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Submission

IPART

Draft Recommendations

Review of Rural Water Charging Systems May 2012

120730

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Introduction

NSW Irrigators' Council (NSWIC) represents more than 12,000 irrigation farmers across NSW. These irrigators access regulated, unregulated and groundwater systems. Our Members include valley water user associations, food and fibre groups, irrigation corporations and community groups from the rice, cotton, dairy and horticulture industries.

This submission represents the views of the Members of NSWIC with respect to the Draft Recommendations for the *Review of the Rural Water Charging System 2012 in New South Wales*. However each Member reserves the right to independent policy on issues that directly relate to their areas of operation, or expertise, or any other issues that they may deem relevant.

Contents

General Comments

IPART's draft recommendations show insignificant changes to the initial Discussion Paper with respect to the tariff structure, the deferral payment options, the cost sharing framework and the cost recovery approach in the Peel Valley.

As in our initial submission to the Discussion Paper, we reiterate our reluctance and concerns about any future regulation of bulk water charges by the ACCC. We have outlined that such a change in regulator would cause a substantial increase in risks and costs for bulk water users in NSW. NSWIC would like to further argue that a regulation by the ACCC will lead to perverse pricing outcomes and lead to a reversal of a decade long reform process for bulk water charging in the state. Additionally, the regulation by the ACCC will cause greater inequity between Basin States, as other Basin States either have no, or heavily subsidised, bulk water charges.

In this context, NSWIC makes the following comments to IPART's six recommendations with respect to the *Review of the Rural Water Charging System 2012 in New South Wales*.

In the absence of the ACCC regulation, NSWIC supports IPART's recommendation to continue the current tariff structure of 40:60 fixed to variable charges in the Murray Darling Basin portion of NSW. Given the high variability in farm cash flow and the high dependency of irrigated agricultural production on water, such a tariff structure provides sufficient flexibility to mitigate financial impacts in case of large variability in water supply.

However, we would like to re-emphasise our concern that the continuation of the current tariff structure regime under the ACCC regulation will cause unnecessary price volatility for bulk water users due to the consumption based pricing approach imposed by the ACCC. Such a consumption based price adjustment would cause an upwards adjustment in prices in case of low water demand the previous year. In the case of a 40:60 tariff structure under the ACCC regulation, NSWIC is therefore of the opinion that bulk water users in NSW will experience more volatile year on year bulk water prices in case of high water availability. Greater variability in input costs associated with high variability in output returns, creates significant uncertainty for bulk water users in NSW - an outcome that is undesirable.

NSWIC strongly supports the continuation of an independent and transparent cost sharing framework that is determined and administered by IPART. We have raised concerns about the current cost share proportions as we do not believe they accurately attribute costs to the respective benefactor. We stress that a review of the current cost share proportions is necessary to align with IPART's benefactor pay principle. Furthermore, we have highlighted in our previous submission that a thorough re-evaluation of an appropriate user base is necessary, as bulk water services are currently enjoyed by certain entities that do not pay for them. This places a disproportional financial burden on irrigators without an equivalent increase in service or quality.

NSWIC does not agree with IPART's assessment that a full cost recovery approach in the Peel Valley is financially viable and the most appropriate mechanism to recover costs for water delivery. Given the substantive costs for bulk water services in this valley, further price increases will have a detrimental effect on the financial viability of the irrigation industry in this area.

Furthermore, NSWIC notices that IPART has made two additional recommendations with respect to the rural water charging system which in our opinion has the capacity to significantly impact bulk water customer in NSW.

The suggestion that SWC should inquire about a *Financeability Allowance* to be paid by customers is not supported by NSWIC. We consider such an allowance to be a further risk compensation paid to SWC additionally to WACC and volatility allowance. NSWIC cannot comprehend how it would be equitable to further transfer risk of water variability and revenue receipts to SWC customers. Furthermore, such a *Financeability Allowance* is suggested to be paid in advance to counterbalance any potential impact on future notional revenue achieved by SWC. NSWIC is of the opinion that customers neither should have to pay for a third risk compensation, nor provide SWC with an 'insurance' payment for services that they have yet to receive.

NSWIC furthermore doubts that any unused *Financeability Allowance* paid by customers would be re-credited to customers in subsequent periods. If such charges weren't necessary in the first instance, they should not have been levied. We re-emphasise that we do not support the introduction of any further risk compensation payment to SWC which would enable SWC to further transfers risk to customers.

Additionally, the final recommendation made by IPART that the regulated asset base should be adjusted due to the potential changes in the WACC calculation is not supported by NSWIC. NSWIC does not consider it necessary to adjust the current RAB nor do we believe there is sufficient information to justify a revaluation on the basis of a potential change in one variable. We support the transfer of the current RAB value should the ACCC regulate bulk water charges in NSW under the ACCC *Water Charge (Infrastructure) Rules 2010*.

Specific Comments

Recommendation 1: Retain existing tariff structure

As outlined in our initial submission, NSWIC supports the continuation of the current tariff structure in the absence of ACCC regulation. It remains our concern that due to the potential involvement of the ACCC, there will be a negative impact on irrigated agricultural producers due to the inverse relationship between prices and water availability. In the case of a 40:60 fixed to variable tariff structure under an ACCC framework, bulk water users will experience more volatile year-on-year price fluctuations should water availability be highly variable. Given the variability of farm cash flow and the high dependency of irrigated agricultural production on the availability and cost of input factors, such an increase is unnecessary and undesirable. NSWIC stresses that this increase in uncertainty is not compensated to customers in any way.

NSWIC has suggested that further work should be conducted that explores alternative options to balance the increased risks and cost for irrigators. We indicated that this alternative option might include the provision of alternative tariff structure options with varying fixed and variable ratios for different bulk water customers. While insufficient information remains on what impact this will have on irrigators, we emphasize that this suggestion could be a possibility and should be explored thoroughly in terms of its feasibility and cost effectiveness.

In order to allow bulk water customers in NSW to make an informed decision, we recommend that further modeling is conducted that assesses the viability of multiple tariff structure options for all consumers of bulk water services in NSW.

Recommendation 2: Conditional deferral payment with interest

NSWIC would like to re-emphasize that a deferral of payments instead of waiving fixed charges due to low water availability is an inappropriate drought relief measure. Further, it does not fulfil the policy commitment of the NSW Government.

NSWIC has sought a relief from payment of fixed charges in extraordinary circumstances[1] and the threshold for extraordinary circumstances should be two consecutive years of one-in-twenty-year event. If that threshold is met, government should make the fixed charge payment on behalf of irrigators.

A deferral of fixed charges with additional interest payment is, in this context, insufficient from NSWIC's perspective. We reiterate that in times of extreme hardship, fixed charges are a significant impost to survival. When, for a significant period, irrigators are not able to receive the benefit of the infrastructure, the payment for its maintenance should be viewed as a public service obligation by government.

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[1] NSWIC Policy: http://www.nswic.org.au/pdf/policy_documents/Fixed%20Charges%20Trigger%20policy%20v5.pdf

In recent years, the NSW government has assisted with payment of fixed charges for irrigators in particular valleys[2]. These 'once off' support mechanisms seem to be a reaction to specific circumstances rather than part of a consistent policy framework to support irrigated agriculture in times of drought.

As outlined in our policy[3], irrigators respond to drought by reducing their own operating costs. The current bulk water pricing system requires water license holders to bear the cost of running the rivers to provide water for non-paying beneficiaries. The cost of meeting this obligation rises steeply under severe drought conditions when most of the flow in the river is to meet these obligations and very little is available for Water Access License holders.

NSWIC does not believe that a deferral of fixed charges to be paid with interest is an adequate response to mitigate the financial impact on irrigators in case of very low water availability. While reducing the total costs to irrigators during the time of drought, it does not solve the overall problem that irrigators pay for services that will not be provided to them but for other beneficiaries in case of exceptional circumstances. Furthermore, IPART's suggestion that this deferral should then trigger interest payments cannot supported by NSWIC. We re-emphasize that these fixed charges should be treated as a CSO in case of extreme low water availability.

Recommendation 3: Maintain cost share framework and proportions

NSWIC strongly supports the continuation of an independent and transparent cost share framework that is determined and administered by IPART. We do not concur with IPART's assessment of the current cost share proportions. We have highlighted in our last submission that we do not consider the current cost share proportions to accurately reflect the conditions prevalent in NSW or align with IPART's beneficiary pay principle.

Individuals who currently pay bulk water charges are only a subset of all those who benefit from the provision of bulk water services. IPART has recognized in its Draft Recommendations that there is currently a lack of information that would allow IPART to make recommendation on charging basic landholders and environmental contingency allowance. Such information have be gathered and an urgent review of the current user base and cost share proportions has to be conducted to accurately reflect conditions prevalent in NSW.

NSWIC understands that the timeframe and complexity makes it difficult for IPART to review the cost share proportions and the user base for the next determination of SWC's charges, however we believe that an urgent review of the cost proportions and user base is necessary. The cost for the provision of bulk water services should be shared between all bulk water users of NOW and SWC services.

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[2] Example: Lachlan Valley
[3] http://www.nswic.org.au/pdf/policy_documents/Fixed%20Charges%20Trigger%20policy%20v5.pdf

NSWIC submits that following this urgent assessment, an eight year revaluation of the cost share framework is an appropriate and cost effective approach to set cost shares in NSW.

Recommendation 4: Full cost recovery approach in the Peel Valley

NSWIC strongly supports an ongoing financial support of the Peel Valley through CSO provided by the NSW Government. Given the low number of bulk water users in the Peel Valley, the costs of bulk water is significant in this valley. Further cost increases for bulk water services will not be financially viable as unit costs would be prohibitively high. NSWIC beliefs this argument will be further supported by the Coastal Valley Regulated River Review that is currently being conducted. The review will provide additional information on the current social and economic costs imposed by the current water charges in the Peel Valley.

As we have outlined in our last submission, NSWIC does not concur with the recommendation made by IPART that an incremental increase of 5% per annum is sustainable. Full cost recovery in the Peel Valley is not financially viable and would place individual irrigators in this region at a substantial competitive disadvantage.

We reiterate our preference to adopt an upper bound pricing approach (strictly less than 100%) that is implemented gradually. To mitigate the impact of bulk water users in the Peel Valley, NSWIC suggests that the upper price is close, if not identical, to the current 90% cost recovery. The remaining 10% should be covered through adequate CSO provided by the NSW government.

Recommendation 5: Financeability allowance

NSWIC does not support the introduction of a further risk compensation factor for SWC. The suggestion that a further *financeability allowance* should be made available to SWC in order to compensate any potential changes in WACC is inadequate and will place further unnecessary financial burden on bulk water customers.

In NSWIC's assessment, such a *financeability allowance* would effectively be an advancement paid by bulk water customers to compensate any notional revenue shortfalls by SWC. This would mean that customers pay in advance in order to mitigate risk faced by SWC. This is simply a further risk transfer from a monopoly service provider to customers who are by definition the most vulnerable. Instead, SWC should implement alternative risk management strategies or defer expenditure to mitigate volatility in revenue.

Furthermore, this *financeability allowance* would be the third risk compensation factor paid by customers for both the systematic and unsystematic risk faced by SWC. As there is no confirmation on changes in the WACC, a discussion on further risk compensation measures paid by customers is not appropriate. Should a change in the WACC materialise, then this would be a result of the regulator's assessment that the underlying systematic risk of SWC is different to previous conditions. It should be emphasised that any changes in the WACC would be a result of changes in the overall economic environment and not simply a method of changes in the calculations. Other financial variables that are required for the calculations of the WACC are in constant flux and hence careful consideration should be taken as to which factor would substantiate changes in the WACC. Simply to suggest that a *financeability allowance* should be introduced due to potential changes in notional revenue under the ACCC framework is not conclusive as changes in the WACC may be a result of various factors independent of the approach to how the ACCC calculates the WACC.

Recommendation 6: Regulated Asset Base

NSWIC does not concur with IPART's recommendation that State Water has a substantive case to ask for a revaluation of the regulated asset base. Not only is there no information currently available as to whether the ACCC will adjust the current WACC value, nor would there be significant changes to the RAB as IPART's Draft Recommendations have indicated.

Furthermore, IPART has correctly pointed out that there is little scope to change the RAB under the *Water Charge (Infrastructure) Rules*. According to the ACCC *pricing principles*, the current RAB value would be adopted from the previous determination.

As a general principle, NSWIC recognizes that capital infrastructure will depreciate during the provision of services to customers, and hence an allowance (return of assets) should be made for the decline in service potential of the asset. That is, an efficiently operating business will allow for the cost of maintaining the financial capital base within current revenue requirements. Given IPART's annuity approach that is based on a long term asset management plan, and hence NSWIC finds insufficient ground for an adjustment in the regulated asset base or its associated return.

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