



Australian  
Competition &  
Consumer  
Commission

## **ACCC final advice on an amendment to the *Water Charge (Termination Fees) Rules 2009***

June 2010



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# Glossary and definitions

This glossary endeavours to provide practical meanings of terms; however, readers may need to consider the legal meaning of some terms under the *Water Act 2007* (Cth) and obtain legal advice on these definitions, if required.

fixed costs	costs that do not vary with the volume of water delivered
GST	Goods and Services Tax. As defined in the <i>A New Tax System (Goods and Services Tax) Act 1999</i>
infrastructure operator	<p>any entity or person who owns or operates infrastructure for one or more of the following purposes:</p> <ul style="list-style-type: none"><li>• the storage of water</li><li>• the delivery of water</li><li>• the drainage of water</li></ul> <p>for the purpose of providing a service to another person</p>
irrigator	a person who receives water delivery services from an irrigation infrastructure operator - may include a person who receives water for any reason, such as for stock and domestic purposes.
irrigation infrastructure operator	any person or entity who owns or operates water service infrastructure for the purpose of delivering irrigation water to another person (e.g. an irrigator)
irrigation network	the water service infrastructure of an irrigation infrastructure operator
minister	the Minister for Climate Change, Energy Efficiency and Water
regulated water charge	a charge to which the water charge rules (Division 1 of part 4 of the <i>Water Act 2007</i> ) may apply. This includes fees and charges payable to an irrigation infrastructure operator for access to, or terminating access to, the irrigation infrastructure operator's network
termination fee	any fee or charge payable to an irrigation infrastructure operator for either terminating or surrendering access to an irrigation network or services provided in relation to that access
total network access charge	the amount on which the termination fee multiple is applied in order to calculate a maximum termination fee. The total network access charge is the sum of all fixed water access fees otherwise payable by an irrigator in a financial year for access to an irrigation infrastructure

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operator's network, excluding certain amounts, including connection/disconnection fees and fees under approved contracts

water access fee      a fee imposed by an infrastructure operator for the provision of access services. Access fees may include multiple components (e.g. a fixed fee component and a variable fee component).

Water Act      the *Water Act 2007* (Cth)

water delivery right      a right to have water delivered by an infrastructure operator

WCTFR      *Water Charge (Termination Fees) Rules 2009*

# 1 Introduction

The Australian Competition and Consumer Commission (ACCC) provided the Minister for Climate Change, Energy Efficiency and Water<sup>1</sup> (minister) with final advice and draft rules on the Water Charge (Termination Fees) Rules in December 2008. The minister made the *Water Charge (Termination Fees) Rules 2009* (WCTFR) on 10 June 2009. Following a transitional period, the WCTFR came into full legal force on 1 September 2009.

On 13 May 2010 the minister wrote to the ACCC seeking the ACCC's advice on an amendment to the WCTFR. The minister requested the ACCC advice be provided to her by the end of June 2010. In the letter the minister noted an issue in relation to the interaction between the WCTFR and the charging of Goods and Services Tax (GST) on termination fees.

The issue arose following a recent Ruling by the Australian Taxation Office (ATO) which found that termination fees are not GST-free supply. The WCTFR were made based on the prevailing view that termination fees, consistent with water access charges, would be considered GST-free supply. The effect of the ATO Ruling and its interaction with the WCTFR means that irrigation infrastructure operators (IIOs) will receive a termination fee that is less than 10 times the total network access charge. This outcome is contrary to the policy intent underlying the WCTFR.

This final advice proposes a draft rule amendment which explicitly allows IIOs to impose a termination fee greater than 10 times the total network access charge (TNAC) where an IIO faces a GST liability for the revenue received from the imposition of termination fees.

It is important to note that this advice and proposed amendment to the WCTFR, while being cognisant of, is a separate issue to the advice the ACCC provided to the minister on amendments to the WCTFR (and *Water Market Rules 2009*) that was requested by the minister on 30 September 2009.<sup>2</sup>

## 1.2 Consultation

The minister has requested that the ACCC, in developing its advice, consult with relevant Basin State Ministers, IIOs and the public to satisfy the consultation requirements as set out in regulations 4.05 and 4.18 of the *Water Regulations 2008*.

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<sup>1</sup> Previously the Minister for Climate Change and Water

<sup>2</sup> On 30 September 2009 the Minister wrote to the ACCC requesting advice on amendments to the WCTFR and the *Water Market Rules 2009* (WMR). The amendments related to Murray Irrigation Limited's reissuance of irrigators' water entitlements and minor amendments to address some technical issues with both the WCTFR and the WMR. The ACCC provided its advice to the minister on 31 March 2010. The minister has not yet made these amendments to the WCTFR or the WMR. For more information see the ACCC website, [www.accc.gov.au/water](http://www.accc.gov.au/water)

In response to the minister's request, on the 14 May 2010 the ACCC released a draft advice and draft amendment to the WCTFR for consultation. The ACCC received two submissions in response to its draft advice and draft amendment.

In preparing its advices, the ACCC has liaised with the Australian Taxation Office (ATO).

### **1.3 Structure**

The final advice presents the ACCC's proposed amendment to the WCTFR, and is structured according to the following:

- **Section 2** provides a brief background to the WCTFR.
- **Section 3** outlines the issue of the treatment of termination fees under the GST Act and how this interacts with the WCTFR.
- **Section 4** provides details on stakeholder's responses to the draft advice and proposed amendment
- **Section 5** provides the ACCC's recommended rule amendment.
- **Section 6** outlines the ACCC's proposed approach to enforcing the WCTFR in relation to GST on termination fees during the period in which the minister is considering amendments to the WCTFR.

## 2 Background

IIOs face ongoing costs for maintaining irrigation infrastructure. Many of these costs are fixed, and are incurred whether an irrigator chooses to terminate or remains connected to the irrigation network.

If irrigators terminate their water delivery right without paying termination fees then IIOs may not be able to recover their committed fixed costs. Over time this may compromise the viability of IIOs, their service standards and level of investment. The prospect of irrigators leaving without paying termination fees creates revenue uncertainty for IIOs which may undermine investment. In this context, termination fees provide a contribution from exiting irrigators for the unavoidable ongoing costs of maintaining irrigation infrastructure.

The ACCC provided its final advice to the minister on water charge rules for termination fees in December 2008 following an extensive consultation process.

In formulating its advice to the minister the ACCC had regard to the Basin water charging objectives and principles set out in Schedule 2 of the *Water Act 2007* (Water Act). These aim to promote the efficient use of and investment in irrigation infrastructure and facilitate the efficient operation of water markets. (See **attachment A** for a copy of Schedule 2).

In addition, the ACCC's advice had regard to section 93(3) of the Water Act. This states that, in giving advice to the minister about proposed water charge rules that relate to regulated water charges imposed by infrastructure operators, the ACCC must have regard to:

- the governance arrangements of those operators
- the current charging arrangements of those operators, and
- the history of the charging arrangements for those operators.<sup>3</sup>

In its final advice to the minister on water charge rules for termination fees the ACCC recommended:

- that termination cannot be forced upon an irrigator (except in specific circumstances)
- capping the termination fee at 10 times the total network access charge (TNAC)
- allowing higher termination fees in new or existing contracts subject to the approval of the ACCC, and

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<sup>3</sup> Section 93(3) of the Water Act

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- that IIOs may be able to impose a disconnection fee to recover the costs of physical disconnection from terminating irrigators.<sup>4</sup>

The ACCC concluded that capping termination fees to a multiple of 10 times the TNAC represents:

a reasonable balance between facilitating the efficient functioning of water markets and providing efficient investment incentives. A multiple of 10 times delivers the IIO between 12 to 15 years of access fees which provides an extended period of revenue stability for IIOs and fee stability for irrigators.<sup>5</sup>

The WCTFR allow for the imposition of termination fees in accordance with rule 7. Rule 7 of the WCTFR states that the termination fee must not be in excess of 10 times the TNAC in respect of the year notice for the termination is given. Furthermore, if a termination fee – however it may be calculated – is less than this capped amount, the fee is permissible under the WCTFR, subject to any lower fee being contractually agreed between the IIO and the irrigator.

### 3 Issue

The ACCC developed its advice on water charge rules for termination fees, and the minister made the WCTFR, on the prevailing view that termination fees would be GST-free supply of water rights. This view was particularly influenced by the fact that water access charges are exempt from GST under subdivision 38-I of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

While the WCTFR are silent on the issue of GST on termination fees, the technical guide to the WCTFR explicitly states that the termination fee may not be uplifted for income tax or the GST.<sup>6</sup>

However, a General Advice Ruling by the ATO on 10 March 2010 states that termination fees are not considered a GST-free supply of water rights. The ATO reasons that:

a termination fee is not for the supply of water or water services, rather it is consideration for the release from an obligation to pay an access fee (release supply). Such fees will be consideration for a taxable supply provided that the other requirements of section 9-5 of the GST are satisfied.<sup>7</sup>

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<sup>4</sup> For more information see ACCC, *Water charge (termination fees) rules; Final advice*, December 2008, on the ACCC website [www.accc.gov.au](http://www.accc.gov.au).

<sup>5</sup> ACCC, *Water charge (termination fees) rules; Final advice*, December 2008, Page xvi

<sup>6</sup> ACCC, *Water charge (termination fees) rules 2009; Technical guide for irrigation infrastructure operators*, June 2009, p.17

<sup>7</sup> General Advice Ruling to the National Irrigators' Council, 10 March 2010, page 4

The lack of an express provision in the WCTFR regarding GST means that it is uncertain whether IIOs in complying with the WCTFR, can increase the termination fee above the 10 times multiple to recover the cost of the GST. In effect, to ensure compliance with the rules, IIOs would need to impose a termination fee less than 10 times the TNAC, and then add the GST component. This is contrary to the policy intent underlying the WCTFR.

## **4 Response to draft advice**

The ACCC received two submissions in response to the draft advice and draft amendment released for public consultation on 14 May 2010.

The National Irrigators' Council expressed its support for the proposed amendment stating:

We believe that the proposed amendment, along with changes to the technical guide for irrigation infrastructure operators, will satisfactorily address the concerns that have arisen since the receipt of advice from the Australian Taxation Office that termination fees should be subject to GST.<sup>8</sup>

Similarly, a submission from the South Australian Government stated that:

South Australia is supportive of the proposed amendments as presented.<sup>9</sup>

## **5 ACCC recommendation**

The ACCC is recommending to the minister that an amendment be made to the WCTFR to ensure that the WCTFR give effect to the policy position that a 10 times multiple is the appropriate cap on termination fees, and not a lesser amount as a result of GST liabilities.

To enable this, the ACCC recommends an amendment to the WCTFR which explicitly allows IIOs to impose a termination fee greater than 10 times the TNAC where an IIO faces a GST liability for the revenue received from the imposition of termination fees. This will ensure that IIOs are able to recover 10 times the TNAC to fund the ongoing costs of maintaining irrigation infrastructure, as consistent with the ACCC's previous advice to the minister. The ACCC understands that this will have a minimal impact on terminating irrigators providing the irrigators are registered for GST and the GST claim is related to their business activities. In this case irrigators can claim the GST back from the ATO as business input credit.<sup>10</sup>

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<sup>8</sup> National Irrigators' Council submission to the draft advice on a proposed amendment to the *Water Charge (Termination Fees) Rules 2009*, p.1

<sup>9</sup> South Australian Government submission to the draft advice on a proposed amendment to the *Water Charge (Termination Fees) Rules 2009*, p.1

<sup>10</sup> For more information please see the ATO website, [www.ato.gov.au](http://www.ato.gov.au).

The recommended amendment also includes an addition to the definition of the TNAC which explicitly excludes any amount of GST to be included in the calculation of the TNAC. At present the ACCC understands that all charges used to formulate the TNAC are GST-exempt under subdivision 38-I of the GST Act. However, if this exemption was to be modified in the future and GST was imposed on water access charges, this could result in a recovery of costs beyond the 10 times multiple of the TNAC . Accordingly, the rule amendment requires IIOs to calculate their TNAC using the amount of the network access charge that is exclusive of GST.

The recommended amendment includes:

- an addition to the definition of the TNAC excluding any amount of GST

Specifically, this amendment would relate to Part 1, Rule 3 and be written in the following manner.

***Part 1, Rule 3***

***Definition of total network access charge, after paragraph (e), add:***

***(f) any amount of GST.***

- an addition to Rule 7 enabling an uplift of termination fees for GST.

Specifically, this amendment would relate to Part 3, Rule 7 and be written in the following manner.

***Part 3, Rule 7 add:***

***(2) Despite subrule (1), if GST is payable in respect of a taxable supply relating to the termination or surrender of the whole or a part of a right of access, or services provided in relation to the whole or a part of such a right:***

***(a) the fee imposed by the irrigation infrastructure operator under subrule 6(1) may be increased by an amount not exceeding the GST payable in respect of that taxable supply; and***

***(b) the fee determined in accordance with a contract referred to in paragraph (1)(b) may be increased by an amount not exceeding the GST payable in respect of that taxable supply.***

In developing the recommended amendment the ACCC has had regard to the factors in section 93(3) and the Basin water charging objectives and principles set out in Schedule 2 of the Water Act. See **attachment B** for the amendment to the WCTFR.

## **6 Enforcement of the WCTFR during the amendment process**

Given uncertainty for the irrigation sector in light of the ATO Rulings and the current rule change process, the ACCC does not propose to take enforcement action on the pass through of GST liabilities on termination fees until the minister has made a decision on an amendment to the WCTFR. The ACCC notes that all other provisions in the WCTFR will be enforced.

The *‘Water charge (termination fees) rules 2009; Technical guide for irrigation infrastructure operators’* will also be revised subject to any amendments to the WCTFR.

# ATTACHMENT A

## Schedule 2 - Basin water charging objectives and principles

### B1. Water charging objectives

The *water charging objectives* are:

- (a) to promote the economically efficient and sustainable use of:
  - (i) water resources; and
  - (ii) water infrastructure assets; and
  - (iii) government resources devoted to the management of water resources; and
- (b) to ensure sufficient revenue streams to allow efficient delivery of the required services; and
- (c) to facilitate the efficient functioning of water markets (including inter-jurisdictional water markets, and in both rural and urban settings); and
- (d) to give effect to the principles of user-pays and achieve pricing transparency in respect of water storage and delivery in irrigation systems and cost recovery for water planning and management; and
- (e) to avoid perverse or unintended pricing outcomes.

### B2. Water charging principles

*Water storage and delivery principles*

- (1) Pricing policies for water storage and delivery in rural systems are to be developed to facilitate efficient water use and trade in water entitlements.
  - (2) Water charges are to include a consumption-based component.
  - (3) Water charges are to be based on full cost recovery for water services to ensure business viability and avoid monopoly rents, including recovery of environmental externalities where feasible and practical.
  - (4) Water charges in the rural water sector are to continue to move towards upper bound pricing where practicable
  - (5) In subclause (4):
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*upper bound pricing* means the level at which, to avoid monopoly rents, a water business should not recover more than:

- (a) the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes; and
  - (b) provision for the cost of asset consumption; and
  - (c) provision for the cost of capital (calculated using a weighted average cost of capital).
- (6) If full cost recovery is unlikely to be achieved and a Community Service Obligation is deemed necessary:
- (a) the size of the subsidy is to be reported publicly; and
  - (b) where practicable, subsidies or Community Service Obligations are to be reduced or eliminated.
- (7) Pricing policies should ensure consistency across sectors and jurisdictions where entitlements are able to be traded.

#### *Cost recovery for planning and management*

See ACCC Water Planning and Management Charge Rules Final Advice, July 2009

#### *Environmental Externalities*

- (1) Market-based mechanisms (such as pricing to account for positive and negative environmental externalities associated with water use) are to be pursued where feasible.
- (2) The cost of environmental externalities is to be included in water charges where found to be feasible.

#### *Benchmarking and efficiency reviews*

- (1) Independent and public benchmarking or efficiency reviews of pricing and service quality relevant to regulated water charges is or are to be undertaken based on a nationally consistent framework.
- (2) The costs of operating these benchmark and efficiency review systems are to be met through recovery of regulated water charges

## **ATTACHMENT B**

# **Water Charge (Termination Fees) Amendment Rules 2010 [DRAFT]**

I, PENELOPE YING YEN WONG, Minister for Climate Change, Energy Efficiency and Water, having regard to advice given by the Australian Competition and Consumer Commission, make the following Rules under section 97 of the *Water Act 2007*.

*Dated*                      2010

Minister for Climate Change, Energy Efficiency and Water

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### **Part 1      Preliminary**

- 1      Name of Rules
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### **Schedule – Amendments**



# Part 1 Preliminary

## 1 Name of Rules

These Rules are the *Water Charge (Termination Fees) Amendment Rules 2010*.

## 2 Commencement

These Rules commence on the day after the Rules are registered.

## 3 Amendment of the *Water Charge (Termination Fees) Rules 2009*

The Schedule amends the *Water Charge (Termination Fees) Rules 2009*.

# Schedule – Amendments

## 1 Part 1, Rule 3

Definition of *total network access charge*, paragraph (e), delete "entered into.", substitute "entered into; or".

## 2 Part 1, Rule 3

Definition of *total network access charge*, after paragraph (e), add:

(f) any amount of GST.

## 3 Part 3, Rule 7

Delete "A fee imposed", substitute "(1) A fee imposed".

## 4 Part 3, Rule 7

Add

(2) Despite subrule (1), if GST is payable in respect of a taxable supply relating to the termination or surrender of the whole or a part of a right of access, or services provided in relation to the whole or a part of such a right:

- (a) the fee imposed by the irrigation infrastructure operator under subrule 6(1) may be increased by an amount not exceeding the GST payable in respect of that taxable supply; and
- (b) the fee determined in accordance with a contract referred to in paragraph (1)(b) may be increased by an amount not exceeding the GST payable in respect of that taxable supply.

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**Note**

1. All legislative instruments and compilations are registered on the Federal Register of Legislative Instruments kept under the *Legislative Instruments Act 2003*. See [www.frli.gov.au](http://www.frli.gov.au)

These Rules amend the *Water Charge (Termination Fees) Rules 2009*.