

***Review of Rural Water
Charging Systems –
Discussion Paper***

Macquarie River Food and Fibre

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Regulatory Tribunal

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About MRFF

Macquarie River Food and Fibre represents the interests of irrigated food and fibre producers in the Macquarie Valley. Our membership comprises riparian irrigators along the regulated section of the Macquarie River downstream of Burrendong Dam, the groundwater irrigators of the Lower Macquarie Groundwater Sources, as well as the individual members of the Valley's seven off-river irrigation schemes being the Buddah Lake, Greenhide, Narromine, Nevertire, Marthaguy, Tenandra and Trangie Nevertire irrigation schemes. MRFF is supported by a number of associated local businesses.

About this Document

This paper has been prepared in response to the Discussion Paper issued by the Independent Pricing and Regulatory Tribunal for their *Review of Rural Water Charging Systems*. The submission is provided on behalf of irrigated food and fibre producers in the Macquarie Valley however it is noted that our individual members may wish to provide their own submission in response to the Discussion Paper.

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1. INTRODUCTION

Macquarie River Food and Fibre (MRFF) welcome the opportunity to respond to the Discussion Paper issued by the Independent Pricing and Regulatory Tribunal (IPART) as part of the *Review of Rural Water Charging Systems* being undertaken for the NSW Government.

MRFF is the peak industry group for irrigated agriculture in the Macquarie Valley representing over 500 water licence holders in the Macquarie regulated river system and the Lower Macquarie groundwater sources. We are a non-profit organisation assisting our members to develop and maintain efficient, productive and profitable irrigation enterprises. We do this by developing, supporting and implementing a range of policies and projects relating to the allocation, delivery and use of water resources in the Macquarie Valley.

It should be noted that MRFF is a member organisation of the state's peak representative group for the irrigation industry, NSW Irrigators Council (NSWIC), and that we generally agree with the submission they have provided to IPART on this discussion paper.

MRFF's submission is structured to provide a summary of our overarching concerns in relation to the current water charging system as well as specific feedback to questions raised by IPART in the Discussion Paper as they relate to the Macquarie Valley irrigation industry.

2. RESPONSE TO TERMS OF REFERENCE FOR THE REVIEW

MRFF has a vision for an efficient, productive and profitable irrigation industry in the Macquarie Valley. We see the irrigation industry as complementary to the strong and diverse agricultural base in central western NSW. However, key to achieving our vision and maximising the contribution of the industry to the social and economic development of NSW is a secure regulatory framework and efficient management and equitable cost-sharing arrangements for the region's water storage and delivery infrastructure and services.

In this light, MRFF welcomes the NSW Government's review of the way that bulk water charges are levied in NSW. We note that the review honours an election commitment in response to concerns that the Coalition held in regards to the impact of water charges on rural industries and communities.

MRFF considers this review an opportunity to raise three issues inherent in the current water charging system that we believe to have the greatest impact on the long-term profitability of the irrigation industry in NSW. These are:

- 1) The impact of continued above inflationary price hikes for water users in valleys that have already reached full cost recovery.

MRFF notes that the impacts in the Macquarie Valley are driven by:

- a. A short-termed and flawed approach to consumption forecasting,

- b. A narrowly defined customer base, and
 - c. An overstatement of the business risk and performance expectations for the NSW water management and delivery businesses.
- 2) The impact of paying fixed charges in years of extraordinary drought conditions.

MRFF considers that there are extraordinary circumstances that warrant a government policy response in the form of an explicit relief subsidy for those experiencing hardship.

- 3) The impacts that will be faced by rural water users in NSW under the ACCC Rules.

MRFF supports the concerns put forward by the NSW Irrigators' Council that the ACCC Rules will create more costs and greater price volatility for bulk water users. It is our view that the NSW Government must consider the impacts that regulation by the ACCC will have on the competitiveness of this state's water-based industries given the inconsistencies that currently exist between Basin states.

MRFF is of the view that each of these issues must be comprehensively addressed if the NSW Government is to meet their objective of maintaining the viable provision of bulk water delivery services and a profitable irrigation industry.

MRFF's response to the specific questions raised in IPART's Discussion Paper is provided below.

3. RESPONSE TO SPECIFIC QUESTIONS TO STAKEHOLDERS

Assessment criteria

1. Are the proposed assessment criteria appropriate?

Taking into account the directions in the Terms of Reference for this review, the assessment criteria proposed by IPART are generally appropriate. That having been said, the time constraints imposed on this review have meant that the depth of analysis that would be required to fully assess the options against each of the criteria has not yet been undertaken.

MRFF notes that IPART will be undertaking more detailed analysis to quantify the magnitude of the likely impacts of each option in the next stage of this review and looks forward to considering these findings.

2. Are there other factors or criteria we should consider when assessing options?

MRFF notes with some concern that the options presented by IPART in relation to addressing customer cash flow issues do not provide consideration of the NSW Government's commitment to "waive fixed water charges for general security licence holders who had received no water allocations for two consecutive years in drought conditions".

It is therefore suggested that the assessment be expanded to include the following criteria:

- Consistency with NSW Government policies or commitments

Water availability and customers' cash flows

3. The most appropriate method of analysing historical water availability to understand the relationship between water availability and customers' cash flows

MRFF remains of the view that the NSW Government's long-run Integrated Quantity and Quality Models (IQQM) remain the most appropriate method for analysing water availability on a valley-by-valley basis. IQQM is purposely developed to assess policies and scenarios around climate, demand environmental flows and system constraints. The modelling is used widely across the Murray Darling Basin and is recognised as the best available method to simulate hydrological processes under current river management rules.

The case for the use of long-run IQQM in analysing consumption is strengthened as the water industry continues along a path of reform that is intended to lead to changes in both system management rules and traditional water uses across the Murray Darling Basin. There is currently no other tool available that is able to simulate policy scenarios and demand responses, be it from traditional irrigators or an increasing portfolio of environmental holdings, in line with a river systems long-run hydrology.

MRFF contends that the current approach to consumption forecasting that uses a 20-year moving average of modelled and actual extractions is flawed because the actual extraction in many cases occurred under a different set of river management rules. For example, in the Macquarie regulated river system, there were changes to management rules in 1996 and 2004, which means that the actual extraction data over this period is not comparable. This problem will be exacerbated as we see further policy changes and demand responses going forward.

As noted at the Public Hearing on 3rd July 2012, the impact of the 2010 Determination was to effectively suggest a change in the long-run average extraction of the valley's general security licence holders from 53% to 42% of entitlement. A change that for the reasons outlined above, MRFF believes to be flawed. Since the completion of the 2010 determination the MDBA has made available the updated modelling (using IQQM) that incorporates the period from 2004 to 2011. The results of this modelling indicate a reduction in general security extraction from 53% to 51% of entitlement, that is, the results show some

downward pressure on average extractions as a result of the millennium drought, however, not to the extent suggested by IPART's approach.

MRFF notes that a move away from using long-run IQQM to forecast consumption in the 2010 determination was one of the main contributing factors that led to significant price increases for regulated river users in this valley. MRFF stresses that it is the continuation of above inflationary price increases that is having the greatest impact on customers' cash flows in the Macquarie Valley.

4. Do the differences between valleys and associated farming systems mean that instituting broad rules across valleys to measure the impact of water availability is not appropriate?

While MRFF supports a user-pays approach and therefore differential pricing across water sources and type of access, it is recognised that for ease of administration and implementation, as well as equity considerations, it is appropriate that there is consistency in the overall approach to rural water charging across NSW.

MRFF contends that this need for consistency in the approach to water charging is a further argument for retaining the use of the full dataset that is available in IQQM. IQQM allows for broad rules to be set, yet recognises the variations in climatic, management and demand conditions that apply in different valleys.

For example, a rule might be set for an extraordinary drought circumstance that warrants a policy response from government such that:

- The NSW Government will waive fixed charges for licence holders whose access is restricted based on extraordinary circumstances, and
- The threshold for extraordinary circumstances will be two consecutive years of one-in-twenty-year events as determined for a given class of access in a given water source.

The actual trigger point, being what constitutes the one-in-twenty-year event for each class of user in each water source, would be determined using the valley-specific modelling over the period from 1890. As IPART well appreciates, different river systems and licence categories within those systems have a range of expected reliabilities and therefore such an approach could feasibly accommodate this range.

5. Which customers are most affected by variability? It is our preliminary view that those most affected by variability are general security users in regulated systems and users in unregulated water sources.

MRFF agrees with IPART's view in this regard.

6. Are there circumstances where water variability affects the high security users?

Under the current Water Sharing Plan for the Macquarie and Cudgegong Regulated Rivers, high security users are essentially provided with surety of two years supply should there be a repeat of the conditions of the historic 'drought of record'.

Given these provisions, high security users in the valley have previously enjoyed 100% reliability of their entitlement and will only be subject to impacts should drought conditions in the valley exceed those on record, which MRFF believes would be grounds for an explicit policy response from government.

7. Are the current customer assistance measures offered by State Water and NOW useful to customers in managing their cash flow issues?

MRFF considers the current assistance measures provided by State Water and NOW for individual customers in hardship are appropriate.

It is noted that the percentage of State Water customers in the Macquarie Valley requesting assistance over the period 2009/09 to 2011/12 was less than 5% in each year, with the greatest level of assistance (4.7%) required in 2010/11. The 2010/11 figure corresponds with the impact felt by many Macquarie Valley customers who experienced severe flood damage during December 2010 following many years of drought. It is also noted that the increase in uptake of assistance in 2010/11 corresponds with a significant increase in water charges as a result of the new determination.

MRFF supports a separate and transparent government policy response in the form of a subsidy that is available to all affected licence holders in the event of extraordinary climatic conditions such that fixed charges are waived.

8. Other options for measuring the impact of rural water bills on users?

As previously flagged, MRFF considers the greatest impact on customer cash flows in the Macquarie Valley to be the continuation of above inflationary price hikes for water management, storage and delivery services, despite the valley having reached full cost recovery many years ago. It would therefore be useful to demonstrate the impact of price increases *ceteris paribus* under different allocation scenarios (low, average, high) as well as present benchmarking information on the increases in prices relative to increases in other key farm inputs.

9. How closely is water availability aligned with farm cash flows?

MRFF has observed a direct correlation between water availability and the area planted to cotton in the valley. It is estimated that over 90% of general security entitlement is used for cotton production. We therefore point to the use of cotton benchmarking statistics, such as those provided by Boyce and the Cotton CRC, and gross margin budgets to assist develop case studies to demonstrate farm business impacts.

10. How and when do farmers take water availability into account when making production decisions?

As mentioned above, cotton is the primary crop grown under irrigation in the Macquarie Valley accounting for over 90% of general security water usage. With cotton planting in September/October, water availability in the first quarter of the water year is a key decision point. It should be noted that water availability will include access to carryover as well as the current year AWD.

11. The degree to which water trading has allowed rural water customers to maintain the viability of their businesses and maintain cash flows in times of drought.

MRFF agrees with IPART's views in relation to water trading as outlined in Section 5.6 of the Discussion Paper. The ability to trade both entitlement and allocation has definite advantages for farm business management and this is reflected through a healthy trading market in the Macquarie Valley. However, as acknowledged by IPART, the usefulness of trade is still limited by overall water availability.

It is worth noting that in addition to trade, the carryover provisions in the Macquarie Valley also have considerable benefits for managing irrigated farming businesses.

12. The limitations of water trading and the impact on customers of these limitations

The limitations of water trading are referred to above.

13. What is an appropriate basis to determine a trigger level of water availability before there is a significant impact on the cash flows of customers

MRFF supports the NSWIC submission on what might trigger a policy response from the NSW Government. That is,

- That fixed charges be waived when water allocations or cumulative AWD as at 31st October in any year is within the lowest 5% of historical allocations for that valley for two consecutive years, and
- That the provision of this relief is through an explicit subsidy from Government that is not sought to be recovered from water users at some future point.

Tariff structure and other policy options to address customer cash flow issues

14. What are the key issues in the current suit of price tariffs, pricing policies and payment terms that cause hardship in periods of low water availability?

MRFF considers the key issues with the current water charging system in NSW to be:

- Continued above inflationary price hikes for water access, the impacts of which are felt most acutely in times of low water availability. MRFF notes that the impacts on irrigation customers in the Macquarie valley are driven by:
 - A short-termed and flawed approach to consumption forecasting,
 - A narrowly defined customer base, and
 - An overstatement of the risk and performance expectations for the NSW water management and delivery businesses;
- The threat of being subject to a higher proportion of fixed charges, which would not align with the annual variability of cash flow from irrigated enterprises in the valley, would exacerbate customer impacts in times of drought, and would fail to provide an efficiency incentive in the operation of the water management and delivery businesses; and
- The need to consider a relief measure for customers in extraordinary circumstances in the form of an explicit policy response from Government.

15. Who should be responsible for establishing the conditions that would trigger a rural water charging policy response?

It is MRFF's view that the NSW Government should have ultimate say in determining the conditions that would trigger a rural water charging policy response. Such a policy response would need to be a transparent and explicit subsidy provided to those entitlement holders facing extraordinary conditions and should not be sought to be recovered from other entitlement holders.

16. Should rural water charging policy triggers be established in the price determination process?

MRFF supports the principle of a user-pays approach to meeting the efficient costs of water storage, and delivery systems. MRFF further notes the intent of the National Water Initiative, that where full cost recovery is not practical, the cost of providing water must be met via a transparent subsidy from government.

MRFF understands that it is the intention of this review to consider ways that the water charging system can be improved to better take into account the impact of pricing on farm businesses, particularly during times of low water availability. We are therefore of the expectation that the policy triggers will be bedded down in this review and that the next determination will focus on determining the efficient costs subject to these policy triggers.

MRFF submits that the government policy responses should include:

- Formalisation of an extraordinary circumstances relief mechanism , and
- Consideration of a cap on above inflationary price increases such that equity is provided to water users across the state.

17. What are your views on the tariff structure options presented? Do you agree with our preliminary view for tariff structure or policy options that best meets the assessment criteria?

MRFF supports the continuation of a two-part tariff with differential pricing based on water source and access rights. It is our preference to maintain the current fixed:variable ratio, however, as previously presented to IPART we do not support the need for a volatility allowance. We believe that the volatility allowance effectively nullifies State Water's supply-side risk placing an undue cost burden on its customers and removing what should be an important efficiency incentive for operation of the water delivery business.

MRFF is aware that customers face a risk in the move to the ACCC pricing process that the NSW Government (through State Water) will respond to a lower WACC requirement by increasing the proportion of fixed charges. In light of this, MRFF is encouraging IPART to conduct a more in-depth assessment of providing pricing choices, or options, for the fixed:variable component. For administrative reasons it is suggested that two pricing options be explored, being 90:10 and 40:60 (fixed:variable).

MRFF considers that there could be merit in this approach in the sense that if there are some customers willing to accept higher fixed charges, then this may strengthen the case for retaining higher variable charges for other users. Obviously we would be looking to see the more in-depth analysis before we are able to provide full support for such an approach.

18. Are there any tariff structure or other policies or approaches that we should consider?

In line with our comments made elsewhere in this submission and at the IPART hearings, MRFF would like to see an assessment of the following options:

- Maintenance of the current fixed:variable ratio based on the long-run IQQM approach to consumption forecasting with no volatility allowance
- Assessment of the current tariff structure (two-part, differential) with the addition of pricing choice for the fixed:variable ratio, where customers are required to select their preferred option at the start of the determination period
- Assessment of a tariff structure that is inclusive of the full range of users of State Water and NOW services, in particular, the Environmental Water Allowance in the Macquarie valley
- Assessment of the NSW Government commitment to waive fixed charges following two-consecutive years of zero allocation
- Assessment of the NSWIC submission to waive fixed charges when water allocations or cumulative AWD as at 31st October in any year is within the lowest 5% of historical allocations for that valley for two consecutive years

19. Are there any other implementation issues that should be considered for the tariff structures or other policy options outlined? Are there any implementation issues for tariff structure or other policy options at a local level (e.g. within irrigation corporations) that we should be aware of?

MRFF would like to raise the following valley specific issues that must be considered in reviewing the appropriateness of the current water charging system going forward:

- The increasing portfolio of environmental water holdings by both the NSW and Commonwealth governments

Recent transfers and commitments suggest that around 27% of the valley's general security entitlement will be held by government environmental water holders. It is likely that the behaviour of these entitlement holders will differ to traditional irrigated agricultural producers, which should be taken into consideration.

- Expansion of the customer base to capture service provision to holders of the Environmental Water Allowance

In addition to the transfer of general security licences to environmental water holders, there is a 160,000 ML environmental water allowance provided for in the Water Sharing Plan for the Macquarie-Cudgegong Regulated Rivers. This allowance has the same characteristics as general security licences and therefore makes use of State Water and NOW's

administration, storage and delivery services. Despite being provided with these services, the Environmental Water Allowance is not subject to water charges.

MRFF submits that the price impact on general security users of the failure to appropriately levy these services is in the order of 20%. MRFF submits that the revenue requirement to be met by general security licence holders should be levied across a customer basis inclusive of the 160,000 ML Environmental Water Allowance and therefore apply to 791,000 ML rather than the current approach of levying only 631,000 ML.

- Recognition of the flood mitigation role of Burrendong dam

As previously submitted to IPART, the officially acknowledged purpose of Burrendong Dam when it was built was for flood mitigation, in addition to irrigation and the provision of stock and domestic supplies. As a result 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.

Despite this recognised role and the impact that mitigating the flood effects on towns often has on the irrigation industry and other riparian landholders, the charges for the operating costs and certain capital costs associated with the dam do not appropriately incorporate the active management of the dam for flood mitigation purposes. That is, not only are irrigation customers often impacted by the flood mitigation activities, they are left subsidising a large component of the services provided by State Water on behalf of the broader community.

Setting the NSW Government's cost share for ACCC determined bulk water charges

20. What are your views on the cost share options presented? Do you agree with our preferred option on determining cost shares?

MRFF understands that the Terms of Reference for this review ask IPART to consider how cost shares might be determined going forward given the ACCC will have no role this. MRFF therefore supports consideration of the options put forward in the discussion paper.

21. Are there alternative options for determining the cost sharing ratios that we have not yet considered?

MRFF notes that Option 3 provides for a review of the cost sharing methodology at every second determination period, with the first review to be undertaken at the 2017 price review. MRFF asks that

this option be expanded such that an Option 3B considers the first review to be undertaken at the upcoming determination given the cost shares were rolled over at the last determination.

MRFF is supportive of a continuing role for IPART as an independent and transparent process for determining government cost shares.

22. Are there any other issues on determining cost shares that we need to consider?

As outlined previously in this submission, MRFF is concerned that irrigation customers in the Macquarie valley are subsidising the cost of providing flood mitigation services to Macquarie valley communities downstream of Burrendong Dam, as well as the costs of services associated with the Environmental Water Allowance. MRFF also supports the case advanced in the previous determination by State Water and many user groups that services provided to non-irrigating riparian landholders, stock and domestic users, and tourism and recreational users are currently being borne by irrigation customers.

MRFF submits that this review should consider more equitable apportionment of these costs in the rural water charging system. MRFF considers that there are two options for addressing these issues:

- Through differential pricing in the tariff structure – this would mean incorporating these classes of use in the customer base. MRFF considers this to be the preferable approach, particularly in the case of the Environmental Water Allowance, which is a clearly definable user.
- Through a review of the cost shares.

Valleys not at full cost recovery and the government contributions

MRFF supports NSW Irrigators' Council submission in response to questions 23 to 26.

4. FURTHER INFORMATION

MRFF once again thanks IPART for the opportunity to participate in the *Review of Rural Water Charging Systems* and looks forward to receiving information on the next stage of the review. In the meantime, should IPART require and additional information or clarification on the issues raised in this submission please be in contact.

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