SUBMISSION

FOR

REVIEW OF BULK WATER AGENCY PRICES

TO

INDEPENDENT PRICING AND REGULATORY TRIBUNAL

JUNE 2006

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1. Background Information – Western Murray Irrigation Limited (WMI)

Western Murray Irrigation Limited (WMI) is a not for profit unlisted public company limited by shares. WMI shareholders hold an entitlement to approximately 61,000ML of high security water, of which approximately 32,000ML is delivered annually to 360 irrigators within WMI's three irrigation areas of Buronga, Coomealla and Curlwaa. The irrigated area represents 4,290 hectares.

The water is pumped directly from the River Murray via three separate pumping stations and delivered through fully pipelined delivery infrastructures. Each pumping station has its own meter and is supplied water under a bulk water licence arrangement.

WMI also undertakes extensive drainage water management, monitoring and reporting. Drainage schemes in each area ensure removal of hundreds of tonnes of salt each year and prevent drainage water from entering flood plains.

2. Summary of impact of IPART determination on WMI

The maximum prices proposed by the IPART Tribunal represent significant increases in bulk water prices for WMI and its irrigators. Specifically the report has recommended the following in relation to WMI:

- A total real increase in prices of 92% from 2005/06 to 2009/10. In dollar terms this is an increase from $359,000 to $689,000. This represents the largest percentage increase in any irrigation district and for any irrigation corporation;
- The reduction of the bulk water licence discount from 27% to 0% over the next five years;
- Provision of a fixed charge rebate of only $23,000 a year for SWC services WMI provides;
- Imposition of a high security licence premium of a 1.5 charge ratio where it is implied it costs more to store and deliver high security water to WMI. As WMI's entire licence is high security the pricing premium disadvantages WMI against other irrigation corporations;
- An assumption WMI provides no system wide benefits and thus receives no rebate for system wide benefits;
- Cost recovery from WMI of a component of the higher levels of costs attributed to the MDBC (which only relate to the Murray Valley);
- An increase in the cost to temporarily trade water. WMI irrigators' trade up to 25,000ML per year. Based on actual water trade in 2005/06 the existing water trade SWC fees would have been $6,920. With the proposed fees increase to $275 maximum per trade the SWC fees would have been $16,111, a 132% increase. Based on the return to the irrigator the fee will now represent 1.7% of the value of the water trade, an increase from 0.7%.
- The bulk water costs as a percentage of total farm costs based on an average farm, and an average year would be low. The ABARE study used to assess this impact looked at crops (eg. rice) and dairy along the Murray. It did not look at WMI irrigators or provide an assessment for horticulture farms where the crop mix is citrus and wine grapes. The report has not assessed the fact these local industries are in an economic crisis at present and the three to five year outlook is showing little improvement.

The COAG water reform agreement states that provision must be made for community service obligations to those regions where full cost recovery would result in unacceptable community outcomes. The price path must reflect the real impacts on rural water users.

The report states the increase in bulk water costs will have a minor impact on farm profits. Table 13.7 of the report shows a sample bill for a high security customer with 1,000ML and 100% allocation. In 2005/06 the bulk water bill would be $7,475, in 2009/10 the bulk water bill would be $11,619, a total real increase of 55%. A 55% increase represents more than a minor impact on farm profits and when combined with rising on farm fuel, wages, freight and insurance costs price increases have a big impact. WMI states this is an unacceptable community outcome at the present time.

3. Summary of Submission

WMI supports the NSW Irrigators Council submission to the IPART Tribunal.

There are six areas where WMI would like the IPART Tribunal to reconsider its draft determinations. These are:

- imposition of high security licence price premium;
- removal of wholesale discounts and lowering of rebates;
- the 'unconstrained' prices submitted by SWC;
- accountability of SWC and DNR;
- transparency of MDBC costs;
- impact of price increases on WMI irrigators and their ability to pay;
- increase in temporary trade fees.

i) Imposition of a high security licence price premium

WMI's licence is for 100% high security water allocation. In the report at Section 11.4 it states most stakeholders were in favour of a price premium for high security licences. This would reflect the fact much of the water held by these stakeholders is general security.

WMI irrigators are being penalised for the risk management decisions made upon privatisation to ensure irrigators were able to invest in permanent high value horticultural plantings. High security water allows irrigators in WMI to farm with confidence, particularly in years of drought.

The argument for the high security premium is the cost associated with the length of time water is required to be held in storage to deliver high security supplies. On the River Murray the cost of providing high security water costs little if any more to provide. On other rivers provision has to be made to guarantee high security water for future years. This is not so on the River Murray as it is guaranteed by minimum releases from the Snowy Hydro scheme. The original premium which had no financial basis to it recognised the fact that in some years a greater amount of water could be provided but this does not apply now. Water delivery charges for both general and high security water are the same.

In light of this the IPART Tribunal have still concluded high security licence holders receive a higher level of service than general security licence holders in relation to SWC services. The recommendation is a minimum premium of 1.5 should apply. WMI believes a premium should not be imposed at all on the River Murray. If the IPART tribunal imposes a premium a maximum of 1.40 should apply, as general security water also requires storage and appropriate management. The SWC submission for the Murray valley was 1.17 and the water sharing plan 1.40. The Tribunal's recommendations should be lowered from 1.50 to reflect at least the water sharing plan of 1.40. WMI also seek further clarification as to the specific costs of receiving the higher level of service in the Murray valley.

When general security allocations reach 100% there is effectively no difference in the storage and supply of the water. In these years high security water licences will be penalised.

When recent water restrictions were proposed in March 2006 WMI high security irrigators ***were to have their water restricted***. This provides a further argument as to why a high security premium is not relevant for the River Murray.

Imposition of a premium also provides a disincentive for irrigators to convert their general security licence to high security licence.

ii) Removal of wholesale discounts and lowering of rebates

WMI believes that it contributes to the operations of SWC in a positive and timely manner. The rebate calculated for WMI is a fixed amount of $23,000 adjusted annually for CPI. The work performed for SWC includes assisting SWC's management of flows by providing four and seven day advance extraction forecasts, as well as actual daily extraction figures. Recently, water restrictions were a real possibility and data generation and supply needs increased to a point where daily information was provided and weekly phone conferences were held to plan for such an event. WMI as an irrigation corporation simplifies this process through its bulk licence where the company retains all responsibility and costs associated with meter reading and billing of irrigators. WMI also supplies water without any conveyance loss and receives no benefit for being efficient users.

The IPART Tribunal has stated in the report at Section 11.5 that WMI provides no system wide benefits. A system wide benefit is something which reduces SWC's costs of running the overall system. Murray Irrigation Limited is the only irrigation corporation to receive a system wide benefit rebate in the Murray Valley. The report does not clearly define what a system wide benefit is and how they have calculated this for Murray Irrigation Limited.

WMI believes it provides system wide benefits through:

- having water supply systems with no conveyance losses; and
- having state of the art drainage systems which divert all drainage water and thousands of tonnes of salt in each of the three irrigation districts away from the River Murray.

The IPART Tribunal has recommended the removal of discounts in relation to DNR services. WMI strongly argue that the phasing out of bulk discounts should not be used to gain more revenue. The restructured charging system must ensure total revenue is not increased.

In relation to the contribution WMI makes to DNR's operations, WMI operates the Curlwaa Tubewells groundwater interception scheme. This scheme is listed by the MDBC as being "owned and operated by NSW". It is in fact owned and operated by WMI, for which WMI receives no financial return or recognition in relation to the tonnes of salt saved from entering the river and the Morgan EC credits.

In addition, under its licence conditions, WMI also undertakes monitoring of drainage water quality as well as monitoring of groundwater levels in a large area surrounding its area of operations. This is in addition to contributing financially to the monitoring program in the same area undertaken by DNR.

WMI maintains that a 'fee for service' type arrangement for the services it provides would not be fairly administered and licence conditions (which are far more stringent than for private diverters) would be used to force irrigation corporations to perform these activities without compensation. In the report DNR have stated it will enter into appropriate service agreements to cover the cost of providing the information. WMI has been unable to ascertain if these service agreement costs have been included in DNR's budget. Removal of the discounts provides a disincentive for WMI to collect information.

WMI continues to maintain that bulk discounts should be in place as they are in many commercial businesses for their larger customers.

The DNR discount reduction in dollar terms to WMI is outlined in the following table:

	2005/06	2006/07	2007/08	2008/09	2009/10
Percentage	27%	20%	13%	7%	0%
Estimated discount in dollars	$96,280	$71,380	$46,380	$24,880	$0

WMI recommends the IPART Tribunal considers in the first instance to retain the discount and in the second instance to phase out the discount over a longer time frame to reduce the impact on the business and allow DNR time to set up appropriate service agreements.

iii) 'Unconstrained' prices submitted by SWC and DNR

WMI is disappointed by the approach taken by SWC in submitting its pricing proposals, but is relieved to see in the determination that the consultants review recommended the lowering of the original proposed operating and capital costs. SWC have included the employment of 310 full time equivalents in its budget for 2006/07, an increase from 253 full time equivalents in 2004/05. In its first year as a corporation overall costs were $25.7 million. In 2006/07 the costs are estimated at $34.2 million.

WMI believes SWC should be encouraged to streamline its business and achieve real cost reductions over time, rather than producing 'unconstrained' prices and expecting irrigators to absorb the cost of growing inefficiencies within its business.

As an example of what can be achieved is outlined as follows:

- WMI's prices have risen from $44/ML excluding Government charges (for the Coomealla Irrigation area) shortly after privatisation in 1995/96 to $61.68/ML in 2005/06.
- This increase, at a levelised rate of 4% just exceeds inflation.
- The increase has included the introduction of full cost recovery by the implementation of a sinking fund for the full replacement of WMI's infrastructure at the end of its life and an annual repayment for a loan to refurbish the irrigation infrastructure.
- It also includes the cost of WMI's commitments to its Land and Water Management Plan.

This has been achieved by the rationalisation of WMI's business and the commercial attitude taken towards the operation of WMI. WMI is very proud of its financial management and the fact it can keep costs down while providing a quality level of services. Both SWC and DNR should be encouraged to take a similar commercial attitude towards its business.

WMI recognises DNR has just been re-structured with staff redundancies being offered. At the time of the draft determination DNR costs had not been updated for these changes. WMI believes the cost savings from the restructure should be included in the pricing determination.

WMI supports the IPART Tribunal decision not to provide allowance for the SWC in relation to revenue risk associated with differing water usage.

iv) Accountability of SWC and DNR for their expenditure

In 1.4 of the draft report under the heading "moving forward" a number of deficiencies were identified by PB Associates in relation to both SWC and DNR. These include the following:

SWC

- financial systems were not sufficiently developed to provide it with an accurate and robust forecast of costs;
- no demonstration of price service information or customer input being used to determine the appropriate levels of service;
- insufficient linkage between the planned programs, the targets to be achieved, and the associated costs; and
- procedures for assessing non-major capital projects were unclear.

DNR

- inadequate risk-based analysis, including price service negotiations with stakeholders to determine willingness to pay for specified levels of service and timing of the provision of these services;
- insufficient linking of expenditure to obligations; and
- an absence of demonstrated options analysis for the proposed service delivery expenditures, including testing contestability of tasks and services provided.

The IPART Tribunal expects that SWC and DNR will address these concerns prior to the next determination which will be in 2010.

Both SWC and DNR are yet to develop and publish performance indicators and measures so that WMI can monitor delivery against forecast outputs. WMI needs to know what its irrigators are paying for.

The prices are to be increased before measures are put in place which identifies the benefits to customers from the increased expenditure and prices.

WMI remain concerned this expectation will not be met and both authorities should publish their plans and identify the performance standards to raise their accountability by 30 June 2007. The length of the determination period should remain short until SWC and DNR have these in place.

v) MDBC Costs

WMI has ongoing concerns about the transparency of the MDBC costs and the efficiency of the expenditure. As the majority of MDBC costs relate to the Murray Valley, WMI water charges reflect movements in MDBC costs.

In Section 4.2.2. of the report it states "a mechanism should be introduced to adjust SWC prices if there are material differences between forecast and actual audited costs paid by the NSW Government to MDBC". The report does not define what is material and WMI seeks clarification as to when and how a material difference will be recognised.

The IPART Tribunal have stated in the report they are still not confident that actual costs to be paid will reflect forecast amounts. WMI fears these actual amounts will be passed through to irrigators without adequate explanation or justification.

The actual percentage allocation of MDBC costs between users and the Government is not clearly defined. The report states they should be allocated consistent with draft findings on other costs but this could range from 50% to 100%.

vi) Impact of price increases on WMI irrigators and their ability to pay

A specific requirement of the IPART act is to maintain consumer protection. In particular:

- protecting customers from abuse of monopoly power;
- ensuring there are standards of quality, reliability and safety of the services concerned; and
- assessing the social and economic impact of its decisions.

Pricing must exhibit a sense of responsibility towards regional development. At Appendix One a table is included showing the increased price per WMI irrigation area for the determination period.

Abuse of monopoly power

WMI have undertaken an analysis of the increase of charges and have provided as an example the impact on the Buronga Irrigation Area.

Year	*Fixed Charge*	*Percentage of Water Charge**	*Variable Charge per ML*	*Percentage of Water Charge*
2005/2006	$3.88	7.2%	$1.47	2.7%
2006/2007	$4.32	7.7%	$2.74	4.8%
2007/2008	$4.72	8.1%	$3.89	6.7%
2008/2009	$5.04	8.4%	$4.98	8.3%
2009/2010	$5.40	8.7%	$5.98	9.6%

*CPI adjusted based on $54 per ML water charge in Buronga Irrigation Area for 2005/06 year.

WMI does support the move toward recovery of 60% of operating costs through the variable charge. This allows the irrigator some choice and encourages water use efficiency. At the end of the determination period bulk water prices will account for 18% of the water charge using the Buronga irrigation area as an example and will be charged over and above the WMI water charge.

If DNR and SWC were in a competitive market based environment price increases of this magnitude would not be accepted by customers. Benefits associated with the price increases need to be quantified at the irrigator level to allow acceptance of the price rise.

Historically SWC has spent less than the forecast expenditure. WMI requires assurance prices will be not be raised where monies are not expended.

Assessing the social and economic impact of its decisions

The ABARE study commissioned by the IPART tribunal to assess the impact of bulk water price increases on farm profitability **did not** study WMI irrigation farms.

Increasing the prices will have a defined negative economic impact on the WMI region. Each horticultural industry is suffering from poor returns and individual irrigators' profitability is at present marginal. All farming is under extreme cost pressures at present. Increases in government charges are passed directly to the irrigator. The increased water prices will mean there is less capital available for on farm investment and employment. WMI recognises its growers need to be commercial and viable in the longer term but feel it is important for the Tribunal to be aware of the situation in the WMI region at present.

An economic sustainability study into the economic impacts of the downturn in irrigated horticulture was completed in March 2006 by RMCG consultants. The study was commissioned by the Wentworth Shire Council and the Mildura Rural City Council. The following provides a summary of the report:

- The Mildura Horticultural Region, which encompasses the WMI is currently suffering severely depressed wine, dried fruit and citrus prices. These three industries are the core industries for WMI irrigators.
- Incomes in many businesses are expected to be down by more than 30% in the 2005/2006 financial year and the value of production is expected to be down by around $117 million for the region. The average gross value of production is $632 million with the forecast decrease to $515 million accounting for the $117 million decline.

- In extreme cases, such as uncontracted wine grapes, incomes for some individuals could be down by as much as 80% to 90%. It is estimated in the Mildura region 50,000 tonnes of wine grapes have been left unharvested and industry predictions are showing limited industry recovery for the next three to five years. Irrigators with uncontracted wine grapes are facing financial ruin.

- It is estimated that 20% or 600 horticulturists are at risk and if the downturn is sustained 600 job losses may occur off-farm as well.

- Irrigators, as shown by the large proportion of mixed properties, have actively managed risk. This is a successful strategy in managing cyclical prices, but fails when price reductions occur across the board, as in 2006.

Why this downturn is so severe?

A downturn in price of 30% for any one crop is bad enough in itself. It barely leaves enough cash to cover average operating costs, let alone pay interest, depreciation and a wage for the owner. It is compounded because of the breadth of crops affected simultaneously. The traditional risk management strategy of having a mix of crops has proven ineffective against this downturn.

If sustained, this is likely to have flow on effects to other industries, especially those servicing horticulture. Usually a downturn in crop does not affect the region to the same extent.

Horticulturists adapt to other crops and production adjusts to the new market conditions.

In the 2005/06 harvest, citrus, wine and dried fruit are all experiencing downturns.

Irrigators are reluctant to move to table grapes as this industry has a notorious volatility and has only recently recovered from a series of bad years.

Profitable options are missing for most irrigators and this is affecting confidence and depressing property values and equity. Confidence is also likely to be affecting other support industries that rely on irrigator investment and redevelopment.

Profit provides a proper return for capital invested and labour. This is essential to fund renewal and to attract the best for the next generation of professional horticulturists.

Rising input costs and falling returns (declining terms of trade) along with the cyclical nature of prices are facts of life in agriculture and irrigators have adapted to this by increasing efficiency, improving yields, adding value and expanding to achieve economics of scale.

When terms of trade decline gradually or are confined to one crop then this can be managed. Irrigators respond by investing capital in expansion and new technology to remain competitive.

In 2006, across the board price reductions are resulting in declining property values and high operating losses. This means that access to capital becomes difficult even for the most viable of businesses.

Addressing this problem is fundamental to the WMI region's recovery. The increase in bulk water prices needs to take into account the need for the irrigators and industries to recover to profitable levels.

vii) Increase in temporary trade fees

The National Water Initiative is supporting removal of barriers to trade. Increasing the maximum SWC fee to apply for a water trade from $75 to $275 could be perceived to be a barrier. WMI irrigators conduct a significant amount of annual temporary trades and water trade income forms a part of the farming business in this area. WMI recommends the IPART tribunal phase in a lesser increase of the fee over three years and ask SWC to make the process more efficient to contain their costs.

Appendix One – IPART Tribunal proposed price increases per WMI irrigation area during the determination period

Irrigation Area Charge per ML*	2005/06	2006/07	% increase on previous year	2007/08	% increase on previous year	2008/09	% increase on previous year	2009/10	% increase on previous year
Buronga Fixed Variable	 $3.88 $1.47	 $4.32 $2.74	 11.3% 86.4%	 $4.72 $3.89	 9.2% 41.9%	 $5.04 $4.98	 6.7% 28.0%	 $5.40 $5.98	 5.4% 5.98%
Coomealla Fixed Variable	 $3.88 $1.49	 $4.32 $2.74	 11.3% 83.9%	 $4.72 $3.95	 9.2% 44.2%	 $5.04 $5.05	 6.7% 27.8%	 $5.40 $6.07	 5.4% 6.1%
Curlwaa Fixed Variable	 $4.00 $1.45	 $4.44 $2.71	 11.0% 86.8%	 $4.84 $3.85	 9.0% 42.0%	 $5.16 $4.91	 6.6% 27.5%	 $5.56 $5.91	 5.6% 5.9%

*** The prices shown take into account the wholesale discount and the fixed annual rebate adjusted for CPI.**