

Kevin Anderson MP
Member for Tamworth Electorate
Chair Legislative Assembly Committee on Community Services

THE NATIONALS *for Regional NSW*

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Mr Sebastian Roberts
General Manager – Water Branch
Australian Competition and Consumer Commission
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Dear Mr Roberts

ACCC Draft Decision on State Water Pricing Application 2014-17

Thank you for the opportunity to make a submission on the Australian Competition and Consumer Commission (ACCC) review of an application by State Water for water charges to be imposed on customers of bulk water infrastructure in the Murray Darling Basin for the three year period commencing 1 July 2014 and ending 30 June 2017.

This submission is based on many representations and expresses the views of bulk water users including irrigators, Tamworth Regional Council rate payers and high security users. It will make general comments about the State Water pricing proposal, and specific recommendations in respect of the economic impact of rural bulk water pricing proposals on consumers and irrigators within the Peel Valley.

We are now part of the one basin and therefore, we should all be paying the same and a uniform price for bulk water being no more than the average price determined across the State for all valleys. It must be a level playing field and uphold the principles of National Competition Policy. Such a system would be inherently fair and equitable for all bulk water users.

Firstly, may I acknowledge the comprehensive nature of the review undertaken by ACCC which follows a similarly comprehensive review undertaken by IPART for the previous three year period ending 30 June 2014.

Secondly and from the outset, I propose the following set of principles, or pricing regime framework, be adopted by State Water to guide future pricing applications. If possible at this late hour, I strongly urge that the principles be also taken into

account by the ACCC when making a final determination for rural bulk water charges in the Murray Darling Basin.

Pricing Principles for determining Bulk Water Charges:

- *Water charges be based on the efficient and economic cost of providing water services.*
- *Water charges be levied on the basis of recovery of the cost of the service provided.*
- *Where a valley has not achieved full cost recovery, progression to full cost recovery be phased in over to two price determination periods.*
- *State Water as provider of bulk water services and custodian of water assets be allocated sufficient funds on an annual basis to achieve long term financial sustainability.*
- *Water pricing policies be structured and designed to ensure environmental sustainable use of water resources and water infrastructure.*
- *Water pricing policies be targeted to ensure the best overall outcome for the community from the use of water resources and the assets used to store, manage and deliver water.*
- *Long term pricing regime paths fix the cost of providing and delivering bulk water services for all valleys on the basis of a 40% to 60% ratio between entitlement charges (40%) and user charges (60%) respectively.*
- *In circumstances where a bulk water user is not permitted access to their annual water allocation, the entitlement charge be waived for the period the water allocation is unavailable due to high security user preference and demands.*
- *Climatic conditions and the financial capacity of consumers to pay during periods of adverse climatic conditions be taken into account by State Water when reviewing bulk water pricing policies and setting charges.*
- *The annual rate of return on the Regulatory Asset Base (RAB) be assessed by a price regulator as representing the actual figure commensurate with the commercial risk to State Water's regulated activities capped at a maximum of 10% per annum.*
- *State Water introduce a system for providing incentives, by way of discounts and concessions on user charges, for proven water efficiency and sustainability measures and infrastructure implemented by users.*

- *State Water structure and adopt a Dams Safety Compliance Long Term Financial Strategy to address priorities and funding for dam safety compliance funded from water entitlement charges and State Government.*

State Water Total Revenue and Expenditure Proposals

The first comment I would make on behalf of my constituents relates to the significant divergence and variation between Income and Expenditure proposals by State Water for the 2014-17 period and the draft determination by the ACCC.

The level of variation is so great that I have received numerous representations, both verbally and in writing, that the State Water 2014-17 Bulk Water Pricing application exhibits an appreciable lack of customer service focus, an absence of financial accountability and a negligible regard for the socio-economic impact of bulk water pricing on consumers and irrigators generally across all catchments within the Murray Darling Basin but particularly in the Peel Valley.

On behalf of my constituents, I strongly encourage State Water to implement an accountable process and methodology for future bulk water pricing applications.

I support my constituents' opinion that State Water lacks capacity and expertise in strategic long term financial planning and modelling for bulk water infrastructure renewal, replacement and creation.

State Water Total Revenue Proposals

On behalf of my constituents, I support the ACCC draft determination for a total revenue allocation of \$283million for the 2014-17 period which includes a user share of \$167.1million and government share of \$115.9million. The draft determination represents a figure 16.8% less than the total revenue bid by State Water. Extrapolating to the Namoi and Peel Valleys, State Water proposes collecting total revenue of \$58.8million for the Namoi Valley while the ACCC draft determination assesses efficient costs at \$47.7million, excluding \$11.1million and representing a reduction of 18.9%.

In respect of the Peel Valley, State Water proposes collecting total revenue of \$15.5million while the ACCC draft determination assesses efficient costs at \$11.5million, excluding \$3.9million and representing a reduction of 25.16%.

ACCC Draft determination charges for each valley are as follows:

Namoi Valley

ACCC Draft Decision **High Security, General Security and usage bulk water charges 2014-15 to 2016-17 (\$ Real, 2013-14)**

	2013-14*	2014-15	2015-16	2016-17
High security (\$/ML)	16.02	17.07	17.20	17.33
General security (\$/ML)	8.98	7.94	8.00	8.06
\$Increase/(Decrease)		(1.04)	(0.98)	(0.92)

%Increase(Decrease)		(11.58%)	(10.9%)	(10.24%)
Usage (\$/ML delivered)	19.73	20.61	20.77	20.92
(Decrease)/Increase		0.88	1.04	1.19
%Increase(Decrease)		4.46%	5.27%	6.03%

Interpreting the above Table in respect of the Namoi Valley, entitlement charges are proposed to reduce by \$0.92 over the three year period representing a decrease of 10.24% over that period. Usages charges are proposed to increase by \$1.19 over the three year period representing an increase of 6.03%.

Peel Valley

ACCC Draft Decision High Security, General Security and usage bulk water charges 2014-15 to 2016-17

	2013-14*	2014-15	2015-16	2016-17
High security (\$/ML)	25.08	27.58	30.34	33.38
General security (\$/ML)	2.76	3.03	3.34	3.67
\$Increase/(Decrease)		0.27	0.58	0.91
%Increase(Decrease)		9.78%	21.01%	32.97%
Usage (\$/ML delivered)	41.42	45.56	50.12	55.13
\$Increase/(Decrease)		4.14	8.70	13.71
%Increase(Decrease)		9.99%	21.0%	33.09%

Interpreting the above Table in respect of the Peel Valley, entitlement charges are proposed to increase by \$0.91 over the three year period representing an increase of 32.97% over that period. Usages charges are proposed to increase by \$13.71 over the three year period representing an increase of 33.09%, a marked variation from the Namoi Valley to say the least.

I strongly support the ACCC draft determination that the State Water total revenue forecast for the 2014-17 period is higher than required to meet the efficient cost of offering bulk water infrastructure services. It follows that I support the ACCC draft determination for a total revenue allocation of \$283million for the 2014-17 period.

It is of great relief to all irrigators in the Namoi and Peel Valleys that the ACCC has formed the view after comprehensive assessment that State Water proposals for operating expenditure (opex) and capital expenditure (capex) are higher than required to meet financially prudent and efficient expenditure. Again, the ACCC draft determination represents an amount 16.8% less than the total revenue bid by State Water.

Determination of Bulk Water Charges

It is the strongly held view of my constituents that State Water should adopt a long term pricing regime to fix the cost of providing and delivering bulk water services for all valleys at a 40% to 60% ratio between entitlement charges (40%) and user charges (60%) respectively.

In stating this view, I note that for the period 2014-17 State Water proposes to recover 80% of its costs through entitlement charges and 20% through usage charges or an 80:20 ratio split between fixed and variable charges. In the view of my constituents, the proposal by State Water for an 80:20 two part tariff is out of touch with commercial reality and completely at odds with widely accepted water pricing methodology. In bidding for an 80:20 ratio, State Water appears to take no account of the realities of climate variability, higher temperatures, reduced rainfall and is an attempt to transfer the risk represented by these factors to bulk water customers.

All irrigators welcome the eminently sensible approach taken by the ACCC in the draft determination to maintain 40:60 ratio for 2014-17 period. Continuation of this ratio will result in progressive transition to full cost recovery in valleys not currently achieving full cost recovery and will protect irrigators from large increases in water charges over the short term.

State Water Strategic Financial Planning

On behalf of my constituents, I record support of a proposal by the ACCC for an 'unders' and 'overs' Reserve Account to address revenue volatility experienced by State Water occasioned by changes in rainfall equating to a 12% reduction in State Water revenue brought on by a 20% reduction in water usage.

The 'unders' and 'overs' account would allow State Water to adjust its charges annually to recover a portion of the revenue not recovered because water usage is lower than that forecast, or to return a portion of revenue to customers if water usage is higher than forecast.

The 'unders' and 'overs' Reserve Account combined with 40:60 two part tariff structure for bulk water services will undoubtedly provide for a pragmatic and strategic approach to water demand planning and a measure of relative price stability for customers.

Overheads

While State Water has not provided the ACCC with information on labour and overhead on-costs charged to capital projects, these costs have been estimated at \$32.9million or 18.4% of overall capex of \$204.1million. In arriving at this estimate, the ACCC has referred to an historical allocation by State Water of 7% for capex labour and overhead on-costs.

As an outcome, the ACCC draft determination provides for capex on-costs for labour and overheads at \$10.7million or \$22.2million (67.7%) less than the State Water proposal.

This is an alarming variation to say the least.

Capex

The ACCC considers that a capex allowance of \$151.8million more accurately reflects the prudent and efficient costs of providing capital infrastructure services for 2014-17, representing \$52.3million, or 34.45% less than the bid for by State Water.

I strongly suggest that 2014-17 capex be mandated in the ACCC 2014-17 final determination for reason there is evidence in past periods of State Water exceeding approved capex limits. Capital infrastructure expenditure overruns benefit State Water in future capex proposals and rewards lack of financial accountability and fiscal compliance at the expense of bulk water users.

Dams Safety Compliance

My constituents are not convinced that State Water has taken a strategic approach to Dams Safety Compliance. My comment in this regard is driven by the State Water proposal to bring forward the safety works for the Oberon Dam to the 2014-17 period on the basis it is efficient to undertake these works concurrently with the Rydal Dam safety works. The context of 'efficient' has not been explained and begs the question is it reasonable for bulk water users to contribute to dams safety without an agreed and publicly available compliance strategy.

This proposal has met with a response from ACCC that it does not consider State Water efficiency gains outweigh the costs of bringing forward compliance by 18 years and has rejected the proposal and reduced capex by \$16million.

Without further information and access to a *Dams Safety Compliance Strategic Plan* nominating projects and time frames, it is hard to conclude other than that the high cost of bulk water in the Peel Valley is an undisclosed funding source for State Water dams safety compliance capex proposals.

Water Delivery and Other Operations

It is alarming to learn that State Water has not completed a detailed business plan for the Computer Aided River Management System (CARMS).

It is difficult to understand the failure of State Water to prepare a business plan or undertake cost benefit analysis to identify benefits and costs of CARMS for State wide application that justify purchase at a cost of \$13.6million.

It follows that this project has appropriately not been included in the ACCC draft determination and expenditure of \$0.4million has been identified as prudent and efficient expenditure for water delivery and other operations.

Waiving of Water Entitlement Charges

I have been informed by Peel Valley irrigators that due to low bulk water availability, the annual water allocation to irrigators in the Peel Valley will be reduced to nil as from the 1st July 2014.

On behalf of my constituents I request that in circumstances where a bulk water user is not permitted access to their annual water allocation, the entitlement charge be waived for the period the water allocation is unavailable.

This recommendation is made on the premise of what other service provider has the ability the continue to impose charges, in this case irrigator water entitlement charges, but fail to deliver the irrigators annual water entitlement for reasons of climatic conditions and the demands of high security entitlement water users.

Continuing to levy water entitlement charges during periods of nil water allocations is most unfair and inequitable and represents transfer of the risk of loss of revenue by State Water from reduced water availability to bulk water user customers.

Merging State Water with NSW Office of Water

Irrigators in the Peel and Namoi Valleys fail to understand the reason for separation of **State Water**, in the capacity of an operator for delivering bulk water to approximately 6,300 licensed water users located on regulated rivers across the State, from the **NSW Office of Water** who is responsible for the management of surface water and groundwater resources, water policy and administration of water management legislation.

Irrigators believe that the separation represents a considerable over bureaucratisation of bulk water regulation, management and operation in NSW resulting in gross inefficiencies, unnecessary overheads and a significant financial burden imposed on irrigators through higher entitlement and user charges for bulk water from regulated rivers.

Anecdotally, I am aware that this view is shared by many irrigators across the State.

If the reason for separation of State Water and the NSW Office of Water is to preserve the integrity of the functions of operator and regulator, this separation can be maintained with only one government corporation managing all bulk water regulatory, management and operational functions through implementation of the principle of the '**Chinese Wall**'.

Such an initiative would ensure ethical and professional separation of performance of the different functions of operator and regulator without diminishing the integrity of each function but delivering economies, efficiencies, productivity improvement and a '*one stop shop*' convenience for financial benefit of NSW bulk water users.

Irrigators have complained to me that the separation of State Water and the NSW Office of Water is not cost effective in the delivery of an essential service to bulk water users.

On behalf of irrigators in Peel and Namoi Valleys I strongly advocate the merging of the functions of State Water and the NSW Office of Water to reduce the level of bureaucracy, red tape, regulatory, management and operational costs and overheads.

Uniform Charges

Irrigators have put to me that there should be a uniform charge for bulk water entitlement charges and consumption charges across the Murray Darling Basin on the basis of State wide cost recovery rather than valley cost recovery, but allowing a

degree of variation to take into account new water infrastructure within individual valleys which provide bulk water users with specific benefits over the life expectancy of the infrastructure.

We are now part of the one basin and therefore, we should all be paying the same and a uniform price for bulk water being no more than the average price determined across the State for all valleys. It must be a level playing field and uphold the principles of National Competition Policy. Such a system would be inherently fair and equitable for all bulk water users.

Socio-Economic Impacts in the Peel Valley

Peel Valley entitlement charges are proposed to increase by \$0.91 over the three year period representing an increase of **32.97%** over that period. Usages charges are proposed to increase by **\$13.71** over the three year period representing an increase of **33.09%**.

The Peel Valley is small by comparison to other valleys across the State and has an equally small number of bulk water users to share cost recovery distribution. Consequently, bulk water charges are very high in comparison to other valleys and represent an equally high and unsustainable input cost to irrigated agriculture in the Peel Valley.

For these reasons, there is a convincing argument for the National Water Initiative not to be applied in respect of the Peel Valley and cost recovery capped at an amount less than 100% to ensure comparative fairness and equity with irrigators in other valleys. I submit that cost recovery for the Peel Valley be fixed at 50% as a measure to ensure comparative fairness and equity with irrigators in larger valleys and to act as a reasonable input cost to irrigated agriculture in the Peel Valley.

Implementation of full cost recovery in the Peel Valley would impose significant financial hardship on irrigators to the point where many would become unviable and be forced to quit their rural enterprise.

Water charges are a significant cost input for irrigated agriculture and rural enterprises. Even with a maximum cap increase of 10% per annum for bulk water charges, in the present climatic conditions many irrigators will be forced out of business directly attributable to the relatively high cost of bulk water charges.

Consequently, on behalf of Peel Valley irrigators I strongly support the ACCC recommendation that the NSW Government continue to provide a subsidy for the Peel Valley in the 2014-17 regulatory period, justified on the basis that such a subsidy would be consistent with the community service obligations (subsidies) within the Water Act where full cost recovery is unlikely to be achieved.

Tamworth Regional Council rate payers and high security users are also at a distinct disadvantage compared to others across the State placing local businesses in a precarious financial situation. Potential economic growth is severely hindered due to the high cost of bulk water.

State Water Service Review

Acting in the best interests of my constituents, particularly those irrigators and bulk water users located in the Peel Valley, and after reading the raft of significant variations between State Water proposals for operational and capital expenditure and the ACCC draft determinations for bulk water pricing for the 2014-17 period, it would be in the public interest for the ACCC State Water Pricing Determination to recommend to the NSW Minister for Primary Industries that the NSW Audit Office be tasked and commissioned to undertake a comprehensive Service Review of the operations of State Water to make recommendations for improved performance in the following areas for the benefit of the overall community, and more specifically, bulk water users:

- ✓ Financial accountability
- ✓ Strategic capacity
- ✓ Strategic business planning
- ✓ Strategic financial planning
- ✓ Resource capacity
- ✓ Long term financial planning and modelling
- ✓ Fairness and equity in water pricing policy
- ✓ Water pricing principles
- ✓ Cost recovery calculations and methodology
- ✓ Overhead on-cost calculations and attribution
- ✓ Total asset management

Recommendations on State Water Bulk Water Pricing:

1 Bulk Water Pricing Principles

- *Water charges be based on the efficient and economic cost of providing water services.*
- *Water charges be levied on the basis of recovery of the cost of the service provided.*
- *Where a valley has not achieved full cost recovery, progression to full cost recovery be phased in over to two price determination periods.*
- *State Water as provider of bulk water services and custodian of water assets be allocated sufficient funds on an annual basis to achieve long term financial sustainability.*
- *Water pricing policies be structured and designed to ensure environmental sustainable use of water resources and water infrastructure.*
- *Water pricing policies be targeted to ensure the best overall outcome for the community from the use of water resources and the assets used to store, manage and deliver water.*
- *Long term pricing regime paths fix the cost of providing and delivering bulk*

water services for all valleys on the basis of a 40% to 60% ratio between entitlement charges (40%) and user charges (60%) respectively.

- In circumstances where a bulk water user is not permitted access to their annual water allocation, the entitlement charge be waived for the period the water allocation is unavailable due to high security user preference and demands.*
- Climatic conditions and the financial capacity of consumers to pay during periods of adverse climatic conditions be taken into account by State Water when reviewing bulk water pricing policies and setting charges.*
- The annual rate of return on the Regulatory Asset Base (RAB) be assessed by a price regulator as representing the actual figure commensurate with the commercial risk to State Water's regulated activities capped at a maximum of 10% per annum.*
- State Water introduce of system for providing incentives, by way of discounts and concessions on user charges, for proven water efficiency and sustainability measures and infrastructure implemented by users.*
- State Water structure and adopt a Dams Safety Compliance Long Term Financial Strategy to address priorities and funding for dam safety compliance funded from water entitlement charges and State Government.*

2 State Water Financial Accountability

State Water implement a much improved and accountable process and methodology for future bulk water pricing proposals including improvements in capacity and expertise in strategic long term financial planning and modelling for bulk water infrastructure renewal, replacement and creation.

3 State Water Strategic Financial Planning

Support of a proposal by the ACCC for an 'unders' and 'overs' Reserve Account to address revenue volatility experienced by State Water occasioned by changes in rainfall and a reduction in water usage. The 'unders' and 'overs' Reserve Account combined with 40:60 two part tariff structure for bulk water services will undoubtedly provide for a pragmatic and strategic approach to water demand planning and a measure of relative price stability for customers.

4 Total ACCC Revenue Forecasts

Strong support recorded the ACCC draft determination that the State Water total revenue forecast for the 2014-17 period is higher than required to meet the efficient cost of offering bulk water infrastructure services

5 Entitlement and User Charges

State Water should adopt a long term pricing regime to fix the cost of providing and delivering bulk water services for all valleys at a 40% to 60% ratio between entitlement charges (40%) and user charges (60%) respectively.

- 6 Capital Expenditure Overheads**
Support for the ACCC draft determination for capex on-costs for labour and overheads at \$10.7million or \$22.2million (67.7%) less than the State Water proposal.
- 7 State Water Capex**
Support for the ACCC capex allowance of \$151.8million as reflective of the prudent and efficient costs of providing capital infrastructure services for 2014-17, representing \$52.3million, or 34.45% less than the bid for by State Water.
- 8 State Water Capex Mandate**
That the 2014-17 capex be mandated in the ACCC 2014-17 final determination for reason there is evidence in past periods of State Water exceeding approved capex limits. Capital infrastructure expenditure overruns benefit State Water in future capex proposals and rewards lack of financial accountability and fiscal compliance at the expense of bulk water users.
- 9 Water Delivery and Other Operations**
State Water ensure that business plans are completed to underpin and justify the purchase of water asset management systems exceeding an estimated purchase price of \$150,000.
- 10 Waiving of Water Entitlement Charges**
State Water waive bulk water entitlement charges for the period annual water allocations are unavailable to bulk water users due to high security user preference and demands.
- 11 Merging State Water with NSW Office of Water**
State Water and the NSW Office of Water be merged to achieve economies, cost savings and efficiencies.
- 12 Uniform Charges**
Introduction of a uniform charge for bulk water entitlement charges and consumption charges across the Murray Darling Basin to provide for water pricing fairness and equity for all bulk water users.
- 13 Socio-Economic Impacts in the Peel Valley**
The National Water Initiative not to be applied in respect of the Peel Valley and cost recovery capped at 50% to ensure comparative fairness and equity with irrigators in other valleys. Implementation of full cost recovery in the Peel Valley would impose significant financial hardship on irrigators to the point where many would become unviable and be forced to quit their rural enterprise. Tamworth Regional Council rate payers and high security users are also at a distinct disadvantage compared to others across the State placing local businesses in a precarious financial situation. Potential economic growth is severely hindered due to the high cost of bulk water. Even with a maximum cap increase of 10% per annum for bulk water charges, in the present climatic conditions many Peel Valley irrigators will be forced out

of business directly attributable to the relatively high cost of bulk water charges.

14 State Water Service Review

The ACCC final determination of the 2014-17 State Water Pricing Application recommend to the Minister for Primary Industries that the NSW Audit Office be tasked and commissioned to undertake a comprehensive Service Review of the operations of State Water to make recommendations for improved performance in the following areas for the benefit bulk water users:

- ✓ Financial accountability
- ✓ Strategic capacity
- ✓ Strategic business planning
- ✓ Strategic financial planning
- ✓ Resource capacity
- ✓ Long term financial planning and modelling
- ✓ Fairness and equity in water pricing policy
- ✓ Water pricing principles
- ✓ Cost recovery calculations and methodology
- ✓ Overhead on-cost calculations and attribution
- ✓ Total asset management

I appreciate the opportunity to make the views of my constituents known on this critically important issue of bulk water pricing. The continued livelihood and irrigated agricultural business activities of bulk water users in the Peel Valley along with rate payers of Tamworth Regional Council and higher security water users is vitally dependent on access to bulk water which is fairly and equitably priced.

I strongly urge the ACCC to take into account the comments and views expressed in the communication made on behalf of my constituents when making the final determination of State Water's 2014-17 Pricing Application.

Yours faithfully



Kevin Anderson MP
Member for Tamworth

14 April 2014