



22 June 2006

Review of Bulk Water Prices – Draft Report
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office 1230

Dear Sir/Madam,

Re: Submission on the IPART Draft Determinations on Bulk Water Prices

The price increases for State Water and DNR, as outlined in the IPART Draft Determination, are nothing short of disastrous for the dairy industry on the far south coast of NSW. The increases over the 4 years will amount to a 100% plus CPI increase on the current rates for the regulated Brogo River users and 90% plus CPI increase for the unregulated river users.

The impact on farm, factory and the community if these charges stand will be enormous. They will represent a “nail in the coffin” for irrigators on the Brogo River.

Bega Cheese and the Bega Valley Water Users members have attempted to highlight the impact if significant price increases for bulk water are implemented. We are extremely disappointed that there appears to have been no attention paid to this information. Why is coastal agriculture to be treated so differently to our western counterparts? Is it State Government policy to see the demise of sustainable and historically profitable agricultural activities in coastal areas?

This draft determination highlights the complete disregard for the farm families, their employees and the communities that these farms sustain. It is ‘budget deficit over people’ and sends a very poor message regarding the priorities of the State Government.

In particular, we would like to make comment on the following:

1. Community Service Obligations (CSO)

Response to CoAG and NWI requirements is reported to be the reasoning in seeking full cost recovery. However, the selective application of the requirement is a concern.

Page 124 of the draft determination in the section headed ‘13.2 Implications for cost reflectivity’ state:

“The Tribunal’s pricing decisions for State Water and DNR required it to balance the objective of achieving full cost recovery with the impact on users. The Tribunal notes that the National Water Commission has recognised the importance of considering the impact on the users in its recent review of the NSW compliance with the National Competition Policy:



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The most recent State Water submission to IPART has foreshadowed the removal of New South Wales Government subsidies to State Water to assist with recovery of operating expenditure in those valleys where operating expenditures are not being fully recovered from water users. While achieving full cost recovery in an important tenet of CoAG water reforms, provisions are made for community service obligations to those regions where full cost recovery would result in unacceptable community outcomes. It is important to governments to fully explain and justify removal of community service obligations.

The Commission considers it critical that price paths recognise the adjustment that moving to lower or upper bound pricing may mean for rural water users in practice. The Commission notes the central role which IPART plays in making judgements necessary to establish effective price paths.”

Page 14 and 16 of the State Water initial submission quotes:

- (i) “the adoption of pricing regimes based on the principals of consumption based pricing, full cost recovery and desirably, the removal of cross subsidies which are not consistent with efficient and effective service, use and provision. Where cross subsidies continue to exist, they be made transparent;
- (ii) where service deliverers are required to provide water services to classes of customers at less than full cost, the cost of this be fully disclosed and ideally be paid to the service deliverer as a community service obligation.”

This determination does not establish the funding gap on the Brogo as a community service obligation and it appears to just remain a revenue shortfall. Nor does it satisfactorily justify the 100% increase eroding what should be classified a community service obligation. This lack of transparency and accountability leaves the water users with no security.

At the end of this determination period a further 100% increase could be implemented as there is no formalised recognition of what the community service obligation on the Brogo is and what its boundaries are.

Full cost recovery on the Brogo is impossible and this has been recognised by State Water and IPART. However, what are the defined limits on what the consumer should pay and what the Government should commit to as a CSO is not clear. We are confident that the proposed rate of \$35/ML plus CPI on the Brogo is beyond the ability of agriculture to return and still remain viable.

Recommendation: We request a clear and transparent determination on CSO.

2. Economic impact

It is not the fault of the Brogo irrigators that they irrigate from a sub-economic dam. Why are they being punished for this? The ABARE report indicated that the Brogo farmers had a small profit of \$39,000. To determine the impact of price increases modelling scenarios occurred with a maximum of 50% increase in water charges investigated. How can IPART assume that a 100% increase in water charges will have “the impact [of such increases] on farm incomes [cash receipts less cash costs] to be relatively small.”?

Dairying is an intensive high cost industry compared to all the other broad-acre industries surveyed in the ABARE report. The broad generalisations of impact are misleading. These increases will result in significant on farm management change resulting in reduced profitability and, ultimately business failure. Dairying in the Bega Valley is extremely cost sensitive and this was not captured in the ABARE findings.

Also an irrigation licence is only of value if it has a purchaser prepared to pay for it. At proposed water rates no agricultural activity could justify using the water therefore seek to buy licence. The licence having no value creates issues in terms of farm equity. Farmers have borrowed money to buy a licence which is now worthless.

Farms should not be punished for being marginally profitable, or being on the wrong river. This ruling will see the demise of irrigation farming on the Brogo. The social and economic impacts of this were clearly presented in Bega Cheese's previous Socio economic Impact Submission which we refer you to again.

Recommendation: A independent, detailed and specific socio-economic impact study be carried out on the Brogo irrigators and the community they sustain.

3. Dam Viability

At the proposed rates on the Brogo River irrigation will overtime cease. Also no other agricultural alternative could afford to pay the proposed rates therefore leaving the water idle. Most of Brogo dam's costs are fixed costs which will create an even larger operational deficit as water use slows. Ultimately as prices increase to accommodate this, no one would use the Brogo water resulting in a dam that would have no income at all. This is not a satisfactory position for State Water or the Government in trying to seek full cost recovery.

4. Regulatory Asset Base (RAB)

The nominal RAB value apportioned to Brogo is not justified. Value or asset price as determined by what someone is proposed to pay for it would mean that even with the current water rates and the cost of running the dam then the asset has no value. The RAB is based on the dam being economically viable, which it is not. No one would purchase Brogo due to its uneconomic size.

Recommendation: The RAB on Brogo dam should be adjusted to zero.

5. DNR

We have concern regarding service levels of DNR. Even though their rates are rising 90% there is no demand for increases in service levels. DNR has to be more responsive with customers to determine what appropriate service levels are. This determination does not address these critical issues.

6. Off Allocation

Off allocation water is charged at full usage rates. Water pricing models used by State Water should not include an average off allocation income. Off allocation water delivery is of minimal cost to State Water to deliver as the dam is spilling and becomes transparent. It is not justifiable to charge full usage rates for off allocation water if they do not incur costs in delivering that water.

Recommendation: Only DNR charges, which includes monitoring, should be applied for off allocation water.

7. Capex/OPEX

We see no justification for the purchase of a new house on the Brogo site. The houses are well maintained as indicated by the significant maintenance budget, and at the most, only need modernising which could occur for less than \$50,000. We would prefer to see expenditure on telemetry and water level surveillance equipment to reduce visual inspections from 7 days a week to 5 days per week, significantly reducing OPEX and freeing up resources to undertake operations and other critical maintenance.

We also question the need to have 3.5 fully qualified technical staff at the dam which results in a personnel cost of \$283,000. Full time staff averages an income package of \$80,000 plus

housing. Using labourers or contractors for less qualified roles would save significant expense on salaries.

Recommendation: Capital expenditure should be focused of activities which will reduce OPEX. Labour management needs to be tightly monitored to minimise unnecessary cost.

RECOMMENDED SOLUTION

We totally reject the current determination on the Brogo for State Water and DNR and subsequently recommend the following option.

1. Price CAP and CSO

We recommend that IPART apply a rates cap on the sub-economic dams. As the Brogo is already at the top end of water pricing and twice the average cost of water, the current 2005/06 rate should be the cap level. Agriculture is not twice as profitable just because it is on the coast, but even at current pricing that is implied. We recommend this capped rate to only rise by CPI.

The short fall to be formalised as a community service obligation and not be subjected to any future price determination. This would give security to farmers so that they could confidently invest in their businesses for the future.

Bega Cheese's milk manufacturing future is now in the hands of IPART. If the current pricing determination on Brogo goes through then the negative economic and social consequences will be dramatic. No agricultural enterprise can justify paying the proposed water rates and we therefore urge you to consider our recommended solution above.

If you have any questions regarding this submission please do not hesitate to contact me.

Yours sincerely,

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Deputy Chairman – Bega Cheese