SUBMISSION PAPER

Submission on
State Water Corporation's Pricing application for regulated charges from 1 July 2014

Macquarie River Food and Fibre

Prepared by:
Susan Madden, Executive Officer
Prepared for:
The Australian Competition and Consumer Commission

September 2013

1/193 Macquarie Street
PO Box 1657
DUBBO NSW 2830
02 6884 9577 / 0400 849 577
mrff@bigpond.com
www.mrff.com.au

About MRFF

Macquarie River Food and Fibre is a non-profit, non-political organisation representing irrigated food and fibre producers in the Macquarie Valley. Our voluntary membership structure incorporates Water Access Licence holders in the Macquarie regulated river system and Acquifer Access Licence holders in the Lower Macquarie Groundwater Sources. Based on current collection rates, MRFF represent 85% of the total volume of entitlement (excluding government owned licences) in the Macquarie system. MRFF is further supported by a number of associated local businesses.

MRFF is a member of the NSW Irrigators' Council and the National Irrigators' Council.

MRFF is represented on State Water's Customer Service Committee for the Macquarie-Cudgegong and on the NSW Government's Macquarie-Cudgegong Environmental Flows Reference Group.

About this Submission

This is a formal submission in response to State Water Corporation's *Pricing application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014*.

While this submission is provided on behalf of irrigated food and fibre producers in the Macquarie Valley our members reserve the right to provide individual submissions.

Contents

EXECUTIVE SUMMARY

Macquarie River Food and Fibre (MRFF) provides this submission in response to State Water Corporation's (SWC's) *Pricing application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014*.

Customers in the Macquarie Valley and elsewhere across NSW have been subject to successive attempts by the state-owned regulator to abuse its monopoly power and exploit the pricing determination process to build in what are essentially 'superprofits' for its shareholders over the longer term.

Throughout the course of our submission, MRFF provides examples of SWC's tendency to understate performance and overstate risk as a means of advancing a campaign toward a fixed charging regime – effectively nullifying its business risk and locking in above market returns for its shareholders. We further argue that the generous provisions that are already contained within the current price setting approach have in effect removed any incentive for SWC to improve its business efficiency or pay heed to customer concerns regarding escalating expenditure patterns.

MRFF is particularly concerned that customers in the Macquarie river system are facing a disproportionate increase in the user share of their revenue requirement when compared to SWC's overall proposal. We have undertaken a review of SWC's pricing application and supporting spreadsheets in an attempt to understand the key drivers for the increases that if left unchecked would result in price shocks for regulated customers in the Macquarie Valley.

It is MRFF's submission that regulated users in the Macquarie Valley are already being charged considerably more than the costs attributable to the provision of infrastructure services from which they benefit. A comparison of the pricing outcomes of MRFF's submissions against SWC's current and proposed approach is provided below.

Price Outcomes $2013/14 per ML	**2013/14**	**2014/15**		**2015/16**		**2015/16**	
	Allowed	**SWC Proposed**	**MRFF Submission**	**SWC Proposed**	**MRFF Submission**	**SWC Proposed**	**MRFF Submission**
General Security	11.42	10.42	5.67	14.73	5.69	19.72	5.72
High Security	4.24	5.54	2.82	7.83	2.83	10.49	2.84
Usage	13.98	14.68	7.99	11.18	8.01	6.96	8.05

MRFF asserts that the outcome of past determinations has resulted in a narrowly defined customer base bearing a disproportionate share of SWC's risk and rising business costs. This situation is clearly unsustainable in the long-term and must be addressed in the interests of SWC's own financial viability and for the protection of its narrow and captive customer base.

MRFF urges the ACCC to take a strong stance in this first determination to ensure that the necessary incentives are put in place for SWC to seek more equitable and efficient pricing solutions into the future.

MRFF calls on the ACCC to comprehensively reject SWC's pricing application and to undertake a full determination of its regulated charges applying from 1 July 2014.

1. INTRODUCTION

1.1 Macquarie River Food and Fibre (MRFF) represents the interests of over 500 irrigated farming families in the Macquarie Valley in central west NSW and is supported by a number of associated local businesses.

1.2 MRFF has a vision for an efficient, productive and profitable irrigation industry in the Macquarie Valley. Key to achieving this vision is a secure regulatory framework and efficient management and equitable pricing for the region's water storage and delivery services.

1.3 In light of this, MRFF welcomes the opportunity to provide a submission to the Australian Competition and Consumer Commission (ACCC) on State Water Corporation's (SWC's) pricing application for regulated charges to apply from 1 July 2014.

1.4 Our organisation is well placed to provide input to the process having participated in each of the previous price determinations for SWC through the Independent Pricing and Regulatory Tribunal (IPART) and through our familiarity and local experience with the state-owned infrastructure service provider, including being a member of SWC's Customer Service Committee for the Macquarie-Cudgegong.

1.5 Our submission is based on this experience along with a review of the information obtained in SWC's pricing application and the supporting spreadsheets made available on the ACCC website. MRFF is also familiar with the *Pricing principles for price approvals and determinations under the Water Charge (Infrastructure) Rules 2010* and has considered the ACCC's *Information Paper on State Water's 2014-17 pricing application*.

1.6 MRFF's submission is structured to provide:

- An understanding of the ACCC's price approval and determination process,
- A general response to SWC's proposal,
- Comments on the implications for customers in the Macquarie Valley, and
- A summary of our preferred approach for determining SWC's regulated charges.

2. UNDERSTANDING OF THE PROCESS

2.1 MRFF notes that SWC's current prices as determined by IPART will expire on 30 June 2014 and that due to changes to water legislation, SWC's prices for valleys within the Murray Darling Basin will now be regulated by the ACCC.

2.2 MRFF understands that the new rules require SWC to submit a pricing application to the ACCC, which should provide information for the ACCC to assess whether to approve or determine the regulated charges.

2.3 MRFF further understands that for SWC's charges to be approved, their pricing application should:

> *…build a persuasive case for the ACCC on why expenditure is needed, justification for the expenditure proposed, and justification for the operator's proposed tariffs*[1].

2.4 Throughout our submission, MRFF demonstrates that SWC has failed to build such a case, and further, that consultation with their customer base has been inadequate for considering the appropriate level of price and service trade-offs, the feasibility of future investment and alternative approaches to the tariff structure.

2.5 On this basis, MRFF submits that the charges outlined in SWC's pricing application must be rejected and we support a full determination of SWC's regulated charges by the ACCC.

[1] ACCC (2011) *A guide to the water charge (infrastructure) rules: Pricing application for Part 6 operators*, page 7.

3. GENERAL COMMENTS ON STATE WATER'S PROPOSAL

3.1 MRFF has long supported the corporatisation of the state-owned infrastructure service provider and recognises the need for the entity to be a commercially viable business.

3.2 Corporatisation has delivered a number of benefits to customers including increased transparency and accountability through consultative forums such as the Customer Service Committees (CSCs), and improvements in operational efficiency such as savings of 20.4% made during the 2006 regulatory period.

3.3 When it comes to price setting, however, SWC has made successive attempts to abuse its monopoly power and exploit the determination process to build in what are effectively 'superprofits' for its shareholders over the longer term.

3.4 The general approach that SWC takes to the determination process is to understate its performance in previous regulatory periods and to overstate the risk associated with delivering its core infrastructure services into the future.

3.5 SWC's current pricing application is no exception. Despite a forecast to meet, if not exceed, allowed revenue over the current regulatory period, and a proposal to "maintain(ing) assets and services to deliver business as usual[2]" for the coming period, SWC is proposing significant changes to the way entitlement and usage charges are levied on regulated customers across NSW.

3.6 The major changes outlined in SWC's pricing application include:

- An almost 20% increase in the revenue required from users to meet forecast operating expenditure and to provide a net return on the current Regulatory Asset Base (RAB) and proposed capital expenditure,
- A transition to a new tariff structure that would double the proportion of revenue collected through fixed charges from 40% to 80%, and
- A change in the price control mechanism from a 'price cap' to a 'revenue cap' where there would be a limit placed on annual price adjustments of +/- 15%. SWC further propose the carryover of any under or over recovery from one regulatory period to the next.

3.7 It is important to note upfront that the key aspects of State Water's proposal have been progressed either without customer consultation or in the absence of customer support.

[2] Page 9 of SWC's Pricing Application

Understating performance and overstating risk

3.8 The key premise underlying SWC's current and past pricing proposals is that its business viability is under continued pressure, predominantly due to revenue volatility.

3.9 In the lead up to the 2010 determination period, SWC painted a dire picture of its financial position directly attributable to reduced water sales at the peak of the millennium drought to support a case for a number of changes to the way it recovered revenue. In presenting this case, SWC glossed over the fact that despite the drought conditions and economic turmoil that prevailed over much of the 2006 determination period, it had still managed to recover allowed operating expenses and provide some return on capital. Also glossed over was the fact that if SWC had not overspent on allowed operating costs during much of the period, the return would have been even greater.

3.10 Despite widespread customer opposition to SWC's submission to the 2010 pricing determination, SWC was successful in lobbying IPART to approve a number of significant changes to its price setting approach. IPART approved the application of a higher Weighted Average Cost of Capital (WACC), the implementation of a revenue volatility allowance and a new method for forecasting consumption. The only area of SWC's submission that IPART did not accede to was in relation to SWC's proposal to change the tariff structure to recover 90% of the user share of allowed revenue through fixed charges.

3.11 While it is disappointing, it is not surprising that SWC has used a change in the regulatory framework to the *Water Charge (Infrastructure) Rules 2010* (WCIR) as an opportunity to further progress its campaign toward a higher fixed charge regime.

3.12 In its current pricing application, SWC continues to understate its past business performance and play on the severity of the drought that affected the 2006 regulatory period. SWC presents outcomes from the 2006 and 2010 regulatory periods side-by-side without giving explicit recognition to the changes in the approach to price setting that occurred between the two periods[3]. SWC rely on the inclusion of the 2006 period to continue to advance a case that:

> "State Water is exposed to *significant* revenue risk relating to water sales volume uncertainty and volatility [4]" (emphasis added).

3.13 The price settings that underlie the 2010 determination, however, and the outcomes that have been achieved over the period to date, present a very different picture of SWC's performance and risk.

3.14 An assessment of SWC's overall revenue requirement in 2013/14, as provided in Table 1 below, reveals that even under the current 40:60 tariff structure, 65% of SWC's revenue is fixed. This

[3] Various examples of this can be found throughout Chapter 4 of SWC's Pricing Application
[4] Page 35 of SWC's Pricing Application

effectively means that SWC is able to cover allowed operating expenses and provide a healthy return on capital without delivering a drop of water to its customer base.

3.15 Should the tariff structure change to an 80:20 ratio, almost 90% of SWC's revenue would be guaranteed providing its shareholders with a locked-in rate of return of 6.5%.

Table 1 – Fixed proportion of SWC's current and proposed revenue requirement

	$2013/14, $million			
	2013/14	**2014/15**	**2015/16**	**2016/17**
Total Revenue Requirement	*126.23*	111.64	118.85	121.54
Government Share	*54.26*	44.24	49.11	50.81
User Share – Fixed	*28.788*	53.92	55.792	56.584
Fixed revenue as a proportion of total revenue	***65%***	**88%**	**88%**	**88%**
Operating costs	*41.64*	49.05	48.5	47.81
Forecast RAB		766.06	871.92	917.97
Net return on assets		**6.4%**	**6.5%**	**6.5%**

3.16 The expected outcomes from the 2010 regulatory period also contradict SWC's assertion that its business viability is under continued pressure due to revenue volatility.

3.17 In Table 2 actual sales are compared to forecast sales for the first three years of the 2010 regulatory period while in Table 3 actual revenue is compared to allowed revenue for the same period. The information illustrates that despite variations in sales over the period ranging from -35% to +29%, the associated variation in revenue was only -10% to +6%.

Table 2 – Actual verse forecast extractions (sales) for the first three years of the 2010 period[5]

	2010/11	**2011/12**	**2012/13**	**TOTAL**
Forecast sales (GL)	4,627	4,627	4,627	13,881
Actual sales (GL)	3,025	4,500	5,986	13,511
Variance (GL)	-1,602	-127	1,359	-370
Variance (%)	-35%	-3%	29%	-3%

[5] Table 4.2 of SWC's Pricing Application

Table 3 – Actual verse allowed recovery over the first three years of the 2010 period[6]

	2010/11	2011/12	2012/13	TOTAL
Allowed revenue ($M)	$92.0	$100.1	$107.8	$299.9
Actual revenue ($ M)	$82.4	$95.4	$114.0	$291.8
Variance (GL)	-$9.6	-$4.7	$6.2	-$8.1
Variance (%)	-10.4%	-4.7%	5.8%	-2.7%

3.18 It is important to note that the results presented in Table 3 do not take into account the fact that over the same period SWC failed to deliver on its allowed capital program. This effectively means that SWC has recovered a net return on assets that its customers have not yet benefited from. If the allowed revenue was adjusted by the $69.5 million underspend in SWC's capital expenditure program, assuming IPART's recommendation of a useful life of 75 years for new assets and a WACC of 7.4%, the downward adjustment would be in the order of $6 million over the three year period resulting in an overall variance in allowed verse actual revenue of less than 1%.

3.19 As a final comment on SWC's performance over the current period it is also worth noting that current storage levels across NSW are such that sales in 2013/14 are expected to be above forecast. Above forecast sales in 2013/14 will ensure that SWC will recover more than its allowed revenue over the 2010 regulatory period. Coupled with lags in its capital expenditure program, this will result in a return to shareholders in excess of 7.4% for the period.

Evidence of monopoly behaviour

3.20 Generous provisions within the current price setting approach have in effect removed any incentive for SWC to improve its business efficiency or pay heed to customer concerns regarding escalating expenditure patterns.

3.21 Looking back at the user share of the allowed operating expenditure from *IPART's 2010 Determination and Final Report*, SWC is proposing a real increase of some 18% from 2013/14 to 2016/17.

3.22 SWC is also proposing significant increases in the user share of capital expenditure for the coming period. When expressed in nominal cashflows with the application of a nominal WACC (8.95%) this has the effect of increasing the user share of net returns on assets by 20% in real terms from 2013/14 to 2016/17.

---

[6] Table 4.1 of SWC's Pricing Application

3.23 These expenditure increases are proposed despite SWC's assertions that their submission is based on "maintaining assets and services to deliver business as usual". Further, there is no evidence within SWC's application or supporting spreadsheets of the increased expenditure in the coming period benefiting customers through improved service provision down the track, where such an improvement might be measured by increased sales or lower future operating costs. On the contrary, SWC is predicting a decline in future sales evidenced through their adoption of a lower consumption forecast and relatively stable operating costs as evidenced by their forward estimates to 2040.

3.24 It is also of some concern that SWC's plans to improve business efficiency on existing costs over the coming period are almost negligible. The statement that they have included an implicit efficiency target on controllable costs of 1% per annum is modest when compared to an overall efficiency of saving of 20.4% that was made during the 2006 determination.

3.25 SWC's overall expenditure proposal has raised very legitimate concern amongst customers that the state-owned entity is taking a 'gold plated' approach to expenditure given their ability to recover costs from a captive customer base.

3.26 Customer concern that SWC is abusing its monopoly power has also arisen in response to the pattern that has developed in SWC's management of its allowed capital program. We have seen a tendency in current and past pricing applications for SWC to weight capital expenditure toward the start of the regulatory period yet fail to deliver on this program until the end of the period. This effectively means that they are recovering a return on services that have not been provided.

3.27 The typically high ranging WACC that has been allowed for SWC in past determinations has only served to exacerbate this problem as the state-owned entity has had an 'incentive to spend' in order to deliver an above market return to its shareholders.

3.28 It is therefore not surprising that SWC has balked at the ACCC's parameters for determining the WACC, which would undoubtedly reduce the rate of return SWC is able to recover. As a result SWC has upped the ante on its campaign to move toward a higher fixed price regime as an alternative approach to locking in monopoly profits for its shareholders.

Failure to consult with customers

3.29 Unfortunately a delay in the finalisation of SWC's pricing application meant that customers have not been able to scrutinise proposed expenditure ahead of SWC submitting their pricing application to the ACCC. SWC presented only aggregate revenue requirements and draft prices to CSC's throughout late May and early June of this year without providing a valley breakdown of proposed operating costs and capital expenditure that accompanied the proposal. There was therefore no opportunity for customers to have input to the appropriate level of price and service trade-offs or to consider the feasibility of future investment.

3.30 SWC has also continued to pursue a change in the tariff structure and price control mechanism in the absence of support from its customer base.

3.31 In February 2012 SWC took the positive step of meeting with its Top 20 customers and CSC Chairs to discuss the change in regulatory framework for price approvals and determinations, and how it might respond. SWC outlined that its interpretation of the ACCC's pricing principles would likely result in a proposal to recover a higher proportion of its revenue through fixed charges.

3.32 SWC were very aware from past price determinations that customers were strongly opposed to higher fixed charges. Customers consider that they have already paid a risk premium to maintain the current tariff structure. This structure provides customers with some control over their annual water bills and provides an incentive for SWC to improve its own efficiency. There is also legitimate concern that a higher fixed price regime encourages inefficient water use by customers placing such an approach at odds with broader water management policy objectives.

3.33 Given their strong preference for maintaining the current tariff structure, customers put forward a number of options that might assist SWC manage its revenue volatility, which included:

- Introduction of a dual tariff structure (or 'price choice'),
- Deferral of non-essential expenditure in times of sever water shortfalls,
- Review of SWC's approach to allocating fixed and variable business costs, and
- Widening of its customer base to recover costs from users of SWC's infrastructure services not captured by the current levies on access licences. This issue had also been recognised by SWC management and IPART as a driver of the entity's rising business costs[7].

3.34 Disappointingly these options were not progressed through further discussion with customers providing no further opportunity for customers to have input on alternative approaches to the tariff structure, or to provide a response to SWC's proposed change to the price control mechanism.

3.35 It is therefore not surprising that in advancing its proposal for a change in the tariff structure and price control mechanism SWC does not address other considerations within the ACCC's pricing principles, such as price transparency, stability and efficiency.

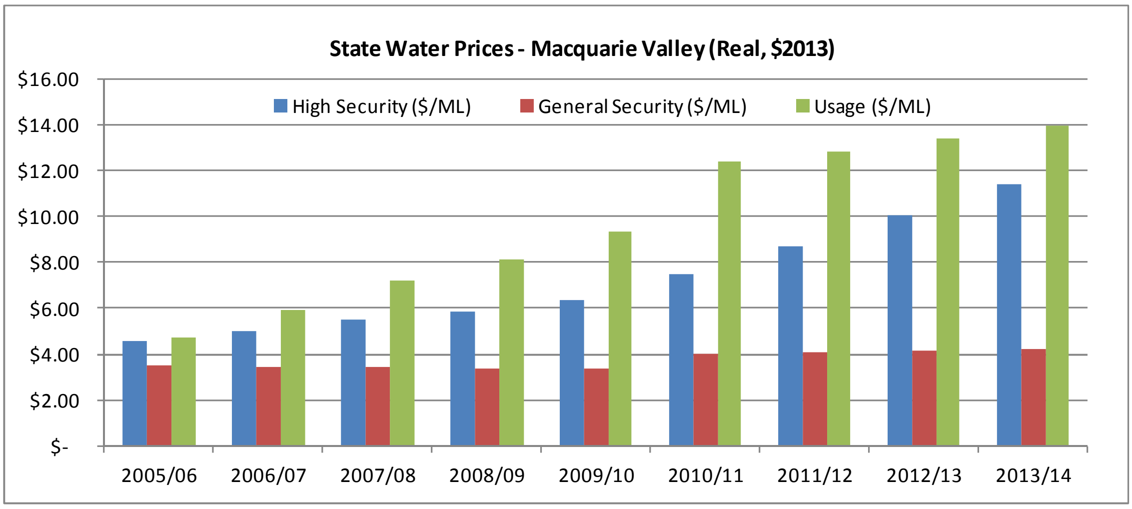
[7] Page 29, Transcript - Review of Prices for State Water Corporation - Dubbo Public Hearing - 25 November 2009, and Page 9 of IPART's 2012 Review of Rural Water Charging Systems

4. IMPLICATIONS FOR CUSTOMERS IN THE MACQUARIE

4.1 MRFF is obviously particularly interested in the implications of SWC's pricing application on regulated customers in the Macquarie river system.

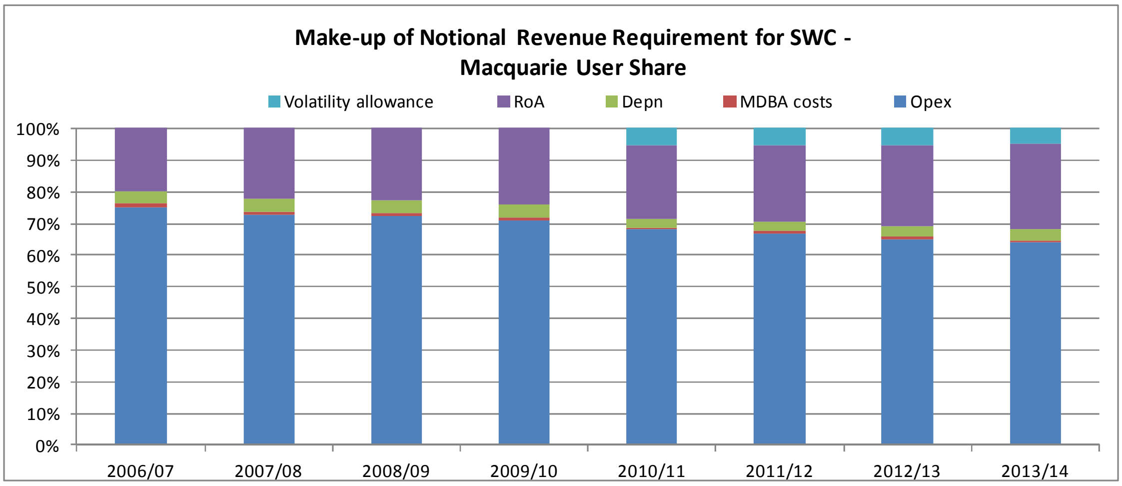
4.2 Despite having already reached full cost recovery in 2005/06, customers in the Macquarie have continued to experience above inflationary price increases for the provision of 'business as usual' infrastructure services.

Figure 1 – Growth in charges levied by SWC in the Macquarie Valley since 2005/06



4.3 A closer look at the make-up of the user share of the valley's notional revenue requirement over this period shows that the increase in prices has predominantly been driven by an increase in the requirements for asset returns.

Figure 2 – Make-up of SWC's revenue requirement for the Macquarie Valley since 2006/07



4.4 A change in the approach used to forecast consumption also had a significant increase on customers in the Macquarie system following the 2010 determination. This can be seen by the jump in usage charges over the last four years as depicted in Figure 1.

4.5 It should therefore come as no surprise that customers in the Macquarie regulated system are greatly concerned that SWC is again proposing significant changes to both the revenue requirement and the approach used to the translate the revenue requirement into prices.

4.6 Looking firstly at the revenue requirement, under SWC's pricing application, customers in the Macquarie river system are facing a disproportionate increase in the user share of their revenue requirement when compared to SWC's overall proposal.

Table 4 – Proposed increases in revenue requirement in Macquarie Valley against All Valleys

Changes proposed by SWC User Share	**($2013/14*, $million)**					
	All Valleys			**Macquarie Valley**		
	2013/14	**2016/17**	**Increase**	**2013/14**	**2016/17**	**Increase**
Operating Expenditure	$37.3	$43.8	**18%**	$4.7	$6.0	**27%**
Net return on assets	$22.4	$26.9	**20%**	$2.3	$3.2	**43%**
Total Revenue Requirement	$62.1	$70.7	**14%**	$7.4	$9.3	**25%**

* Note that MRFF has adjusted allowed revenue for 2013/14 as reported in IPART's 2010 determination using the CPI adjustment table in Appendix 1.

4.7 A review of the information obtained in the spreadsheets accompanying SWC's pricing application show that these increases are driven by an above average increase in operating costs and a number of extraordinary capital projects, the feasibility of which have not been discussed with customers.

4.8 Customers in the Macquarie Valley also continue to be particularly sensitive to SWC's approach to consumption forecasting and the proposed change to the current tariff structure. Customer feedback has already indicated that a move to an 80:20 tariff structure will lead to a number of possible perverse outcomes impacting the water trading market. These effects might include inefficient water use or a disincentive to hold entitlement to avoid contributing to the valley infrastructure costs – driving up temporary trade prices and driving down entitlement values.

4.9 MRFF's key submissions in relation to SWC's current and proposed approach to determining the revenue requirement and translation of this requirement into prices for regulated customers in the Macquarie system are outlined in Tables 5 and 6 below.

Table 5 – MRFF response to the drivers of the proposed increase in the revenue requirement for the Macquarie Valley

Building Blocks (User Shares)	**IPART Determination 2010**	**SWC Proposal 2013**	**MRFF Submissions**
Operating expenditure	Allowed $4.1 - $4.3M/yr Includes costs associated with servicing non-paying customers who fall outside the "access licence" framework, including but not limited to the provision of infrastructure services (storage and delivery) for the NSW Government controlled Environmental Water Allowance (EWA - 160 GL) and services to those holding Basic Landholder Rights	A 27% real ↑ by 2017 to $6.0M/yr, Including • material unexplained increases in corrective and routine maintenance, and water delivery costs • the socialisation of corporate expenditure • up to $200,000 /yr for discretionary projects as recommended by the CSC, • an implicit efficiency target of 1% • continued inclusion of the costs of providing infrastructure services to non-paying customers	MRFF considers a more appropriate level of operating expenditure for 'business as usual' infrastructure services to include: • removal of socialised corporate costs for projects that will not result in increased water deliveries or cost savings in the foreseeable future • inclusion of $200,000 /yr for discretionary projects as recommended by the CSC • a minimum efficiency target of 2.5% • removal of costs associated with servicing currently non-paying customers – EWA account holders are provided with the same services as general security licence holders therefore 160 GL equates to approximately 18% of valley operating costs
MDBA pass through	Allowed approximately $40,000/yr	Removed on advice from ACCC	Concur with removal
Volatility Allowance	Allowed approximately $325,000 /yr	Removed as no precedent under ACCC	Concur with removal

Building Blocks (User Shares)	IPART Determination 2010	SWC Proposal 2013	MRFF Submissions
Regulatory Asset Base	Closing Asset Base estimated at approximately $27 million Includes costs associated with maintaining and investing in assets used to service non-paying customers who fall outside the “access licence” framework, including but not limited to the provision of infrastructure services (storage and delivery) for the NSW Government controlled Environmental Water Allowance (EWA - 160 GL) and services to those holding Basic Landholder Rights	Opening RAB reflects allowed capital expenditure from 2010 determination. It is understood that the RAB has been adjusted for underspend in the allowed capital program. A significant ↑ to the RAB is proposed for the coming period driven by the inclusion of socialised corporate system costs and three extraordinary valley specific projects[8]: • $3.5 M for Crooked Creek water efficiency project • $2.8 M for North Marsh desilting • $3.6 M for dam safety upgrade fish offset projects The asset base continues to be affected by maintenance and investment in assets servicing non-paying customers	MRFF agrees that the opening RAB needs to be adjusted to reflect current underspend. MRFF submits that the level of capital expenditure over the coming period should take account of SWC’s ability to deliver on such an ambition program given underspend in its current program. MRFF recommends: • removal of Crooked Creek and North Marsh projects on the basis that they have not been discussed with customers despite reflecting extraordinary expenditure that would result in likely price shocks – if future customer consultation finds the expenditure is warranted, the timeframe for project roll-out should be staged to avoid price shocks • removal of fish offset projects that have been triggered by Dam Safety Upgrades rather than by the provision of infrastructure services to customers • removal of socialised costs for corporate projects that will not result in increased water deliveries or future cost savings for customers in the Macquarie • removal of costs associated with servicing currently non-paying customers – EWA account holders are provided with the same services as general security licence holders therefore 160 GL equates to approximately 18% of asset expenditure

[8] From State Water’s Regulatory Information Template 2014-17

Building Blocks (User Shares)	IPART Determination 2010	SWC Proposal 2013	MRFF Submissions
Return *of* Assets (Depreciation)	Allowed $166-$242 K/yr 160 yrs for existing assets 75 yrs for new assets	A 43% real ↑ by 2017 to $3.2 M for net return on assets Includes WACC of 8.95% and a reduction in the useful life of assets for from 83 t 61 yrs	MRFF submits that the WACC must be lowered to better reflect current economic conditions and SWC's business risk. For pricing consistency and transparency, MRFF proposes use of a real WACC and annual indexation of prices to reflect actual inflationary outcomes. MRFF recommends a real WACC of 3.5% (refer to Appendix 3). MRFF suggests maintenance of the current useful life of 83 years for all assets
Return *on* Assets (WACC)	Allowed $1.4 - $1.8 M/yr WACC set at 7.9%		
Total Revenue Requirement	Allowed $6.1-$6.7 M/yr	Propose a 25% real ↑ by 2017 to $9.3 M/yr	The overall impact of SWC's proposal for the Macquarie Valley is unacceptable and would lead to price shocks for its current customers. Based on our submissions above, MRFF proposes a downward adjustment to the total revenue requirement and recommends it not exceed $5.1 M/yr over the three year period

Table 6 – MRFF response to the approach to translating the revenue requirement into prices for the Macquarie Valley

Tariff Structure (User Shares)	IPART Determination 2010	SWC Proposal 2013	MRFF Draft Response
Cost base	High Security entitlement - 42.6 GL General Security entitlement - 631.7 GL	High Security entitlement - 42.6 GL General Security entitlement - 631.7 GL	MRFF submits that SWC expand its cost base to include an additional 160 GL to capture the EWA account holders who are provided the same service as General Security licence holders. MRFF further submits that SWC be instructed to put forward an appropriate charging structure for capturing other classes of non-paying customers

Tariff Structure (User Shares)	**IPART Determination 2010**	**SWC Proposal 2013**	**MRFF Draft Response**
High Security Premium	Multiplier of 3.12	Multiplier of 1.88	MRFF accepts SWC arguments for changes to the High Security premium but notes that it should take account of the latest IQQM model outputs, which suggests a multiplier of 2.01 to reflect the increased reliability of High Security entitlement in the Macquarie river system
Consumption forecasts	Forecast usage of 301 GL / yr based on a 20 year rolling average approach using actual extractions	Forecast usage of 269 GL / yr based on rolling average approach, which will have a 10% impact on the variable price	MRFF submits that the current approach to consumption forecasting is inequitable and flawed given changes to water management rules and therefore water availability over this time. In the absence of any other suitable predictive modeling tools, MRFF recommends the use of the long-term average diversion limit as an appropriate proxy for future extractions as determined by the valley hydrology models (IQQM). The IQQM output for long-term extraction by regulated customers in the Macquarie valley under current water management rules is currently 380 GL
Tariff Structure	40:60 fixed:variable ratio	Transition to a higher fixed charge – 50:50 in year 1, 65:35 in year 2 and 80:20 fixed:variable in year 3	MRFF rejects SWC's arguments for transitioning to a higher fixed charge regime and submits that maintenance of the current tariff structure is paramount for pricing efficiency (in terms of both SWC business efficiency and customer water use efficiency), transparency and stability
Price Control	Price cap	Revenue Cap with annual price adjustment of +/- 15% plus carryover of any additional under / over recovery from one regulatory period to the next	MRFF rejects SWC's arguments for a change in the price control mechanism and submits that a revenue cap is effectively a fixed charge regime that will adversely impact pricing efficiency, transparency and stability

5. THE PREFERRED APPROACH

5.1 MRFF has constructed a simplified valley model to test the impact of SWC's proposal against the submissions we make in the previous section. A summary of this valley pricing model is provided as Attachment 2. Our model is based on real cash flows and applies a real WACC as it is assumed that prices will continue to be adjusted annually to compensate SWC for inflation.

5.2 It is our assertion that the state-owned infrastructure service provider has sought to exploit the price setting process to secure monopoly profits for its shareholders. This assertion is backed by our analysis.

5.3 MRFF submits that regulated customers in the Macquarie Valley are already being charged considerably more than the amount necessary to recover costs attributable to the provision of infrastructure services from which they benefit. A comparison of the outcomes of MRFF's submissions against SWC's current and proposed approach is provided in Table 7 below.

Table 7 – Outcomes of MRFF's submissions against SWC's proposal for the Macquarie Valley

$2013/14	2013/14	2014/15		2015/16		2015/16	
	Allowed	SWC	MRFF	SWC	MRFF	SWC	MRFF
User Revenue Requirement ($'000)	7,448	7,890	5,061	8,630	5,075	9,250	5,101
Price Outcomes ($/ML)							
General Security	11.42	10.42	5.67	14.73	5.69	19.72	5.72
High Security	4.24	5.54	2.82	7.83	2.83	10.49	2.84
Usage	13.98	14.68	7.99	11.18	8.01	6.96	8.05

5.4 MRFF asserts that the already generous provisions within SWC's current pricing approach has resulted in a narrowly defined customer base bearing a disproportionate share of its risk and rising business costs. This situation is clearly unsustainable in the long-term and must be addressed in the interests of SWC's own financial viability and for the protection of its narrow and captive customer base.

5.5 MRFF urges the ACCC to take a strong stance in this first determination to ensure that SWC has the necessary incentives to seek more equitable and efficient pricing solutions into the future.

5.6 MRFF asks the ACCC to comprehensively reject SWC's pricing application and to undertake a full determination of its regulated charges applying from 1 July 2014. MRFF submits that this determination must include a more realistic revenue requirement as well as maintenance of the current tariff structure and price control mechanism to ensure pricing efficiency, transparency and stability for customers.

6. FURTHER INFORMATION

MRFF thanks the ACCC for the opportunity to provide a submission on SWC's pricing application.

Given the disproportionate pricing increases proposed for the Macquarie system and the particular sensitivity of our members to price shocks from both the proposed increase in revenue requirement and changes to the current tariff structure, MRFF seeks a meeting with the ACCC to further discuss our submission.

In the meantime, MRFF is available to provide further information or clarification on any of the points raised in our submission via the contact details provided below.

Contact: **Susan Madden, Executive Officer**
1/193 Macquarie Street
PO Box 1657
DUBBO NSW 2830
02 6884 9577 / 0400 849 577
mrff@bigpond.com

APPENDIX 1 – CPI ADJUSTMENT

The following table shows the multipliers that have been used throughout MRFF's submission to adjust amounts to $2013/14. These figures have been obtained using the June Quarter in the ABS's Consumer Price Index Inflation Calculator.

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Multipler	1.19	1.17	1.12	1.1	1.07	1.03	1.02	1

http://www.abs.gov.au/websitedbs/d3310114.nsf/home/consumer+price+index+inflation+calculator

APPENDIX 2 – MRFF VALLEY PRICING MODEL

	$2013/14, '000			
	2013/14 (current)	**2014/15**	**2015/16**	**2016/17**
Opening RAB estimate		28,120	23,880	24,172
CAPEX adjusted for unapproved projects		1,088	356	677
Removal of costs attributable to 160GL EWA account		-5328	-65	-123
CLOSING USER SHARE RAB ESTIMATE	**28,120**	**23,880**	**24,172**	**24,725**
Return on assets (3.5% WACC)		836	846	865
Depreciation estimate (83 year asset life)		288	291	298
USER SHARE NET RETURN ON ASSETS ESTIMATE	**2,264**	**1,124**	**1,137**	**1,163**
Base OPEX		4,734	4,734	4,734
Allowance for discretionary projects		200	200	200
Removal of costs attributable to 160 GL EWA account		-900	-900	-900
Adjustment for 2.5% efficiency target		-97	-97	-97
CLOSING USER SHARE OPEX ESTIMATE	**4,734**	**3,937**	**3,937**	**3,937**
USER SHARE REVENUE REQUIREMENT ESTIMATE	**7,448**	**5,061**	**5,075**	**5,101**
Fixed proportion of revenue requirement (40%)	3,242	2,024	2,030	2,040
Variable proportion of revenue requirement (60%)	4,206	3,036	3,045	3,060
High Security entitlement	42,606	42,606	42,606	42,606
HS Premium Adjustment (propose 2.01 multiplier)	3.12	2.01	2.01	2.01
General Security entitlement	631,716	631,716	631,716	631,716
Consumption forecast (propose IQQM LTAEL)	300,832	380,000	380,000	380,000

HIGH SECURITY CHARGE ($/ML)	**11.42**	**5.67**	**5.69**	**5.72**
GENERAL SECURITY CHARGE ($/ML)	**4.24**	**2.82**	**2.83**	**2.84**
USAGE CHARGE ($/ML)	**13.98**	**7.99**	**8.01**	**8.05**

APPENDIX 3 – WACC ESTIMATES

	SWC Proposal	MRFF Submission
Market Risk Premium	6.00%	6.00%
Beta	0.9	0.7
Risk Free Rate (nominal)	5.26%	3.00%
Risk Free Rate (real)	2.69%	0.49%
Debt Risk Premium	2.55%	2.30%
Gearing	0.6	0.6
Inflation	2.50%	2.50%
Nominal outcome		
Cost of Equity	10.66%	7.20%
Cost of Debt	7.81%	5.30%
WACC	**8.95%**	**6.06%**
Real outcome		
Cost of Equity	7.96%	4.59%
Cost of Debt	5.18%	2.73%
WACC	**6.29%**	**3.47%**