

17 August 2005

Mr John Feil
Executive Director
National Competition Council
GPO Box 250B
Melbourne VIC 3001

Dear Mr Feil

Subject : Lakes R Us Application for Declaration of Parts of the Snowy Hydro System

The Murray-Darling Basin Commission opposes the application by Lakes R Us for the declaration under Part III A of the Trade Practices Act (TPA) 1974 for 5 water storage services and 10 transportation services operated by Snowy Hydro and the State Water Corporation on the grounds that:

- The service can not practically be utilised without impacting on a production process. This process is the conversion of the potential energy in the water harvested from the catchment of the Scheme into electrical energy that is generated at times which match the peak demand for that energy;
- That there are alternative mechanisms available to improve the reliability of downstream water;
- The water which flows from the Scheme that the applicants propose to swap does not belong to individual irrigators but is only a component of the resources used to supply those irrigators. Approval to convert an allocation to divert water from a downstream river into a right to either permit or require Snowy Hydro Limited (SHL) to alter its Required Release from the Scheme requires special approval from:
 - The NSW Government as administrator of the Snowy Water Licence,
 - The Water Authorities which administer the water allocations on the downstream rivers, and
 - The Murray-Darling Basin Commission which administers the accounting between the States of the Snowy Scheme releases to the Murray Catchment; and
- It is contrary to the public interest.

Commission Interest in the Snowy Scheme

The works of the Snowy Scheme harvest and release water both from the catchment of the Snowy River and from the Murray and Murrumbidgee Rivers in the Murray-Darling Basin. On average the Scheme releases 2390 GL/year to the MD Basin of which 1120 GL/year has been transferred from the Snowy River Catchment. The large storages in the Scheme enable these releases to be highly regulated with 2088 GL/year being supplied as a highly reliable annual Required Release. This Required Release is 1062 GL/year to the Murray Catchment

and 1026 GL/year to the Murrumbidgee Catchment. These highly reliable releases underwrite the reliability of both high and general security water entitlements in New South Wales, Victoria and South Australia.

Previous use of the Snowy Scheme to supply extra water to irrigators in times of shortage

Prior to corporatisation of the Snowy Scheme, numerous requests were made to the Snowy Mountains Council for the Scheme to provide additional water during times of shortage. Although on occasion the Scheme was able to provide assistance in this regard, in most cases more weight was given to the interests of the electricity producers.

Following corporatisation, there have been a number of deals between Snowy Hydro Limited, the New South Wales Government and NSW irrigators in both the Murrumbidgee and Murray valleys for advances to be made on next year's Required Release to increase supplies in drought years. Irrigators were offered the right to subscribe early in the season for the opportunity to obtain in the current season an advance on next year's allocation. In some deals the requirement to repay this advance in the next season was subject to specified allocation levels being announced in that season. Any advance not repaid next year would have to be repaid in the following year.

An irrigator's allocation is a right to divert water from a specified river. The water resources used to supply this allocation includes water entering from tributaries downstream of the headworks dam. A Murray or Murrumbidgee allocation therefore does not give the irrigator a direct right to the water released from the Snowy Scheme. The deals that have been done to date were possible only because the NSW Government was prepared to sponsor them and to make the appropriate adjustments to the allocation process. In sponsoring these deals, the NSW Government needed to ensure that there were no adverse impacts on third parties including the reliability of NSW high security licences in subsequent years.

In the cases involving advances to the Murray Catchment, additional approval has been required from the Murray-Darling Basin Commission (MDBC) to ensure that the advance was added to the NSW share of the water released from the Snowy and the repayment was subtracted from it. In permitting these deals the MDBC needed to ensure that there were no adverse impacts on the water supply reliability in the other States.

The Murray-Darling Basin Commission's reasons for opposing the declaration

Impact on a production process

Section 44B of the TPA excludes the 'use of a production process' from the definition of a 'service' that can be declared. In the case of the Snowy Scheme, a production process exists in the conversion of the potential energy in the water harvested from the catchment into electrical energy. A key component of this production process is matching the timing of generation with the peak demand for energy. Because of their ability to switch on and off rapidly, the flexibility and timing of generation from hydroelectric generation represents a large part of its value. This is especially the case in the Snowy Scheme where the generating capacity of the plant exceeds by a large margin the average outflow from the system.

Unlike in a rail network, it is not practically possible, other than by the use of cloud-seeding, to add more water to the Snowy Scheme to utilise the spare capacity of water storages and

transportation systems. The method proposed by Lakes R Us to utilise this capacity is to change the timing of the existing SHL releases. This is analogous to claiming that the spare capacity in a rail network can be utilised by changing the departure times of the existing trains without increasing the number of services.

The proposal by Lakes R Us to store irrigator's unused allocations for delivery in future years may compromise SHL's flexibility to schedule its generation to match peak electricity demands. The Snowy Water Licence specifies that the year over which the Required Release must be supplied starts on 1 May and ends on 30 April. Water allocations on the Murray and Murrumbidgee apply to years which start on 1 July and end on 30 June. However planting decisions are typically made in October and peak usage continues until March. An irrigator is therefore unlikely to know before February whether he will have surplus allocation to carry over. If SHL were notified at that time they would have only three months to reduce releases. A reduction late in the year may not be possible with existing contracts or may preclude the writing of such contracts. Similarly a late requirement to increase outflows from the Scheme could result in forced generation at times of low electricity prices.

The Lakes R Us application has sought to have the water storage and transportation services declared but has not sought to have the swap mechanism declared. Without this mechanism, the other services would have no value. It is not clear whether the National Competition Council has the power to make a declaration in relation to this swap mechanism especially since it involves the use of a production process.

Alternative mechanisms available to improve the reliability of downstream water

Although it would not be possible or practical to duplicate the Snowy Scheme, other options are available for developing a more reliable water supply. NSW irrigators for example have access to carry-over which enables them to carry over unused entitlement up to 50% of their licensed entitlement to the following year. The difference between water carried over under the existing system and water carried over under the scheme proposed by Lakes R Us is that the maximum usage in any one year is limited to 100% of entitlement. Thus under the current system all carried over allocation is lost once the allocation reaches 100%. Despite this limitation, the existing NSW carry-over rules still offer considerable scope for NSW irrigators to improve the reliability of the existing entitlements by carrying over unused entitlements.

Other options that might be possible for improving reliability include the construction of surface or groundwater storage and the greater utilisation of water trade.

Approvals required before swapping could be possible

As discussed above, the irrigator's diversion allocation is not equivalent to water released from the Snowy Scheme. Additional approvals would be required including the renegotiation of the Snowy Water Licence (SWL). Altering the SWL would require:

- agreement in principle by the Snowy Water Consultation and Liaison Committee;
- endorsement by the NSW Department of Infrastructure, Planning and Natural Resources (DIPNR), as the authority responsible for issuing this SWL to SHL;
- development of a Draft Replacement Snowy Water Licence (RSWL) by DIPNR;

- application by DIPNR to the Murray-Darling Basin Ministerial Council to modify Schedule G to the *Murray-Darling Basin Agreement*;
- unanimous agreement by the representatives of the New South Wales, Victorian, South Australian and the Australian Governments on the Murray-Darling Basin Ministerial Council to modify Schedule G to the *Murray-Darling Basin Agreement*; and
- NSW issuing a new licence to SHL.

Given the resistance to the Lakes R Us proposal by SHL and the difficulties it would present to the MDBC, this seems unlikely.

Public Interest

The primary reason why the declaration is not in the public interest is that it may compromise SHL's ability to generate electricity at times of peak demand. Control of the timing of releases would shift from SHL to the users of the declared services. The ability for hydroelectric generators to switch on and off quickly make them an important component in the National Electricity Market and the opportunities for hydroelectric generation in Australia are limited. Any action which reduces the ability of SHL to plan its releases will result in losses to SHL. The proposal would differ from the deals that have been made in recent years in that those deals were finalised early in the season and were made with the agreement of SHL at times which suited SHL's planned releases.

For the declaration to be in the public interest, the benefits to irrigation and to the community would have to exceed the costs to electricity generation and to the community. The primary benefit to irrigators relates to creating a more reliable water supply. As discussed above, carry-over is already possible in NSW and, properly managed, the existing system can provide many of the improvements in water supply reliability promised by the Lakes R Us proposal. In New South Wales it is also possible to convert 2 ML of General Security Entitlement into 1 ML of High Security Entitlement.

In assessing the benefits of the proposal it is also necessary to consider whether the proposal would affect third party irrigators who do not participate in the scheme. The interaction of allocation levels, water use, carry-over and the Murray-Darling Basin Ministerial Council decision to Cap diversions is a complicated one. The Cap in the Murray and Murrumbidgee valleys limits diversions to corresponding to the level of development that existed in 1993/94. Not all the existing allocations are used each year, and this under-usage is factored into the announced allocations. The average usage of allocated water is only 70 per cent although this percentage varies from year to year. Over time it is expected that this level of utilisation will increase and that future allocations will have to be limited to ensure diversions in each valley do not exceed the agreed Cap levels.

The Lakes R Us proposal, by reserving unused entitlement and carrying it over to subsequent years, is likely to increase the ultimate level of utilisation. Since the proposal will not alter the average volume of water that can be diverted under the Cap, it must impact upon the levels of announced allocation. Any increase in usage by participants in the Lakes R Us venture will therefore ultimately result in a consequent reduction in use by non-participants.

In summary it appears that the costs of the proposal to electrical generation may be substantial, that the benefits to irrigators participating in the scheme will be modest and that

some of these benefits will be at the expense of third party irrigators. For these reasons it appears that the Lakes R Us proposal is not in the public interest.

If we can be of any further assistance please do not hesitate to contact us.

Yours sincerely

Wendy Craik
Chief Executive