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Policy for Application of Risk Assignment Principles

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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.

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

Along with other industry groups, NSWIC has wrestled with the concept of Risk Assignment and its implementation since the National Water Initiative was signed. Whilst a noble concept at the time, significant work has since been required to determine how such a process would be implemented.

The issue is one which will be determined, to large extent, by the Murray-Darling Basin Authority with publication of the Basin Plan. To that end, NSWIC has worked with its Membership to gain a firm grasp on both what was intended at the outset of this process and, moreover, what can be understood from the *Water Act 2007 (Cth)*. This paper is a result of that work and sets out how irrigators in NSW believe that the risk assignment provisions ought be implemented. Importantly, it does not seek to assert influence or preference in terms of what those principles ought be, but instead attempts to describe a process which we believe is legitimate pursuant to the *Act* and provides a fair and reasonable outcome for all.

Important Disclaimer

This policy *does not* necessarily provide endorsement of compensation solely by means of risk assignment principles. Specifically, Council (and its Members) reserve the right to develop, hold or endorse policy in respect of compensation for loss of licensed entitlement or reliability (collectively “property rights”) howsoever occasioned.

Background

In 2004, an Inter-Governmental Agreement known as the National Water Initiative (NWI) was executed between State and Commonwealth Government's¹. A precursor to this Agreement had been executed by the Council of Australian Governments (COAG) in 1994.

The stated objective of the NWI was to:

“result in a nationally-compatible, market, regulatory and planning based system of managing surface and groundwater resources for rural and urban use that optimises economic, social and environmental outcomes...”²

In specifying key objectives, the NWI aimed to provide:

“clarity around the assignment of risk arising from future changes in the availability of water for the consumptive pool...”³

The NWI became a precursor for the *Water Act 2007 (Cth)*. In context, the *Act* provides detail around the implementation of the assignment of risk⁴ whilst annexing certain provisions of the assignment principles of the NWI⁵.

Whilst NSWIC has been involved in the formation of risk assignment principles since their inception, emphasis has now turned to how the principles will be implemented in 2014.⁶ Further emphasis was provided by a December 2009 decision in the High Court of Australia⁷ which found, *inter alia*, against a common law principle for compensation on the acquisition of a license in a natural resource. This decision reinforced the importance of risk assignment principles as a source of compensation for possible loss on the implementation of the Basin Plan.

The process of risk assignment compensation will essentially occur in two stages – quantification of the volume of water reduction, if any, for which the Commonwealth is responsible; and determination of loss to individual license holders. The first of these processes will be carried out by the MDBA in writing the Basin Plan. The second will be more complex as the impacts are distributed by the implementation of Water Sharing Plans (pursuant to NSW legislation) amongst user groups (High Security, General Security, Groundwater, Supplementary, etc) which must then be measured both as gross loss and as reliability loss before being valued.

Given the proximate nature of the Basin Plan, this paper deals only with the first stage of the matter.

¹ Tasmania executed 2005 and Western Australia 2006.

² Clause 23.

³ Clause 23 (vi).

⁴ Division 4.

⁵ Schedule 3A.

⁶ The expiry of Transitional Plans (Water Sharing Plans) in NSW triggers risk assignment if a reduction occurs.

⁷ *ICM Agriculture Pty Ltd v The Commonwealth of Australia & Ors* [2009] HCA 51

Legislative Context

Discussion in some quarters has focused in part on the accuracy of the risk assignment principles reflection from the NWI to the *Act*. NSWIC notes that, to the extent that the *Act* provides sufficient clarity to interpret a result, it will prevail over the NWI. In that context, this policy is drawn to reflect the contents of the *Act*.

Notwithstanding that principle, NSWIC notes that the NWI required that “a pathway for dealing with known overallocation and/or overuse has been agreed.”⁸ Further, the NWI noted that risk assignment principles were intended to apply to reductions “that are additional to those identified for the purpose of addressing known overallocation and or overuse”.⁹

We note that clauses 46 and 47 of the NWI are not annexed to the *Act*.

NSWIC is aware that the National Water Commission (NWC) has suggested that “further clarification ... is clearly required”¹⁰ in respect of risk assignment and overallocation. We also note that the Intergovernmental Agreement (IGA) on Murray-Darling Basin Reform determined that risk assignment liability dates would be altered to match the conclusion of Transitional Water Resource Plans¹¹.

NSWIC is of the opinion that the omission of clauses 46 and 47 from the *Act*, either as annexure or through substantive form, and the IGA subsequent to the NWI have effectively made redundant the requirement to address “overallocation” or “overuse” prior to risk assignment liability being triggered. Whilst NSWIC is of the opinion that Water Sharing Plan’s (WSP’s) in NSW did address these requirements, we do not believe that any formal recognition as such is a precursor to risk assignment liability.

NSWIC is of the opinion that the contents of the *Act* are sufficient to establish practical principles of the establishment of risk assignment process. That is, further reference to the NWI (save and except possibly those clauses annexed to the *Act*) or any other extraneous material is not necessary to implement risk assignment.

Stages of Risk Assignment Process

Risk Assignment will effectively be implemented in three stages; calculation of compensable reduction, determination of value and identification of affected parties.

The first of these stages will be a key component of the Basin Plan, whilst the second two will be determined and implemented in Water Sharing Plans to commence in 2014 that are compliant with the Basin Plan.

This paper considers only the first stage of the process.

⁸ Clause 47.

⁹ Clause 46.

¹⁰ “Australian Water Reform” 2009, National Water Commission Report, at page 198.

¹¹ As evidenced by amendments to the *Act* in December 2008.

Application of Risk Assignment Principles in NSW

Calculation of Change

Risk assignment principles are relevant in the event that a reduction in either entitlement or yield is a result of the implementation of the Basin Plan. Importantly, the principles are based on a *presumption* that one or the other will occur. It should be noted that neither are presumed nor, indeed, conceded by NSWIC.

The principles will be applied on a valley-by-valley basis¹² in line with the Sustainable Diversion Limit (SDL) set pursuant to the Basin Plan.

The principles are best conceptualised as a mathematical formula:

$$\text{Plan Cap} - \text{SDL} = \text{Change}$$

Each of these three ought be seen as a variable subject to quantification.

Plan Cap

The Plan Cap is the limit on extractions under the current resource arrangements. In NSW, this must be seen as the limit set out under each WSP. Section 78 (2) of the *Act* appears to describe what this commencement point ought be, taking into account that it will be described differently in the implementation of the Basin Plan (transiting from transitional plans to Basin Plan compliant plans implementing the SDL) to how it will be described in subsequent iterations of the Basin Plan (from one SDL to another).

NSWIC notes that Plan Caps under NSW WSP's vary, in many cases, from their commencement (2004) to their conclusion (2014), mostly transitioning downward. We note that "Risk Assignment was never meant to be a *de facto* compensation process for reductions before 2014"¹³ and hence accept the construction of Section 75 (4) that the Plan Cap is the limit on extractions set at the commencement of a WSP for the Commonwealth Share calculations.

SDL

This figure will be provided by the Basin Plan on a valley-by-valley basis.

Nothing in this document ought be construed as acceptance of any particular figure or method of deriving that figure that may create an SDL within the Basin Plan.

¹² "Water Resource Plan Area" in the nomenclature of the *Act*. In particular, SDL's that are offset by Commonwealth or State acquisition programs must be calculated according to the WRP of a particular state where the resource cross state borders e.g. the Murray River.

¹³ Conversation with senior DEWHA staff, 14 January 2010.

Change

In the context of this equation, the quantum of change is a function of the Plan Cap and the SDL.

NSWIC prefers that the calculation of change be derived by this method.

Categorising Reasons for Change

Both the NWI and the *Act* categorised the change into three possibilities; new knowledge, policy change and climate change. The categorisation process is critical to Risk Assignment and varying levels of liability are attached to each. Pursuant to Section 75 (3A) of the *Act*, the latter is non-compensable whilst the former two attract compensation¹⁴.

Again, a formulaic approach to this consideration is useful:

$$\text{Change} = \text{New Knowledge} + \text{Policy} + \text{Climate Change}$$

It would be inappropriate to define Change through reference to this formula. That is, Change ought be quantified *prior* to the balance of the equation being assessed. NSWIC expects that the Basin Plan will quantify each of the variables separately and not use any as a “catch all” provision. That is, qualification of three of the four variables with the fourth being derived will be poorly received by industry.

New Knowledge

This variable has been the source of great consternation in both industry and government prior to the ink drying on the NWI. NSWIC understands that a precise definition – elusive to date – is to be provided by the Murray-Darling Basin Authority (MDBA), that it is soon to be considered by the Authority Members and that it is a “key call”¹⁵ that the Authority must make.

It is our opinion that quantification of New Knowledge in a NSW context is relatively straightforward. WSP’s in this state – for both surface and ground water – were set and, in some instances, refined, based on principles of resource sustainability¹⁶ pursuant to the *Water Management Act*. Each WSP in NSW – Transitional Plans pursuant to the *Commonwealth Act* – was based on the *best available knowledge* at the time of their creation.

Seen in that context, the Plan Cap was based on the principle of sustainability using the best available knowledge at the time. Any understanding that these levels were

¹⁴ At 100% for policy and all but 3% of new knowledge.

¹⁵ Conversation with senior MDBA staff, 13 January 2010.

¹⁶ *Water Management Act* 2000 (NSW), Section 5 “Water Management Principles”.

incorrect and that a further reduction is required, to be implemented by the SDL, must self-evidently be based on knowledge that was not available at the time.

Policy

Whilst the quantum of water required to provide sustainability might alter as a result of new knowledge, NSWIC notes that a separate issue may develop in terms of *what* is to be sustained.

Water Sharing Plans in NSW contain defined environmental objectives. Pursuant to Section 20 (generally) and Section 22 Item 4 (more specifically) of the *Water Act*, the Basin Plan must contain defined environmental objectives and outcomes.

In both instances, the objectives are policy decisions. NSWIC therefore submits that any variance between the two is therefore a policy change which must be accounted for as Policy in the risk assignment equation.

Climate Change

It is the opinion of NSWIC that an amended Basin Plan subsequent to the first iteration will be best placed to deal with climate change should it occur at a macro level. Further, WSP’s together with the NSW system of Available Water Determination (AWD) are best placed to deal with short-term climate variability.

In light of this, NSWIC is of the opinion that reductions due to climate change ought not appear in the first iteration of the Basin Plan and hence ought not be relevant to the first consideration of Risk Assignment.

In particular, NSWIC points to the fact that the CSIRO Sustainable Yields Audit provides basic predictions of climate at 2030 and beyond. The first WSP’s in NSW, with a 10 year lifespan, will expire in 2024 – six years before the relevant period is reached.

Summary

NSWIC believes that the Climate Change variable is zero in the Change equation at the first iteration of the Basin Plan and therefore the Change quantum is in fact equal to the New Knowledge quantum plus any Policy. That is,

$$\text{Change} = \text{New Knowledge} + \text{Policy}$$

Establishing the Commonwealth Share

Section 76 of the *Act* notes that the Commonwealth must “endeavour to manage the impact”¹⁷ and “may take steps to ensure that (irrigators) do not suffer a reduction in ... allocations, or a change in ... reliability”¹⁸.

¹⁷ Section 76 (a).

NSWIC acknowledges that a significant volume of entitlement has been obtained by the Commonwealth through the Restoring the Balance in the Basin¹⁹ program and will obtain further entitlement through the Sustainable Rural Water Use and Infrastructure program²⁰. We further acknowledge that these acquisitions should offset – at a valley-by-valley level – any reduction required pursuant to the Basin Plan. That is, these acquisitions ought be considered management pursuant to Section 76. In some valleys, there is clearly the possibility that these acquisitions will meet or even exceed the SDL reduction, which would render Risk Assignment unnecessary. We do not expect this to be the case across all valleys.

The risk assignment principles are based on identifying a volume of water, whilst the entitlements held by the Commonwealth (and irrigators) are expressed as unit shares in available water. NSWIC believes that calculation of volumes against entitlements held must be made in identical fashion whether held by the Commonwealth or by irrigators.

A question arises as to *where* in calculations the volume of Commonwealth acquisitions is to be taken account of. In considering the initial equation,

$$\text{Plan Cap} \quad - \quad \text{SDL} \quad = \quad \text{Change}$$

it appears that the most logical inclusion is in the calculation of the Sustainable Diversion Limit. Commonwealth acquisition must have the impact of reducing the quantum of *Change*. In the context of the equation, this is achieved by reducing the difference between Plan Cap and SDL. Given that Plan Cap is an historical figure (having already been described), it would be inappropriate to alter this. Alteration to the SDL figure, then, would have the desired impact. In practice, water owned by the Commonwealth would not be considered diverted, resulting in a higher SDL than would otherwise be the case if those entitlements were considered otherwise.

Whilst this gives rise to accounting difficulties when Commonwealth Environmental Water Holders (CEWH) entitlements are traded back into the consumptive pool²¹, NSWIC understands that a “rolling average” approach is likely to be taken to determining SDL’s as is currently the case in NSW WSP’s. We believe that this approach allows scope to account for CEWH traded water in the event that the rolling average period is a minimum of three years (and preferably five)²².

¹⁸ Section 76 (b).
¹⁹ Commonly referred to as “buyback”.
²⁰ Including on-farm infrastructure, Private Irrigation Operator Program and NSW State Priority Projects.
²¹ As allowed pursuant to Section 105 (2) of the *Act*.
²² This discussion is solely in respect of the determination of Commonwealth liability vis a viz Risk Assignment. This paper does not, nor is it intended to, reflect on how environmental water holdings – either Commonwealth or State – ought be accounted for in setting or monitoring the SDL.

Calculating the 3% Non-Compensable Amount

Pursuant to the NWI and codified in Section 75 (3A) of the *Act*, compensation is not payable on 3% of the *relevant diversion limit* against new knowledge.

The *relevant diversion limit* is as defined in Section 75 (4) and is considerably different to the perception held by some sections of the industry. This diversion limit is, as discussed previously, the Plan Cap set at the *commencement* of a NSW WSP – it is not 3% of the calculated reduction (Change).

NSWIC concedes that calculation pursuant to Section 75 (4) must be taken as the requirement in implementing risk assignment principles.

Conclusion

The process outlined in this paper will identify any reduction as a *volume of water*. It will not place a value on that water nor will it identify upon whom the reduction is visited (or how) and it will not identify whom ought be paid what amount. The process that this paper identifies matches what we understand to be the requirements of the Basin Plan. We understand that the Basin Plan must detail the process for establishing the reduction volume and that further questions in respect of valuation and compensation are dealt with subsequent to that, primarily by the Minister²³.

Like the Basin Plan itself, the volume reduction must be at a valley-by-valley level; or, as described in the *Act*, by water resource plan area. This process allows the benefits of Commonwealth acquisition processes to be enjoyed by those that have engaged in them, rather than further disadvantaging those communities and economies.

Worked Example

This example is not based on any specific valley. It merely applies numbers to the process described in this paper.

Further, this example assumes that the environmental objectives between the existing Plan and the new SDL (BP) are identical. That is, there is no Policy component to the example.

$$\text{Plan Cap} \quad - \quad \text{SDL} \quad = \quad \text{Change}$$

Assume that the Plan Cap in a valley was 15,000 and that the new SDL was to be 10,000. The equation would appear thus:

$$15,000 \quad - \quad 10,000 \quad = \quad 5,000$$

²³ Section 83.

Assume further that the Commonwealth has acquired entitlement that will deliver on average 2,000 per annum. This figure would not be included as diverted and hence the equation would appear thus:

$$15,000 \quad - \quad (10,000 + 2000) \quad = \quad 3,000$$

Having identified a total Change of 3,000, calculations as to what that was attributable to would need to be made.

Pursuant to this paper and the position of NSWIC, at the first Basin Plan the amount attributed to Climate Change would be zero. Assume for the purposes of example that no policy based expansion of environmental watering was proposed for the water resource plan area and hence Policy would also be set at zero. The full volume of change is therefore attributable to New Knowledge.

3% of the relevant diversion limit must be subtracted from the New Knowledge component of Change. In this example, that would appear thus:

$$\begin{aligned} \text{Change} &= 3,000 \quad - \quad (3\% \times 15,000) \\ \text{Change} &= 3,000 \quad - \quad 450 \\ \text{Change} &= 2,550 \end{aligned}$$

In this instance, then, the Commonwealth would be liable (in NSW) for compensation for the value of a reliability reduction brought about by 2,550 less water being available. Pursuant to this paper, how the value and direction of that money is determined must be considered by the Minister in consultation with NSWIC and the industry.