

Gwydir Valley Irrigators Association Inc.

458 Frome St, PO Box 1451, Moree NSW 2400

23-6-2006

James Cox
CEO,
Independent Pricing and Regulatory Tribunal,
Level 2,
44 Market St,
Sydney, NSW, 2000

Dear James,

The Gwydir Valley Irrigators Association (GVIA) would like to take this opportunity to respond to the Independent Pricing and Regulatory Tribunal's (IPART) Draft Determination and Draft Report for Bulk Water Prices.

As you are aware GVIA is a voluntary organisation that represents the interests of regulated, unregulated and groundwater irrigation licence holders in the Gwydir Valley of North-West NSW.

GVIA is a member of NSW Irrigators Council (NSWIC), and in the main fully supports NSWIC submission to this draft report. However, on a small number of issues, outlined in this letter, GVIA's position differs from NSWIC. Unless an issue is specifically raised in this letter, and is contrary to NSWIC position, IPART can assume that GVIA is in agreement with the NSWIC position.

In this letter GVIA intends to address issues in the same order as they appear in the draft report.

However, prior to going into detail, I would like to touch on some issues in summary.

Firstly, GVIA would like to congratulate IPART in rejecting some of the more outrageous claims by both State Water and the Department of Natural Resources (DNR). GVIA is particularly pleased that IPART will not be adopting average water use less one standard deviation as the planning base for setting State Water's prices, and that it has adopted a far more reasonable approach to setting the High Security premium, than the one championed by State Water. However, GVIA still believes the premium has been set too high in the Gwydir Valley.

GVIA is also pleased that IPART has exerted its independence and not accepted DNR's proposed cost shares, and has more fairly apportioned the cost burden between Government and the user, although inequities remain within some of the cost shares.

However, a number of matters remain of major concern to the membership of the GVIA, some concerning general principals and others specifics.

GVIA strongly believes that State Water, DNR and IPART, have all unjustifiably relied on the National Water Initiative to support increased charges.

State Water's drive towards "upper bound" pricing and IPART's acceptance of it, is nothing more than exploiting the NWI, to increase revenue for the NSW Government.

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It is not *practicable* or desirable to move towards “upper bound” pricing, and given the performance of State Water, any move to do so is clearly a *perverse* outcome, and therefore unacceptable under the National Water Initiative.

GVIA fully expects DNR’s recently announced restructure, and budgeted annual savings of \$16 million will be fully reflected in IPART’s final determination. It is GVIA’s understanding, that much of the savings will result from decreased resources being applied to water resource management.

GVIA has had a great deal of difficulty in understanding how IPART can pursue full cost recovery for water, with annual real price increases of upto 25%, while at the same time announcing CityRail price increases averaging only 2.9%, when fares are only recovery 22% of CityRail’s operating costs.

This discrimination is even harder to swallow when IPART’s sharp water price increases include an allowance to pay dividends back to government. Like suburban rail, bulk water infrastructure is essential infrastructure for the health of the entire economy, and not just the direct users.

GVIA is also very concerned that while IPART pursues full-cost recovery on one hand, it is prepared to allow over recovery in some valleys and water resource types, such as Unregulated Water Charges in the Gwydir Valley.

GVIA is also mystified by the fact that at the end of the 2001 determination period the Gwydir Regulated water source was considered to be at 95% recovery of State Water’s costs, yet at the start of this period Gwydir is considered to be at only 75% cost recovery.

Despite claims by State Water of extra responsibilities associated with the introduction of the National Water Initiative and changes brought on by the separation of DNR and State Water, the fundamentals of its business of storing and delivering water has not changed. In a world where almost all costs have fallen in real terms it is hard to see why State Water should be able to use the excuses above to justify significant increases in its cost base, without investing significant effort into improving its own efficiencies and performance.

GVIA also remains very concerned about its and others ability to adequately assess the performance of State Water and DNR, against IPART determinations.

GVIA calls on IPART to require both State Water and DNR to provide clear financial reports that track valley-by-valley actual income and expenditure against prices set by IPART and the proposed expenditure that the prices were based on. These reports should be filed with IPART on an annual basis, and should be publicly accessible documents. Without this reporting, stakeholders like the GVIA can only have limited faith in the robustness of the IPART price determination process.

GVIA is also very disappointed that IPART has decided to remain silent on the important issue of the environment (government) meeting its share of costs associated with the storage and release of environmental water.

Specific Comments relating to the Draft Report

1.1

The corporatisation of State Water should not be a justification to increase costs. Corporatisation was justified as a way toward improving service and efficiency, and for this reason it was supported by irrigators. State Water has an obligation to deliver operational performance.

GVIA rejects the notion that there have been significant increases in both State and DNR costs as the result of the introduction of Water Sharing Plans. In almost all instances in the Gwydir Valley core business operations have remained largely unchanged, and while procedures may have altered, and there has been an increased emphasis on accountability, there as always been a requirement for sound record keeping and reporting.

1.2

GVIA supports the move to consumption based pricing.

GVIA strongly questions the need for an average increase of 5.5% per annum above inflation over the 2006 determination period for State Water, and believes far more emphasis should be placed on State Water achieving efficiency gains.

GVIA supports the principal of capping maximum rises, but believes it is entirely unreasonable to ask any business to wear a 15% annual real increase. (By way of comparison the NSW State Government has set 2006 rate pegging at 3.6%.)

GVIA welcomes IPART's decision not to accept State Water's proposed opening RAB of \$304 million, but believes if a RAB has to be used it should be based on capital expenditure post 1997. GVIA is also very concerned that the use of the RAB over the annuity method, will see a massive and continual blow-out in user charges as time progresses.

In relation to DNR's charges it is entirely unreasonable to allow price increases of up to 25% in real terms for groundwater unregulated users. Such increases will destroy the viability of businesses.

GVIA is concerned about the phased abolishment of base groundwater charges. In the Gwydir Valley there is a very large proportion of small entitlement holders, whose new charges will not cover the base cost of metering, billing and licence compliance. GVIA considers the system of a base charge, entitlement and usage to be the most equitable, and the best reflection of the services provided. An alternative would be to move to a self-metering regime, which would eliminate the majority of base costs.

1.3

GVIA finds it hard to place much importance on IPART determining most valleys will be at full-cost recovery at the end of the determination period, when the rules as to what constitutes full cost recovery appear to constantly change. At the end of the 2001 determination period Gwydir Regulated was meant to be at 95% full-cost recovery, yet we start the 2006 period supposedly at 75% cost recovery.

1.4

GVIA shares PB Associates concerns regarding State Water and DNR's financial reporting systems, and their ability to adequately link expenditure and income to the determination. And while GVIA fully supports an improved performance in this area, it notes that all recent determinations have seen similar comments from IPART, and despite DNR and State Water failing to provide the standard of information required, they have been rewarded with real increases in charges.

IPART must ensure high degree of annual finance reporting against the determination and ensure these reports are public documents.

2.2

As mentioned in the introductory comments, GVIA strongly believes that it is not *practical* to move towards upper bound pricing, and any move to do so would be a *perverse* pricing outcome under the NWI. Making provisions for the cost of capital and dividends cannot be justified in a monopolistic organisation such as State Water, where no emphasis has been placed on operational or asset efficiency.

2.3

GVIA supports the move towards State Water generating at least 50% of its revenue through usage charges by 1-7-2006, and 60% by 1-7-2008.

3.2.1

GVIA believes DNR has transferred more of its water WRM functions to Catchment Management Authorities than the draft report suggests. However, it does acknowledge that this is a grey area, and urges IPART to independently investigate the extent of WRM responsibilities the CMAs now have.

4.1.2

GVIA supports the tribunal's decision not to allow for adjustments to be made to prices associated with revenue risk during this determination period.

4.1.3

GVIA maintains there should be a review of past expenditure and revenue projections against actual performance. If IPART is not prepared to take this step in this determination process, as requested by numerous stakeholders, then it must ensure adequate financial reporting to allow such a review to occur during the next determination.

4.2.1

GVIA is unconvinced that the adoption of a RAB approach will serve water users well into the future, and is very concerned, given the cost of some capital projects, that it will result in a rapid escalation of water charges.

However, if a RAB is to be used, it should reflect capital expenditure since 1997 (RAB of approx \$75 million). While GVIA acknowledges that this may result in a short-term funding deficit, the potential growth mentioned above would more than compensate State Water in the longer term.

By using the 1997 start date, the RAB would be consistent with the "line-in-sand" principle, instead IPART is proposing a manufactured RAB, which while much better than the one proposed by State Water, has still be designed more to meet State Water's immediate revenue requirements, rather than reflect the principles behind a RAB and the "line-in-the-sand".

5.5

While noting that irrigators submissions raised concerns regarding the transfer of water from extractive use to environmental water, and the consequential affect this has on State Water's ability to recover costs, IPART appears to have decided to remain silent on this issue.

GVIA strongly urges a charge on government to be levied on all stored environmental water, and those charges should be the same as charges levied on irrigators, and reflect the relative security of the stored water.

5.6

If IPART is determined to apply 100% of hydrometric costs onto users then it must demand that State Water and DNR make this a fully contestable service, and that State Water must recover from other users of the information commercial charges to offset the total cost being applied to irrigators.

GVIA welcomes IPART's decision to maintain OH & S Compliance as a shared cost, but strongly argues that cold water mitigation works should be a 100% cost of government, as the importance of such works was well known prior to 1997, and the installation of such works should be considered part of the need to bring dams upto 1997 standards.

GVIA is concerned by IPART's decision to shift 100% of insurance costs onto users. Surely a more equitable approach would have been to share insurance in the same ratio as the total user: government cost ratio. The same should apply to other overhead costs, including the cost of corporatisation.

GVIA is very disappointed that although IPART went to the expense of engaging consultants CIE on government: user shares with regards to DNR's costs, IPART has either ignored CIE's recommendations, or opted for the higher end of the user cost scale.

In particular, GVIA is very concerned that the C02 categories have been assigned a 100% user cost, and this would suggest that if it was not for irrigators, DNR would not carryout any of these tasks. Yet we see groundwater work still occurs in coastal regions where there is no irrigation (and charged, rightly so, 100% to Government), this would suggest that at least some of the groundwater work would still occur in inland regions, and government should be shouldering some of the cost.

The high user share in the C06 & C07 categories also needs further review, as the government has been absolutely clear that water sharing plans were brought in to benefit all residents of NSW, and it is completely inequitable to assign the vast majority of costs onto irrigators and other extractors.

6.1

While GVIA welcomes IPART's significant downward review of State Water's notional revenue requirements, it would still like a rationale explanation as to how requirements of \$57.6 million in 2005/06 can rise to \$75.6 million 2006/07, when there has been no fundamental change in the service or product supplied. Only a monopolistic business such as State Water could put forward such a claim. This appears to be exactly the type of perverse pricing outcomes that the National Water Initiative has warned against.

With specific reference to the Gwydir, GVIA seeks a fully costed explanation as to how State Water's requirements have increased by \$1 million, yet it is managing the same resource it has had in previous years.

GVIA is also concerned that IPART as adopted a WACC of 6.4%, while this is less than what State Water proposed, it would appear to be at the higher end of the scale, and is hard to justify given the business security provided to State Water by its monopoly position.

While notional revenue requirements for State Water have actually reduced, it is GVIA's understanding that the draft report does not take into account the latest DNR restructure

which is expected to generate operating savings of \$16 million per annum. GVIA insists that IPART take this restructure into account prior to making its final determination.

7.2

GVIA totally rejects the argument that the introduction of the Water Sharing Plans has increased costs by \$5.4 million, when compared to 2004/05. This is in fact an extraordinary claim as the majority of water sharing plans were introduced on July 1, 2004, and therefore any additional costs associated with them should have been incurred in 2004/05.

It is equally hard to accept State Water's argument that staffing needs to increase by 57 EFT, to effectively provide the same service. State Water's solution of simply increasing staff numbers, shows it has no efficiency drive, and is willing to rest on its monopoly position.

8.

GVIA strongly questions the justification of increasing State Water's capital expenditure level from \$19.9 million in 2006/07, to \$38.6 million in 2007/08. State Water's track record on capital programmes indicates that this level of expenditure is unlikely to be met, even if it can be justified by the significant requirements of the Dam Safety Committee and its compliance regime.

GVIA acknowledges that IPART's draft determination in this area is less than what State Water forecasted, but is still significantly higher than what State Water's history suggests can be achieved.

9.2

As mentioned previously GVIA has serious concerns re the need for a RAB approach, and if used, the level of the opening RAB. If a RAB approach is to be used, the opening RAB should be consistent with the 1997 "line-in-the-sand".

GVIA is also very concerned about how the RAB has been apportioned across valley's and seeks a more detailed explanation from IPART on this matter.

Given the nature of the valley's assets the Gwydir appears to have, proportionally speaking, a very high opening RAB, in particular when compared with the Border Rivers, Murray and Murrumbidgee.

9.3.1

GVIA believes the real pre-tax rate of return, (if this method is applied at all) should be at the lower end of the industry average, given the long-term relatively low risk nature of State Water's business.

9.3.3

While State Water's may be subject to relatively high revenue risk in the short-term, the consistency of long-term average sales actually mitigates the risks faced by State Water. GVIA also strongly rejects that the Water Sharing Plans cap maximum extractions in individual years, and in fact in the Gwydir maximum extraction in particular years has been increased under the Gwydir Regulated River Water Sharing Plan.

10.1

The GVIA endorses IPART's draft determination average consumption figures for the Gwydir Regulated River, and believe they closely correlated with the valley's average consumption over the past 20 years.

GVIA is disappointed that DNR has only supplied IPART with aggregate Barwon Region numbers for groundwater usage and entitlement. GVIA thinks this is an indication of the appalling state of DNR's groundwater entitlement and usage database, and the inadequate service it provides groundwater entitlement holders.

11.2

GVIA is glad that the draft determination makes it explicit that State Water may charge for the extraction of domestic and stock water, but believes IPART should require State Water to charge, or the government make a transparent Community Service Obligation payment, to cover foregone revenue from this source.

11.3

GVIA welcomes the draft determination that DNR should maintain a two-part tariff that varies valley to valley.

11.4

GVIA concurs with the draft determination that State Water should maintain different fixed charges for different classes of water, reflecting their level of security, but DNR should only apply one valley specific level of fixed charge on regulated river entitlement, regardless of security level.

11.4.3

GVIA supports the application of a high security premium, and IPART's draft determination not to apply a multiplier of two to water sharing ratios, but does request an explanation as to how the Gwydir premium was calculated, as the Gwydir Regulated Water Sharing Plan does not contain a conversion ratio. GVIA argues that although the 1.81 ratio is clearly far more acceptable than the 3.5 proposed by State Water, it is still higher than what can be justified and should be in the order of 1.3 to 1.5. If an adequate explanation cannot be provided, GVIA requests that the current ratio of 1.5 be maintained.

11.7

GVIA supports the draft determination that DNR can charge for the extraction of unregulated water by holders of domestic and stock licences, but request IPART either directs DNR to do so, or calculates and applies a transparent Community Service Obligation payment to recoup the foregone revenue.

11.7.1

GVIA believes IPART should direct DNR to expedite its unregulated water-metering program, and move as quickly as possible to a revenue neutral two-part tariff.

11.8.1

GVIA requests IPART reconsider its draft determination to abolish the base groundwater charge.

GVIA believes this charge should be maintained as a revenue neutral charge, because the three charge system, better reflects the cost incurred by DNR. in managing groundwater.

In the Gwydir there is a large number of small entitlement holders, and without the base charge, payments from these entitlement holders will not cover the fixed costs of metering and billing, as well as basic monitoring.

The abolishment of the base charge would result in an unacceptable cross-subsidy by larger entitlement holders to smaller entitlement holders.

GVIA does believe much could be done to reduce these base costs, and if IPART insists on abolishing the fixed charge, then it should instruct DNR to immediately introduce cost saving measures such as self-regulation of metering by entitlement holders. In any event, DNR should be actively pursuing cost reducing actions.

11.11

GVIA supports IPART's draft determination not to introduce uniform DNR charges across valleys.

12.1

For the reasons set out previously, GVIA cannot endorse the proposed price increases put forward by IPART. GVIA does not accept that State Water has justified any real increase, and strongly believes that State Water should be actively pursuing efficiency gains.

GVIA has particular concerns regarding the massive proposed increases in groundwater charges, not only because when coupled with rising extraction costs caused by soaring energy prices, it could well make groundwater use uneconomic, but also because DNR has failed to provide detail information regarding its costs.

In particular GVIA is concerned that metering and billing services has never been contested, and no effort has been made by DNR on the level of service that irrigators would find acceptable.

While appreciating that IPART has proposed a cap on real increases, GVIA believes these caps are unacceptably high, and question how any business can absorb on-going annual real increases of between 15 and 25%.

For a valley that was supposedly at 95% cost recovery at the end of 2005/06, it is very hard to see how IPART can justify a real increase in regulated usage prices from \$3.29 a megalitre in 2005/06 to \$7.04 in 2009/10.

GVIA fully understands that in part this is a result of the positive move to put more weighting on usage, but feels there has been no significant reduction in entitlement charges to compensate for this.

12.6.2

GVIA believes it is unacceptable that IPART has not moved to immediately bring Unregulated River charges in the Gwydir Valley down to cost recovery levels. This decision makes a mockery of valley-by-valley accounting.

12.10

As a general principle, GVIA believes licence fees should reflect the time and resources required to carry-out the transaction, and with that in mind believes the size of an entitlement or pump capacity has very little to do with the effort required.

GVIA also believes that DNR has plenty of scope to improve the efficiencies of the transaction process and therefore drive down costs. Many of the processes are administrative in nature, and should be fully contestable services.

12.11

GVIA total rejects IPART's proposal to increase the maximum charge for processing temporary assignment applications. Until State Water can convincingly prove that more effort is required to transact an application involving a large number of megalitres, than a smaller application, then postage stamp pricing should apply.

However, it is completely unjustifiable for State Water to claim annual costs of approximately \$350,000 to process 1600 applications.

IPART must put State Water on notice to drive down these costs, or make temporary transfer applications a fully contestable service.

13.

As commented on earlier, GVIA can place little emphasis of on supposed cost recovery, as what constitutes full cost recovery is a constantly shifting target.

13.3.1

GVIA is mystified as to why IPART has included comments comparing the bulk delivery price of water, to the price of temporary transferred water, and in doing so implies that because irrigators are prepared to pay a higher price for temporary transferred water, then they should be prepared to pay more in bulk water charges.

There is no linkage between the costs. What an irrigator pays for temporary water can be best compared to as a rent for a capital item, while water charges are the cost of delivering the item.

It would be similar to saying because a person is prepared to pay a higher daily rent on a caravan, he should be able to pay a higher delivery charge to get it to his caravan site.

It is disappointing that such poor analysis and faulty conclusion appears in an IPART document, and it should be removed from the final report.

It is highly disappointing that IPART has not been able to provide valley-by-valley analysis of the impact of the outrageous increases in groundwater charges in the Barown region. GVIA can only assume that it is because DNR's appalling handling of groundwater databases does not allow it to provide that detail to IPART.

However, the Groundwater Tables 13.20 and 13.21 clearly demonstrates the unacceptable impact of doing away with the base charge, leading to massive hikes in costs for larger users subsidising dramatic falls for smaller users.

13.5.2

GVIA is amazed that IPART can factor in costs to allow for dividend payments to the State Government, given its concerns about the financial management and reporting of State Water. In the private sector, no company with State Water's record of inefficiency and poor reporting would make a surplus capable of supporting a shareholder dividend, yet it appears IPART is prepared to award one to State Water through setting higher charges.

GVIA also believes that given the extent that State Water has argued about its revenue and business risk, any surplus made by State Water should be retained by State Water to fund any short-term revenue shortfalls.

GVIA strongly believes that IPART should recommend to government that the shareholders seek no dividend over this determination period. Not only would the payment of dividend make it more difficult for State Water to manage any revenue shortfalls, it would amount to another transfer of wealth from regional NSW to Sydney.

GVIA thanks IPART for providing this opportunity to respond to its draft report, and urges it to take the issues raised seriously when drafting its final report and making its determination.

Yours sincerely

Michael Murray,



CEO,
Gwydir Valley Irrigators Association