Murray Irrigation

Response to ACCC Draft Decision on State Water Pricing Application 2014-15 – 2016-17

Submission to the Australian Competition and Consumer Commission.

April 2014

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Executive summary

Murray Irrigation welcomes the ACCC's decision to retain the current tariff structure of 40:60 and to forecast lower operating and capital costs than those proposed by State Water Corporation (State Water).

In the NSW Murray, where Murray Darling Basin Authority (MDBA) costs are a major component of bulk water charges, the draft price determination can only be viewed as an indicative portion of what the final State Water charges will be. This is a disappointing outcome and does not align with our expectations of the Water Charge Rules.

There has been no opportunity for customers to review the MDBA component of the charges and while we acknowledge this is not the fault of the ACCC, we are concerned that the late addition of these charges does not give customers the opportunity to review the bulk water charges in full. In addition we are concerned that there will be no opportunity to confirm whether agreed cost shares, and the efficiency dividend previously applied by IPART, or past attribution of MDBA costs between valleys are maintained.

The last-minute addition of these charges is likely to mean the draft determination reduction in charges for the Murray Valley will become an increase when MDBA charges are added in to the final determination.

Adding to business uncertainty are the 'unders-and-overs' account, 20 year rolling average forecast demand and annual charge adjustment process proposed in the draft determination. Murray Irrigation submits the combination of these factors will not provide "better price stability and relative certainty for customers"[1] as asserted by the ACCC. Murray Irrigation believes that the annual price adjustment process means that irrigators and irrigation corporations will be unable to accurately forecast future costs for the duration of the determination leading to business uncertainty.

Adding to this uncertainty is the decision of the ACCC to apply an 'unders-and-overs' mechanism to the MDBA charges, but allow full recovery (reduction) in the subsequent regulatory year. This could have a significant impact on price variations year on year.

Murray Irrigation commends the ACCC's decision to approve rebates for Irrigation Corporations and Districts (ICDs). This decision reflects the avoided costs to State Water through dealing with one large customer, instead of multiple small customers. This rebate is vital to ensuring the value of the services provided by ICDs is reflected in pricing policy.

Murray Irrigation is concerned that the opportunity is open for State Water to provide further information on capital expenditure items to the ACCC for review and consideration without the same information being provided to customers in a timely manner to allow their review and consultation, specifically in regard to capitalised labour and overhead costs[2]. Murray Irrigation is of the view that customers and stakeholders must have the opportunity to assess any new data before it is included in a determination decision.

Murray Irrigation has previously highlighted the timing of the price determination noting that the current schedule does not allow enough time between the publication of the final determination and the opening of the water year to finalise our fees and charges schedule and inform our customers consistent with our obligations under the Water Charge (Infrastructure) Rules. Murray Irrigation would urge the ACCC to consider adjusting the determination time-frame and the timing of annual pricing reviews to address this issue.

Murray Irrigation is a member of the NSW Irrigators' Council and endorses the Council's submission to the ACCC on the State Water price determinations.

Murray Irrigation expects the final determination to closely reflect the draft determination with regards to the State Water controlled charges, with no significant upward pressure on prices.

[1] *ACCC draft determination on State Water Pricing Application 2014-15 – 2016-17, March 2014, p5*
[2] *ACCC draft determination on State Water Pricing Application, Attachments, March 2014, p95.*

1 Submission

Murray Irrigation is pleased to provide this submission to the ACCC and would be available to respond to any queries or to meet with the ACCC to discuss this submission if required. Murray Irrigation made has made a previous submission to the ACCC on State Water's pricing application which we continue to endorse.

1.1 Total Revenue Requirement

Murray Irrigation commends the ACCC's determination for State Water's total revenue requirement and the use of a reduced rate of return and forecast capital and operational expenditure.

State Water's pricing application represented neither prudent nor efficient costs for a 'business as usual'[3] scenario.

Further, Murray Irrigation believes the ACCC should consider the impact of the recently announced merger between State Water and Sydney Catchment Authority. While it is true that the full impact of this merger on operational costs will not be realised for some 12 to 18 months, there must be operational savings and the merger may also represent a reduced volumetric risk that may influence the required rate of return. At the very least, Murray Irrigation would like to see the ACCC allow for a revision of the impact of this merger on costs prior to each annual pricing review during the determination to allow for adjustments to be made.

It must also be recognised the potential for this merger to impact on State Water's proposed Business Transformation Program (BTP) expenditure which includes corporate systems capital expenditure and proposed IT expenditure. As such, Murray Irrigation would submit that it would be prudent to defer capital expenditure on capital corporate and IT projects until the merger has been undertaken and the new entity has determined its future corporate and IT needs.

Murray Irrigation recognises that the ACCC has not accepted the totality of the State Water application for step increases for the BTP or the IT or corporate services expenditure; however, we would propose that further consideration is given to this line-item in light of the merger announcement that we note was made after the ACCC had considered State Water's pricing application. Given that the ACCC is unable to re-open the determination to review changes to operational efficiencies that may result from the merger, we would suggest that these items be held over to the next determination period.

> **Murray Irrigation requests that capital expenditure on BTP, IT systems and corporate services be held over to the next determination pending the outcome of the merger between State Water and Sydney Catchment Authority.**

Murray Irrigation congratulates the ACCC on taking the decision not to approve step increases in operating expenditure (opex) for implementation of the Murray-Darling Basin Plan. Murray Irrigation maintains the position that as a Commonwealth program, implementation costs outside of historical base opex should be borne by the Commonwealth.

It is noted that the ACCC has adjusted State Water's applied debt raising costs and determined a reduced figure[4]; however, Murray Irrigation questions whether debt raising costs are applicable to a monopoly enterprise solely owned by Government. Unlike corporate entities who do need to conduct roadshows and extensive groundwork for debt raising activities, State Water need simply make a request to Government.

> **Murray Irrigation requests the allowance for debt raising costs should be further reviewed and revised downwards.**

[3] *Pricing application to the ACCC for regulated charges to apply from 1 July 2014, State Water Corporation, June 2013, Ch3.1, p9*
[4] *ACCC draft determination on State Water Pricing Application, Attachments, Marc 2014, p55*

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Murray Irrigation commends the decrease in proposed capital expenditure (capex) over the term of the next regulatory period[5] having previously noted that discrepancies in actual versus forecast capex appears to be a regular occurrence for State Water.

Murray Irrigation would strongly oppose any revision to the draft determination on capex that occurs as a result of new data from State Water, particularly in regards to capitalised labour and overheads noting the ACCC's comment:

> *"If State Water provides the ACCC with additional information from which it can ascertain the capitalised labour and overheads in the remaining projects, the ACCC will take this information into account in its final determination."*[6]

State Water has had ample opportunity to prepare for the determination process, which it delayed by submitting its application two months late. If State Water were not able to provide a justifiable argument for its approach to forecasting the costs of capitalised labour and overheads in the original timeframe, it should not be given the opportunity to provide new data now.

Further the ACCC must ensure that there is no double counting of labour and overheads by way of opex and capex. Where the ACCC has accepted an allowance for capitalised labour and overheads, there must be no such costs in opex.

> **Murray Irrigation requests the ACCC ensure there is no double counting of costs.**
>
> **The ACCC must not consider new data provided by State Water to justify an increase in capitalised labour and overheads without the opportunity for full stakeholder consultation.**

Murray Irrigation agrees with the ACCC's decision not to accept State Water's proposal for increased capital expenditure on water delivery and other operations. As noted in the ACCC report, initiatives identified under these programs would have had a significant impact on customer costs in the Murray Valley (up to 50 percent[7]), however, customers within the Murray Irrigation area of operations would gain little, if any benefit from them.

Further, these projects have not been broadly supported by the Customer Service Committees (CSCs) and specifically the proposed Water Accounting System upgrade known as OPAL[8] has not been reviewed in detail at all by the CSCs.

Without a detailed business plan and broad stakeholder consultation for both the CARMS and the water accounting system upgrades it is only appropriate that the ACCC defer these capex items to a future determination to be reviewed. Again, Murray Irrigation stresses that any further information provided by State Water to the ACCC to try to justify this expenditure must not be considered as stakeholders have not had an opportunity to comment on the proposed business case and roll-out.

Murray Irrigation agrees with the ACCC's draft determination that State Water's proposed total revenue requirement was too high; however, we note that the ACCC's draft decision still allows for a similar overall revenue than what is available to State Water under the current IPART determination and until the MDBA charges are added in, the final impact on customers is still uncertain.

1.2 Cost recovery

1.2.1 Tariff Structure

The ACCC's decision to maintain the current tariff structure so that 40 percent of its revenue is recovered through entitlement charges (fixed) and 60 percent is recovered through usage charges (variable) is welcome.

[5] *Information paper on State Water's 2014-17 pricing application, ACCC, August 2013, p 25*
[6] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p95.*
[7] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p125*
[8] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p129*

This decision recognises the reality of the relationship between water availability and cash flow for farm businesses.

Murray Irrigation also welcomes the ACCC's decision to maintain the high security entitlement charge premium.

1.2.2 MDBA Charges

Murray Irrigation accepts that the late decision by the NSW Government to recover its contribution to the MDBA and Border Rivers Commission (BRC) costs was outside the ACCC's control; however, we note our concern at the lack of process with the result being that stakeholders have had no opportunity to review these charges and the implications for our customers. The actions of the NSW Government have increased business uncertainty for irrigators in effected valleys.

The ACCC considers the recovery of these charges through State Water's bulk water charges is a regulated water charge under the Water Act 2007[9]; however, at a meeting of NSW Irrigators' Council in Sydney in March 2014 representatives of the ACCC said it was 'outside their jurisdiction'[10] to make a determination about the efficiency or appropriateness of these charges.

Murray Irrigation would suggest that these charges should be applied with the same Government cost shares as per State Water costs. For example, MDBA costs attributed towards dam safety and compliance should be shared 50:50 between users and Government while renewal and replacement costs should be 90:10 and so on[11]. This would acknowledge the fact that irrigators are not the sole beneficiary of Murray River operations and would reflect the same level of community service obligation that the Government cost shares rationale was designed to reflect.

If the ACCC is unable to make a determination on these charges, or request the NSW Government to provide the costs based on the agreed cost shares, NSW irrigators effectively have less regulatory protection than they had under the IPART determination process which, in the absence of a review capacity, applied an efficiency dividend to the MDBA charges[12].

> **Murray Irrigation submits the ACCC must use its powers to scrutinise the MDBA charge pass through or, at the very least, adopt the efficiency dividend approach taken by IPART.**

Further, Murray Irrigation believes that there must be an opportunity for stakeholders to comment on the proposed distribution of these cost recoveries. We note that in the past MDBA charges recovered through State Water charges have been proportioned across the Murray and Murrumbidgee valleys.

> **Murray Irrigation requests that stakeholders are able to review the ACCC's proposed allocation and distribution of MDBA costs before the final determination is implemented.**

Whatever the final amount of MDBA charges to be recovered through State Water charges is; it will be a fixed annual cost and will not vary based on actual water deliveries, even if the operational costs of the MDBA River Operations varies. Murray Irrigation supports the principle of applying a tariff structure to this cost recovery to reduce the cost burden on customers in times of low water availability, however, without the final numbers we are unable to take a position.

> **Murray Irrigation requests that customers are given the opportunity to provide comment on how MDBA costs are recovered, once the costs are known.**

Murray Irrigation is further concerned about the price control mechanism that the ACCC proposes to apply to the MDBA charges by way of an 'unders-and-overs' account that, unlike the account for State Water charges

[9] ACCC draft decision on State Water Pricing Application: 2014-15 – 2016-17, March 2014, p8
[10] ACCC meeting with NSWIC, Sydney, 12 March 2014.
[11] ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p22, Table 1-12 IPART user cost shares by activity
[12] Review of bulk water charges for State Water Corporation 2010-14, IPART, June 2010, p17

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whereby the residual balance is multiplied by the rate of return, the ACCC proposes allowing the full under/over recovery of MDBA charges to be recovered in the next year[13].

The ACCC is effectively proposing that a revenue cap form of price control is applied to MDBA charges, as opposed to the hybrid model to be applied to the State Water charges. The implications of this methodology and the risk of substantial price shocks is significant and goes against the ACCC's pricing principle to achieve "revenue stability for the operator <u>and</u> price stability for customers[14]" (emphasis added).

This places increased likelihood of significant price fluctuations between years for customers in valleys where MDBA charges are recovered.

For example, under the IPART determination the MDBA/BRC charges were $13,207,000 for 2013/14[15]. Using the 60:40 tarriff structure just under $8million would be required to be recovered through variable charges. But in a year of low water availability and use, for example 30 percent, only around $2.4million would actually be recovered – increasing the following year's MDBA cost recovery requirement up to almost $18million in total. The cumulative effect of this adjustment process where there are sequential dry years could be substantial.

The addition of the 'unders-and-overs' account adds to the uncertainty created by the price control measures adopted by the ACCC, mentioned below, where in these valleys three data points will be used to adjust prices at the annual price review.

> **Murray Irrigation requests the ACCC to reconsider the price control applied to MDBA charges to ensure protection for customers and to maintain price stability in line with section 6.4 of the ACCC pricing principles.**

1.3 ICD Rebates

Murray Irrigation welcomes the decision of the ACCC to maintain the Irrigation Corporations and Districts (ICD) rebates and maintain the IPART approved methodology rather than that proposed by State Water. Murray Irrigation supports the decision to base calculations of avoided costs on customer sites rather than accepting the State Water proposal to base rebates on volumetric entitlement held.

Murray Irrigation was of the view that State Water's approach to calculating avoided costs oversimplified the service that ICD's provide to state Water it is pleasing the effort the ACCC has applied to understanding this issue.

Murray Irrigation holds five water access licences with the NSW Government and services 3,514 large irrigation supply points (metered outlets), 318 small irrigation supply points and 1,271 unmetered pipes for stock and domestic use through 1,850 regulating structures all at our own cost. By comparison, State Water charges Murray Irrigation based on diversions, through only two independently metered diversion points at Lake Mulwala and the Wakool Offtake, and credits through five accredited escapes.

There has been no reduction in Murray Irrigation's metering and compliance costs to justify the level of reduction in rebates proposed by State Water.

> **Murray Irrigation requests that there be no further reduction in ICD rebates without proportionally matched reduction in business costs and State Water charges.**

[13] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p256*
[14] *ACCC WCIR pricing principles, July 2011, p 51.*
[15] *Review of bulk water charges for State Water Corporation 2010-2014, IPART, June 2010, p7*

1.4 Price Control and Consumption forecasts

While Murray Irrigation commends the ACCC's decision not to approve a revenue cap as proposed by State Water, we are concerned that the proposed price control measures increase the uncertainty for customers.

The ACCC proposes to implement an annual review of charges based on a 20 year rolling average consumption forecast and the implementation of an 'unders-and-overs' account.

As mentioned in Murray Irrigation's previous submission to the ACCC, Murray Irrigation did not support the change to consumption forecasts adopted by IPART for the current determination, which the ACCC now proposes to adopt and adjust to become a rolling average with annual price variations.

At least with IPART's price cap model, the consumption forecast was based on the average consumption of the previous 20 years at the time of the determination which allowed some form of consistency in price estimates based on a consistent forecast for the regulatory period.

The ACCC acknowledges that yearly fluctuations in forecast water extractions would be translated into price variations[16], however, it says "fluctuations would be small given that only one data point will be changed each year".

Murray Irrigation submits that this may be true if adjustments were only conducted against the rolling average forecasts; however, the ACCC proposes adjustments based on the forecasts and the 'unders-and-overs' account. Add to this the fact that in those valleys where MDBA and BRC costs are passed through to irrigators it is proposed that these costs will also be subject to adjustment based on an 'unders-and-overs' account. That is three data points that will all contribute to price fluctuations.

Murray Irrigation is concerned that the annual price adjustment process means that irrigators and irrigation corporations will be unable to accurately forecast future costs for the duration of the determination leading to business uncertainty.

Murray Irrigation appreciates the ACCC's attempt to minimise price fluctuations by multiplying the balance held in the State Water 'unders-and-overs' account by the rate of return, however, we do not consider this, in combination with the other factors contributing to price adjustments, will protect customers from price variations.

Both the State Water 'unders-and-overs' account and the MDBA 'unders-and overs' account will likely be linked to water availability, whereby there is a need to adjust prices to recover 'unders' in a year following low water deliveries, which is in direct contrast with customers likely cash flow as acknowledged by the ACCC[17].

Murray Irrigation submits that the price control mechanisms do nothing to achieve price stability for customers in line the ACCC's pricing principle and make it difficult for farm businesses and Irrigation Corporations to predict future prices and adjust their business plans accordingly.

Murray Irrigation understands the impact fluctuating water availability and water use has on a business reliant on water sales and delivery, however, we note the ACCC submits the "regulatory framework ensures that over time State Water will on average earn sufficient revenue to cover its costs"[18]. Murray Irrigation is of the view that State Water must be commercially responsive to circumstances and the determination must provide continued pressure on State Water to react commercially to changing circumstances.

Murray Irrigation understands the needs for a form of price control and accepts the annual review process; however, we consider three data points to consider in the review risk considerable price fluctuations.

> **Murray Irrigation requests the ACCC reconsider the impact of multiple datasets on annual prices, particularly in valleys that will have MDBA charges applied to ensure the methods proposed really do reflect the best option to deliver price stability.**

[16] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p 200*
[17] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p 255*
[18] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p 215*

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1.4.1 Timing of determination

In order to meet our obligations under the Water Charge (Infrastructure) Rules (WCIR), Murray Irrigation must inform customers in writing of any changes to fees and charges 10 business days before the change is implemented. Therefore, prior to the commencement of water year 2014/15, Murray Irrigation must have the fees and prices schedule approved by the Board and mailed to reach our customers by 17 June 2014 in order for implementation from 1 July 2014. Working backwards this means our Fees and Prices are determined at our May Board meeting for fees commencing on 1 July.

As the ACCC determination is not expected to be published until June, Murray Irrigation must base its fees and prices on a set of assumptions, formed by reviewing the draft determination, in the first instance with a fees and prices update to be undertaken, at a cost of over $5,000 in mail-out fees alone, on receipt of the final determination.

Further, any significant difference in Murray Irrigation's assumptions and the actual State Water charges will be borne by Murray Irrigation in the interim.

Adding to the uncertainty is the late decision by the NSW Government to pass through MDBA costs to irrigators through State Water charges. Without those charges included in the draft determination process, Murray Irrigation has nothing to base its assumptions on with regard to this cost input, increasing the risk of a significant disparity between the fees and charges applied at the opening of the season and what they will actually be once we have access to the final determination.

> **Murray Irrigation requests the ACCC consider the obligations imposed on irrigation corporations by the WCIR when setting dates for the annual price reviews during the determination period and for the next determination process.**

2 Conclusion

Murray Irrigation supports in principal the proposed reduction in charges for customers in the Murray Valley; however, we note that the addition of MDBA charges may see the real charges for the Murray Valley increase significantly.

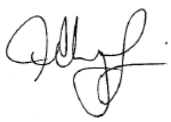
Added to this is the risk of price fluctuations from the suite of price control mechanisms recommended by the ACCC, particularly in valleys where MDBA charges are recovered.

The annual price review based on three data points; the 20 year rolling average; the ‘unders-and-overs’ account and the MDBA ‘unders-and-overs’ account transfers a portion of State Water’s business risk onto customers who are least able to bear it.

Murray Irrigation congratulates the ACCC for undertaking a thorough review of State Water’s proposed cost base, operating and capital expenditure items.

Murray Irrigation commends the ACCC for remaining committed to customer consultation and for making staff available to respond to stakeholders.

Murray Irrigation requests that the ACCC consider other regulatory obligations placed on customers when developing timelines for future price reviews.



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