JEMALONG IRRIGATION LTD

BULK WATER PRICES FOR 2006/07 – 2008/09

SUBMISSION TO IPART

1 Introduction

Jemalong Irrigation Limited (JIL) is an unlisted private company responsible for managing the privatised Jemalong Irrigation District on the Lachlan River. The company has licensed entitlements of 100,000 ML (including our conveyance access licence), which account for approximately 15% of the total licensed entitlement on the Lachlan River. JIL delivers water to 158 holdings over an area of 96,000 ha, and in an average year diverts around 60,000 ML/year. This long term average is based on the last ten years and includes the last four years of an exceptional drought.

2 Support for Lachlan Valley Water and NSWIC Submissions

JIL shareholders also belong to our industry bodies, Lachlan Valley Water and NSW Irrigators Council (NSWIC). JIL endorses the submissions to IPART by both Lachlan Valley Water and NSWIC but have reserved the right to present our own view on Wholesale Discounts.

This submission builds on our April 2005 submission and reinforces the points made there. Our submission addresses Wholesale Discounts in detail and emphasises our concerns regarding other key issues covered in the LVW and NSWIC submissions.

3 Wholesale Discounts

Both State Water Corporation (SWC) and DNR have proposed that the wholesale discounts be removed, and that any services provided by Irrigation Corporations to either SWC or DNR be managed through a fee-for-service agreement.

3.1 SWC Water Delivery Charges

In terms of delivery services, SWC claims that it costs the same to supply a 10 ML order to a river pumper as it costs to supply 1,000 ML to an irrigation company. The issue however, is not the volume of water supplied but the fact that JIL allows SWC to deal with one company and one order rather than 150 individual irrigators, all of whom would otherwise lodge individual orders, and who have 426 water outlets or individual metering points.

SWC argues that its responsibility for delivery ends at the river diversion point, and it views JIL as one customer with one licence, rather than an aggregation of separate customers. This is at odds with DNR's 2005 submission (p33) which notes that at privatisation it was

acknowledged "wholesale irrigation customers defrayed some of DLWC's costs by aggregating water orders and undertaking metering and billing functions on its behalf." IPART also accepted the aggregation function of irrigation corporations in its 1998 determination which found savings are likely in delivering water to an irrigation district compared with a river pumper because "the district aggregates water orders, billing and all interactions with DLWC."

Those savings still exist and in our April 2005 submission we estimated the additional costs SWC would incur in servicing water users in the Jemalong district if JIL did not exist. JIL does not consider the position has changed and we restate that section of our submission below:

- ***"Collecting water demand and usage information.*** *As noted in the State Water submission, until the irrigation district was privatised DLWC had been responsible for delivering water to the farm boundary. They employed 15 staff to manage the Jemalong District, of which two staff members were largely occupied with collecting water demand and usage information. At current State Water staffing levels collecting this information from the 158 holdings in Jemalong would be the equivalent of one extra full-time position for a Customer Service Officer, given that State Water currently employs 5 Customer Service Officers to collect water demand and usage information, process transfers and manage compliance for 850 surface water licences in the Lachlan.*

- ***Managing flow distribution down channels.*** *Part of the function of reading meters and collecting usage information is to manage both distribution to individual holdings and flow distribution down channels.*

- ***Communicating with licence holders.*** *JIL handles all communication of State Water information to its shareholders. This includes both written communication and face to face contact, including arranging meetings with shareholders for State Water and DIPNR. 15% of the total licensed entitlements on the Lachlan can be handled through one point of contact.*

Overall JIL saves the cost of two staff members (including travel) for State Water. Estimated cost saving is $120,000, or $1.20/ML entitlement."
Jemalong Irrigation Ltd, submission to IPART, April 2005.

We also point out that JIL has installed a state-of-the-art AFFRA meter at its river offtake and is able to provide SWC with high quality information on diversions accurate to within $\pm$ 4% thereby minimising the cost to SWC of servicing a customer responsible for 20% of the diversions within the Lachlan. SWC agreed this was an improvement on the previous meter used at the Jemalong Weir.

3.2 DNR Water Resource Management (WRM) Costs

JIL is required to provide monitoring data to DNR as a condition of our Land and Water Management Plan (LWMP).

DNR maintains that the type of WRM activities undertaken by Irrigation Corporations do not materially offset their (DNR's) water resource management costs. This is a surprising claim, given the range of activities DNR now seeks to include in its WRM activities profile.

JIL collects data on a range of environmental criteria and reports annually through our Environmental Report. While this is a condition of our Pollution Control Licence, it adds value to a number of Government environmental management and WRM programs.

The Government retains a responsibility for and an interest in JIL through the LWMP and JIL pays extensive costs for the LWMP through contributions and licence fees. The information that JIL collects makes a clear contribution to the following DNR activities:

JIL Data Collection	**DNR WRM Activity**
Water quality monitoring	C01-03 Surface water quality monitoring
Groundwater monitoring	C02-02 Groundwater quality monitoring
Crop and water use data	C05-03 Water balances/accounting C06-05 System operation rules C06-06 Monitoring & reporting C07-11 NRC reviews and support
Wetland monitoring data	C07-10 NSW wetland policy implementation

Due to the lack of cost detail provided in DNR's submission we find it difficult to assess their claim that irrigation corporations' WRM activities do not materially contribute to DNR's WRM costs. We have estimated that data collection and reporting undertaken by JIL requires 0.5 FTE, equivalent to a $40,000 cost saving for DNR.

Recommendation

JIL recommends that the cost savings to SWC and DNR, on bulk water delivery and WRM functions respectively, justify the continuation of the 27% wholesale discount on the entitlement charge.

4 Jemalong Weir Costs

In its 2004 submission SWC proposed that the cost of operating Jemalong Weir be included in the total valley operating costs, rather than JIL being responsible for 92% of costs as is currently the case. While it is not specifically mentioned in SWC's 2005 submission, SWC has confirmed their proposal is to socialise the cost across the whole valley.

In that case we reiterate the concerns from our previous submission about weir maintenance costs. While JIL has been responsible for 92% of costs since privatisation, SWC has decided what maintenance is required and JIL has had no option but to pay for the works program determined by SWC. SWC (and DLWC before that) had an obligation to inform JIL of the proposed program and establish an approved works program. The actual costs JIL has been required to pay have been grossly over budget - a budget that was established at privatisation by the then DLWC, who had been managing the weir for years and should have been well aware of the reasonable maintenance requirements. This broke the original agreement and the costs have never been agreed to by the JIL Board. We believe it is appropriate that this be recognised now by IPART and that an adjustment be determined.

Recommendation
That the overcharging for Jemalong Weir maintenance borne by JIL be recognised, and an adjustment determined.

5 Efficient Costs

SWC Operating Expenditure

SWC is projecting a $1.5 million, or 50%, increase in its operating costs for the Lachlan in 2005/06 and 2006/07 compared with the average for 2001/02 to 2003/04. SWC maintains it was "starved of funds by its previous controlling entities" (p74) and that revenue in 2003/04 was $6 million below budget due to the drought and Departmental constraints (p77). SWC also states that the 2001-2004 levels of expenditure were unsustainable and were only possible by deferring maintenance and other expenditure. With regard to the revenue shortfall due to drought, we point out SWC's response to the revenue shortfall is nothing more than would be expected from any prudent business manager, and no different to the measures JIL took to survive through 3 years with no water. SWC needs to have the flexibility to respond to these crisis situations.

However, with regard to the constraints imposed on SWC as a result of DIPNR not fully funding the required budget, SWC and its customers should not be disadvantaged by that, and any shortfall in the funds that were allocated to SWC but not transferred over by DIPNR should now be paid by Government.

IPART determined in August 2005 that the Lachlan was already at around 110% of full efficient cost recovery at 2004/05 prices and yet SWC now wants to move the goal posts again and increase costs by a further $1 million. This constant redefinition of what constitutes "efficient costs" epitomises an organisation in a monopoly pricing position rather than one operating under the discipline of the market.

JIL does not consider the projected 2006/07 figures are an efficient level of operating costs and have highlighted several factors causing the blow out in costs:

- **increased costs of corporatisation.** In 2004 SWC estimated $2.7 million additional costs, one year later that has increased threefold to $8.2 million. SWC's submission (p 98) makes it clear neither State Water nor the consultants advising Government on corporatisation knew the true cost of operating State Water because of the poor standard of financial information available to the State Water business unit within DIPNR, and because of DIPNR's own internal management policies. Water users should not be paying for the previous underfunding of State Water by DIPNR (p77 - 78 SWC submission) or for the fact that State Water was not "business ready" for corporatisation. Government had a responsibility to remedy these shortcomings prior to corporatisation and to establish SWC as a going concern rather than simply transfer the problem 'off the books' and into State Water Corporation.

- **lack of cost control.** We supported the corporatisation of State Water partly because we expected efficiency gains in the operation of SWC, similar to the gains that JIL and other Irrigation Corporations made post-privatisation. However, the 2006/07 projected costs make it clear that SWC is not striving for efficiency gains, but instead exhibiting monopoly pricing behaviour.

It was difficult to compare past costs with projected because of the change in cost classification and codes, and SWC maintains they are not directly comparable, but there are two areas with significant increases which illustrate our concerns that SWC is not achieving efficient operating costs:

New Product Code	**Old Sub-product code**	**Increase**
2120. Hydrometric monitoring. 2006/07 cost $670,000.	PA 100 Quantity data collection. 2003/04 cost $219,000	$451,000
3130 & 3140. Dam safety & Preventative maintenance 2006/07 cost $2,241,000	PC 410 - PC 423 2003/04 cost $1,427,000	$814,000

SWC has explained that in the past DNR did not meet service standards for hydrometric services or pass on full costs, but where the costs in other valleys have increased by 50-100%, the Lachlan's increase is 300%, and there is no explanation for this. With regard to Products 3130 Dam Safety and 3140 Preventative Maintenance, if these items haven't been properly funded prior to corporatisation, then there is an obligation for Government to fully fund the shortfall rather than transfer that liability for deferred or inadequately funded maintenance to irrigators.

- An area with potential for efficiency gains is the **level of service**. We see this as being about the most economic way to get the outcomes rather than merely about "service". 45% of SWC's direct costs (rising to 60% with on-costs) are employment related costs, yet SWC is planning to increase numbers by 20% to fill vacant positions. Staff should not be put under unreasonable workloads, but there is little evidence that SWC has looked critically at its business and considered how technology and an innovative approach could be used to increase productivity and reduce costs.

  It is possible to undertake this type of review and reduce costs. JIL has been through enormous pain and restructuring as a result of the drought. Staff numbers have been reduced from 7 to 3 over the last 4 years, and overall operating costs have been reduced accordingly. For JIL to be subjected to huge cost increases because there is no flexibility within SWC would be grossly unfair and go a considerable way to undoing JIL's hard won savings. We accept entirely the need to maintain core staff but the central issue is to manage the business effectively.

Summary

SWC's objectives include *"to operate at least as efficiently as any comparable business"*. Clearly there are differences between JIL and State Water, but our experience since privatisation tells us that SWC's projected costs do not represent efficient operating costs and there is scope for efficiency gains. This is supported by the Marsden Jacobs report, which also found that SWC's forecast costs for 2005/06 to 2008/09 did not represent efficient costs.

"No material change in function, obligation or service standards, post 2003/04 or the next regulatory period, was identified that justified an increase in total Opex costs in State Water's forecasts."

Executive Summary, Marsden Jacobs Associates Report to IPART, 2005.

JIL considers that State Water's projected 2006/07 operating costs do not represent efficient costs and that there is scope for further efficiency gains.

6 Usage Base for Pricing

JIL strongly supports the Lachlan Valley Water submission. Basing the usage price on diversions of 1 standard deviation below average is very conservative because the WSP IQQM model already factors in climatic variation over 100 years and the imposition of the Use Limit to keep usage below the MDBC Cap. Based on 2006/07 costs, and recovering 50% of costs from usage charges, we calculate the effect of assuming usage at one standard deviation below long term average diversions is:

50% of total 2006/07 costs = $2,867,500.	At 198,952 ML usage price is	$14.41
	At 305,000 ML, usage price is	$ 9.40
	Difference	$ 5.01/ML

This is a huge impost on customers and will severely disadvantage our shareholders. In an average usage year where we divert 60,000 ML, JIL shareholders would pay an extra $300,000 to SWC basically as a risk management premium.

We accept that SWC must manage the risk of variations in use and recommend they base usage pricing on average modelled diversions. In years where usage is higher than average SWC can invest the over-recovery to fund the years when usage drops below average.

JIL recommends that the usage charge for the Lachlan be based on average modelled diversions.

7 SWC Capital Costs

JIL endorses the need for SWC to be able to fund capital expenditure in a flexible, cost-effective manner and accepts that debt funding meets these requirements. However, we are concerned that SWC's proposal to adopt an RAB of $300 million as at 1/07/04 ignores the 1997 'line in the sand' and is once again shifting the goal posts without justification.

Pre-1997 assets have previously been excluded from the asset base for pricing purposes by IPART. If SWC's post-1997 asset base is unable to generate the required income to fund its capital expenditure program and provide a return to government, that reinforces our concerns that State Water was simply not ready for corporatisation in its current state and is unable to meet the proposed timeframes for its capital expenditure program and achieving full cost recovery.

SWC's proposal to charge a WACC of 7% appears to be another instance where SWC wants to operate as a commercial entity when it comes to price but is not prepared to accept commercial discipline in terms of managing its own risk by any means other than passing on the cost, which reflects its monopoly position.

A high rate of return would be expected either where a company is high risk or where it is outperforming. We don't believe either factor applies to SWC. Despite SWC's claims about revenue risk, 50% of its income is absolutely guaranteed through fixed charges, and the tendency will be for the Lachlan valley to use close to the Plan limit whenever that water is available because the valley had actually developed to the stage where it was using about 20% more than the Plan limit prior to the drought. In our view SWC is still adjusting to the challenge of operating commercially as a state owned corporation and is not outperforming other water delivery businesses.

Recommendations
JIL recommends that the opening value of the RAB should reflect IPART's pricing principle that no rate of return is payable on pre-1997 assets.

That the WACC be set no higher than 5%.

8 Cost Shares

Water Sharing Plans enshrine the rights of the environment to water in quantitative terms in a way that tells the government and the community the environment's share of the total resource both in measured flows and in other non-measured water reserved from extraction. The water shares and flow distribution rules specified in the Water Sharing Plans mean that the riverine environment, basic rights holders, recreational users and licence holders all have requirements for water management and delivery services from SWC. However, currently all those service requirements are being paid for by one group only, the licence holders.

The implementation of the WSP's has increased SWC's workload and costs (p 78 SWC submission). SWC is required to undertake work to actively ensure environmental and basic rights requirements are met rather than merely ensure the supply of water to extractive users does not negatively impact on the ability of the environment and basic rights holders to receive water. All users of SWC services should therefore be identified and the costs of meeting their service requirements recovered from those users. That will ensure services are provided at efficient cost levels and assist SWC to meet its objective of "operating at least as efficiently as any other comparable business".

SWC's submission (p 108) lists some pricing principles but doesn't reconcile the conflicting positions and ends by recommending full cost recovery of bulk water delivery costs from customers, ie, water access licence holders. In that case the bulk water delivery costs should not include the additional costs SWC refers to on page 78 of their submission, and these should be recovered from other users, or alternatively government on behalf of the wider community.

The cost of meeting basic rights requirements is particularly high under drought conditions such as the Lachlan has endured for the last 4 years, where virtually no water was supplied to extractive users (18,000 ML out of 136,000 ML flow in 2004/05) but the full costs of running the river to also meet basic rights delivery are being charged to extractive users This is both inequitable and inefficient.

Recommendations
That SWC recover costs from the full range of users of their services in proportion to the users requirement for service. Where it is not possible to recover costs directly from users they should be covered by a Community Service Obligation.

The delivery of basic rights should be defined by a Community Service Obligation, and the costs borne by government.

9 DNR Water Resource Management (WRM) Costs

DNR's submission makes an ambit claim to redefine almost every water related function performed by DNR as an WRM function, even those clearly related to statutory obligations or formulation and implementation of Government policy, for example:

C07-03 Development of statutory drainage plans
C07-04 Development and refinement of policies and plans for floodplains
C07-07 Revision and implementation of state water savings policy planning
C07-10 NSW wetland policy implementation
C07-13 River health and water quality plans, including unsolicited advice, community campaigns.

DNR's interpretation of the NWI ignores the fact that government constructed dams to promote a range of economic and social policy goals, and irrigators responded to the government's initiative through developing an irrigation industry. Through the mechanism of Water Sharing Plans Government now wants to ensure its dams and associated infrastructure don't cause unwanted impacts on the environment. There is a clear legacy effect and Government must bear the cost of addressing these third party impacts created as a result of previous policy decisions. Irrigators did not sign up, either through their water access licences or through Water Sharing Plans, to take responsibility for these impacts.

DNR appears to be exploiting the captive position of irrigators who have no option but to pay for a service to try and redefine its core business as WRM functions. We reject this and support the retention of IPART's definition of WRM activities as those "*where the benefits to extractive users are insufficient on their own to justify the costs of the activities.*"

With regard to cost shares for WRM costs, JIL supports the user pays approach, similar to that advocated for SWC services. We ask that IPART identify the beneficiaries of DNR's WRM activities and apportion costs relative to the benefit received.

Recommendation
That DNR's WRM activities be defined as those "where the benefits to extractive users are insufficient on their own to justify the costs of the activities."

JIL recommends the user pays principle be applied to DNR WRM costs.