Murray Irrigation

Review of prices for WaterNSW

Submission to the Independent Pricing and Regulatory Tribunal for rural bulk water services from 1 July 2017.

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Executive summary

Murray Irrigation welcomes the opportunity to review the WaterNSW (WNSW) pricing application and provide comments to the IPART issues paper. This open and transparent process ensures all interested parties can participate, evaluate and comment on whether the pricing application represents fair and efficient prices.

This is more than can be said for the addition of the MDBA charges which are passed through with no scrutiny or review as a regulatory obligation rather than a regulatory charge.

If the WNSW application is accepted, the MDBA charges will represent 86 percent of Murray Valley General Security entitlement holders' fixed charges. That is 86 percent that is not open to any form of public review or scrutiny that is passed straight onto water users.

The Water Charge (Infrastructure) Rules (WCIR) and associated pricing principles were put in place to protect consumers from monopoly practices, yet there is no such oversight of the monopoly operations and costs of the MDBA river operations to protect consumers who, in NSW, must pay for their services through pass through costs..

IPART has, in the past, applied an efficiency dividend to the MDBA charges in lieu of capacity to review. Murray Irrigation would ask IPART to apply the same diligence this time around if again the charges are not put forward for public scrutiny.

With regards to the WNSW charges, Murray Irrigation appreciates that efficiency savings from the merger of Sydney Catchment Authority and State Water Corporation are being realised, however, we hold concerns that the transitional arrangements from the transfer of staff and duties from the Department of Primary Industries have already been determined under the *Water Administration Ministerial Council* determination that was completed and implemented from July 2016. IPART must closely evaluate all charges to ensure there is no double-up of duties and customers are only paying once, regardless of under whose name the actual activity takes place.

By the same token, WNSW's application for two volatility risk mitigation mechanisms is, in our opinion, double dipping. An 'unders and overs' mechanism (UOM) provides adequate protection against the peaks and troughs of water availability, as well as a level of protection for water users against paying a premium even in years of high water sales and over recovery for WNSW.

The fact that WNSW has consistently returned an excessive net profit after tax for the five years up to 2014-15 indicates that further volatility protection over and above a UOM is unnecessary.

Murray Irrigation welcomes IPART reviewing the government/user cost share ratios. River management rules and priorities have changed significantly since the cost shares were first determined and we no longer believe the current ratios are reflective of the impactor pays principles applied by IPART.

Murray Irrigation addresses our concerns in the following submission. We focus on issues pertinent to Murray Irrigation. Murray Irrigation is a member of NSW Irrigators' Council and we endorse their submission on broader issues relevant to the irrigation industry in NSW as a whole.

1 Submission

Murray Irrigation is pleased to provide this submission to IPART. Murray Irrigation has registered to make a presentation to the public hearing to be held in Coleambally on 14 November 2016.

1.1 Regulatory framework

Murray Irrigation is pleased that some efficiencies from the merger of the Sydney Catchment Authority and State Water Corporation appear to have been passed on in this pricing application. We believe streamlining the pricing review processes to ensure all future determinations for both arms of the organisation are run concurrently to increase efficiencies.

Of more concern to Murray Irrigation is ensuring that the expected efficiencies from streamlining services from the Department of Primary Industries, Water (DPIW) into WaterNSW be passed onto customers.

The WaterNSW Amendment (Staff Transfer) Bill 2016 passed through Parliament just prior to the finalization of the most recent determination of the Water Administration Ministerial Corporation's (WAMC) water management charges. These charges incorporated cost recovery for activities that will now be transitioned to WNSW.

Murray Irrigation is seeking assurances from IPART that there will be no recovery of charges by WNSW for staff and functions that are now transferred to them when those costs are already being recovered through charges to water licence holders to WAMC.

At the very least, Murray Irrigation requests IPART provide more transparency regarding which WAMC costs are related to transfers to WNSW, clarity on the issue of costs arising from staff transfers and seeks a commitment from IPART that any additional efficiencies resulting from the transfer of functions will flow through to customers in form of lower water charges.

> **Murray Irrigation recommends IPART scrutinise costs proposed by WNSW to ensure there is no double dipping, whereby costs are being recovered by both DPIW and WNSW for operations that are transitioning from one organisation to the other.**

1.2 Revenue requirement

1.2.1 Capex

While Murray Irrigation welcomes WNSW's proposed reduction in operational expenditure, we are concerned that some of this cost is now proposed to be recovered through capital expenditure.

WNSW's adoption of the MEERA methodology to assess required capex for this determination lacks the transparency of the asset management planning approach used in past determinations.

While we acknowledge that WNSW did present the change in capex planning and budgeting to stakeholders during the consultation process, we submit that the methodology adopted does not provide IPART with adequate information to determine if it is prudent and efficient capital investment planning.

At one consultation, WNSW implied that the use of MEERA is standard practice in industry. This is not the case for Murray Irrigation and we continue to view asset management planning as the right approach for our business and our accountability for capital expenditure planning.

> **Murray Irrigation recommends IPART review the use of the MEERA methodology and evaluate if there is enough information for it to determine if it is efficient and prudent budget practice.**

Murray Irrigation notes the proposed capital expenditure increase for the Murray Valley is in excess of 300 percent for the life of the determination. Murray Irrigation fails to see how this can be so when most of the infrastructure in the Murray Valley falls under management of the MDBA, whose costs we are required to pay as a "pass through" cost.

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As noted in the IPART issues paper (p71):

> *"The costs of construction, operation and maintenance of assets under the MDBA arrangements are jointly paid by the signatory states."*

Murray Irrigation notes that the revenue requirement for capex is added to the Regulated Asset Base which is then recovered through an allowance for a return on assets and regulatory depreciation.

We are unaware of how the MDBA recovers funds for capital expenditure, suffice to say that we would expect an allowance for capex is added to the joint program funds recovered from the states. Therefore, it is reasonable to assume that a significant portion of capex related to Murray River assets is collected through the MDBA charges, although a lack of transparency of those charges makes it impossible to determine.

> **Murray Irrigation requests IPART to closely scrutinise the proposed capex revenue for the Murray Valley to ensure water users are not paying twice, through WNSW and the MDBA for the operation and maintenance of assets.**

1.2.2 Tariff structure

WNSW'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 and consistent with the feedback from the Murray Lower Darling Customer Service Committee.

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

1.2.3 User share

Murray Irrigation supports IPART's position to review the cost shares for this determination to ensure they continue to reflect the share of costs imposed by each party. It is our view that the cost shares, developed in 2001, no longer represent the cost burden of today. Much has changed in river operations and the impact on costs needs to be adjusted in accordance with newer river operating priorities.

In 2001, when ACIL conducted the last review[1] there were no water sharing plans and less emphasis on the environment. Since the establishment of the water sharing plans, the increasing amounts of rules-based environmental water and the construction and operation of environmental works and measures, which, while constructed under funded programs, now contribute to the planning and management costs of the river, we believe environmental management issues now have a significantly higher impact on costs than they did in 2001.

For example, WNSW has currently identified 100 percent user share for water delivery and other operations, yet part of that water delivery includes delivering planned environmental water in accordance with the rules of the Water Sharing Plan. This should not be paid for by users. Further, corrective maintenance is not only caused by delivering water for irrigation purposes. The impact of delivering both base flows and environmental flows must be considered in the process. Asset management and planning, also 100 percent user share under the current regime, is now significantly influenced by planning for environmental impact of river operations and, to a lesser extent, the impact on cultural heritage sites. These should all be recognised as public benefit and funded by a Government share.

[1] *Appendix C, Review of Prices for WaterNSW, Issues Paper, IPART, 2016*

Further, hydrometric monitoring is currently 90 percent user share. Again, it would be argued that a significantly larger portion of hydrometric modelling activity is now done for environmental purposes as well as consumptive use and therefore the tax-payer contribution should be higher.

Further, there are many other impactors who do not contribute to the costs of operating the river. We have held this position for multiple determinations. In 2013, Murray Irrigation's submission to the ACCC for the (then) State Water pricing application said:

> *"In the River Murray there are a multitude of businesses and recreational activities that are reliant on a regulated Murray that are not licensed to consume water and currently make no contribution to either capital or river operation costs, however, these industries place demands and impose costs on State Water and River Murray Water, the majority of which are passed on to water users."*
>
> **Murray Irrigation requests IPART adjust the cost share ratios to better reflect the current river operations priorities and to recognise the public cost of impactors that are not captured under the current licence-based cost recovery regime.**

1.2.4 MDBA charges

Murray Irrigation again notes the lack of transparency in the MDBA prices. The ACCC and IPART both state that the MDBA charges are not within their jurisdiction with regards to the determination process as bulk water charges. However, in 2014 the ACCC found the recovery of these charges through (then) State Water's bulk water charges is a regulated water charge under the Water Act 2007[2].

It is Murray Irrigation's view that the collection of MDBA charges by WNSW is a regulatory obligation and therefore the water users subjected to these charges should be afforded a level of transparency for the charges they are being subjected to. This is particularly true when you start to evaluate whether water users are being charged twice for capital expenditure activities and other river operational activities.

> **Murray Irrigation recommends IPART advocate for a full determination process for the NSW component of River Murray Operations (MDBA) charges to ascertain if they are efficient and prudent.**

Further, there is no consistency with how MDBA charges are recovered across contributing states. Under the last IPART determination in 2010, cost shares were applied, however under the ACCC determination, the full amount required by NSW Treasury was passed onto water users through WNSW charges. This potentially sets NSW water users at cost a disadvantage when compared to irrigators in other States.

At the very least, 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 (post 1997) while renewal and replacement costs should be 90:10 and so on[3]. 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.

Murray Irrigation reminds IPART of its finding in 2010[4], that in the absence of a capacity to review MDBA charges, it applied an efficiency dividend to ensure that water users had a level of protection against these monopoly charges.

> **Murray Irrigation submits IPART use its powers to scrutinise the MDBA charge pass through or, at the very least, adopt the efficiency dividend approach taken in 2010.**

[2] *ACCC draft decision on State Water Pricing Application: 2014-15 – 2016-17, March 2014, p8*
[3] *ACCC draft decision on State Water Pricing Application, Attachments, March 2014, p22, Table 1-12 IPART user cost shares by activity*
[4] *Review of bulk water charges for State Water Corporation 2010-14, IPART, June 2010, p17*

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Further, Murray Irrigation believes that there must be an opportunity for stakeholders to comment on the proposed distribution of these cost recoveries. Without transparency as to exactly what these charges are for, water users cannot determine if the distribution is fair or reasonable. We note that MDBA charges recovered through WNSW charges are only proportioned across the Murray and Murrumbidgee valleys, with the lion's share (95 percent) coming directly out of the Murray.

Whatever the final amount of MDBA charges to be recovered through WNSW 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. We submit the impact of moving to fully fixed MDBA charges does not provide any incentive for the NSW Government to hold the MDBA to account for their costs and to encourage them to operate to maximise efficiencies.

Murray Irrigation notes the impact of fully fixed charges for MDBA pass through costs will see an increase in Murray general security entitlement charges of almost 105 percent across the determination[5]. This results in a 12.6 percent increase to the 'average' general security customers' bills which is the largest increase in bills out of all Murray-Darling Basin valleys.

When viewed in context of our fees and charges, the MDBA component is significant. Currently Murray Irrigation recovers fixed fees through delivery entitlement fees which is $10.57 (2016/17). The proposed fixed MDBA fee for 2017/18 is $6.17 (NSW Murray General Security) which would add almost 60 percent on top of our delivery entitlement fee.

> **Murray Irrigation requests IPART review the impact on customers' bills from recovering MDBA charges through fully fixed costs and consider applying a tariff structure.**

1.3 ICD rebates

Murray Irrigation has concerns with the ICD rebates proposed by WNSW on a number of levels.

1.3.1 Entitlement based rebate

WNSW is proposing to determine the ICD rebates on a per entitlement basis, however they provide no information as to what the per-entitlement rate is, nor what their assumption of our entitlement volume is in their application.

In 2014, Murray Irrigation contended that a per-entitlement formula is not an accurate reflection of the avoided costs of metering, compliance and customer billing are actually incurred on a per-site basis. It is our view that the WNSW approach to calculating avoided costs oversimplifies the service that ICD's provide.

Murray Irrigation holds five water access licences with the NSW Government and services 506 extra-large irrigation outlets, 2,636 large irrigation outlets, 284 small irrigation outlets (all of which are metered), as well as 1,258 unmetered pipes for stock and domestic use. All of these are serviced by almost 3,000km of earthen supply channel and around 1,300 regulating structures, all at our own cost. State Water charges Murray Irrigation based on diversions through only two independently metered diversion points at Lake Mulwala and the Wakool Offtake. If Murray Irrigation did not exist, State Water would need to administer the accounts of our almost 1,200 farm customers and monitor, maintain and manage all of our infrastructure.

There has been no reduction in Murray Irrigation's metering and compliance costs to justify the level of reduction in rebates proposed by WNSW. Further, there has not been a significant reduction in our held entitlement numbers since 2015/16 that would seem to justify the reduction to the extent proposed by WNSW.

> **Murray Irrigation requests IPART retain the current ICD rebates to recognise that there has been no reduction in our compliance costs or the avoided costs for WNSW.**

[5] *IPART review of prices for WaterNSW, Issues Paper, 2016, p101*

1.3.2 Avoided costs

WNSW reported to IPART that the reduction in ICD rebates is “largely driven by a step change reduction in metering, compliance and customer billing operational expenditure”[6]. However, the metering service charge proposed in the WNSW application for users of WNSW owned meters on regulated rivers is increasing for every category of meter except open channel.

This begs the question, if the metering service charge is levied to cover the cost of operating, maintaining and reading the meters, as well as provision, maintenance and operation of information systems, and it is going up, then why are ICD rebates for “metering, compliance and customer billing” avoided costs going down?

> **Murray Irrigation requests IPART review the ‘avoided cost’ formula used by WNSW to ensure the rebate accurately reflects the true avoided costs**

1.4 Risk management – UOM and risk mitigation

Murray Irrigation is opposed to the proposal by WNSW to apply two risk management mechanisms to its charges.

1.4.1 Unders and overs

We note the IPART issues paper (p63) acknowledges that if water sales equal forecasts, WNSW will receive revenue equal to its notional revenue requirement and that if water sales are less than forecast they will under-recover. What it fails to acknowledge is that where water sales are higher than forecast, they will over recover.

The ACCC opted to apply an ‘unders and overs’ mechanism with an annual review. At the time, Murray Irrigation argued that this mechanism had the potential to result in price fluctuations, especially in valleys with MDBA charges. However, we accept that the ‘unders and overs’ mechanism does at least give water holders a return in the event of over recovery through adjusted charges the following year. It is our view that this mechanism is a fairer tool for revenue stability than the previous revenue volatility allowance which was recover from water users regardless of whether WNSW was in line to over or under recover.

Murray Irrigation submits that if the only concern is for a risk management tool, the ‘unders and overs’ mechanism should be enough to provide WNSW with confidence of recovering its notional revenue requirement.

While WNSW identifies the fact that as at 1 July 2016, the unders and overs account balance is -$19.5 million, Murray Irrigation makes the point that its net profit after tax over the preceding five years averaged $25.5 million which is adequate to pay out the UOM account balance each year and still return a profit.

Murray Irrigation understands the impact fluctuating water availability and water use has on a business reliant on water sales and delivery, however, the regulatory framework ensures that over time WNSW will, on balance, earn sufficient revenue to cover its costs as evidenced by its net profit figures. Murray Irrigation is of the view that WNSW must be commercially responsive to circumstances and the determination must provide continued pressure on WNSW to react commercially to changing circumstances.

> **Murray Irrigation supports the retention of the UOM as a risk mitigation mechanism that also provides returns to water users when WNSW over recovers.**

Murray Irrigation does not support any risk mitigation mechanism being applied to MDBA charges while the proposal is for fully fixed cost recovery. If costs are recovered through fixed charges, there will be no revenue volatility and no need for adjustments.

[6] *IPART review of prices for WaterNSW, Issues Paper, 2016, p62*

1.4.2 Risk mitigation allowance

As mentioned above, if WNSW is capable of returning a net profit before tax over the last determination and the determination before based solely on actual revenue, then there is little need for revenue volatility allowances.

Murray Irrigation does not support contracting a third party to absorb the risk which is in turn passed onto water users by way of paying a premium on charges for the service. This premium is paid regardless of the prevailing circumstances. That is, it is paid in years of high water sales or low water sales.

Murray Irrigation would argue that if the UOM as applied by the ACCC is maintained, with annual adjustments to both prices and water sale forecasts, then there is no need for another risk mitigation product.

We submit that the application by WNSW for both a UOM and a risk mitigation allowance is effectively double dipping.

Murray Irrigation does not support the application of two risk mitigation mechanisms.

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, that are not transparent and have not been reviewed against any assessment of prudency or efficiency, sees the real charges for the Murray Valley increase and the impact of a customer's bill is significant.

Added to this is effective double dipping by WNSW for risk mitigation strategies in both a UOM and a risk mitigation levy which is effectively a volatility allowance. Further, the change to the capex programing from project budgeting to a theoretical methodology lacks transparency and accountability.

The burden on water users to bear the costs of river operations in an age when the priorities for river operators is shifting and the first priority is now delivery of planned environmental water must be reviewed. This is becoming even more evident as environmental works and measures are being commissioned and forming a growing part of river management planning. We welcome IPART's review of cost shares in light of the changing circumstances.

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

Murray Irrigation has registered to attend the public hearings in Coleambally in November and will be available to answer any queries regarding this submission.

[redacted]

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