Submission to the ACCC on

STATE WATER CORPORATION'S PRICING APPLICATION TO THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION FOR REGULATED CHARGES TO APPLY FROM 1 JULY 2014

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NSW Farmers' Association Background
The NSW Farmers' Association (the Association) is Australia's largest State farmer organisation representing the interests of its farmer members – ranging from broad acre, livestock, wool and grain producers, to more specialised producers in the horticulture, dairy, egg, poultry, pork, oyster and goat industries.

State Water Corporation and the ACCC

Under its governing legislation, the principle objectives of State Water are to capture, store and release water in an efficient, effective, safe and financially responsible manner[1]. One of the key roles of the ACCC is to enforce the *Competition and Consumer Act 2010* , the objective of that Act being to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection[2].

New legislation and rules[3] now require the ACCC to approve or determine State Water's pricing application for water users within the Murray-Darling Basin (MDB), the determination of which formerly fell with the Independent Pricing and Regulatory Tribunal (IPART). NSW Farmers assert that both State Water and the ACCC have a codified responsibility to ensure consumers are not exposed to or bear the cost of inefficient financial practices.

NSW Farmers' recommendations

NSW Farmers welcomes the opportunity to comment on State Water's application to the Australian Competition and Consumer Commission (ACCC) for approval or determination for bulk water charges for the period 2014-2017. Primarily, NSW Farmers is concerned that the pricing scheme proposed by State Water has a negative impact on water users in cases of low water availability, a commonplace scenario in the Murray Darling Basin, and a scenario that State Water has neglected to address in its application. This proves an unacceptable shift of business risk to customers, which should not be accepted by the ACCC.

As well as providing the following points and recommendations, NSW Farmers endorse the submission of the NSW Irrigators' Council; its detailed economic analysis and full suite of recommendations.

RECOMENDATION 1

NSW Farmers recommends that the ACCC reject the gliding path to the 80:20 tariff structure on the basis that it is not only an improper shift of business risk to customers, but will have a significant, uncompensated financial impact on customers where water availability is low.

RECOMENDATION 2

NSW Farmers recommends that the ACCC reject State Water's claims for increased operational expenditure on the basis of insufficient specification of each cost driver and insufficient justification for that cost driver to be borne by the user portion of the cost-sharing arrangement.

[1] *State Water Corporation Act 2004* (NSW) s 5 (1).
[2] *Competition and Consumer Act 2010* (Cth) s 2.
[3] *Water Act 2007* (Cth); *Water Charge (Infrastructure Rules 2010).*

State Water's pricing application

State Water currently recovers 40 per cent of costs through fixed charges. In its submission, one of State Water's key proposals is a new tariff structure whereby it will recover 80 per cent of its costs through fixed charges using a gliding path through 2014-2017. State Water's application also includes the removal of the current premium on fixed charges for high security entitlement holders, meaning the fixed charges for general security entitlement holders are proposed to increase at a greater rate than fixed charges for high security entitlement holders.

State Water also proposes a new price control mechanism: a revenue cap and carryover of any shortage or excess revenue between regulatory periods, and an annual price adjustment constraint of 15 per cent. This means that any excess or shortage in revenue requirements experienced by State Water over a determination period can be 'carried over' to the next determination period, but the 15 per cent constraint means that State Water cannot increase or decrease (adjust) their pricing by more than 15 per cent to 'make good' this surplus/deficit.

Why an increase to an 80% fixed charge

In State Water's application, State Water has based its proposed regulatory charges on its proposed required revenue to cover its costs.[4] State Water's proposal for the new 80:20 (%fixed: %variable) tariff ratio and new form of regulatory control is 'based on the fact that its costs are independent of sales (water extractions) and its understanding of the new regulatory framework that a cost reflective tariff design is the most effective mechanism to set prices'[5] , meaning State Water's interpretation of the ACCC pricing principles.

State Water claim that one of the main factors expected to influence charges over the forthcoming regulatory period is an expected increase in operating costs. State Water forecast an 8.4 per cent increase in operational expenditures over the determination period.[6]

State Water's costs are shared between the NSW Government and water users under a cost-sharing arrangement implemented by IPART. State Water maintains a 100 per cent operating expenditure recovery from customers.[7] NSW Farmers argue that 'increased regulatory costs' such as costs driven by the ACCC acquiring powers to regulate State Water's bulk water charges in the Murray Darling Basin is outside of customer control, and should therefore not be attributed to the user through the calculation of cost recovery.

[4] ACCC 'Information paper on State Water's 2014-2017 pricing application August 2013' available http://transition.accc.gov.au/content/index.phtml?itemId=1085557

[5] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 129.

[6] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 44.

[7] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 45.

Shift of business risk

NSW Farmers believe that there should be a risk sharing between State Water and its customers- and that the risk that State Water face should be reflected in their achieved return. NSW Farmers proposes that the volatility of water availability and the risks associated with that in terms of commercial viability must be borne by the business purporting to provide a rate of return to its shareholders and improving business efficacy and delivery. A tariff design may be an effective mechanism to set prices in the context of water entitlements, however NSW Farmers believe that State Water have not substantiated its claim that the proposed tariff ratio is cost 'reflective' in order to be effective.

NSW Farmers recognise the virtue of State Water's corporatisation and there are incentives and requirements for consumers in this context to bear costs which are independent of sales. State Water have stated that their current price cap and tariff structure of 40:60 (%fixed:%variable) ratio (decided in IPART's 2006 Determination) 'results in a high risk of revenue under-recovery as a result of volatility in water availability and/or demand.'[8]

NSW Farmers argues that the current system is understood and accepted and has even provided State Water with a positive profit over current and previous periods. NSW Farmers believe that it is the corporation's responsibility to mitigate the risk referred to above, and further assert that the current 40:60 price regime appears to be doing so for the purposes of State Water's sales. Furthermore, State Water claims that their pricing application; their establishment of revenue requirements and the pricing outcomes of these revenue requirements is a confirmation of 'business as usual', as outlined in its application application: 'The proposed expenditure in this submission is dominated by maintaining assets and services to deliver business as usual.'[9]

NSW Farmers is of the opinion that it is irresponsible to not provide evidence where this increase in non-consumptive water use charge is derived, and to claim that it is 'business as usual' when in effect, 80% of the commercial risk of the business will be shifted to the customer.

NSW Farmers are concerned that State Water has not substantiated the claim for this change to the current pricing determination scheme, nor the increase in its required revenue. The pricing, revenue and expenditure outcomes proposed by State Water should be rejected by the ACCC. NSW Farmers believe that the proposed pricing scheme proposes a significant shift of business risk to State Water's customers, which the ACCC should oppose as the now regulator of this monopoly operator.

[8] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 131.
[9] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 9.

The risk in practice

In its application to the ACCC, State Water have exemplified the proposed charges in an 'indicative bills'[10] which show comparisons for the bill for a customer in each valley in the financial years of 2014, 2015, 2016, 2017 for:

- High security customer with a 500ML entitlement who have used 100 per cent of the entitlement: State Water propose an 11% on average decrease.
- General security customer with a 500ML entitlement who have used 100 per cent of the entitlement: State Water propose a 19% on average decrease
- General security customer with a 500ML entitlement who have used 60 per cent of the entitlement: State Water propose a 6% on average decrease

These estimations include transition to 'cost reflective'[11] tariff – of a gliding path to 80% fixed, 20% variable charge which will comprise of 50:50 (2014-2015), 65:35 (2015-2016) and 80:20 (2016-2017). As indicated earlier in this submission and in the indicative bills themselves, this glide path is a clear shift of business risk to customers, which State Water have only chosen to exemplify using scenarios of 100 per cent water availability.

State Water's exclusion of an indicative bill showing a customer using a low amount of the water entitlement is an indication of irresponsibility that State Water proposes. The NSW Irrigators' Council (NSWIC) aim to show indicative bills for high and general security entitlement holders with 20 per cent usage. The NSWIC have included this in their submission to the ACCC to exemplify cases where water availability may be low over the incoming determination period using the proposed tariff structure.

As indicated in that submission, the NSWIC have found that the total costs for both high and general security customers in this scenario significantly increase in most valleys[12]. In cases of low water availability, the customer is clearly to bear the costs, which NSW Farmers believe is not financially responsible as per the objectives of the State Water Corporation and the ACCC governing legislation.

State Water as a monopoly operator

Operating licences will provide for the obligations surrounding State Water's delivery of water. As well as this, State Water provide specific service priorities for the submission. These are: safe and reliable assets, reliable and timely bulk water release to customers and other users, and responsive, courteous and consistent customer services[13]. NSW Farmers has concerns that the proposal to make the majority of their charge not related to the delivery of the product (80% fixed charge), will markedly reduce financial incentive for State Water to deliver the actual product, water, in a competitive and efficient manner.

[10] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 4.
[11] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 4.
[12] New South Wales Irrigators' Council 'Submission to Australian Competition and Consumer Commission State Water Corporation Pricing application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 17.
[13] State Water Corporation 'Pricing Application to the Australian Competition and Consumer Commission for regulated charges to apply from 1 July 2014' 10.

The current pricing determination (40% fixed charge) being the majority of the charge is directly related to the product delivered, provides a financial incentive to ensure that State Water lives up to its own and the community's expectations surrounding water delivery.

Another perceived problem is that irrigators feel forced to over produce in order to make up for the higher fixed portion. This is obviously a perverse outcome which becomes more likely the more the scheme is skewed away from the actual product delivered. These incentives are of prime importance as State Water Corporation is a monopoly operator in delivering a product to NSW bulk water users. The corporation is regulated to ensure that it delivers water in a financially responsible manner.

ACCC to promote financial responsibility and consumer protection

NSW Farmers believe that the proposal within State Water's application is not financially responsible. It poses a shift of business risk to customers with no evidenced compensation or return for that risk. This risk is proven in times of low water availability. NSW Farmers are also of the opinion that State Water have not substantiated their claim to an increase in revenue costs, when the current 40:60 tariff structure, purported to be reflective of required revenue, has delivered a positive net profit over the current and previous determination periods. NSW Farmers recommends that the ACCC reject State Water's application.