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1 July 2015 Ref: 291044

Review of the water charge rules
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

By email: waterchargerules@accc.gov.au

WATER CHARGE RULES SUBMISSION FROM MURRUMBIDGEE IRRIGATION LIMITED

Please find enclosed the submission to the Review of Water Charge Rules that responds to the issues paper released in May 2015.

I hope stakeholder views are given due consideration in the review process and I look forward to the opportunity to participate further as part of the stakeholder consultation process over coming months.

Yours sincerely

Matt Thorpe
Interim Chief Executive Officer

Encl.

Murrumbidgee Irrigation Limited

Submission to Review of Water Charges Rules

29 July 2015

Introduction

The *Water Charge (Infrastructure) Rules 2010* (Rules) are made under section 92(1) of the *Water Act 2007* (Water Act), and deal with fees or charges payable to infrastructure operators, including bulk water operators and irrigation infrastructure operators.

The Report of the Independent Review of the *Water Act 2007* (Review Report) made 23 recommendations, including a review of the Rules, with a focus on reducing the cost to industry and governments. This included the appropriateness of tiered regulation of infrastructure operators and the potential for streamlining or eliminating regulation, and notably, whether to remove the current requirements for member-owned operators under Part 5 of the Rules.

The Rules follow a three-tiered regulatory structure with more light-handed approaches under tier 1 and direct regulatory oversight of charges under tier 3. The three tiers apply to different operators depending on the ownership and size of each operator.

Murrumbidgee Irrigation Limited, as a member owned operator that provides services in relation to more than 125 GL of water, is required to comply with tier 2 rules. Tier 2 rules require infrastructure operators to develop network service plans outlining the processes for determining charges, including approaches to asset management, every five years. Tier 2 rules apply to larger member owned infrastructure operators and medium-sized non-member owned infrastructure operators not captured under tier 3.

In justifying the need for regulatory intervention in the rural water sector, the Regulatory Impact Statement accompanying the introduction of the Rules states that,

> *"...effective economic regulation should foster efficient pricing, investment and operating practices, and ensure quality of service in the provision of water storage and delivery services."*

The Regulatory Impact Statement acknowledges that member owned operators are less likely to exercise their market power to extract monopoly rents from their member customers, on the basis that member-owned operators tend to be non-profit organisations, and that member and operator incentives tend to be aligned.

The Explanatory Statement accompanying the introduction of the Rule states that,

> "*Tier 2 rules (Part 5 of the Rules) address concerns about asymmetric information and a lack of transparency in the processes used by operators to determine their charges. These will apply to the larger member owned operators and any medium-sized non-member owned operators not captured under the tier 3 rules (Part 6 of the Rules). These operators will be required to produce network service plans and information statements and to consult with customers in undertaking their infrastructure planning processes."*

The Explanatory Statement also highlights,

> *"The risk of adverse outcomes in the absence of regulation is strongest for non-member owned operators. Many operators currently involved in water supply and delivery in the Basin predominantly provide services to member customers. For example, customers of NSW irrigation corporations are generally also shareholders of the corporation. Member ownership of natural monopolies is likely to provide stronger incentives to ensure efficient investment and charging outcomes for member customers than would be the case for non-member owned operators. Notwithstanding this, there is potential for asymmetric information and a lack of transparency in the processes used by the larger member-owned operators to determine their charges."*

MI has incurred significant costs in complying with the Rules that have been passed on to customers in the form of an increase in charges without the commensurate benefits that can be identified for customers. This is similar to the experience of other member owned operators.

We welcome the opportunity to make this submission to the ACCC review of the water charges rules and look forward to participating in further stakeholder consultation. Responses to key questions identified in the issues paper are provided below.

Scope to simplify rules while still achieving effective regulation (Question 1 and 2)

We strongly support the removal of the current requirements for member owned operators under Part 5 of the Rules raised by the Review Report. We propose that member owned operators be subject to regulation more reflective of tier 1 rules and that this would represent an appropriate simplification that would remove significant compliance costs for operators (that are levied on their customers) who are currently subject to more onerous tier 2 rules. This in part reflects past acknowledgements by the ACCC that the ownership and governance arrangements of member owned operators make it unlikely that these operators will make inefficient charging, service, and investment decisions for their member customers.

Accordingly, we recommend that the requirement in the Rules for member owned operators to complete a network consultation paper that is sent to each customer is unnecessarily onerous. This requirement imposes significant compliance costs on member owned operators and their customers. This reflects direct feedback from our customers whose charges reflect the costs of producing and sending these documents in the mail but do not consider they represent value.

In December 2011, each of our customers was mailed a copy of our first network consultation paper. Only 20 submissions were received from some 2,500 customers (equating to a 0.8% response rate) over the formal consultation period in response to the issues raised in the network consultation paper. A similar response rate was experienced by other member-owned operators.

We appreciate that customer views are an important input to policy decisions and implementation arrangements for all member owned operators. This is a key reason we hold Customer Focus Group and shed meetings with customers at regular intervals throughout the year, and provide opportunities for customer feedback in an annual customer survey and as part of our Customer Charter. There are other such opportunities at the Annual General Meeting which is attended by members. Similar opportunities exist for other member owned operators.

We also recommend that the requirement in the Rules for member owned operators to consult, distribute to each customer, independently review and amend network service plans be removed or simplified. This reflects direct feedback from our customers questioning the value in presenting forecasts over a 5-year period that cannot be relied on due to changing external factors (which

customers consider as unnecessary compliance costs that are reflected in increasing charges). This is also consistent with the independent reviews of the prudency and efficiency of the current network service plans of member owner operators which stated there are many unknowns and uncertainties over the period of the network service plans.
The requirements on member owned operators for network service plans could effectively be removed, or simplified by the requirement for publishing:

- a standard Customer Charter (outlining service standards and targets);
- an Information Statement (outlining changes in the schedule of charges from the previous year);
- annual infrastructure plans (providing transparency of the capital investment to be funded by the charges); and
- annual performance reporting (against relevant industry benchmarks previous established by the National Water Commission).

This would provide customers (and other parties) with the ability to review the prudency of the charges proposed against the respective service standards and infrastructure investment plans of member owner operators. Annual performance reporting using comparable information would be expected to provide the necessary incentives for member owned operators to seek efficiency improvements that deliver value to their customers.

Giving notices by publication on a web site (Questions 2, 19 and 21)

We recommend that each of the rules be amended to permit notices to be published on a web site, in particular notices of network service plans, the schedule of charges and changes to them.

Rule 12.47 of the *Water Trading Rules* provide a model in this regard by requiring operators to publish their trading rules on their web site, and in a way that is "*readily ascertainable and accessible*", but not more. This reflects an appropriate balance and consistent approach able to reduce regulatory burden and reduce the recovery of additional costs with little or no benefit for customer members who generally seek cost efficiencies reflected in water delivery service charges.

The Rules require operators to ensure that all customers receive network service plans, imposing the obligation on operators to ensure that each and every customer is provided with these documents. This obligation is not imposed on regulated electricity and gas infrastructure operators, and would not appear to reflect the importance the Australian Government has placed on reducing the regulatory burden. We suggest the utilisation of the cost calculator adopted by the Office of Best Practice Regulation under the Regulatory Burden Measurement framework be applied to test that compliance requirements represent a cost effective approach.

Network services plans (Questions 3, 4 and 22)

We recommend that the costly requirement under Part 5 of the Rules for member owner operators to prepare, consult, distribute to each customer and amend network service plans outweigh the benefits and be removed or at least significantly reduced.

It is not apparent how the costs of requiring Part 5 operators to prepare, to consult, distribute to each customer, independently review and amend network service plans outweigh the benefits. Operators are best placed to decide the necessary level of consultation with customers and input from independent engineering or other experts, as well as other matters such as the frequency with which network service plans should be made and revised (which may be more frequently than five years, in which case the regulation under the Rules is redundant, or less frequently than five years, in which case the regulation under the Rules is unnecessarily burdensome).

At most, the requirement to include an information statement when providing a revised schedule of charges could be retained, but in our view, it is sufficient to require the publication of schedules of charges and leave the level and nature of consultation between the operator, its customers and its members to be arranged at the discretion of those parties. This is particularly the case with member owned operators, which have regular elections to the board of directors and accountability mechanisms which are more flexible and less burdensome than the network services plan requirements.

We note that the requirement to prepare, consult, distribute to each customer and amend network service plans is not imposed on regulated electricity and gas infrastructure operators. This review should ensure the compliance obligation for member owner operators under the Rules reflect the importance the Australian Government has placed on reducing the regulatory burden. Accordingly, we suggest the utilisation of the cost calculator adopted by the Office of Best Practice Regulation to test that the regulatory compliance burden represents a cost effective approach to meeting regulatory compliance requirements.

We also consider that it is important to appreciate that a key component of charges for member owned operators reflect future forecast asset renewal expenditure, given their significant long lived asset base. Member owned operators have typically adopted a renewals annuity approach to the recovery of this forecast expenditure to provide a stable and predictable charge that is calculated over a 20-100 year time horizon. This reflects the need to continue to maintain (or renew) system assets of member owned operators in perpetuity.

As background, in 1997, the Standing Committee of the Agriculture and Resource Management Council (SCARM) recommended the adoption of renewals annuities (condition based depreciation based on asset management plans) for water infrastructure assets that are system assets which are essentially renewable rather than replaceable. These SCARM Guidelines were subsequently endorsed by the Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ). The use of renewals annuities for water businesses has subsequently been incorporated into the National Water Initiative (NWI) pricing principles.

The extent of caveats reflected in the forecasts of network service plans highlight a range of factors over which member owned operators have no control that are expected to impact on future business operations and costs, including:

- the extent to which members sell water entitlements and terminate delivery entitlements in response to Commonwealth ‘buy back’ programs or external events;
- the availability of Commonwealth funding for infrastructure modernisation under the $5.8 billion Sustainable Rural Water Use and Infrastructure Program (SRWUIP);
- changing nature of compliance and legal obligations;
- impacts on supply and drainage networks that might be caused by natural events such as widespread flooding that occurred in 2012; and
- changes to economic conditions, including rates of inflation (ie. consumer price index).

The level of uncertainty contained in the forecasts provided in network service that is beyond the control of member owned operators suggest this information cannot be relied on for any useful purpose and questions the value of network service plans. This is consistent with the independent reviews of the prudency and efficiency of the current network service plans of member owner operators which stated there are many unknowns and uncertainties over the period of the network service plans.

The requirements on member owned operators for network service plans could effectively be removed or simplified by the requirement for publishing:

- a standard Customer Charter (outlining service standards and targets);
- an Information Statement (outlining changes in the schedule of charges from the previous year);
- annual infrastructure plans (providing transparency of the capital investment to be funded by the charges); and
- annual performance reporting (against relevant industry benchmarks previous established by the National Water Commission).

This would expect to provide customers (and other parties) the ability to review the prudency of the charges proposed against the respective service standards and infrastructure investment plans of member owner operators. Annual performance reporting using comparable information would be expected to provide the necessary incentives for member owned operators to seek efficiency improvements that deliver value to members.

No discrimination rule (Question 4)

We recommend that Rule 10 (the 'no discrimination rule') be redrafted to accurately reflect the policy intent to cover systemic discrimination by operators against non-irrigation right holders based on their status as persons who do not hold irrigation rights.

Rule 10 is drafted in significantly broader terms than its policy intent would require. Taken literally, the rule prohibits delivery charges payable by *any one* non-irrigation right holder for a class of service exceeding delivery charges payable by *any one* irrigation right holder for the same class of service even though they may be in different pricing groups (except to the extent that the excess reflects higher delivery costs), whereas the rule is actually intended to cover systemic discrimination by operators against non-irrigation right holders based on their status as persons who do not hold irrigation rights.

We understand that the ACCC has previously agreed that the rule should be interpreted in the narrower fashion, consistently with the policy intent, but in our view, the rule, if it is to be retained, should be amended so that the literal meaning matches the policy intent.

Usefulness of ACCC's guidance material (Question 6)

We recommend that ACCC's guides be reviewed to ensure they accurately reflect the relevant legislation as they may be relied on by member owned operators to ensure compliance with the Rules.

In principle, the ACCC guides provide a useful means to assist in understanding legislative requirements and expand on some aspects of the Rules. However, it would be unfortunate if ACCC enforcement action relied on information contained in guides in preference to the implementing legislation where differences emerged.

The ACCC's enforcement and compliance approach (Questions 7 and 8)

We recommend that the ACCC pursue an approach to compliance and enforcement of the Rules designed to educate regulated water stakeholders and other water users about their rights and obligations under the Rules.

We suggest that the ACCC should not approach operators on the basis that it is offering to assist with compliance, and then subsequently use the information obtained during such communications to

allege contraventions of the Rules. If the ACCC is not seeking to offer assistance with compliance but attempting to use information provided to allege contraventions of the Rules, all initiation of contact by the ACCC should be in writing. In this case, it should contain a warning to the effect that any information provided by operators to the ACCC can be used against the operators in subsequent compliance and enforcement action.

Treatment of member-owned operators (Questions 11, 12 and 13)

We recommend that it remains appropriate that member owned operators be subject to less burdensome regulation because they are controlled by their shareholder customers, and this ensures a natural check and balance against operators taking advantage of their market power.

The directors of member owned operators are required by law to act in the best interests of the shareholders as a whole.

Standard template for schedules of charges (Question 18)

We recommend that a prescribed template for operators' schedules of charges is unnecessary. In our view, such a regulation would:

a) increase the burden of regulation upon operators, whereas the Review Report has recommended decreasing the burden of regulation;
b) diminish innovation in charging structures within the sector, resulting in poorer service offerings to customers; and
c) reduce the ability of operators to adjust their charges and match charges more closely to costs, resulting in unfairness and inefficiency to customers where their charges do not reflect service costs.

Exemptions from publication of schedule of charges (Question 20)

We recommend that only an operator's "standard" set of charges that are reasonably foreseeable should be compulsorily published as the schedule of charges.

Operators commonly service the bulk of their customers under a standard charging regime set by a standard form customer contract, but also from time to time enter into individual arrangements for specific services under separate commercial contracts. Examples of these types of arrangements are leases granting hydroelectric power station operators access to an irrigation work and arrangements with governmental entities for the use by the governmental entity of the operator's infrastructure for the delivery of water for environmental or other purposes.

Only an operator's "standard" set of charges should be compulsorily published. Individual charges for one-off arrangements under a discrete commercial contract should not have to be published, particularly where they are confidential. The basic common law requirement of certainty in contracts is quite sufficient to ensure that operators publish their charges in advance and are known with certainty by the person paying the charge. The agreement of the principal (ie the entity receiving the service) and the contractor (i.e., the operator) should be sufficient to exempt the charges from the publication requirement under the Rules.

In addition, electricity charges for pumping systems levied on member owned operators by electricity retailers that are passed through to customers, including those that are determined by an industry regulator, are not typically publicly available in sufficient time for inclusion in the schedule of charges issued by operators for the coming year. This may lead to a perverse outcome where operators adopt higher maximum charges to avoid the costly process of re-issuing revised schedule of charges at the time when electricity charges are eventually made public. This is similar for the

determination of NSW Office of Water charges by the Independent Pricing and Regulatory Tribunal (IPART) and the Water NSW portion of Government bulk water charges which includes pass-through of the NSW Government's contribution to MDBA costs.

A similar issue arises in respect of question 45.

Distributions to related customers (Question 35)

We recommend that the definition of a Part 7 operator should not extend to an operator that makes a distribution to some (but not all) of its members. This would result in Part 7 catching a range of common forms of distributions by operators to their customers, for example, efficiency gains credited on the basis of water delivery rights held by customers. Effectively, operators would be required to cease making such distributions, which would reduce the flexibility and value of their service offering to customers.

Accordingly, this amendment to the definition of Part 7 operator would effectively increase the burden of regulation under the Rules, not reduce it.

Water charging arrangements (Question 44)

We recommend that the requirement for all operators' charging arrangements be consistent with Basin water charging objectives and principles should not be adopted. In our view, such a requirement would:

a) increase the burden of regulation under the Rules, not reduce it;
b) be ambiguous and difficult to apply in practice when considering specific charging arrangements, and accordingly would create considerable uncertainty; and
c) result in significant compliance costs for operators – all operators would need to carry out a review of their current charging arrangements, and it would add another compliance burden to operators who wish to amend their charging arrangements for the benefit of customers and members.

Differences in charging arrangements are to be expected in a competitive and innovative industry.

Bulk water charges (Question 49)

We recommend that the Rules should not regulate how water planning and management charges and bulk water charges are passed on to customers.

Operators should retain discretion as to how to account for revenues and costs of whatever kind, including bulk water charges. Absorbing these costs into overall pricing structures should be one option available. The requirement for operators to publish their schedules of charges is sufficient for customers to compare different pricing structures.

Modifying the approach to termination fees (Question 51)

We recommend no change to the approach to termination fees.

Other issues in the Review Report

ACCC regulation of the Water Trading Rules

We note that Recommendation 8 of the Review Report (page 51) is to undertake a detailed analysis of the potential benefits of reassigning responsibility for regulating the Basin Plan's *Water Trading Rules* from the Murray-Darling Basin Authority (MDBA) to the ACCC.

Chapter 12 of the Murray-Darling Basin Plan (Basin Plan) specifies new arrangements and obligations in relation to water trading throughout the Murray-Darling Basin which came into effect on 1 July 2014. The MDBA has stated that the purpose of Chapter 12 is "*to contribute to an effective and efficient water market in the Murray Darling Basin, consistent with the National Water Initiative (NWI) objectives for water markets".*

We recommend that the MDBA continue with the role in the administration of the *Water Trading Rules,* given their responsibility in implementing the Basin Plan, and their pragmatic and consultative approach to the interpretation and enforcement of these rules. A subsequent review of the operation of the *Water Trading Rules* in coming years may identify whether there is sufficient merit in reassigning this role to the ACCC, given their narrower focus in enforcing the various water charge rules and the *Water Market Rules 2009* (Cth).

Amendments to be made to defined terms

We note that Recommendation 13 of the Review Report (page 66) is to review the definitions of "*bulk water charges*", "*infrastructure operator*" and "*irrigation infrastructure operator*" and, if necessary, amend them to reflect the policy intent and reduce ambiguity.

We recommend there be no change to these definitions.