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Mr J Cox
Chairman, IPART
PO Box Q290
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SYDNEY NSW 1230

Dear Mr Cox,

Re: Review of Bulk Water Prices 2005

Thank you for the opportunity to provide input to the current water pricing process. Our submission is attached and we would welcome the opportunity to attend a hearing and speak to our submission.

Please do not hesitate to contact me if you have any questions relating to it.

Yours sincerely

Ted Morgan
Chairman

JEMALONG IRRIGATION LTD

BULK WATER PRICES FOR 2005/06

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, accounting 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 80,000 ML/year.

2 Support for Lachlan Valley Water and NSWIC Submissions

JIL shareholders are members of their valley based industry organisation, Lachlan Valley Water, and are represented at the state level by NSW Irrigators Council (NSWIC). JIL endorses the submissions to IPART by both Lachlan Valley Water and NSWIC in all aspects except the sections on Wholesale Discounts and the Jemalong Weir Costs.

Our submission addresses Wholesale Discounts and Jemalong Weir Costs in detail and provides supporting comment on other aspects of bulk water pricing.

3 Wholesale Discounts

The IPART Issues Paper requested comment on:

- whether wholesale discounts are still appropriate
- if so, what level of discount is appropriate

3.1 Discount on Water Delivery

In 1997 the Tribunal found there were cost savings for DLWC in delivering water to an irrigation district compared with delivering to a river pumper, and in 2001 IPART accepted DLWC's proposal to retain the discounts, partly because adequate information to evaluate the discounts was not available.

The current value of the discount at 2003/04 prices is \$129,000.

State Water now claims that the cost savings on delivery of bulk water no longer exist and advances a number of arguments about why the discount is not justified, including State

Water's perspective that each corporation is a single customer with a single entitlement, rather than an aggregation of separate customers.

We accept that JIL holds a single licence, but State Water overlooks the fact that part of the whole privatisation process was that it freed DLWC from having to manage 160 separate licences. It was clearly understood there was a cost saving for Government as a result, and State Water cannot now refuse to recognise part of the rationale for privatisation.

Similarly, State Water takes the view that management of water within the Corporations' areas of operation is their core business, but doesn't acknowledge that the existence of the Corporations reduces State Water's costs.

To evaluate whether the discount can be substantiated we have considered what costs State Water would incur in servicing water users in the Jemalong district if JIL did not exist:

- **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.

In addition to the above direct savings related to servicing irrigators in the Jemalong district, JIL regularly provides assistance to State Water on operational matters on an informal basis. JIL staff check readings or other matters at Jemalong Weir on request when staff at Dubbo or Forbes require an on-site check to confirm automated data recording.

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.

3.2 Discount on Water Resource Management (WRM) Costs

DIPNR maintains that Irrigation Corporations do not supply DIPNR with information that supports the WRM function, nor do their operational activities provide any WRM benefit to DIPNR. However, we believe this is not an accurate representation of the functions undertaken by JIL.

JIL collects data and reports on a range of environmental and land use information in its annual Environmental Report. While this is a condition of JIL's Pollution Control Licence, the information provides value to WRM functions of Government agencies as follows:

- JIL's compliance with the reporting requirements, and the information provided, assists DIPNR to fulfil its objectives as a regulator
- some of the information is used by DIPNR for WRM purposes and by other agencies in a range of water related functions, eg,
 - crop and water use data is used as an input to DIPNR's IQQM modelling, which provides input for DIPNR's PD1 Surface Water Allocation Strategies, as well as MDBC Cap and WSP Plan Limit compliance purposes
 - wetland monitoring data contributes to DIPNR's PD6 Wetland Strategies
 - groundwater monitoring data can be used by DIPNR's Salt Action program and PD5 Groundwater Management Strategies
- Some of the information gathered by JIL is collected as a Government function in other situations, eg water quality data and wetland monitoring, therefore providing a cost saving to Government.

The operations of JIL provide DIPNR with a range of information that supports DIPNR's regulatory and WRM functions. We estimate that data collection and reporting requires half a full time staff position, equivalent to \$40,000.

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

4 Jemalong Weir Costs

Currently JIL is responsible for 92% of the Jemalong Weir costs and the rest of the river is responsible for 8%. State Water proposes to include the total cost in the valley pricing, resulting in JIL being responsible for approximately 15% of the weir costs as it holds approximately 15% of total licensed entitlement.

Unfortunately State Water's submission does not contain enough detailed information for us to fully assess this proposal. However, while State Water's proposal is a benefit to JIL, and under the current drought conditions 15% is probably a fair representation of the utilisation JIL gains from the weir, we are conscious that when more water is available the weir is used more often to manage supply for JIL and less for the benefit of the rest of the river.

Over the long term we consider that JIL paying 30% of the Jemalong Weir costs would be a fair reflection of the utilisation JIL gains from the weir.

In light of this proposal and in consideration of the amount that JIL has paid to State Water over the last 10 years for weir maintenance we believe JIL has been paying more than their share of weir maintenance. Not only has JIL been paying a disproportionate share, the actual costs for which JIL has been charged have been over budget. We believe it is appropriate that this be recognised now by IPART and that an adjustment be determined.

There should be recognition of the disproportionate share of Jemalong Weir maintenance borne by JIL, and an adjustment determined.

5 Efficient Costs

5.1 State Water's Operating Expenditure

Our analysis of State Water's projected operating costs indicates a 60% (\$1,800,000) increase for the Lachlan from 2003/04 to 2005/06. Based on JIL's experience managing Jemalong Irrigation District over the last 10 years we would not expect in our own operation to increase operating expenses by 60% over a 2 year period without a corresponding increase in service levels. Consequently we do not consider State Water's projected 2005/06 operating costs represent an efficient level of costs.

We supported the corporatisation of State Water in part because we anticipated this would lead to efficiency gains in the operation of State Water, similar to the gains that JIL and other Irrigation Corporations were able to achieve on privatisation. However, it is clear from State Water's pricing proposal that corporatisation has not encouraged any progress towards efficiency gains, and State Water is instead exhibiting monopoly pricing behaviour.

The State Water Corporation Act identifies a number of objectives for State Water, including "to operate at least as efficiently as any comparable business". While we accept that there are differences between Irrigation Corporations and State Water, JIL's experience in driving efficiency gains and controlling costs indicates to us that there is scope for efficiency gains in State Water's current operations.

State Water, in its pricing submission, is attempting to minimise its risk by recovering 60% of costs through fixed charges, and by moving to the building block approach. An unfortunate outcome of this is that it provides no incentive to achieve efficiency gains.

JIL considers that State Water's projected 2005/06 operating costs do not represent efficient costs and that there is scope for further efficiency gains.

5.2 Capital Expenditure on Long Lived Assets

5.2.1 Regulatory Asset Base (RAB) Proposal

State Water proposes a significant change from annuity funding to a 'building block' approach involving a rate of return on the Regulatory Asset Base. We have a number of concerns whether this approach is the most appropriate funding mechanism:

- the building block approach, where revenue is not related to the expected future capital expenditure, does not provide the financial discipline that the annuity approach does by funding only identified future capital costs.
- State Water's proposal to set an RAB of \$300 million is a clear departure from the pre-1997 'line in the sand' previously set and reaffirmed by IPART. We do not support State Water seeking a rate of return on pre-1997 assets when the principle has already been well-established that those assets were not constructed with the objective of earning commercial rates of return.

- State Water’s argument for setting the RAB at \$300 million seems to be using some circular logic: the only value the assets have is the income stream they can earn and the value of the assets need to be set a high enough level to earn an income stream which justifies the value of the assets.
- if the only way that the RAB can generate State Water’s desired level of income is by bringing the pre-1997 assets into the equation, then possibly State Water needs to reconsider either the level of income it wishes to generate or its method of funding capital expenditure

JIL does not support the ‘building block’ approach as currently proposed by State Water, and is strongly opposed to State Water seeking a rate of return on pre-1997 assets.

5.2.2 Capital Expenditure Program

State Water’s submission indicates that revenue and profitability will accelerate rapidly under the ‘building block’ approach. As profits are earned there will be an expectation that dividends and/or tax equivalents will be payable. However, refurbishment and upgrading of water supply infrastructure in the Lachlan has been under-funded for decades. We consider that it is State Water’s responsibility to apply profits to return or improve all infrastructure to optimum service levels before paying any dividends to Government.

The whole pricing process has been overseen by Government and it is not acceptable for Government to accept under-funding of infrastructure for years then simply transfer the problem to the State Water Corporation and wash its hands of the outcome.

We recommend the shortfall on full service capability be determined as a liability of State Water and that the first requirements for any cost recovery exceeding lower bound pricing is to be applied against that liability.

6 Water Resource Management (WRM) Costs

6.1 Efficient Costs of Providing WRM Services

The DIPNR submission was unclear, completely lacking in detail on the costs of WRM services and we could make no informed conclusions from the information provided. In view of DIPNR’s failure to meet IPART’s requirements for full and transparent provision of information we have no confidence in the indicative estimates for WRM costs for 2003/04 to 2005/06. DIPNR is a monopoly supplier of WRM services and should be able to provide information of an adequate standard to ensure an equitable sharing of WRM costs between water users and the broader community.

The proposal to derive a nominal WRM charge for each valley based on the current percentage share of WRM to total bulk water costs suggests that the cost of providing WRM services is directly related to the cost of providing bulk water delivery services, which is simply not realistic.

In view of the lack of information provided we recommend that no CPI increase on WRM costs be approved for 2005/06.

8 Cost Sharing Principles

Basic Rights Delivery

State Water's Operating Licence specifies that its functions include the release of water to "persons entitled to take water, including release to regional towns." Included in those persons entitled to take water are basic rights holders, ie riparian landholders who have a right to take stock and domestic water from the river without a licence and without any charge.

As basic rights holders do not pay for water, the cost of their delivery is borne by licensed water users. Under normal supply conditions the provision of basic rights is a minor part of running the river but under drought conditions it assumes major importance because the Water Management Act gives priority to town supplies and basic rights holders over irrigators and other licence holders during water shortages.

The Lachlan has been in drought for the last 4 years, with general security licence holders receiving allocations of 3% in 2002/03, 0 in 2003/04 and 0 in 2004/05, and high security receiving 100%, 70% and 30% over the same period. As the drought has persisted, increasingly the purpose of State Water's river operation has been to provide town supplies and deliver basic rights water. However, licence holders continue to be charged the fixed charges on 100% of entitlement every year, despite receiving no allocation.

The delivery of basic rights should be defined as a Community Service Obligation, and the costs borne by government. This is particularly important in exceptional drought sequences such as the current one where irrigators are completing their third year without water and lack the resources to pay the fixed charges.

JIL recommends that basic rights delivery be defined as a Community Service Obligation and the cost borne by Government.

Environmental Share of Water

We recommend that the management of environmental contingency allowances and environmental flows be explicitly recognised as an impact on State Water's workload and a Community Service Obligation. The Lachlan is perhaps more affected than many other valleys because the Water Sharing Plan limits the consumptive share of the water to 25% of the long term average annual flow, and therefore also limits the paying customer base. State Water notes on p 15 of its submission that if the water available for consumptive use decreases it will need to recover costs from non-consumptive users or increase prices to consumptive users.

Water pricing needs to recognise the very real costs incurred in managing environmental water requirements and the limits to the paying customer base.

We recommend that a Community Service Obligation be determined for the management and delivery of environmental water.