

**Submission on
*WaterNSW's pricing application
for rural bulk water services
from 1 July 2017***

Macquarie River Food and Fibre

Prepared by:

Grant Buckley, Executive Officer

Prepared for:

The Independent Pricing and Regulatory Tribunal

October 2016



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 Acquirer Access Licence holders in the Lower Macquarie Groundwater Sources. Based on current collection rates, MRFF represent 80% 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 and service providers.

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

MRFF is represented on WaterNSW'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 WaterNSW's *Pricing Proposal to the Independent Pricing and Regulatory Tribunal – Regulated prices for NSW Rural Bulk Water Services from 1 July 2017 to 30 June 2021*.

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

1.	INTRODUCTION.....	1
2.	UNDERSTANDING OF THE PROCESS.....	2
3.	GENERAL COMMENTS ON WaterNSW's PROPOSAL.....	3
	Understating performance and overstating risk	4
4.	IMPLICATIONS FOR CUSTOMERS IN THE MACQUARIE	6
	Cost Allocation Ratios	6
5.	FURTHER INFORMATION	14
6.	APPENDIX 1 – CPI ADJUSTMENT	15

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 and service providers.
- 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, 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 WaterNSW's Pricing Proposal to the Independent Pricing and Regulatory Tribunal (IPART) – Regulated prices for NSW Rural Bulk Water Services from 1 July 2017.
- 1.4 Our organisation is well placed to provide input to the process having participated in each of the previous price determinations for WaterNSW (previously State Water Corporation) conducted by IPART and the Australian Competition and Consumer Commission (ACCC). Additionally, we have strong local experience and familiarity with the state-owned infrastructure service provider, being a key member of WaterNSW's Customer Service Committee for the Macquarie-Cudgegong Valley.
- 1.5 Our submission is based on this experience along with a review of the information obtained in WaterNSW's pricing application and the supporting material made available on the IPART website. MRFF has also considered the IPART Issues Paper on WaterNSW's review of prices for rural bulk water services from 1 July 2017.
- 1.6 MRFF understands and generally agrees with the submission that the NSW Irrigation Council (NSWIC) makes to IPART.
- 1.7 This submission has been developed to further highlight those points we believe to be of particular importance to MRFF members and, where we can, to provide further information and detail relevant to the Macquarie Valley.
- 1.8 MRFF's submission is structured to provide:
 - An understanding of IPART's price approval and determination process,
 - A general response to WaterNSW's proposal, and
 - Comments on the implications for customers in the Macquarie Valley.

2. UNDERSTANDING OF THE PROCESS

- 2.1 MRFF notes that WaterNSW's current prices as determined by the ACCC will expire on 30 June 2017 and IPART have been accredited by the ACCC under the Commonwealth Government's Water Charge (Infrastructure) Rules 2010 (WCIR) to set bulk water prices in the Murray-Darling Basin (MDB).
- 2.2 While the ACCC are currently conducting a review of WCIR we understand, from the IPART Issues Papers, that if the WCIR are amended in accordance with the ACCC's draft advice, IPART will regulate WaterNSW's maximum prices for the MDB valleys under the IPART Act¹.
- 2.3 MRFF understands that the current rules require WaterNSW to submit a pricing application to IPART, which should provide information for IPART to assess whether to approve or determine the regulated charges.
- 2.4 MRFF further understands that for WaterNSW's charges to be approved, their pricing application should build a persuasive case on why expenditure is needed, justification for the expenditure proposed, and justification for the operator's proposed tariffs².
- 2.5 MRFF urges the Independent Pricing and Regulatory Tribunal (IPART) to take a strong stance in this determination to ensure that the necessary incentives are put in place for WaterNSW to seek more equitable and efficient pricing solutions into the future.
- 2.6 Throughout our submission, MRFF highlights a number of areas of concern that we believe require further investigation.

¹ IPART Issues Paper, September 2016, p2

² ACCC (2011) *A guide to the water charge (infrastructure) rules: Pricing application for Part 6 operators*, p7.

3. GENERAL COMMENTS ON WaterNSW'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.
- 3.3 Historically, the general approach that WaterNSW has taken 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.
- 3.4 It is therefore pleasing to see some improvements in relation to WaterNSW's current proposal particularly in relation to the efficiencies related to operational expenditure. There are however a number of items that require additional scrutiny and detail.
- 3.5 In particular WaterNSW's significant change in approach to forecasting capital expenditure (CAPEX) is concerning. WaterNSW has moved away from providing a capital works plan and is basing its future CAPEX proposal on a 'theoretical upper limit benchmark' derived through the Modern Engineering Equivalent Replacement Asset model (MEERA) to establish the level of investment required to maintain assets in "as new" condition. It is difficult to see how such an approach will enable a clear and transparent assessment of WaterNSW's actual CAPEX needs over the next determination period.
- 3.6 As a minimum we would expect that WaterNSW would have identified the major items of capital expenditure required in each valley, particularly the Macquarie, to implement the maintaining capability approach.
- 3.7 Furthermore, the significant changes to the user share of CAPEX is worrying. WaterNSW's proposed user share of CAPEX of 77% in the proposal is a significant shift from the ACCC's final decision in 2014 when a user share of CAPEX of 49.8% was approved³.
- 3.8 In addition to an analysis of WaterNSW's CAPEX cost shares we believe it is important for a more holistic review of cost shares for water pricing. IPART last conducted a review of cost shares in 2012, at the request of the NSW Government, and recommended that the current approach to determining government costs be maintained 1 July 2017.
- 3.9 For many years MRFF has maintained that the cost shares, and customer base in general, need to be updated to appropriately reflect current water entitlements and operations.

³ IPART Issues Paper, September 2016, p45

Understating performance and overstating risk

- 3.10 A key argument underlying WaterNSW’s current and past pricing proposals is that its business viability is under continued pressure, predominantly due to revenue volatility. In its current proposal WaterNSW states that “the lack of a cost-reflective tariff structure has resulted in WaterNSW substantially under-recovering the revenue requirement in most valleys” for the current determination period⁴.
- 3.11 In the 2010-2014 regulatory period IPART included, in the then State Water’s revenue allowance, a ‘volatility allowance’ calculated for each valley. However in the most recent determination, to determine prices for the current period, the ACCC decided not to allow the re-introduction of the volatility allowance. Instead the ACCC introduced the Unders and Overs Mechanism (UOM) which has been applied in the Macquarie Valley and other MDB valleys with the exception of Lowbidgee and Peel.
- 3.12 An assessment of WaterNSW’s overall revenue requirement for the 2017-2021 period, as provided in Table 1 below, reveals that even under the current 40:60 tariff structure, a minimum of 61% of WaterNSW’s revenue is fixed for the determination period. This effectively means that WaterNSW is able to cover allowed operating expenses and provide a healthy return on capital without delivering a drop of water to its customer base.

Table 1 – Fixed proportion of WaterNSW’s current and proposed revenue requirement

	\$2016/17, \$million			
	2017/18	2018/19	2019/20	2020/21
Total Revenue Requirement	86.235	86.880	88.313	88.989
Government Share	30.445	30.776	30.854	30.848
User Share – Fixed	55.790	56.104	57.460	58.140
Minimum fixed revenue as a proportion of total revenue	61%	61%	61%	61%

- 3.13 The expected outcomes from the current regulatory period also suggest that WaterNSW’s assertion that its business viability is under continued pressure due to revenue volatility.
- 3.14 In Table 2 actual revenue is compared to allowed revenue for the for the current determination period (2014-2017). The information illustrates that despite claims of significant revenue volatility the total shortfall over the three year period is 12.6%.
- 3.15 It is important to consider the results presented with the fact that over the same period WaterNSW did not deliver on its allowed capital program. If the allowed revenue was adjusted

⁴ WaterNSW’s Pricing Proposal, June 2016, p35

by the \$20.7 million underspend in WaterNSW's capital expenditure program the overall variance in allowed verse actual revenue would disappear.

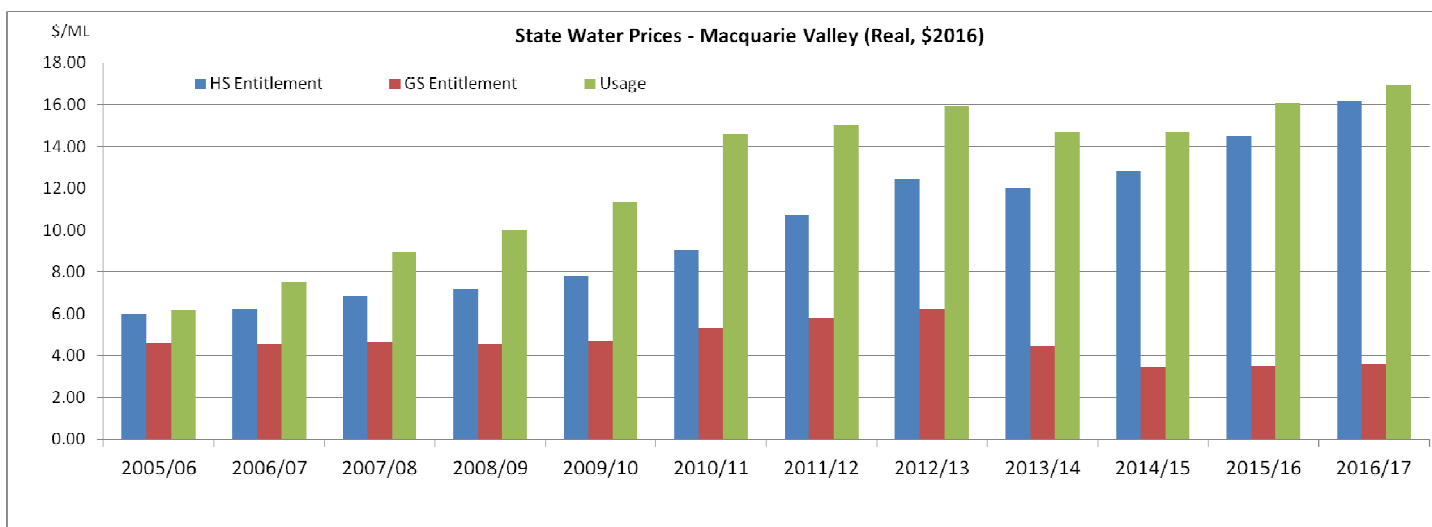
Table 2 – Actual verse allowed recovery for the three years from 2014/15 to 2016/17(\$ nominal)^

	2014/15	2015/16	2016/17	TOTAL
Allowed revenue (\$M)	\$51M	\$53M	\$55M	\$159M
Actual revenue (\$ M)	\$43M	\$41M	\$55M	\$139M
Variance (\$)	-\$8M	-\$12M	\$0	-\$20M
Variance (%)	-15.6%	-22.6%	0%	-12.6%

4. IMPLICATIONS FOR CUSTOMERS IN THE MACQUARIE

- 4.1 MRFF is obviously particularly interested in the implications of WaterNSW'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 WaterNSW in the Macquarie Valley since 2005/06



- 4.3 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 relative jump in usage charges in the Macquarie Valley since 1 July 2010.
- 4.4 While it is reassuring to see that WaterNSW are proposing that customers in the Macquarie regulated system receive a reduction in High Security (HS) Fixed and Variable Usage charges customers have been subject to higher than inflationary price increases for many years as illustrated above.
- 4.5 Furthermore WaterNSW are proposing a 10.2% increase of GS Fixed charges between 2016/17 and 2020/21 which, in light of previous price increases is extensive, and along with HS and Usage charges needs to be scrutinised by IPART.

Cost Allocation Ratios

- 4.6 MRFF recognises that in the current determination an 'impactor pays' approach is used to sharing costs between users and government. MRFF recognises and concurs with the notion of users paying full cost recovery for access, however, there is an extended list of users that must also be included as paying customers. MRFF have made sound arguments

during the course of previous pricing determinations and we believe that IPART must revisit these arguments when considering cost sharing principles.

MRFF submits that, in line with WaterNSW's proposal, a comprehensive review of cost sharing arrangements should be initiated (following the current pricing review) to ensure the appropriateness of cost allocations moving forward.

- 4.7 Flood Mitigation Role of Burrendong Dam - The officially acknowledged purpose of Burrendong Dam when it was expanded in the 1950s, was for flood mitigation, in addition to irrigation and provision of stock and domestic supplies. In fact, almost one-third (489,000 ML) of the dam's total storage capacity (1,678,000) is designated and operated solely for flood mitigation, with the remaining 1,189,000 ML designated for irrigation, stock, domestic and environmental purposes. To then allocate all operating costs associated with the dam to irrigation customers is not only inequitable but plainly incorrect.

MRFF submits that recognition of Burrendong Dam's flood mitigation role is particularly important, and valley specific, given such a large part of the Macquarie's infrastructure, storage and delivery costs are related to Burrendong Dam. Bearing in mind this officially recognised role of the dam, flood mitigation must be recognised under the 'impactor pays' approach.

- 4.8 MRFF also notes that numerous higher priority water users in the Macquarie, are not currently included as paying customers and this needs to be addressed. Examples of this include water delivered under the 160,000ML environmental water allowance⁵ as well as the regulated and unregulated water used as replenishment flows in the effluent creeks of the Macquarie system.

⁵ Note that the environmental water allowance is an allowance within the Water Sharing Plan and does not refer to environmental water purchases made through State and Commonwealth Government programs, which are subject to the same conditions and charges as the licence class from which they were purchased.

Table 3 – MRFF response to the drivers of the proposed revenue requirement for the Macquarie Valley

Building Blocks (User Shares)	ACCC Determination 2014	WaterNSW Proposal 2016	MRFF Comments and Submissions
<p>Operating expenditure (OPEX)</p>	<p>Allowed \$5.08M in first year - \$5.01M in last year⁶.</p> <p>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</p>	<p>Propose \$4.1M in year one with gradual reduction to \$3.5M in final year.</p> <p>This represents a 24% reduction in OPEX between 2016/17 and 2017/18 and a further 14.6% reduction between 2017/18 and 2020/21.</p>	<p>MRFF welcomes the efficiency gains in OPEX costs being realised by WaterNSW, primarily as a result of the integration and restructuring of the former State Water Corporation and Sydney Catchment Authority.</p> <p>We would expect that as the new business structure is bedded down that there would be room for further efficiency gains within WaterNSW’s operations.</p> <p>MRFF also acknowledges and welcomes IPART’s decision to engage a consultant⁷ to review the efficiency of the proposed level of OPEX for the current pricing review.</p>
<p>Capital expenditure (CAPEX)</p>	<p>Allowed \$10.4M⁸ over the 3 year determination period (average of \$3.47M/yr) which was a 69% reduction on WaterNSW’s original proposal of \$33.2M.</p>	<p>A total of \$15.68M proposed for the four year determination period (average of \$3.92M/yr representing 10.2% real ↑).</p> <p>No capital program has been provided to outline where this</p>	<p>MRFF notes a significant change to the CAPEX approach taken by WaterNSW in their determination of CAPEX requirements.</p> <p><i>MRFF submits that IPART must request WaterNSW to provide further detail on the assumptions and parameters underlying WaterNSW’s MEERA calculations in order to assess whether the</i></p>

⁶ Attachments to ACCC Final Decision on State Water Pricing Application 2014-15 – 2016-17, p27

⁷ IPART Issues Paper, September 2016, p39

⁸ Attachments to ACCC Final Decision on State Water Pricing Application 2014-15 – 2016-17, p62

Building Blocks (User Shares)	ACCC Determination 2014	WaterNSW Proposal 2016	MRFF Comments and Submissions
	<p>During the current determination period WaterNSW have only spent \$7.6M (73% of the allowed amount).</p>	<p>money is intended to be spent.</p>	<p><i>approach is prudent and efficient.</i></p> <p>MRFF seriously questions the prudence and efficiency of WaterNSW’s capital expenditure requirements in the absence of a capital works program and emphasizes that customers should only pay for what is needed, efficient and planned.</p> <p>WaterNSW’s proposal for a CAPEX allowance does not provide any transparency and would likely see customers paying for works that are not required, or not actually completed. WaterNSW has a history of over estimating their CAPEX requirements and not delivering on planned works even when a plan is in place.</p> <p><i>MRFF submits that IPART must scrutinise WaterNSW’s proposed CAPEX program for the next determination period to ensure that it only includes necessary capital.</i></p> <p><i>MRFF submits that customers need visibility of the CAPEX program that WaterNSW intend to complete in the valley, particularly the large projects. This could be best managed through the Macquarie-Cudgegong Customer Service Committee.</i></p>
<p>MDBA pass through</p>	<p>Removed on advice from ACCC</p>	<p>Not included for the Macquarie-Cudgegong Valley</p>	<p>Concur with absence of the MDBA pass through cost for the Macquarie-Cudgegong</p>

Building Blocks (User Shares)	ACCC Determination 2014	WaterNSW Proposal 2016	MRFF Comments and Submissions
Volatility Allowance	<p>Removed and replaced with:</p> <p>1) an annual adjustment to prices, which is based on updated sales forecasts (annual reviews are discussed in more detail in Chapter 9), and</p> <p>2) an unders and overs mechanism (UOM).</p>	<p>WaterNSW has obtained an initial quote of a risk transfer product (RTP) that would replicate an 80:20 fixed to variable tariff structure. The RTP is a simple swap arrangement whereby two-thirds of WaterNSW's usage revenue (in valleys with a 40:60 or 60:40 fixed variable structure) is swapped for a fixed revenue stream.</p>	<p>MRFF rejects the inclusion of a volatility allowance on top of an already adequate range of Risk Transfer Products (RTP).</p> <p>The UOM is sufficient for mitigating the risk of both WaterNSW and licence holders and provides a transparent mechanism that water customers can more easily monitor.</p> <p>Furthermore, with the Macquarie Valley being subject to some of the highest variability in water availability the inclusion of a volatility allowance would account for a significant proportion (>10%) of the valley's notional revenue requirement.</p> <p><i>MRFF submits that the 2014 ACCC determination on the removal of the volatility allowance should be the starting point for the current price review. Additionally, MRFF submits that the inclusion of a volatility allowance in addition to the current RTPs is clearly a case of WaterNSW 'double-dipping'.</i></p>

Building Blocks (User Shares)	ACCC Determination 2014	WaterNSW Proposal 2016	MRFF Comments and Submissions
Regulatory Asset Base	<p>Closing Asset Base estimated at approximately \$78 million⁹</p> <p>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</p>	<p>Opening RAB reflects allowed capital expenditure from 2014 determination. An increase of approximately 8.5%¹⁰ to the RAB is proposed for the coming period, however WaterNSW have not outlined the projects to be completed that will contribute to this in future years.</p> <p>The asset base continues to be affected by maintenance and investment in assets servicing non-paying customers.</p>	<p>MRFF recommends:</p> <ul style="list-style-type: none"> • avoidance of socialised costs for corporate projects that will not result in increased water deliveries or future cost savings for customers in the Macquarie • avoidance of costs associated with servicing currently non-paying customers – EWA account holders are provided with the same services as general security licence holders and should be charged accordingly.
Return of Assets (Depreciation) and Return on	<p>Valley based approach to determining asset lives.</p> <p>and</p>	<p>WaterNSW has adopted the estimates of the average life of existing assets, updated for actual expenditure during the 2014-17 period</p>	<p>Given WaterNSW’s proposal to include a volatility allowance on top of the Risk Transfer Products already in place (Unders and Overs Mechanism, Tariffs and Cost Shares), it is not prudent or efficient to continue to use a beta value - determined in the previous determination – when there is a proposal to include a volatility allowance</p>

⁹ Attachments to ACCC Final Decision on State Water Pricing Application 2014–15 — 2016–17, p55

¹⁰ WaterNSW Pricing Proposal – Appendices, p111

Building Blocks (User Shares)	ACCC Determination 2014	WaterNSW Proposal 2016	MRFF Comments and Submissions
Assets (WACC)	WACC set at 6.92%	and Includes WACC of 5.9%.	<p>while maintaining all other Risk Transfer Products.</p> <p><i>MRFF submits IPART must consider the business risk faced by WaterNSW and adjust the proposed beta value accordingly.</i></p> <p><i>MRFF submits that the WACC must be lowered to better reflect current economic conditions and WaterNSW'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.</i></p>
Total Revenue Requirement	Allowed \$9.7M in the first year with incremental increases to \$10.5M in the final year.	Propose a 14% nominal decrease in the first year (to \$9.01M) when compared to the ACCCs 2014 determination and then a 1.4% increase by 2021 to \$9.13M.	<p>While MRFF acknowledge the reduction in total revenue requirements for the 2017/18 – 2020/21 period we have concerns with the how the requirements was determined, particularly in relation to CAPEX, cost shares, RTPs and WACC.</p> <p><i>MRFF submits that IPART scrutinise the prudence and efficiency of WaterNSW's proposed revenue requirements, particularly in light of the significant increase in CAPEX and user share of CAPEX.</i></p>

Table 4 – MRFF response to the approach to translating the revenue requirement into prices for the Macquarie Valley

Tariff Structure (User Shares)	ACCC Determination 2014	WaterNSW Proposal 2016	MRFF Comments and Submissions
Cost base	High Security entitlement - 42.6 GL General Security entitlement - 631.7 GL	High Security entitlement - 42.7 GL General Security entitlement - 632.5 GL	<i>MRFF submits that WaterNSW 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.</i> <i>MRFF submits that WaterNSW be instructed to put forward an appropriate charging structure for capturing other classes of non-paying customers.</i>
Tariff Structure	40:60 fixed:variable ratio	40:60 fixed:variable ratio	MRFF accepts WaterNSW’s proposal to maintain the 40:60 tariff structure in the Macquarie-Cudgegong for the next determination period

5. FURTHER INFORMATION

MRFF thanks IPART for the opportunity to provide a submission on WaterNSW's pricing proposal

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: **Grant Buckley, Executive Officer**

1/193 Macquarie Street

PO Box 1657

DUBBO NSW 2830

02 6884 9577 / 0400 849 577

mrff@bigpond.com

6. APPENDIX 1 – CPI ADJUSTMENT

The following table shows the multipliers that have been used throughout MRFF’s submission to adjust amounts to \$2016/17. These figures have been obtained using the June Quarter in the ABS’s Consumer Price Index Inflation Calculator.

	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16
Multiplier	1.26	1.23	1.18	1.16	1.13	1.09	1.08	1.05	1.02	1.01

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