

STAFF REPORT

TO: Mayor and Councillors

FROM: Chief Executive Officer

DATE: 3 June 2010

SUBJECT: Water Supply Charges for Major Industrial Water Users RCN10-06-11

1. BACKGROUND

- 1.1 Council sets targeted rates for the supply of water. One of the rates is based on the volume of water supplied to all rating units with a metered connection.
- 1.2 The categories of connected property and the proposed rates included in the Draft Annual Plan 2010/2011 were as follows.

<i>Category</i>	<i>2009/2010</i>	<i>2010/2011</i>
	\$	\$
<i>All metered connections excluding the major industrial water users</i>	\$1.17	\$1.43
<i>Major industrial water users</i>	39.22 cents	41.00 cents*

**This figure is currently being renegotiated and is likely to change for the final Annual Plan*

- 1.3 The 'Major Industrial Water Users' are Nelson Pine Industries, Alliance Group and ENZA Foods. While Nelson Pine Industries resides within the Tasman District Council area, both Alliance and ENZA reside within part of the Stoke area of Nelson City Council.
- 1.4 This part of the Stoke area is supplied by the Tasman District Council by way of an agreement between the Tasman District Council and the Nelson City Council. Under the terms of this agreement, these Stoke connections are supplied with water at a rate no more than if the Nelson City Council were to provide the supply. Note that the price of water supplied elsewhere in Nelson is significantly higher than the normal full price of Tasman water. In practice, water has been supplied to the Stoke connections (except ENZA Foods and Alliance Group) at the normal, lower, Tasman District Council price.
- 1.5 The significant discount enjoyed by the three Industrial Water Users comes about as a result of a series of long-standing arrangements, dating back to the 1970's. At that time, the Councils involved were sympathetic to the establishment of industry in the region and inducements by way of low cost water were offered to the three companies.
- 1.6 These discount arrangements have been renegotiated at 10-year intervals. In the last negotiations in 2000, the Tasman District Council initially sought an end to the discounts, but eventually agreed to a continuation, albeit with slight progressive price increases, for a further ten years.
- 1.7 In 2000, all other metered residential and industrial users with a metered connection were required to pay a fee of 47 cents (GST inclusive) per cubic metre. Under the

terms of their special agreement, the three industrial water users were required to pay a fee of 24.4 cents (GST inclusive) per cubic metre. That agreement comes to on 30 June 2010. All other metered residential and industrial users are currently paying \$1.17 (GST inclusive); while the three major industrial water users are now paying 39.9 cents, (GST inclusive) per cubic metre.

- 1.8 Over the ten year period the contract price for the three Industrial Water Users has increased in accordance with an agreed schedule. However this increase has failed to match the increases in the cost of supplying water. In 2000, the contract price represents a discount of 48 percent. In 2010, the contract price of 39.22 cents represents a discount of just on 66 percent against the price paid by all other industrial and residential water users.

2. NEGOTIATIONS

- 2.1 The Tasman District Council's Engineering Manager, Peter Thomson, provided the Engineering Services committee with a staff report on the question of Industrial Water Supplies on the 10th September 2009. That report recommended that the Council's Chief Executive Officer be given delegated authority to renegotiate the Industrial Water Supply agreements with Nelson Pine Industries, Alliance Group and ENZA Foods for the period commencing 1st July 2010.
- 2.2 Formal negotiations commenced on 21st September 2009. Since that time the Industrial Water Users and Council representatives have met on several occasions. During that time the Council has provided a considerable volume of background material to the Industrial Water User representatives.
- 2.3 While arguments relating to historical contributions, financial viability, economic value to the region, volume discounts, guaranteed supply, cost structures and even Tasman District Council's management of the water resource have been advanced by the three historical Industrial Water Users, it has difficult to obtain any price offer from those three Industrial Water Users.
- 2.4 At all times, Tasman District Council negotiations have maintained the position that there are currently no reasons, either in equity or good commercial practice, to justify a separate price for the three historical Industrial Water Users. Tasman District Council negotiators have consistently argued that the three Industrial Water Users should pay the same price as is paid by all other industrial and residential water users.
- 2.5 Tasman District Council negotiators have provided full costings and explained the principles in practice of the 'water club', and the district-wide cross-subsidised approach, on which Tasman District water charges are calculated, with the expectation that they should apply to all industrial and residential water users without any form of differential or discount.
- 2.6 The three historical Industrial Water Users have consistently rejected the Tasman District Council 'club' approach. The Industrial Water Users are adamant that they must be supplied on the basis of an individually calculated theoretical cost of supply. They specifically reject Council's right to include them in any 'club' approach.
- 2.7 While Tasman District Council negotiators have maintained a firm position that the three historical Industrial Water Users should eventually pay the same price as all other industrial and residential water users, Tasman District Council negotiators

have at all times offered a 'soft' transition period, which would involve the continuation of large discounts for several years before the three Industrial Water Users eventually migrate to a position where they are paying the same price as all other water users.

- 2.8 In all meetings and in all correspondence, this Tasman District Council offer of a transitional period has been rejected outright by the three Industrial Water Users. At the same time, all requests by Tasman District Council negotiators for the Industrial Water Users to offer some form of counter offer has failed to elicit a response, until mid-March of this year.
- 2.9 In a letter dated 18 March 2010, the three Industrial Water Users eventually made an offer of 30.3 cents per cubic metre (GST inclusive).
- 2.10 This 'offer' of 30.3 cents represents a reduction of the price currently paid by the three Industrial Water Users. Currently the price is 39.22 cents per cubic metre and the price offered in mid-March represents a further reduction of approximately 25 percent.
- 2.11 This offer to pay a further reduced price was made in terms of the argument by the three historical Industrial Water Users that they should be paying a price based on a theoretical calculation of their individual cost of supply. The three historical Industrial Water Users provided their own calculation of this theoretical cost of supply as justification of this reduced price offer and again rejected the Council's view that they should be required to become members of the district-wide 'club'.
- 2.12 The calculations and documentation provided to support the theoretical calculation were cursory and unrealistic. Tasman District Council negotiators did not accept the counter-offer.
- 2.13 A 'last ditch' attempt by Tasman District Council negotiators to reach a settlement was undertaken on Friday the 28th May. This meeting was unsuccessful.
- 2.14 The water supply contracts for the three Industrial Water Users contain an arbitration clause which comes into effect when negotiations reach an impasse. All parties have now agreed to invoke this clause, and in terms of the supply contracts, an arbitrator will now be appointed.
- 2.15 In a move that was independent of the negotiations, the three Industrial Water Users made a late submission to the Council's Draft Annual Plan process. In that submission the three Industrial Water Users offered 41 cents per cubic metre against the \$1.43 proposed for all other users. This offer represents a demand for a discount of just over 71 percent.

3 COMMENT

- 3.1 Historically the three Industrial Water Users have been successful in negotiating prices for the supply of water where the agreed prices have been significantly lower than the prices which have applied to all other Tasman ratepayers receiving water for either industrial purposes or residential purposes.
- 3.2 The water account is run as a self-equalising 'club'. If three club members pay less, it automatically follows that the remaining club members have to pay more to equalise revenue and costs. Tasman District Council staff have calculated that, as a direct result of the high discounts enjoyed by the three historical Industrial Water

Users all other industrial and residential water users have paid additional water rates, totalling approximately \$3 million during the period 2000-2010.

- 3.3 Tasman District Council staff have further calculated that should the Tasman District Council accept the three Industrial Water Users offer of 30.3 cents per cubic metre as set out in their letter of 18th March 2010, this would again result in additional water charges being paid by all other industrial and residential water users. The additional amounts paid by those other industrial and residential water users would total approximately \$10 million during the remaining nine years of the Tasman District Council's current Ten Year Plan 2009/2019.
- 3.4 Since its establishment in 1989, the Tasman District Council has prided itself on its 'no differentials' approach to rating and charges. The water 'club' is a core component of that approach.
- 3.5 The three historical Industrial Water Users have failed to produce any evidence or reasonable argument to justify a continuation of a separate pricing structure for their three enterprises. That pricing schedule would continue to require that all other industrial and residential water users would have to pay more in order that the three historical Industrial Water Users continue to maintain a position whereby they pay a lesser sum.
- 3.6 Two of the three historical Industrial Water Users are not located within the Tasman District Council area. The rates for those two enterprises (Alliance Group and ENZA Foods) are paid to the Nelson City Council. If those two enterprises were to obtain their water supplies from Nelson City Council, they would be required to pay Nelson City Council charges which are significantly higher than the normal full price that the Tasman District Council proposes that those two enterprises should now pay.
- 3.7 Tasman District Council negotiators have been mindful of the economic importance of Nelson Pine Industries, ENZA Foods and the Alliance Group to the regional economy. Tasman District Council negotiators have recognised that payment of the of normal full price for water supplies will increase the cost structure for those enterprises. The three Industrial Water Users were offered the opportunity to state a case for some form of continued discount based on 'affordability'. Despite guarantees of confidentiality and a clear willingness by Council to consider such an argument the three Industrial Water Users refused to provide any financial data or other evidence to support any contention that the increased costs would place their financial viability at significant risk. The Tasman District Council negotiators were left with the impression that the three Industrial Water Users are well established and secure in their respective areas of operation and that, while there will be increased costs that will be inconvenient and reduce profits, the effect of those increased costs will not endanger the economic viability of those enterprises.
- 3.9 Notwithstanding the aforementioned conclusion re: affordability, the Tasman District Council negotiators have repeatedly offered to negotiate transitional arrangements that would mitigate against increased costs due to a requirement to move to the 'normal' pricing structure. It is a matter of regret that the three Industrial Water Users have consistently failed to take up these offers.

4. CONCLUSION

- 4.1 For the past ten years, the Tasman District Council has faithfully and competently honoured the three contracts for a secure supply of water to Alliance, ENZA and Nelson Pine Industries.
- 4.2 Compliance with those contracts has imposed an additional burden of approximately \$3 million on all other metered industrial and residential water users.
- 4.3 This has created an unacceptable lack of equity between the three historical Industrial Water Users, and all other water users.
- 4.4 This inequity will increase significantly if the Council submits to the demands of the three Industrial Water Users.
- 4.5 Currently, no good reason exists for the provision of discounts to the three 'Industrial Water Users'. On the contrary, all industrial and residential water users should pay the same price in accordance with the 'club' principle.

RECOMMENDATION

That Council receives this report; and

Notes that the dispute over future water supply to Nelson Pine Industries, ENZA Foods and the Alliance Group (Nelson) will be referred to arbitration.

**Paul Wylie
Chief Executive Officer**