



## NSW IRRIGATORS' COUNCIL

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### **Submission to IPART**

### **State Water Price Determination From 1 July 2010**

### **DRAFT DETERMINATION**

### **100416**

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Chief Executive Officer

## **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 commodity groups from the rice, cotton, dairy and horticultural industries.

This document represents the views of the members of NSWIC. 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.

## Executive Summary

This submission sets out the view of NSWIC and – importantly – its Members on a macro scale. It does not provide a response to proposed pricing on a valley-by-valley basis. IPART should expect to receive specific valley submissions from a number of NSWIC Members. NSWIC encourages IPART to consider those individual submissions with the full weight of NSWIC behind them.

NSWIC recognises that IPART has faced a difficult challenge in making this Draft Determination in order to recognise the revenue volatility that State Water Corporation (SWC) faces. That said, we are greatly concerned that the Draft shows hallmarks of an “ambit claim” process where SWC ask for more than is required in the knowledge that IPART will reduce that claim marginally. We are concerned by a process where the current Determination is, in essence, an accepted starting point that is deemed efficient with increases built atop that. NSWIC submits that the four year process ought see full analysis and proof of efficiency of all spending, together with an analysis and accounting to customers for underspend across the previous Determination period.

Our greatest concern in respect of the Draft Determination is the focus on risk removal for SWC by shifting risk to its customers through higher charges. SWC has been protected with an increased Weighted Average Cost of Capital (WACC) return **and** a revenue volatility allowance **and** a highly favourable method for forecasting consumption. None of these protections are available to SWC customers yet are provided by customers – through increased charges – to SWC.

We are enormously disappointed that IPART has chosen to reward SWC’s ambit claim with three separate measures to address the same perceived issue. This is clearly a highly inefficient methodology that will result in significant wealth and risk transfer from customers to SWC. NSWIC submit that this **could not** occur in the private sector and hence represents an abuse of monopoly power that IPART is specifically tasked with preventing. We submit that IPART must look very seriously at what we consider to be a grave error.

Further, we submit that IPART have not considered the case where consumption exceeds forecasts and SWC realises what under the Draft Determination will be significant profits. As IPART acknowledge – and as is discussed herein – SWC provides large slabs of excess revenue back to its shareholder (the NSW Government) which, in the event of consumption recovery, will essentially be a further tax on an industry already facing a broad range of external pressures.

## Chapter Three

NSWIC concurs with the 4 year Determination period.

We reject the Smoothed Net Present Value (SNPV) approach in light of how it will manifest in individual valleys. Detailed submissions in respect of that will be provided by individual Members of NSWIC.

In particular, we draw the attention of IPART to the submission of the Gwydir Valley Irrigators Association (GVIA) in respect of the clearly unreasonable cost implications that the Draft Determination will impose on that valley. GVIA is a Member of NSWIC and have provided a copy of their submission in response to the Draft to us. We concur with that submission in respect of their valley-specific issues and note to IPART that it carries the support of irrigators across NSW.

We submit that the imposition of SNPV in valleys currently at full cost recovery with the retention of maximum increase caps in other valleys results in dramatic inequities and hence should be scrapped in favour of the glide path approach. In a number of valleys at full cost recovery, increases pursuant to the Draft Determination will significantly exceed 10%. The Lachlan, for example, will see increases of 23% in the first year for an irrigator with 1,000 megalitres at 50% allocation.

It cannot be argued in response to this inequity that the proportional impact of charges is less in valleys at full cost recovery. In the same example as above, the 13/14 farm cash costs of Draft Determination charges will be some 4.11% whereas capped valleys remain considerably less.

For clarity, NSWIC reiterates its previous submission – that cost increases must be capped in certain valleys. The submission has not altered and we note that IPART also adopted that position. We submit, however, that the same reasoning must be applied to valleys at full cost recovery to ensure equitable treatment of customers which, in our submission, is one of the key functions that IPART must fulfil.

Whilst we recognise the necessity to achieve a defined level of revenue over the period of the Determination, we also note that the IPART process appears to have set ending process as the commencement point for prices in the following Determination. We believe that the smoothed NPV approach may result in a negative outcome under that scenario, although our concerns may be obviated by a statement that the commencing point process will not be continued in the next Determination.

It is, however, the very clear preference of NSWIC that the glide path process be maintained. We submit that it has served well to date, mitigates the price shock impact on the customers of SWC and that the revenue volatility risk has been more than compensated elsewhere in the Draft Determination.

## Chapter Four

### ***Volatility Charge***

NSWIC notes the proposal of IPART to include a volatility charge to offset the revenue volatility risk that SWC faces. We note that SWC had sought a significant WACC increase to offset this risk.

NSWIC acknowledges that there are advantages to this approach, including visiting the charge on the impactor (General Security rather than High Security) and significantly reducing the quantum that would have been payable under the WACC increase sought by SWC.

That said, we submit that the charge is neither necessary nor useful. We submit that it should be removed from the Draft Determination and, in particular, refer to our opening comments in respect of the threefold measures offered to SWC to address the perceived volatility issue.

The revenue volatility risk which SWC make centrepiece of this Determination process has been addressed by both the significant increase in WACC together with the proposed 20 year consumption forecasting model mooted by IPART. There is clearly no need to address the issue – such that it is – with *three* separate charges. NSWIC submits that the issue is perceived only – pursuant to our initial submission – and most certainly does not need a threefold response.

Moreover, IPART have identified that SWC pay some 70% of profit as dividends to the NSW Government. We are greatly concerned that the “pool” treatment of the volatility charge envisaged by IPART will not be the reality, but that excess funds will merely be transferred to Treasury, leaving SWC in the same cash-poor position and customers facing identical claims from SWC in four years.

NSWIC notes the decision of IPART to set the WACC based on the mid-point of its determined range. NSWIC submits that the decision to *then* add a volatility charge (having removed risk through a highly favourable consumption forecast) in fact moves the overall revenue recovery beyond the midpoint to the upper part (or possibly beyond) of the determined range – clearly showing that the issue has been compensated multiple times.

### ***MDBA and BRC Costs***

NSWIC does not accept IPART’s logic that a 1.25% “efficiency” reduction is an acceptable way of dealing with this matter. It is entirely inappropriate that IPART sanction the levying of a charge which is not assessed in any reasonable manner for efficiency.

***If IPART cannot determine if the expense is efficiently incurred, it should not recommend a charge based on recovery of that expense. This entirely defeats the purpose of IPART’s very existence.***

Moreover, NSWIC notes that the MDBA allegedly refused to provide data as part of this process. If this is indeed the case, IPART should at very least “stop the clock” on this part of the Determination until such time as relevant data is provided. We note that this has been the approach that IPART has adopted vis a viz the NSW Office of Water (NOW) Determination.

Further, IPART (and SWC) note that SWC receives “no net revenue” for these charges, but that they are passed on to the NSW Government. We therefore submit that this issue has no place within the SWC Determination process and that it ought properly be handled in the NOW Determination.

## **Chapter Five**

NSWIC notes with particular alarm the submission of the NSW Department of Climate Change and Water that the budget allocated to environmental water management ought be increased in line with the revenue received from environmental water holders.

NSWIC objects in the strongest possible terms to this submission.

Clear understandings have been provided by all parties that the purchase of entitlements for environmental use will not result in changes to the fundamental characteristics of an entitlement. NSWIC submits that the manner in which an entitlement is charges for services and the destination within SWC's budget of the revenue recovered is a fundamental characteristic, the change of which would be a breach of this undertaking. Whilst we do not expect IPART to take a position in this, we flag that we will take this matter up with the Government.

In any event, NSWIC submits that the services rendered by SWC to environmental water holders will not be substantially different to other holders. As such, no budgetary implications ought be considered.

## **Chapter 6**

NSWIC notes that reallocation of the Capex budget in response to timing concerns raised by Atkins/Cardno. In our submission, the timeframe for large scale Capex programs remains ambitious.

We are concerned at the IPART view that customers are not greatly affected by the large-scale Capex program. Chapter 7 clearly shows that both the return on and return of (depreciation) assets increases from 36.5% of notional revenue in 09/10 to 52.9% in 13/14. In our submission, the increased RAB driven by a large scale Capex manifests in significant additional charges to SWC customers.

Based on the reasoning advanced by IPART and our submission that it is flawed, we ask that IPART re-examine our submissions in respect of Capex.



## Chapter 8 – Ratios

NSWIC is pleased that IPART have determined that this issue need not be reopened.

That said, NSWIC sought clarification from IPART in respect of what we submit is a significant anomaly is cost-share ratios set for fish passage works which are triggered by dam safety upgrades. From our initial submission;

*NSWIC submits that where fish passage works are triggered by dam safety upgrades, the cost of those works ought be attributed as the dam works are attributed; that is, 100% borne by government.*

IPART appear to have rejected this submission but have not provided significant reasoning. NSWIC submits that the matter must be seriously reconsidered given the significant ongoing cost implications as such works are added to RAB.

Where capital works for the upgrade of fish passage works are triggered by dam safety upgrades on pre-1997 assets, it is logical to state that those works would not be carried out *but for* the triggering event. It is therefore both illogical and unfair to customers that they ought bear a charge for works that are carried out for and on behalf of others.

## **Chapter 9 – Forecasting**

NSWIC again notes that revenue volatility has been addressed in three separate manners which will clearly result in overcompensation to SWC and overcharging to customers. We submit that IPART ought reexamine the interaction of these three measures with a view to addressing the problem singly or as an aggregate of all three with only a portion contributed by each.

Moreover, consideration must be given as to treatment of excess revenue.

NSWIC is extremely concerned about the Draft Determination to abandon the use of full IQQM data pursuant to previous Determinations. As IPART note, the “structural break” evidence provided by CIE (as consultants to SWC) is valid only at aggregate level. We submit that SWC does not operate at aggregate level – and specifically note that pricing is not set at aggregate level. Operations in the main are at a valley-specific level as are prices set by IPART.

NSWIC submits that localised climate variability is offset across regions, that no credible position exists that climate change will manifest in the coming four years and that no credible evidence has been provided at the micro level to discount 90% of the available data.

## **Chapter 10**

NSWIC commends IPART for the retention of the fixed to variable pricing ratio as providing a modicum of risk support to customers of SWC.

It is incorrect of IPART to suggest that NSWIC remained neutral on the issue of a premium for high security users. NSWIC did not remain neutral on the issue but submitted that the impactor pays approach favoured by IPART ought correctly be implemented in respect of this issue through valley-by-valley charges against cost centres. Where costs are incurred by SWC in servicing high security (against general security), those costs ought be separately identified and attributed (and vice versa).

Whilst acknowledging that the intent of the premium is to recognise the differing cost bases, NSWIC submits that it is a crude tool to address the situation that would be far better addressed through the method in our initial submission.

## Chapter 12

IPART will not be surprised to hear that NSWIC submits that equity funding from shareholders is the preferred solution of SWC customers.

In our submission, the maintenance of a nominated credit rating is a policy decision of Government and, as such, ought be funded by Government. No benefit accrues to customers of SWC on the basis of a higher credit rating and, as such, no cost ought accrue to customers on the basis of a lower rating.

NSWIC notes that we sought the deferral of capital expenditure in our initial submission. Given IPART's reaction to that submission, deferral in respect of credit ratings is clearly not an option.

NSWIC rejects the notion of an increased WACC premium *unless* 100% of that increase is borne in this Determination – and into the future – by Government, based on the “impactor pays” principle and the driver of the credit rating issue.

The discussion of dividend retention or reduction highlights the concerns of NSWIC in respect of the risk premium pool mooted by IPART. Unless that pool is formally protected, it would seem clear to us that it will disappear into consolidated revenue.