements, but, on the whole, it is a good process.

Joe might make some comments for the Gwydir, but other than my comments earlier, where the process breaks down, it's not good, but we do get our opportunity to make our points.

MS JON-MAREE BAKER: Probably adding to the question, John, really it is around the delegated authority and the role of the CSCs, which is changing substantially as the transformation process occurs. I think WaterNSW should probably consider how they reshape the terms of reference of their CSCs given that transformation process is occurring. It is a very relevant issue in terms of how decisions are actually made and proposals put forward to those delegated representatives and also on how you actually gauge wider feedback on issues.

In this pricing determination, WaterNSW made a substantial effort to ensure that their delegated representatives on the CSC took the information that was provided to them back to the customer base and clearly articulated to them their responsibility as delegates. That was probably a change from previous determinations holding the delegates to account in terms of communicating any changes that might occur or actually representing feedback from the valley as a whole.

I think it is really around the process and it does very much relate to the concept of whether or not it actually is capex or opex in relation to what it is you are proposing to change, and that might actually be different in terms of the delegated authority.

THE CHAIRMAN: Thank you, Jon-Maree. Yes, Joe?

MR ROBINSON: Thank you. In terms of whether the CSCs have got the authority to make the decision, I am unsure of that. However, what I would say is that the majority of water users are pretty well represented at the CSCs. I would say as an irrigators' association, potentially we might have more authority from an irrigators' point of view, but we are not actually covering all the users, so I think with the CSCs it is a reasonable assumption to say this is a fair view because everyone gets a hearing.

There is one thing that I am not 100 per cent sure on. We obviously say we want a 40:60, but I don't know if we absolutely know what the cost of that alignment with our business is in terms of insurances or what the determination looks like. The example there of Border Rivers with their variable cost, you know, for the MDBA costs it looked like the 40:60 compared to a fixed was probably adding 30 per cent to the total cost. If I saw that I would probably say, "I want it up-front."

I have to be careful of what I say for my members, but realistically across the board we need to know exactly what premium we are paying for 40:60 against an 80:20 or a 100 per cent fixed charge. I know it's going to be very difficult to do it, but I think there are some people who, rather than pay the premium, if they actually knew what the cost of the premium is, might decide that it is too expensive.

THE CHAIRMAN: Thanks very much, Joe. That's a good contribution and the tribunal will spend much more time on this matter. Zara?

MS LOWIEN: Just to follow on from Joe's point, the representation at the CSC is a key point. I think that how much there is buy-in from all those different users needs to be investigated on the authority. Obviously, we have a number of members from the irrigation sector who are quite well represented. They also have a backing structure behind them in most cases as with ours, who are nominated by the Gwydir Valley Irrigators.

However, there are a range of other users around the table with different levels of participation. I think to make sure the CSC represents all water users, those people need to be canvassed directly. Whether it has to be a 100 per cent response rate via a survey is really up to the level of decision on what it is if we make a substantial move. At this stage, we have fed back to our other bodies and our other customers and canvassed through that and have said that we are interested in user choice down the track on an individual basis potentially but, at the moment, as a whole valley we will stick where we are.

MR MADDEN: Just to add a question - this is about the Lachlan, but it is to illustrate an example - the Lachlan, you noted in your proposal, flagged potentially they would move to an 80:20. I wonder what does WaterNSW think about what is the process from here in terms of them actually making a decision, communicating that to you through to IPART? Is that something that is on the table to come through to our draft report or, from your perspective, what would occur from this point forward around making their choice?

THE CHAIRMAN: Thanks, John. WaterNSW?

MR HARRIS: In relation to the Lachlan, with that valley, as we understand it, the CSC continues to look at the question of tariff structure and that is entirely in their hands at the moment.

Can I make a couple of points about this CSC issue. We at WaterNSW see ourselves as completely accountable for our customer relationships. That is point number one. This time, in preparing our pricing submission, we offered a choice on a valley basis in regards to tariff. We are aiming to offer a choice at a user level, but for various reasons we are not able to do that this time. To express that choice we use the mechanism specified by IPART in our operating licence - that is, the CSC mechanism.

We intend to broaden our customer channels and deepen our relationship with our customers. In the future, we would urge IPART to look at questions such as this on a holistic basis including but not limited to just CSCs. We are completely motivated to do our customer relationships better.

THE CHAIRMAN: Thank you, David. Anybody else? John?

MR BRIGDEN: I have a follow-on comment, which is about customer service. I know that the guillotine is about to drop. As far as pricing reduction or a request for pricing reduction in the Peel, we are not looking for charity; we are looking for fairness. Therefore, any determination should be based on a fair determination and not a charitable one.

Secondly, I was surprised to see that high security usage costs have been reduced. I don't know about other valleys but, in our valley, the biggest high security users would be Tamworth City Council, and the others are the chicken farms which are well downstream of Chaffey Dam.

With Chaffey Dam, to release water for the Tamworth City Council high security, high security is paid by what goes through the meter not what comes out of the dam. There is something like a 35 per cent transmission loss between Chaffey Dam and where Tamworth City Council pump to their treatment plant.

As far as the chicken farms are concerned, because they are down the bottom end of the valley, there is nearly 80 per cent transmission loss to get that high security water. They are getting the water at a price that has now been reduced that everybody else has been denied, but the cost of running the dam is still apportioned to that transmission loss. Again, I don't know who looks at that, but I can't see any argument for reducing high security costs in our valley when I think they are getting it way too cheap. That will be the end of me for the day, thank you.

THE CHAIRMAN: Thank you very much, John. John Madden?

MR MADDEN: I come back to that point that I asked about the Lachlan. I take the point about deepening relationships but within this determination point of view, is there a CSC meeting coming up where Lachlan, for example, has an option to make that choice? Is it still on the table or is it something that is now not off the table?

MR HARRIS: They will be attending the Sydney session next week. We heard that at our CSC group meeting last week. There is a further CSC round early next year.

MR STOCKLER: They are continuing to look at it and to do their independent analysis. Really, as David said, it is with them now. However, they did indicate to us at the CSC reference group last week that they were still very interested in exploring that.

THE CHAIRMAN: Okay, thank you, WaterNSW. Just one question from Matt and then we will wrap up.

MR EDGERTON: Matt Edgerton from the IPART secretariat.

David. As a follow-up to that, just to confirm, is that the only valley where you see the question of price structure still being on the table or an open question for this determination?

MR STOCKLER: As Joe indicated - wherever Joe is; he has moved on me - a number of customers could be interested in a different structure if they were presented the opportunity at a customer level. At this point, Lachlan are the most progressed in terms of doing an independent review analysis on what it would mean to them.

THE CHAIRMAN: Thank you, David. Joe?

MR ROBINSON: Who's providing the independent analysis? Are they doing it themselves.

MR STOCKLER: Lachlan are doing it themselves.

THE CHAIRMAN: We are moving to wrap up now, so I'll pass it over to Jon-Maree.

MS JON-MAREE BAKER: I have just one last thing on that issue. User choice and different levels of service come at a cost. In terms of customers choosing to move to different ratios, I guess what we have not actually seen on the table is what are the costs that would be incurred with parts of the business delivering different levels of service. If you actually have people changing to 80:20, what does that do to the remaining customers? I think that is something to consider as part of that choice in costs.

To wrap up, we are obviously pleased to see that IPART is looking at the review of cost shares, but we feel that stakeholders should be given the opportunity to submit particularly on the results of the external review that is being undertaken. Whilst we welcome the fact that you have engaged someone to look at the cost shares, we would be very interested in that information and the actual provision of some feedback on it as part of that consideration.

In relation to cost shares, we do see that there has been a bit of blurring between impactor pays and beneficiary pays over the pricing determinations. We also believe the legacy issue needs to be explored in detail, in particular with a valley that has a dam where, under asset efficiency, for example, we could have had Keepit upgraded versus building Split Rock. That legacy issue should really be considered because the asset efficiency with Split Rock is not there and it costs us substantially year in and year out on both opex and capex.

We would ask IPART to provide some further information in relation to how asset efficiency is actually assessed and we would seek that Split Rock be reassessed, particularly because, if an upgraded Keepit had been undertaken, there would have been far greater efficiency from an irrigator's perspective.

Also obviously there is environmental operating expenditure, particularly with the implementation of the Basin Plan and prerequisite policy measures and planning assumptions coming in at the back end of this pricing determination. Those things materially affect how planned environmental water is managed.

The cost of managing planned environmental water has not been provided in detail, although I believe that WaterNSW has said that it has been costed out as part of the business structure. We would like some transparency on what it has cost the business to manage planned environmental water which we believe has been paid for by the existing customers. Obviously environmental compliance costs are another issue that we would like to see further investigated.

THE CHAIRMAN: Thanks, Jon-Maree. Zara?

MS LOWIEN: Staying on the issue of user shares, we have outlined a couple of areas where we think there needs to be investigation on those. I would second most of what has been outlined by Jon-Maree, in particular the more active management of planned environmental water both within our valleys and others. We have seen potential changes to our water sharing plan to stipulate that more active management. That will have a cost impact to customers. At this stage, for the majority share of that and in reference to the supplementary water use in our valley, which is shared 50:50 between the environment and users, the majority user base is covering for that delivery cost and for that decision-making, that active management. I think that needs to be investigated.

We don't often have a chance for a user share review. I appreciate the water sharing plan may not have been amended and changed before this review is finalised, but it needs to be taken into consideration if that is moving forward with the Basin Plan.

On some other issues that we are considering, I think there are two more remaining which we would like to flesh out a little bit more, and the first relates to the high security premium and its calculation. We have had a couple of changes in the Gwydir Valley which have been reflected in the report, but we have not seen the high security premium amended, and that is a result of the change in entitlement in the valley. We would like that just to be double-checked. That is an increase in both high security and general security entitlement. We would also like to see the reliability ratio updated with the new IQQM outputs. I think that information might change that premium into the future.

The final one is bill impacts, and I note we have made some comments before, I needed to flesh out the facts, and I am more than happy to share my spreadsheet with both WaterNSW and IPART on this. It is a pretty simple calculation. I can see why WaterNSW chose to do it the way they did it because it presents a certain case to users.

In reality, WaterNSW has compared current costs between determination periods - between 2016-17 and 2017-18 going forward, so, yes, indeed, their report does outline that difference. I note that actual expenditure is underneath that allowance, so that would be even a better price if they used actuals versus allowances. But in moving forward, what --

MR HARRIS: Give us credit for achieving that, though, won't you?

MS LOWIEN: I beg your pardon?

MS HARRIS: Give us credit for achieving that 20 percent --

MS LOWIEN: Yes, yes, and it is in here. You have --

MR HARRIS: -- reduction. Come on --

THE CHAIRMAN: Hang on, hang on.

MS LOWIEN: Yes, and it is here. Credit where it's due, there has been a reduction and we would hope to see that pass through into the future, as is outlined in the report.

However, where I believe there is the sticking point and the difference between WaterNSW's approach and what we do on behalf of users is we look at the actual and we look at, going forward, what are the changes. We know over the next determination period in the Gwydir there is a difference between 2.2 per cent increase for high security fixed, a 30.5 per cent increase for general security fixed, and a 1.6 per cent increase on variable charges.

Now, that is a comparison between the final year allowances and the final year of the determination period. That is key information because that is showing you what the difference between the two determination periods is. That is quite substantially different to the difference between the first year of this upcoming determination and the last.

I think that is where we need to see more transparency in the way bill impacts are looked at. Obviously we are seeing between a 7.6 and 7.9 per cent increase within the determination period most likely predominantly driven by capex as well as an RTP allowance. Whether that is in that or not might have an impact on that.

The other key point with bill impacts is also, and I do like credit where it's due, the difference in the different types of holdings provided in the bill impact analysis - so a small to a medium to a large user. That is very handy in a situation where you have a whole range of people. But in a valley like Gwydir, where we see the analysis on 100 per cent to 60 per cent, we should also consider a 30 per cent percentage as well, because we often flick between those types of scenarios, quite reasonably, and that will allow individuals to make a better assessment provided it is looked at on that between and within scenario for quite a comprehensive matter.

I would happy to share that spreadsheet, but I think it is important to provide the overall impact, which is quite different to the headline especially for this valley.

THE CHAIRMAN: Thank you very much, Zara. Do you want to say anything more, David?

MR HARRIS: No, I think I've said enough, thank you.

CLOSING REMARKS

THE CHAIRMAN: All right, I think that's it. Thank you very much. It has been a very good session and I would like to thank you all for participating and coming today.

A transcript of today's proceedings will be available on our website in a few days.

We will consider all that has been said today, including the plea from Peel to have more explanation, when we make our decisions on WaterNSW's prices for rural bulk water services to apply from 1 July 2017.

As previously mentioned, we plan to release a draft report for public comment in March 2017. People will then have about four weeks to make further written submissions for consideration by IPART before we make our final decision on WaterNSW's prices for rural bulk water services.

A final report and determination will be released in June 2017 and the maximum prices that we set will apply from 1 July 2017.

I encourage you to monitor IPART's website for updates and further information on our timetable including the release date for the draft report.

Finally, I note that we will hold two further hearings this year and we will also hold a public hearing in Sydney on 4 April 2017 following the release of our draft report which will provide an opportunity for further stakeholder consultation.

This brings us to a close to today's session. Once again, thank you very much and have a good afternoon.

AT 1.15PM THE TRIBUNAL WAS ADJOURNED ACCORDINGLY