

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Estimates 22-23 October 2008

Question: sbt 17

Topic: ACCC & Market Rules

Hansard Page: Written

Senator Nash asked:

1. It would appear that NSW and SA operators are the only focus of the draft market rules for water (ie. Victorian government owned entities are not considered within the scope yet their “market” behaviour has been consistently the greatest impediment to trade reform). The Market Rules will miss the main game if they exclude whole states and the large “operators” which exist within these states.

Why has the ACCC adopted such a narrow scope for this report and is the government going to insist that government-owned entities are included within the scope of preferred market rules?
2. Is the ACCC going to force the break-up of NSW and SA Irrigation Corporations by insisting that all customers be allowed to hold statutory water rights whilst still insisting on continued service delivery from an irrigation corporation? If so, what analyses have been undertaken to prove that this model will create net benefits to regional investment, cost reform and environmental water recoveries and what alternatives have been examined?
3. Is the government going to insist – potentially via COAG – that Victorian Infrastructure Operators comply with the provisions of Schedule E of the MDB Agreement?
4. Would ACCC support a proposal to remove the 4% annual trade limit provided water infrastructure providers in exchange for the ability to require payment of Termination Fees at time of sale of water entitlement?
5. Does the ACCC acknowledge that the current “multiples” approach ie. the imposition of a maximum fee of 15 times their annual fixed charges, as endorsed by the ACCC, is creating some perverse economic outcomes with water form? Will the ACCC be reconsidering its approach to avoid such outcomes?

Answers:

1. The water market rules apply in all Basin states and territories but in accordance with the Water Act only in situations where a group water right is held by the operator. In these cases, the irrigator holds a share of the group water right. Irrigators in NSW and SA are more likely to hold water in this way.

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The operator's co-operation is required if an irrigator wishes to trade their share of a group water right. The operator must identify the individual irrigator's share of the group water right, adjust the right for conveyance losses, apply to the relevant authority for approval of the transfer of ownership of the rights and apply to the relevant authority to register the change in ownership.

The ACCC has received a number of complaints from irrigators about lack of co-operation from operators. The actions of operators can prevent the trade of water outside the operator's irrigation district.

The draft water market rules address this impediment to trade by allowing irrigators to 'transform' their collectively held water entitlement into separately held statutory entitlement. Once the irrigator holds their own entitlement the operators cannot prevent trade.

Irrigators in Victoria and Queensland generally hold statutory water access entitlements on an individual basis, so transformation is not required. However, the water market rules apply in Victoria and Queensland to those operators who hold water rights on behalf of their members in the form of group water rights.

2. The focus of the water market rules is on providing for transformation of an irrigator's share in a group water right to an individually held statutory entitlement. Transformation is voluntary and can only be triggered by a request from an irrigator. The water market rules will not force the break up of NSW and SA irrigation corporations.
3. The provisions in Schedule E can be captured by the water market, water charge rules and water trading rules. The water charge rules will apply to all entities charging regulated water charges, irrespective of their ownership and governance structure. The draft water charge rules include a cap on termination fees. The ACCC will monitor compliance and enforce the water market and water charge rules once they come into effect. The MDBA will monitor compliance and enforce the water trading rules once they come into effect.
4. The ACCC does not support exit fees (where irrigators must pay termination fees when they sell their water entitlements) irrespective of the approach adopted by governments to the 4 per cent annual trade limit. It is legitimate for irrigators to sell their water rights but retain water delivery rights for purposes of buying back water rights in future or buying water allocations on a year to year basis. For example, growers of annual crops (such as rice, pasture and cotton) could hold off planting in dry years when water prices are high, and buy allocations in the wet years when prices are lower. The approach recommended by the ACCC in the draft rules is in line with Schedule E.

Some irrigation operators are concerned about the security of ongoing payments for water delivery rights when irrigators sell their water. The ACCC has addressed these concerns in the draft rules by proposing that irrigation operators be allowed to hold up to 20 per cent of an irrigator's water rights as security. The irrigator cannot sell this water without the irrigation operator's agreement.

5. The ACCC considers that the 15 times multiple adopted by most irrigation operators acts as a barrier to water trade, and works against the objectives in the

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Water Act 2007. The ACCC considers that the objectives of the *Water Act 2007* include facilitating the efficient functioning of water markets and ensuring the efficient use of infrastructure.

In cases where irrigators terminate access as well as selling their water access rights, termination fees need to be subtracted from the proceeds from selling water access rights to determine the net returns to the irrigator. The higher the termination fee, the lower the net returns, and the lower the incentive for the irrigator to trade water for a given water price.

At the same time many of the ongoing costs of operating and maintaining irrigation infrastructure are fixed in the short term, that is, they are incurred by the operator whether or not an irrigator chooses to terminate access. If irrigators terminate access without paying termination fees, then operators may not be able to recover their committed fixed costs.

The ACCC's draft rules have tried to balance the legitimate interests of irrigation operators against the objective of facilitating trade and achieving efficient use of infrastructure. The proposed approach is to allow termination fees, but cap them at 10 times annual access fees. This approach recognises that irrigation operators will need time to assess the impact of trading and to restructure if necessary. The 10 times multiple gives the operators between 12 and 15 years of access fees (using a discount rate between 3 and 6 per cent) to make the necessary adjustments.

The multiple of 10 is higher than what the ACCC originally proposed in its 2006 report, *A regime for the calculation and implementation of exit, access and termination fees charged by irrigation water delivery businesses in the southern Murray–Darling Basin*. In this report the ACCC proposed a multiple of eight times the annual access fee. The ACCC's draft rules also propose a review of the multiple by mid 2013 to assess, amongst other things, its adequacy for operators.