Murray Irrigation Limited

Response to NSW State Water Corporation Submission to

IPART 2010 Bulk Water Prices Determination

Friday 23 October 2009

1. Introduction

Murray Irrigation holds five water access licences with the NSW Government and has issued contractual rights to its members. Murray Irrigation's NSW Murray general security licence is equal to 71% of the total general security water entitlements in the NSW Murray. The company supplies irrigation water and associated services to 2,389 landholdings over an area of 748,00ha in the southern Riverina. Further information about the company and its operation is available at www.murrayirrigation.com.au.

Murray Irrigation welcomes the opportunity to respond to the State Water submission to IPART's 2010 bulk water prices determination.

Murray Irrigation congratulates State Water on its submission which clearly articulates their methodology and approach. In contrast with previous State Water submissions to IPART, this submission is more succinct and more clearly presented.

State Water has also aspired to improve its efficiency with demonstrated improvements, particularly in operating expenditure in the last two years. These improvements are appreciated by water users.

Murray Irrigation notes that achievement of budget versus actual capital expenditure continues to be an issue for State Water and is therefore concerned that forecast budget capital expenditure over the next determination will differ from actual capital expenditure. It is essential that double accounting does not occur between determinations of expenditure.

Murray Irrigation's submission focuses on the issues and priorities for its customers; it does not address all of the issues that arise from the State Water submission, which have been addressed in the NSW Irrigators' Council response.

2. Price setting approach

Murray Irrigation supports State Water's approach to cost recovery and price setting, to the extent it is based on cost recovery and transparency where operating subsidies are agreed to by IPART and paid by Government i.e. not from revenue collected from other water users.

Murray Irrigation continues to oppose the transition to upper bound pricing, where practicable and considers upper bound is effectively a tax on the productive sector. The NSW Government, to Murray Irrigation's knowledge, is the only Government in the Murray Darling Basin that includes a rate of return on capital in rural water pricing. This disadvantages NSW irrigators in this highly competitive e market place.

Murray Irrigation also supports transitional price paths where the price increases are proposed.

In the NSW Murray the impact of State Water's proposed prices on general security water entitlement holders' unit water prices is relatively small for this determination. This statement assumes IPART's acceptance of State Water's assumptions in relation to the Murray Darling Basin Authority costs and an increased premium for high security water entitlement holders.

Murray Irrigation supports the continuation of the current ratio between water entitlement charges and usage charges, where prices are set based on State Water receiving 40% of its revenue from fixed charges and 60% from usage charges.

3. Wholesale discounts or rebates

The concept of wholesale discounts or rebates for large customers has been a feature of bulk water determinations since the referral of bulk water charges to IPART's predecessor.

Murray Irrigation welcomes State Water's acknowledgement that there are substantive benefits and avoided costs as a result of the activities of irrigation corporations and other large customers.

Murray Irrigation also welcomes the proposition from State Water that the rebate remains a feature of bulk water charges for the 2010 determination.

State Water proposes a reduction in the rebates for irrigation corporations, with Murray Irrigation's rebate decreased from $1.56M in 2009/10 to $0.896M by 2013/14 or a reduction of 42%. Under the proposed rebates, State Water has assumed an unchanged entitlement volume.

State Water also suggests, an alternative a sliding scale for rebates (pg. 10-10), whereby the rebate received in any one year depends on the volumetric entitlement held by the irrigation corporation. It is not clear whether the proposed rebate (table 10.7 pg. 10-11) would be further adjusted on an annual basis for reductions in the number of water entitlements owned by the irrigation corporation.

This issue needs to be clarified by State Water and IPART.

State Water's argument for a reduction in the rebate is twofold;

1. That members of irrigation corporations will "transform" their contractual irrigation right with their irrigation corporation resulting in an increase in the number of water access licences and State Water customers, therefore increasing State Water's costs.

2. That 2009/10 (current) rebate is higher than State Water's assumed future saving per entitlement; this analysis is being used by State Water to further justify a reduction in the rebate from the current.

Murray Irrigation makes the following comments in relation to these two arguments.

- Murray Irrigation customers have been able to (using the *Water Act 2007* (Cth) terminology) transform their contractual irrigation right to a NSW Murray Water Access Licence since at least February 2006.

- **To date none of Murray Irrigation's irrigation customers have elected to transform their Murray Irrigation water entitlements.**

- It is premature for State Water to assume that customers of irrigation corporations will transform their water entitlements. The *Water Market Rules 2009* (Cth) do not require transformation, it is a voluntary process.

- In the event transformation does occur, it is not conceivable that State Water's costs will increase significantly as a result of transformation. Furthermore the additional work associated with transformation from an irrigation corporation's water access licence relates to the requirement to assign the annual allocation from the new water access licence to the irrigation corporation's water access licence. This will be necessary for the irrigation corporation's customer to be able to order and receive water. The cost associated with this activity is recovered through State Water's transfer fees for assignment of annual allocation. Additional supply points, metering and compliance costs will not apply.

- State Water makes a valid point that if the annual rebate paid is not linked to the entitlements owned by the irrigation corporation. In the event that the volume of water entitlements owned by the irrigation corporation changes significantly during the determination period, the rebate as it is currently applied, (assuming a reduction in water entitlements owned by the irrigation corporation) results in advantages to irrigation corporation customers. A solution to this problem is to link the rebate to entitlements.

- State Water has calculated the avoided costs on the basis of entitlements. Murray Irrigation does not support this method of calculation because the majority of the cost savings identified by State Water are related to the number of licences and extraction points and not related to entitlement volume or usage. It is therefore incorrect to use this analysis to calculate the rebate.

Murray Irrigation recommends continuation of the current rebate at the 2009/10 levels adjusted for CPI.

4. General security and high security premium

Murray Irrigation supports State Water's proposition that entitlement charges for high security entitlement holders' increase relative to general security entitlements, however Murray Irrigation does not support State Water's terminology in relation to the reasons for this premium. Scarcity pricing is not supported by Murray Irrigation as the basis for pricing. Murray Irrigation continues to be supportive of cost reflective pricing as a principle. However, given the high level and coarse application of valley based cost reflective pricing Murray Irrigation does not believe cost reflective pricing should be the only factor that is considered when setting prices. Murray Irrigation considers the primary argument for supporting an increased premium for high security entitlements is fairness and equity.

The effective price paid for the water available to general security entitlement holders compared to high security entitlement holders in the NSW Murray over the last four years is significantly different. In table 1 Murray Irrigation has calculated the effective price paid per megalitre of water received from the announced allocation over the last four years. These calculations are exclusive of the survival water allocated to high security licences in 2007 and the bulk discount received by Murray Irrigation. However they are indicative of the order of the magnitude in the effective price paid per megalitre of allocation.

Table One – Effective price per ML available for high security and general security entitlements in the NSW Murray from 2005/06 – 2008/09

Year	Announced allocation %		Effective price $ per ML (assumes 100 water entitlements)	
	HS	GS	HS	GS
2005/06	97	67	4.57	6.00
2006/07	97	0	3.56	327.00
2007/08	25	0	14.36	311.00
2008/09	95	9	3.33	28.89

HS – high security, GS – general security

Murray Irrigation's fixed charges and State Water's charges have collectively impacted significantly on the viability of individual farm businesses within Murray Irrigation. In Murray Irrigation's view the resultant effective price differences between holders of general security water entitlements and high security water entitlements holders warrant support for an additional premium to apply to high security licence holders.

Murray Irrigation supports State Water's proposed premiums and is not advocating equalising entitlement prices at current levels of water availability.

Based on State Water's information (pg 9-4) NSW high security entitlements are only 11% of the licence regulated entitlements. The 257,438 entitlements include high security irrigation, industry and local water utilities. The *Water Management Act 2004* (NSW) prioritises allocation of water to high security licences, ahead of general security licences – this prioritisation has continued to apply between high and general security licence, during the suspension of the NSW Murray Lower Darling Water Sharing Plan in October 2006. NSW high security entitlement holders have received direct financial benefits from this situation because they have had access to their annual allocation, carryover and also the annual water market, which has operated at record price levels for the last four years.

The previous IPART determination included a premium based on the conversion factor applied by the NSW Government for conversion from general security entitlements to high security entitlements. The conversion of general security licences to high security licences has been suspended by the NSW Government since July 2008 because of concerns about third part impacts of conversion and the efficacy of the conversion factor, given the revised minimum inflows for the River Murray system and uncertainty about future water availability. The suspension of conversion by the NSW Government indicates that the conversion factor, if reinstated is likely to reduce i.e. less high security entitlements would be received as a result of conversion from general security to high security entitlements. There is also significant uncertainty as to whether conversion to high security from general security will be re-instated. The ACCC preliminary position in their advice to the Murray Darling Basin Authority (MDBA) on the Basin Plan, Water Trading Rules is;

> The ACCC recommends against allowing for conversion between priority classes of water access rights.[1]

If this position is adopted by the MDBA current holders of high security water entitlements in the NSW Murray and Murrumbidgee Valleys will hold the most secure (reliable) water entitlements in the southern Murray Darling Basin.

Murray Irrigation supports the proposed premium for high security entitlements, not on the basis of a scarcity premium, but on fairness and equity.

5. Consumption forecasts

Murray Irrigation does not support the Centre for International Economics (CIE) approach to consumption forecasts. Adopting the CIE approach will effectively lock the last 10 years of low water availability and use in the NSW Murray into pricing path for a number of years.

Murray Irrigation recommends that IPART base their consumption forecast on an updated IQQM model output, (including the last four years) OR use the CSIRO model data for median 2030 climate and current development.

Murray Irrigation appreciates the issues facing State Water, where 60% of the revenue is planned to be from usage charges, therefore price setting relies on the infrastructure operator assuming a volume of use. This is exactly the issue facing Murray Irrigation where; 1) customers are demanding reduced fixed charges because their capacity to earn an income is diminished by low water availability 2) infrastructure costs are largely fixed and 3) operating costs are not strongly linked to the volume of sales. In response Murray Irrigation has altered its consumption forecast and deferred capital and maintenance expenditure, to reduce costs and minimise operating losses.

However there are two important differences between State Water and Murray Irrigation in its price setting approach. 1) State Water's prices assume a return on capital with a dividend paid to Government and 2) State Water has an important revenue stream from Government for pre 1997 capital works which are funded 100% by Government.

State Water has operated successfully despite water use being significantly less than the consumption the previous IPART determination was based on, across the Murray Darling Basin.

The primary impact of reduced sales is on NSW Treasury because State Water's profit has been less than was anticipated by the last determination.

In contrast to State Water, Murray Irrigation's prices are set to allow the company to effectively "break even," this situation has demanded Murray Irrigation revise its consumption forecast to avoid financially unsustainable operating losses.

Murray Irrigation believes it is imperative the IPART price determination continues to apply pressure on State Water to improve its efficiency and productivity and be commercially responsive to the circumstances faced by State Water. One mechanism to achieve this is to either maintain or only make minor adjustments to the consumption forecasts.

[1] ACCC (2009) Water Trading Rules, position paper, pg 53.

In the southern connected Murray Darling Basin the Victorian Government and the South Australian Government both subsidise rural bulk water prices. South Australia do not pass on to their irrigators MDBA costs and Victoria 1) recovers a lower proportion of MDBA costs from irrigators and 2) in recent years have provided Goulburn Murray Water with an operating subsidy to reduce fixed charges to irrigators.

Murray Irrigation encourages IPART to take these issues and inequities into account in their decision making.

6. Murray Darling Basin Authority costs

MDBA costs are the major driver of the costs associated with bulk water services in the NSW Murray.

Murray Irrigation supports State Water's proposed sharing of these costs across valleys in the Murray Darling Basin, which Murray Irrigation understands is based on the same attribution of costs as IPART included in their last determination.

Murray Irrigation understands that State Water's proposed prices are based on information provided by the NSW Office of Water; the disclosure of MDBA costs continues to be inadequate. Water users have no capacity to 1) influence these costs in terms of priorities or requirements for customer services and 2) are not able to assess the efficiency of these costs.

Furthermore it would appear that the MDBA and its operating arm River Murray Water have escaped any regulation or public scrutiny under the *Water Act 2007* (Cth). Murray Irrigation finds this situation totally unacceptable.

In contrast to the MDBA's regulatory regime the proposed draft Water Charge (Infrastructure) Rules under the the *Water Act 2007* (Cth) requires Murray Irrigation by July 2011 to:

Prepare a five year network services plan which includes plans for;

a. Level of service

b. Plans for maintenance, improvement, enhancement or expansion of water services;

c. Estimates of capital and recurrent expenditure related to water service;

d. Plans for financing capital;

e. Details of grants or subsidies; and

f. Estimates for regulated charges for each year of the five year period.

Consult with customers before the network service plan is completed

Provide an information statement to its customers, including details of the current schedule of charges.

Civil penalties apply if Murray Irrigation fails to comply with the Water Charge (Infrastructure) Rules.

Murray Irrigation strongly encourages IPART, through this determination, to pursue greater transparency and associated analysis of MDBA costs and to provide this information to water users through the determination process.

Murray Irrigation expects IPART to include the same scrutiny and consideration of opportunities for efficiency improvements in MDBA costs as they apply to State Water.

If adequate information is not provided by either NSW Office of Water and or the MDBA Murray Irrigation recommends a lower user share is passed onto water users.

7. User contributions

IPART and water users, in earlier determinations have invested significant time and resources into consideration of the issues associated with user shares. The user shares adopted by IPART and applied by State Water to the 2010 proposed prices have effectively been in place for at least two determinations.

In Murray Irrigation's opinion water users are more than meeting their contribution to regulated river costs, including environmental enhancement and dam safety compliance. These activities involve significant capital expenditure and ongoing asset renewal costs that water users are paying. These arguments were put to IPART when the user shares were being established and the current user shares are a product of this debate.

Murray Irrigation does not support re-opening debate on cost shares.