

Submission to ACCC

Transformation

More Than Meets the Eye

081008

Andrew Gregson
Chief Executive Officer

Introduction

NSW Irrigators' Council (NSWIC) represents more than 12,000 irrigation farmers across NSW. These irrigators are on 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.

In making this submission to Australian Competition & Consumer Commission, NSWIC is responding with the views of its members. However, each member reserves the right to make independent submissions on issues that directly relate to their areas of operation, or expertise, or any other issues that they may deem relevant.

Background

On 1 September 2008, NSWIC met with Commission Ed Willett and staff of the ACCC to discuss the implications for Irrigation Infrastructure Operators (IIO's) of the Water Market Rules position paper recently published by the ACCC. IIO members of NSWIC were also present – Murray Irrigation, Murrumbidgee Irrigation, Coleambally Irrigation and Western Murray Irrigation. These entities are the major irrigation corporations in NSW and together comprise more than 5,000 irrigator customers.

These corporations are not opposed to water trade.

During the course of the meeting, the subject of Transformation was discussed at some length.

Parties present recognised that Transformation is an issue driven at a government policy level and that the ACCC has been asked to advise on rules surrounding that policy. Nevertheless, NSWIC and its members asked the ACCC to further consider the alleged benefits of Transformation and to provide the results of that consideration to government. We noted that we did not, on balance, see benefit over and above the significant imposition that it will cause.

Commissioner Willett agreed to accept a further written submission from NSWIC on this matter.

The Reasons for Transformation

IIO's in NSW to a large extent, and particularly in the case of large corporations and cooperatives, hold water as a group license. That is, the individual irrigators within an irrigation area do not hold their license directly. Instead, it is held on the group license with the individual irrigator have an equitable interest in that group license. The interest is noted on ASIC compliant registers.

In order for an individual irrigator to trade water out of an irrigation area, there needs to be a process whereby the individual license is separated from the group license to enable that trade to occur. Government has seen this process as a barrier to trade and has sought a process to remove it.

The process proposed is that any irrigator within an irrigation area must be able to separate their part of the group license and to hold it as an individual entitlement – to “transform” their entitlement from one to the other. The rules then require an IIO to deliver services to a “transformed” customer under the same terms as prior to their transformation (although we note the security provisions provided in the market rules).

This process raises a significant number of issues for IIO's and, as a result, questions should be asked by the ACCC as to the actual benefits that will accrue.

1. *Is a Group License a barrier to trade?*

NSWIC is yet to see convincing evidence of a group license being a barrier to trade. Whilst acknowledging that submissions to the ACCC have been able to be kept confidential at the request of the party involved, NSWIC considers it questionable, at best, that no submissions suggested that IIO's have provided unreasonable hurdles in approving external trades.

It is our understanding that the major IIO's in NSW both can and will approve trades within 5 days in the event that all necessary paperwork is adequately completed and lodged.

This timeframe compares *most favourably* with the timeframes taken by government departments to approve trades – even trades within the same state.

Whilst the ACCC note that the ability to transform will be at the option of an irrigators (and hence a supporter of a group license is free to remain within the group license), NSWIC submits that external pressure (particularly from financiers) is likely to see transformation driven for reasons other than removal of trade restraints. We are unable to find a benefit for either irrigators or irrigation corporations in providing a perceived greater degree of security for financiers (a perception with which we disagree in any event).

It is no secret that irrigation areas are concerned at the potential loss of water and hence irrigated agriculture from their area. It is inappropriate, at best, to suggest that this concern has created an administrative barrier to trade without providing evidence of systematic abuse – or any evidence of abuse whatsoever.

2. *If it is a barrier to trade, can it be overcome in another fashion*

Leaving aside for a moment the lack of evidence, the ACCC should ask if time consuming, costly, draconian and counter productive rules are the solution to a potential issue. In the vernacular, is a sledge hammer really required to crack this nut?

Alternately, NSWIC submits that the benefits of a group license can be maintained whilst ensuring that a barrier to trade is not formed by implementing rules that require IIO's to operate in a particular fashion when an irrigator wishes to sell water out of the area. For instance, the ACCC could set timeframes within which actions must occur, subject to documentation being in order. Failure to meet those timeframes could result in a penalty payment to the party concerned, or a fine from government. Systematic abuse by an IIO could be handled by an escalating penalty.

3. *Financial Security*

One of the key benefits espoused in favour of transformation has been the value of the asset as a form of security. NSWIC is aware that this view has been put strongly by the Australian Bankers Association. We do not concur with the view and have yet to see evidence of it. In a legal context, and equitable interest is equally as strong as a direct interest in a property right. Why should this not be the case with water?

The Benefits of a Group License

Group licenses provide a wide range of benefits both for operators and irrigators.

These include:

Efficiency

Since privatisation, efficiency within NSW irrigation corporations has dramatically increased. As an example, Murrumbidgee Irrigation has achieved a 35% real reduction in costs since being privatised in 1999.

Accountability

Where customers and shareholders are from a common pool, the actions of those controlling the operator are subject entirely to the satisfaction of the customer. Put simply, a Board that does not satisfy the demands of its shareholder customers will be replaced at the next available opportunity.

This accountability results in both service levels and prices with which customers are content.

Responsibility

Unlike their interstate counterparts, irrigation corporations in NSW are governed by the Corporations Act and, as such, face normal commercial demands. They must operate at a profit. The ACCC must be mindful of the repeated “bail outs” that have been occasioned interstate. Such events have not been duplicated in NSW.

Security

Like any business, an irrigation corporation must protect its revenue stream. Such protection comes at a cost, which is obviously passed on to customers. The Corporations in NSW are able to achieve revenue security by virtue of holding a group license. Without payment of legitimate invoices, the product may be withheld. An inability to engage in this method will clearly increase operating costs (and risk), which must be passed on to shareholders and customers. Increased costs, we submit, are a counterproductive result from ACCC regulation.

Transformation – The Drawbacks

Administrative Compliance

Much of the Water Market Rules Position Paper is written around actions that will need to take place subsequent to transformation.

Aside from the administrative requirements for transformation itself, something which IIO's accept as a normal course of business, the ability for irrigators to split from a group license but still receive services creates a significant further administrative burden for IIO's, the State Government and the State Water Corporation in NSW.

Put simply, each transformed irrigator becomes both a customer of the IIO and State Water. Further, management and compliance issues for the new entity will be the responsibility of the Department of Water and the Environment. Rather than simply be government by one body, the task will effectively be "tripled up". This is clearly an inefficient use of resources which will result in higher costs for all.

Financial Insecurity

In an era of decreasing water availability, IIO's are having to manage their businesses extremely closely. It is inevitable that these businesses will have to operate with limited access to their main commodity – water.

The natural result of this management will be greater attention to cash flow. At present, the group license enables an IIO to ensure that it will be paid for its services. The result is that it does not have to charge a significant risk premium to customers as part of its operating costs and it does not have to enter into costly and time consuming legal action to recover unpaid costs.

In seeking to provide security for payment of ongoing access fees and/or termination fees, the ACCC has itself proved the administrative difficulty that will be placed on IIO's. The Position Paper published by the ACCC is, at best, confusing on this matter. Pursuant to our submission in response and those of our members, the security provisions remain inadequate in any event.

Perverse Results

A primary role of the ACCC is to ensure that consumers pay a fair price in a monopoly environment. It is clear that water delivery, due to its geographic and physical constraints, will maintain its monopoly characteristics. The ACCC must therefore recommend rules that ensure that monopoly pricing does not ensue.

The ACCC notes, in its Water Charging Rules paper, that monopoly pricing has not occurred within IIO's, attributing this to the fact that customers and shareholders are merged. In short, a Board that elevates prices to its customers above acceptable levels will be removed by the shareholder/customers.

In encouraging transformation, the nexus between customers and shareholders will be broken. Those that choose to transform their entitlement will become customers only.

Given the higher costs of administering customers that are not part of the group entitlement, it is probable that varying charging tiers will emerge. The tendency toward discriminatory pricing – a classic characteristic of monopoly pricing – will therefore have been engaged.

NSWIC submits that this is clearly a perverse outcome, an outcome that is contrary to the basic tenets of the ACCC and an outcome that the ACCC should recommend should be avoided – by ruling against transformation.