IPART DETERMINATION
GWYDIR VALLEY MARCH 2010
RESPONSE BY STAHMANN FARMS ENTERPRISES
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Prepared by:

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1.0 BACKGROUND

Stahmann Farms Enterprises is a 100% Australian owned and operated family business focused on the production, processing and marketing of Australian Tree Nuts. Although it currently processes and markets macadamias, almonds and walnuts its most important asset is “Trawalla” a 750 hectare pecan orchard n the Gwydir Valley near Pallamallawa.

It is 100% reliant on State Water delivered High Security Surface Water from the Copeton Dam.

The farm business employs 18 permanent staff as well as over 40 casual employees during the harvest and pruning seasons. The nut in shell grown at “Trawalla” is shipped to the business’s processing plant in Toowoomba where a further 100 employees add value to the pecans and other nuts for sale domestically and internationally.

We operate in a very price conscious competitive market with international competition from countries like Mexico and South Africa driving our need to manage costs as aggressively as possible.

Our largest customer s are the national supermarket chains in Australia who have strict rules regarding the mechanisms allowed for price increases, essentially limiting our annual rate of increase to less than

5% per annum if at all. The balance of our sales are of a commodity trade nature where we are price takers with little to no ability to pass on increased costs.

2.0 WATER USE

"Trawalla" has been managed as a surface irrigation property since its inception in the late 1960's. Over the past 40 years we have invested in technology to improve our efficiency such as concrete lining all our distribution ditches, installing a full tail water reticulation system, and installing electronic soil water monitoring systems across the farm.

Four years ago the business began a research program to determine the impact of conversion from surface to subsurface drip irrigation. The key issues of concern were how the mature trees would respond to this change and what level of water saving could be obtained. The results were positive and by the end of this year we will have converted nearly 30% of the entire farm area to subsurface drip at an overall cost of just under $4.0million.

The water savings achieved through this investment provide us with the following advantages:

- Greater security during periods of low supply;
- Improved agronomic performance and competitive productive performance; and
- The ability to grow our business through the expansion of horticultural production in the Gwydir.

3.0 OUR EXPECTATIONS OF STATE WATER

Clearly we are committed to the long term sustainability of our business in the Gwydir. Our investments on farm are mirrored by continued investment throughout the business in improving our capacity to deliver high quality products at a cost effective price to our customers.

As part of our standard QA Procedures we undertake a review of all our suppliers on an annual basis and rank them against the following key performance indicators:

- Cultural and commercial alignment with the objectives of our business;
- Consistent provision of products and services which meet our quality specifications; and
- The capacity to deliver the cost savings and service offerings necessary to support our competitive position in the market place.

State Water Ranks as follows:

KPI	RANK 1 -10	COMMENTS
Corporate Alignment: To what extent are they culturally and commercially aligned with the objectives of our business	2	Difficult for a public sector entity to have a strong cultural fit with a private sector entity – particularly when they do not appear to demonstrate any strong commitment to our district.
Operational Performance: Do they consistently provide products and services which meet our quality specifications	7	State Water have provided strong operational support to our business over the past 12 months.
Value for Money: Have they demonstrated the capacity to deliver the cost savings and/or service level offerings necessary to support our competitive position in the market place	1	Clearly 83% price increases with no evidence of improved service levels do not represent a supportive business partner.
ACTION	**3**	**Seek alternative source of supply if possible**

On the basis of the State Water's failure to demonstrate a commitment to lowering cost and/or improving service delivery over time we would seek to identify an alternative source of supply if it were not for the Monopoly Supply position which this organisation currently holds.

4.0 OUR SPECIFIC CONERNS REGARDING THE IPART WATER PRICING DETERMINATION

Clearly we are unhappy about the outcome of State Waters pricing proposal and in particular are concerned that IPARTS input into the process has made the situation considerably worse as far as our business is concerned.

We do not seek to make any general comments regarding the economic or political justification for the pricing policies which IPART seeks to police on behalf of their state and federal masters. The comments below relate specifically to the impact of IPART's decisions on our business and in particular how we believe these determinations deviate from what we understand to be reasonable commercial terms of trade.

4.1 Scarcity Pricing:

The IPART determination supports the concept of "Scarcity Pricing" as a reasonable means of establishing the costs associated with the delivery of High Security water by State Water. Commodity markets operate on the basis of supply and demand with scarcity of a particular commodity leading to

an increase in its market price. These principles clearly operate within Australia's water markets particularly in the southern connected systems where temporary trade values have at times exceeded $1000/ML.

State Water does not sell water though. It provides a service to allocation holders related to the storage and distribution of their entitlements. The "scarcity" or value of the water distributed should not in my mind have any impact on the costs associated with the actual delivery of the water.

If State Water wants to purchase my High Security allocation and then on lease it back to me on an annual basis then it would be in a position to charge what ever "Scarcity Premium" the market provided for.

The use of the concept of "Scarcity" based pricing in this context is in my opinion a clear abuse of the monopoly power of the service provider involved.

I am astounded that IPART whose primary charter is to provide a foil to such behavior by government owned monopolies should see fit to not only support but in fact validate such behavior.

The GVIA has presented a justifiable model for sharing the burden between high and general security users which is in keeping with the principals of equitable cost sharing – see Appendix 1.

4.2 The Scale of the Price Increases:

As noted above we carefully screen our supply partners in every other aspect of our business. I have never encountered a situation where a supplier has attempted to justify price increases of the scale proposed by State Water over the coming four years.

In doing so State Water demonstrates a complete lack of empathy and understanding for the nature of the business that we are all in –Irrigated Agriculture. If it were not for its monopoly position there is no way it could sustain such a predatory pricing approach without a competitive offer being provided by an alternative market player.

4.3 The Inequity of the Mechanism for Estimating the Reliability of Supply:

As a result of a decision by IPART to randomly allocate a 20 year supply analysis period the overall pricing structure of the Gwydir has increased dramatically against the original supply estimates provided by State Water or the previously mandated approach based on the IQQM model.

The apparently random selection of the last 20 years as a proxy for the future not only increases the overall charges for the Gwydir but dramatically increases High Security Charges in this valley due the imposition of the Scaricy Pricing Multiplier.

4.4 The disconnect between Water Pricing Decisions and the Industries which this Water Supports:

We are price takers in a predominately commodity based trading environment. We are subject to the general terms of trade associated with all agricultural commodities which essentially sees prices increase at or below the CPI.

If we wish to maintain our current levels of profitability where we must seek to imbed efficiency gains of at least the level at which our costs are rising. Where price increases are above this level we must seek to obtain larger efficiency dividends or reduce overheads directly by reducing permanent employment and on going investment in our business.

In seeking to increase costs by over 80% and in addition to apply annual CPI increases State Water places itself in complete isolation to the world in which we operate.

5.0 IMPACT OF CHARGES ON OUR PROFIT AND LOSS

The table below demonstrates the significance of these price increases on our business.

ITEM	2009 - 2010	2013 - 2014
FARM OPERATING COSTS	$ 3,414,795.00	$ 3,414,795.00
STATE WATER CHARGES	$ 149,504.00	$ 294,688.00
TOTAL FARM OPERATING COSTS	$ 3,564,299.00	$ 3,709,483.00
STATE WATER CHARGES AS A PROPORTION OF OUR TOTAL OPERATING COSTS	***4.19%***	***7.94%***
Estimated Farm Profits based on an initial 10% Margin	**$356,429.90**	**$ 211,245.90**
Impact of cost increase on profit	**40.7%**	

By 2014 water charges will represent nearly 8% of our total operating costs.

The increase in charges of nearly $145,000 will come directly off our bottom line. It is not accompanied with any improvement in service or delivery efficiency which will in any way improve the profitability of our business. The net impact is a potential reduction in our net earnings of over 40%.

In supporting the price increases proposed you are not “Fiddling” with the margins of our business profitability you are striking hard at the fundamental sustainability of our operation.

6.0 THE OUTCOME WE SEEK

In summary we seek at least the following outcomes:

1. The removal of the "Scarcity Principle" in relation to pricing of High Security Water and the implementation of a user pays principle to the services provided by Sate Water. The original proposal provided by GVIA represents a reasonable alternative in this respect.

2. A return to the use of the original IQQM based supply models.

3. Limiting annual State Water price increases to CPI plus a maximum of 5% per annum.

4. Evidence that State Water is actively seeking to implement both cost management and alternative income generation programs to allow them to demonstrate either a reduction in annual service costs or an increase in service levels at no extra cost.

I understand that other users within our valley have different concerns particularly related to their fixed costs. We support their attempts at seeking redress for the significant impacts these charges have within the context of the worst water supply position faced by our valley since irrigation commenced.

We are committed to our valley because we have faith in its capacity to support a growing horticultural industry. Unfortunately the behavior of State Water in this matter seriously undermines our resolve and the investment attractiveness of our region in this regard. If we are to grow our business and to expand high intensity horticultural investment in the region we must have confidence that we can do so in partnership with an organisation capable of meeting our on going needs for greater water security, improved service delivery levels and overall reductions in service delivery costs. These demands are not unreasonable as they represent the demands which we place on all suppliers and which are placed on ourselves by our retail and food processing customers.

We do not dispute the fact that State Water must cover its costs of operation. We can agree to differ in relation to the demands placed on State Water to generate a commercial return on its assets. What we cannot accept is that the only way in which State Water can improve its commercial returns is to increase prices to its defenseless customer base.

APPENDIX 1:

Gwydir Valley Irrigators Associations submission to – Review of Prices for State Water Corporation Independent Pricing and Regulatory Tribunal October, 2009

26. The appropriate balance between high security and general security entitlement prices.

GVIA supports differential pricing between high security customers and general security customers, but has never been particularly comfortable with the model previously used by State Water and IPART to determine a high security premium (based on Water Sharing Plan Conversion factors), and completely rejects State Water's proposed "scarcity" model.

GVIA believes that a more appropriate model would be based on high security charges recouping the costs associated with delivering high security water, and therefore it has looked at total valley revenue requirements, and divided them by the average High Security use.

It should be noted High Security includes all high security classes, including Urban Water Supplies, Domestic and Stock and High Security agriculture.

In making this comparison GVIA has used the same base numbers as used in the State Water submission including:

Total High Security entitlement – 21,458 megalitres

Total Gwydir Forecasted Consumption (15-year rolling average) – 275,597

Total Gwydir Forecasted Consumption (IQQM) – 309,164

Total Gwydir Revenue Requirement (2010/11) - $5,104,000

The model assumes 100% High Security use, on the basis of 100% being made available.

Table 1: Comparison of High Security Contribution through SW model & Alternative Model /General Security

Model	Percentage of total average water use	Revenue Needed to be Generated
State Water's Model	N/A	$486,023
GVIA's with 15 year Forecast	7.8%	$398,112
GVIA's Model with IQQM Forecast	7%	$357,280

Table 2: Impact on Proposed Prices (2010/11) All other factors remaining the same

Model	HS Entitlement Charge	GS Entitlement Charge	Usage charge	HS Revenue	GS Revenue	Total Revenue
State Water's Model	**11.54**	**3.52**	**11.11**	**$486,023**	**$4,617,977**	**$5,104,000**
GVIA's with 15 year Forecast	**7.44**	**3.69**	**11.11**	**$398,112**	**$4,705,888**	**$5,104,000**
GVIA's Model with IQQM Forecast	**7.44**	**3.69**	**9.91**	**$357,280**	**$4,746,720**	**$5,104,000**

GVIA believes it model represents a rationale way of proportioning actual cost, and is much more equitable and justifiable than either the existing model or State Water's proposed model.

GVIA wants to be very clear that although it has quoted State Water's revenue requirements in the above example, it does not accept the validity of these requirements as has been detailed throughout the rest of the submission.
And while GVIA has provided two versions of its model, its clear preference, as documented throughout this submission is to use the IQQM based Consumption forecast.

GVIA can envisage that this High Security/General Security pricing model may not be attractive to all valleys, but believes it could be implemented on a valley-by-valley basis.

The GVIA model is based on 100% high security usage. If analysis of High Security usage shows long-term usage is less than this, GVIA would suggest the High Security fixed charge is raised to cover any difference.

Recommendation 30: IPART should adopt a High Security/General Security charging model based on actual costs and the percentage of water made available to each class on average.