

HIGH SECURITY IRRIGATORS- MURRUMBIDGEE

SUBMISSION ON NSW STATE WATER'S 2010-2014 PRICE DETERMINATION

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The Organisation

High Security Irrigators- Murrumbidgee (HSI-M) is a new organisation formed from the former Murrumbidgee Horticulture Council. Changes were made to allow the organisation to more accurately represent all high security irrigators in the Murrumbidgee valley. Membership is open to individual irrigators, multiple licence holders operating as a single farming unit, corporate holders of high security entitlements, industry bodies and community members. The latter two being classed as associate members that do not have voting rights. HSI is a member of the Irrigators Council of NSW and agrees with the points that the council has made in its submission on State Water's proposed charges for 2011-2014. We do however wish to comment on issues that we feel directly affect High Security users in the Murrumbidgee.

State Water's Financial Position

In looking at the position that State Water's submission shows in chapter 2, it would appear that despite the drought, State Water have managed to make a profit for each year during the last determination period. In table 2.3 Regulated EBIT has been positive rising from 0.5M in 06/07 to 7.7M in 09/10 and showing a positive rate of return on assets. This position would be envied by many of their customers.

Additional Thematic Expenditure

HSI-M does not believe that all the additional expenditure listed on page 3-11 of the State Water submission is applicable and payable to and by irrigators. The EMP plan has been developed as part of the compliance requirements forced on State Water by both State and Commonwealth Government Acts and as such should be funded by the Government not users.

Land management as listed in the submission would seem to be purely commercial in nature and certainly should not be an activity charged to irrigators. As a prudent land manager State Water should be looking to maximise the returns on the land under it's' control as a normal business practice.

Emergency and security planning is a public responsibility and as such should be funded from the public purse.

The activities listed as corporate are internal and part of normal business practices and therefore should be funded as such and not as additional expenditure sought from users.

Capital Expenditure

HSI-M has some difficulty understanding the accounting practices used in determining how the figures for revenue required have been arrived at. There is no amount recorded for disposal of assets, even small ones such as plant and equipment, which would seem unusual for such a large organisation. The indexation figure on tables 5.1 and 5.2 really should be recorded as income and not as an increase in the value of a depreciated asset. Normal accounting practice for taxation purposes would suggest that once an asset has been depreciated it cannot be re-valued upwards each year. One could also question the prudence of a major capital expenditure program when as acknowledged in the submission, the inability of State Water to feel secure in its' future forecast income and yet such a program is still proposed. In private enterprise when one is under financial pressure the normal practise is to defer major spending until the outlook has improved.

Appropriate Level of WACC

It is clear in State Water's Submission that they wish to increase the rate of WACC to address, as that organisation sees it, their risk factor. HSI-M contends that the current level of WACC should not be altered because the organisation has come through the worst drought on record and has still managed to return a profit on its' operations. Therefore it would be inappropriate to increase the WACC as there appears to be no change in the level of risk

Appropriate Length for the 2010 Determination Period

HSI-M believes that a four year period for the next determination is the right length of time. This would allow continuity in length of each of the pricing determination making it easier for all parties to be able to compare each of the pricing periods in an open and transparent manner.

Consumption Forecasts

HSI-M fails to see why State Water should move away from the IQQM method of forecasting water availability just because current climatic conditions do not suit their budgetary expectations. On page 9-2 of State Water's submission the third dot point states: "Historical records adjusted for climate change and assessed through IQQM models will continue to be the basis for the longer term water resource planning, however for the purposes of predicting likely revenue of the next four years using the dry sequence of the last 15 years will reduce the risks of under-recovery in the event that the dry sequence continues". This is a clear bid by State Water to bolster their bottom line at the expense of water users who have no way of being able to insulate themselves from the same dry conditions.

Balance between Fixed and Variable Charges

HSI-M supports the continued split of 40%-60% ratio of fixed to variable charges. An attempt by State Water to shift more of their costs to the fixed side of the ratio is in our opinion a blatant bid to insulate them from any risk associated with continued drought conditions. This move would run contrary to one of the objectives stated in the State Water Corporation Act, "To exhibit a sense of social responsibility by having regard to the interests of the community in which it operates". Clearly a move by State Water to go to a 90/10 % fixed/variable pricing regime would be socially irresponsible as all water users are struggling under reduced water availability.

Impact of State Water's Proposed Prices on High Security Users

The effect of large percentage increases to high security users would of course be unpopular in the extreme. The wine industry is currently facing hard times with the world economic decline and huge over supply problems estimated by some industry sources to be in the vicinity of 400000 tonnes or approximately 25% of current production. This could see many growers exit the industry. The citrus industry while appearing to be holding its own, is at the mercy of a fickle exchange rate and with little competition in the domestic market for its products because of the dominance of the two major supermarket chains, would appear to be finely balanced. Dried fruit has experienced a poor production season this year resulting in reduced incomes. The vegetable industry like the citrus industry while appearing outwardly to be doing reasonably well, is also being squeezed on payment terms by the two major supermarket chains. Only the nut and olive industries appear to be experiencing anything like positive outcomes. With all of these industries the uncertainty of water supply is causing great concern. Recently Murrumbidgee Irrigation has announced increases in their charges for season 2009-10 of 5-10% depending upon where one is in the system. Thus any further increase in water charges by State Water would impose severe hardship to most horticulture industries.

Ability to Pay- RMCG Study

In the study undertaken by RMCG commissioned by State Water to analyse the ability of their customers to absorb higher bulk water charges, many of the points made in the study have selectively been ignored in the submission made to IPART. The basis of the report uses data from ABARE taken from the 2006-07 and RMCG make the point that in the absence of more up to date figures, the ensuing years that make up the bulk of the last determination period from 2006-07 to 2009-10 "it is more likely overall farm financial performance would have remained weak" during that period. The report also shows that the Return on Capital (ROC) for most farming enterprises is less than State Water achieves on its assets.

When the report comes to the Murrumbidgee Valley the effect on high security water users is skewed by averaging the reduction in fixed price that general security users receive -26% over the total general entitlement of 2,264,065ML against the 36% increase that high security have on the

total of 436,928ML. Thus the resultant average fall in fixed charges has been eagerly seized on by State Water to show a positive effect for the whole valley.

One of the conclusions the report comes to is that because the increases that are proposed by State Water are relatively small the overall effect will be minimal. However added to other "relatively small" increases in the cost of fuel, fertiliser, repairs and maintenance, interest rates, insurance and labour the overall effect is significant, particularly as most horticultural commodities are experiencing falling prices.

Impact of Water Markets on Customer Ability to Pay

State Water in its submission infers that high security entitlement holders are able to benefit more from higher prices on the temporary water market than general security entitlement holders in times of drought and therefore should pay more for their entitlement. The fact is that the market does not reflect this. Out of the 224,000ML traded in the Murrumbidgee Valley during the 2008-09 season, only 15-25% were high security entitlements, clearly demonstrating that benefits from high water prices on the spot market were equally shared by all entitlement holders. Thus the argument that high security entitlement holders should pay more for the privilege of participating in water markets is false.

Scarcity Pricing

HSI-M rejects the notion that high security entitlement holders should be hit with an additional scarcity charge. The access premium that is already charged reflects the relative value of water between high and general security entitlements and is based on the already agreed water sharing plan. The proposed new charge is based on the fifteen year rolling average that has been rejected already under the section on consumption forecasts. This new charge should be viewed as a blatant attempt to bolster State Water coffers on users that are perceived to be able to afford it.

Balance between High and General Security Charges

Under the previous pricing structure the differential between general security and high security in the Murrumbidgee Valley was approximately 60%, (general security being 60% of the price of high security water) under the scenario in State Water's submission the differential is now a factor of three (high security is 300% the price of general security). It is clear from State Water's submission that the proposed scarcity charge has already been applied to these prices. While the proposed charges for high security users in the Murrumbidgee Valley is a "modest" 36% increase other valleys have had proposed increases of up to 1241%, an increase that is impossible to justify under any circumstance. For this reason HSI-M rejects this methodology as being flawed because many of the arguments put forward in the submission are factual incorrect. For example (the demand for the high number of conversions of general to high security) in the State Water submission the reason given is the attractiveness of the conversion factor, HSI-M contends that the reason is more

the number of permanent plantings made recently with only general security entitlement that were facing the prospect of total loss in the ongoing drought and a Government that bowed to political pressure to allow such conversions.

Translating User's Share of Revenue Requirement into Prices

HSI-M would favour the glide path modelling approach to be applied to any price increases that may occur over the next pricing period. We believe this to be the most acceptable to high security users especially if charges are increased to the level that State Water would like. The only alternative HSI would consider is the P-nought modelling approach as long as the initial price rise is not too large.

Rebates for Irrigation Companies and Districts

HSI supports the continued payments of rebates to ICDs as we contend that nothing has changed in relation to these rebate payments since the 2006 Determination for all the reasons that were outlined in that submission.