

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL**

**REVIEW OF PRICES FOR STATE WATER CORPORATION  
FROM 1 JULY 2010**

**Tribunal Members**

**Mr James Cox, CEO and Acting Chairman  
Ms Sibylle Krieger, Part-Time Member**

**Members of the Secretariat**

**Mr Colin Reid, Director Water  
Mr Richard Warner, Program Manager Water Pricing**

**Held at Dubbo RSL Club Resort,  
The Crossroads, Mitchell & Newell Highways, Dubbo**

**On Wednesday, 25 November 2009, at 10.30am  
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1 THE ACTING CHAIRMAN: Good morning, ladies and  
2 gentlemen. I would like to welcome you to this public hearing.  
3 We are inquiring into the maximum prices that State Water will  
4 be permitted to charge for bulk water services in New South  
5 Wales for the period commencing on 1 July 2010.

6  
7 First of all, I would like to introduce ourselves.

8 I am Jim Cox and I am the Acting Chairman and Chief  
9 Executive Officer of the Tribunal. I am joined on this  
10 review by my fellow Tribunal Member, Ms Sibylle Krieger,  
11 who is on my right.

12  
13 IPART last determined prices for State Water's bulk  
14 water services in 2006 and that pricing determination  
15 covered a four-year period and is due to expire on 30 June  
16 2010. As part of this investigation the Tribunal released  
17 an issues paper in July 2009 which set out key aspects of  
18 the review process. That issues paper outlined some of the  
19 matters which the Tribunal considers are important to this  
20 review, the matters that its Act says it must take into  
21 account in conducting an investigation and also a draft  
22 timetable for the review.

23  
24 In the issues paper the Tribunal called for  
25 submissions from State Water, its customers and other  
26 interested stakeholders. The Tribunal is grateful to those  
27 who have taken the time and trouble to make a submission.  
28 A number of the organisations that have made a submission  
29 to this review will be presenting their views to this  
30 hearing today. We are most grateful to people who have  
31 made a considerable effort to be here today and give us the  
32 benefit of their views. All submissions received by the  
33 Tribunal will be carefully considered in developing our  
34 findings and recommendations.

35  
36 The Tribunal considers this to be a most important  
37 investigation. At the last determination IPART determined  
38 a revenue requirement for State Water of \$335 million for  
39 the term of the four-year price path. Of this total some  
40 \$230 million was expected to be recovered by tariffs paid  
41 by extractive users and the rest effectively was to be paid  
42 for by the State Government on behalf of the community.

43  
44 In its submission State Water Corporation has argued  
45 that drought conditions have meant that it has not been  
46 able to generate the revenue that was forecast at the time  
47 of the 2006 determination and they argue the continuation

1 of low revenue will threaten the longer-term financial  
2 viability of State Water. State Water has suggested a  
3 range of measures that it would like to see put in place to  
4 address the matter of climate induced revenue volatilities.  
5 These include changing the manner in which efficient water  
6 supply availability is estimated, changing the charging  
7 structure and adjusting allowed rate of return to reflect  
8 the increased risk. We will be exploring these issues more  
9 fully over the course of this review and I have no doubt  
10 that they will be a key feature of presentations and  
11 discussions today.

12  
13 State Water has forecast an increase in operating  
14 expenditure of almost 9 per cent in real terms over the  
15 next four years. Much of this is due to what they term  
16 thematic expenditure items. We will be seeking to explore  
17 the reasons for these additional costs today. State Water  
18 is also forecasting a significant increase in capital  
19 expenditure from the sum of \$117 million over the four  
20 years to 2009-10 to \$342 million over the four years to  
21 2013-14. Compliance with pre-1997 dam safety requirements  
22 makes up a significant proportion of this expenditure and  
23 this expenditure will be met by the government if existing  
24 cost shares are maintained.

25  
26 However, there is forecast to be significant capital  
27 expenditure on the renewal and replacement of assets and  
28 also upgrading and modernising water delivery and  
29 operational aspects of State Water's business.

30  
31 State Water is also proposing that a premium should be  
32 introduced on high security entitlements to incorporate a  
33 scarcity premium to reflect the value of water under  
34 changing seasonal conditions. The scarcity premium would  
35 change through time depending on the relative availability  
36 of general security water.

37  
38 State Water has proposed a considerable price increase  
39 for high security entitlement holders as well as usage  
40 charges in the Lachlan and Macquarie Valleys. Lower  
41 increases are proposed for general security entitlement  
42 holders. For high security entitlement holders we estimate  
43 that for the Macquarie, State Water has proposed to  
44 increase entitlement charges by 185 per cent over four  
45 years. For the Lachlan, the increase will be 179 per cent.  
46 This is largely driven by State Water's proposed scarcity  
47 premium.

1  
2 General security entitlement charges are projected to  
3 increase by 4.2 per cent in the Macquarie and by  
4 20 per cent in the Lachlan. Water usage charges are  
5 projected to increase by 79 per cent in the Macquarie and  
6 by 105 per cent in the Lachlan.  
7  
8 This hearing is an important part of a broader price  
9 review process. It provides an opportunity to hear in a  
10 public forum from State Water and other stakeholders and to  
11 question the propositions put forward. The submissions  
12 made by State Water and stakeholders are available to the  
13 public through the Tribunal's website.  
14  
15 Before we commence proceedings today I would like to  
16 say a few words about the process for this hearing. You  
17 have available to you a timetable which indicates the order  
18 in which organisations will be presenting before the  
19 Tribunal. For each organisation appearing a presentation  
20 time has been allowed and this will be followed by a period  
21 for questions by the Tribunal. Assisting the Tribunal are  
22 the Tribunal's Secretariat members, Mr Colin Reid,  
23 Director Water, who is on my left, and Mr Richard Warner,  
24 Program Manager Water Pricing, who is on Colin's left.  
25  
26 At the conclusion of all the scheduled presentations  
27 I will make time available for members of the public to  
28 express their views and opinions on the proposals that have  
29 been put forward by State Water and other stakeholders.  
30 State Water will then be given a short opportunity to  
31 respond to matters during the day should it so wish.  
32  
33 I should point out that the proceedings today are  
34 being transcribed to provide a record for our assistance  
35 and the Secretariat's in finalising our work and I would  
36 request you when you speak to do so slowly and clearly.  
37  
38 The Tribunal will consider all of the submissions  
39 received and all that is said today when it makes its  
40 decisions on bulk water prices for State Water. The  
41 Tribunal plans to release a draft determination for public  
42 comment in March 2010 and interested parties will have a  
43 four to five-week period to make submissions for  
44 consideration by the Tribunal before it makes its final  
45 decisions. A final report and determination will be  
46 released in June 2010.  
47

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1 We will commence proceedings today with State Water.  
2 I would ask the representatives of State Water to identify  
3 themselves for the record. Would you state your names and  
4 positions and then commence your presentation. Thank you.  
5  
6 STATE WATER CORPORATION  
7  
8 MR WARNE: Thank you very much. My name is George  
9 Warne. I am the CEO of the State Water Corp. Lisa Welsh is  
10 immediately on my right. Lisa has been responsible for  
11 coordinating State Water's response. She will give the  
12 lion's share of the presentation today.  
13  
14 We thank you for being given the opportunity to speak.  
15 We have had the benefit of one prior hearing - which you  
16 may have already discussed at the Irrigators' Council or  
17 elsewhere - in Griffith earlier in the week and it was  
18 certainly interesting to hear some of the views of the  
19 stakeholders.  
20  
21 What I am going to talk about very briefly and Lisa is  
22 going to elaborate on is the issue of our achievements  
23 during the period just past because we think that is worthy  
24 of some note. We will talk about the drought. We will  
25 talk about our own financial viability. We will talk about  
26 changes to prices proposed and we will talk about our  
27 proposals for managing the impact on our customers.  
28  
29 In terms of our achievements so far, you can see that  
30 IPART in their wisdom determined that State Water's average  
31 sales statewide would be of the order of 5.5 million  
32 megalitres per year and notwithstanding the fact that this  
33 year is not yet over, we are arguing that in the very best  
34 of those years we only sold 40 per cent of what IPART  
35 thought we would sell and more recently we have been  
36 selling as little as 20 or 30 per cent of what IPART's  
37 projection of water sales would be. That has had a  
38 dramatic impact on our gross income and our ability to  
39 deliver water to people and it has obviously had a terrible  
40 impact on farming communities and irrigators as well,  
41 certainly in some valleys.  
42  
43 I did hear the specific instruction to speak slowly,  
44 so I will try to get this over in three minutes rather than  
45 two. State Water was asked by IPART - in fact, directed by  
46 IPART - to reduce operating expenditure and we believe that  
47 we have now achieved the targeted reduction in annual

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1 expenditure. That is, IPART determined that the  
2 organisation should see its way steadily to a \$36.1 million  
3 expenditure and we believe that this year we will achieve  
4 the targeted expenditure of \$36.1 million in our operating  
5 expenses. We believe to a very large extent, although  
6 perhaps not as rapidly as IPART had requested, we have  
7 achieved the changes that have been requested.

8  
9 In terms of how we did it, there were key drivers to  
10 that. Obviously, one of the key drivers was the prompt  
11 given by IPART, but I think the management of State Water  
12 had recognised for some time that there was a need to  
13 become a more effective and a more efficient organisation,  
14 so it wasn't solely the IPART driver. I think anyone who  
15 is running a business in the modern world is constantly  
16 looking at ways to do it better or to do it smarter or to  
17 do it more efficiently.

18  
19 We would like to think that we are an organisation  
20 that is valued by our stakeholders and particularly by our  
21 shareholders and that through our organisational structure  
22 and through the work we do, we can actually create a  
23 platform for future growth to provide - God forbid - a  
24 benefit or a dividend for our shareholders.

25  
26 The organisation replaced the geographical structure  
27 with a functional structure and most of you who are  
28 irrigators would understand what that means; that is,  
29 instead of having a strong local presence operating really  
30 as a local fiefdom, we have gone to an organisation based  
31 on what people do, not where they live, and to that extent  
32 we have centralised a lot of the functions of finance,  
33 infrastructure development and technology applications to a  
34 statewide basis rather than district by district. I am not  
35 sure that it has provided the perfect result for every  
36 customer in every circumstance, but it has certainly  
37 enabled us to achieve the targeted restructuring and cost  
38 reductions.

39  
40 We believe those savings are substantial and  
41 we believe they lead to ongoing improvements and provided  
42 we can deliver some of the technologies that are now well  
43 in train, we believe we will be in a place to offer further  
44 efficiency savings as an organisation.

45  
46 In term of the organisational restructure, we think  
47 that it is a better organisation because information is

1 shared right across the organisation. There was a little  
2 bit of tribalism developing between north, south and  
3 central. The same task is accomplished in multiple valleys  
4 and we can literally now ask the operator in Goondiwindi on  
5 a Saturday night to review and access the data of water  
6 flows in the Murrumbidgee Valley and if need be alter them.

7  
8 We have gone a long way towards developing and  
9 understanding state wide and creating skills that are  
10 immediately transferable throughout the entire  
11 organisation. Obviously, centralised data collection is  
12 quite important because it's amazing how little we seem to  
13 have learnt when it comes to repeating the mistakes of the  
14 past.

15  
16 By centralising data and having very good data  
17 retrieval mechanisms, we hope that we can not only store  
18 the physical learning, that is, how a river operates, and  
19 the financial learning, what things cost and how many  
20 people it takes to do a job, but we can learn from and  
21 improve on them.

22  
23 The corporate restructure was really about delivering  
24 organisational change and I have to say we are part the way  
25 through that and it has been very successful in terms of  
26 establishing a model that will work for delivery of the  
27 restructure and I think we have some way to go there.

28  
29 In terms of investing in technology, we have improved  
30 reporting and some of the irrigators would cynically say,  
31 "Well, so you'd want to have," but State Water have  
32 dramatically improved financial reporting and now we're  
33 going to the next stage where our focus is not just on  
34 providing mandated accounts or accounts for customers, but  
35 providing very timely reports for managers, weekly, daily  
36 in real-time, so they can actually change their behaviours  
37 to improve the outcomes for the business units that they  
38 are responsible for. It is amazing what a powerful tool an  
39 effective budgeting module with very good reporting can  
40 provide a manager.

41  
42 We are also very keen to improve customer service  
43 through technology and to save money. We have invested  
44 quite a lot of time and effort in iWAS and its precursors,  
45 WIX and others. I am confident to say today we have a  
46 platform that works and is valued by an increasing number  
47 of our customers. Unlike the organisation I worked for

1 before where we were committed to an internet platform, a  
2 text service, a phone-up service, a fax service, weekly  
3 advertisements in local papers and a mail-out, State Water  
4 is putting all of its eggs into an internet based product  
5 and we hope that we can provide a very high quality of  
6 interaction with our customers there and over time wean our  
7 customers off the other forms of communication that they  
8 may have come to enjoy.

9  
10 In terms of future improvements, State Water has  
11 targeted a further 6 per cent efficiency saving over the  
12 next determination period. We have broken that down and  
13 IPART have asked questions of that. That is really about  
14 delivering a consistent improvement in business delivery in  
15 our operational area and as a business we think we can do  
16 that. Some of that hangs off some of the technologies that  
17 have now been produced.

18  
19 In terms of the capital expenditure program, the  
20 delivery of the capital program is very largely and heavily  
21 weighted towards the dam subsidy program, which is, as you  
22 would be aware, a legacy issue, but you can see in terms of  
23 the capital what we are targeting. As of this morning when  
24 I was looking at some of the capex projections, I think  
25 that we're going to end up very close to 117.3 or  
26 thereabouts. We will be very close to the actual capital  
27 determination for the four-year period, notwithstanding the  
28 fact that some of the years have been spectacularly good or  
29 bad.

30  
31 Capital programs are a very important part of our  
32 responsibility to establish safe dams. It has been  
33 interesting to see how different communities have responded  
34 to those projects. At Tumut we had enormous enthusiasm for  
35 the Blowering Dam safety upgrade. It created a lot of jobs  
36 in the local community. It created better pieces of  
37 infrastructure. In some of the other communities they're  
38 very concerned about the short-term impacts on the  
39 boat ramp or the longer-term impacts on the road over the  
40 dam wall, or whatever it may be, but it's obviously an  
41 important part of what we are delivering for the  
42 State Government.

43  
44 In terms of the drought, you can see there quite a  
45 dramatic demonstration of the variance to what IPART  
46 determined State Water would probably earn over the  
47 four-year period. On the face of it, we have a

1 \$83.2 million shortfall in income over the period. It is  
2 actually not quite that bad because about \$26 million of  
3 that is picked up in CSOs that are paid for by the  
4 government, but it did lead to a more than \$50 million  
5 shortfall in our revenues. The Treasurer keeps asking me,  
6 "Why aren't you delivering a dividend?" I guess that's  
7 part of the reason. I think that's probably exclusively  
8 the reason. The fact is that we have been dealing with a  
9 drought of record. I say "drought of record" because that  
10 is certainly what we're dealing with, but I think it would  
11 be foolish of us to say, "We're going to return to normal  
12 immediately." That is certainly not the view of  
13 State Water. Our submission indicated some science - and  
14 I will go into that in a second - as to why we think that  
15 might be the case.

16  
17 In terms of understanding the drought, in substance it  
18 probably - dare I say it - may have been forgivable for  
19 IPART to think that we were going to sell 5.5 million  
20 megalitres a year, because the records up to four years ago  
21 showed a variation around that constant of about 5 million  
22 megalitres with a few poor years amongst them and some  
23 very good one. I don't think any statistician would have  
24 forecast what we have been through where we have sold less  
25 than half of what they predicted would be our worst year  
26 ever in two of the four years. I think they said that on  
27 an analysis of the available storage, the available  
28 delivery systems, that State Water should bank on  
29 occasionally selling as little as 2.9 million megalitres.  
30 We have had a couple of years where we've sold of the order  
31 of 1.2 million megalitres. I know those of you who are  
32 living there have been living through this drought of  
33 record and it has certainly been very significant.

34  
35 Any of you from the Lachlan Valley will have seen this  
36 graph. It is basically a graph of nine years of inflows  
37 and they have picked the four worst nine-year periods.  
38 What it demonstrates in the blue line is the drought we're  
39 going through now has inflows that are less than half the  
40 worst ever recorded nine-year period. For the sceptics of  
41 climate change or those who think that the world hasn't  
42 changed, I present this graph because I think it  
43 demonstrates that we do have to recalibrate our future if  
44 we're going to seriously think about a sustainable future.

45  
46 Likewise, in the Macquarie the graph is not quite as  
47 well defined, but it certainly shows for a 100-month period

1 - and that is about nine years - something very similar in  
2 terms of this being far worse than any other nine-year  
3 period. Interestingly, when you look at 50 months or you  
4 look at 30 months, there are other periods that are  
5 actually as bad in that shorter run period in the  
6 Macquarie Valley, so it has been a more variable water  
7 supply.

8  
9 In terms of our financial viability, the drought has  
10 exposed us, particularly when you couple that with the  
11 government's direction initially, since I think reiterated  
12 by IPART, that we were to move towards a higher proportion  
13 of our costs being variable. We have not been meeting our  
14 obligations under the National Water Initiative Pricing  
15 Principles: that is, full cost recovery and an appropriate  
16 rate of return to shareholders. I think irrigators won the  
17 argument in 1996 about the sunk costs of the past assets,  
18 but even when you look at the current asset basket that we  
19 are asked to deliver a dividend upon, we are performing  
20 extremely poorly.

21  
22 We have an increased forward capital program which  
23 makes us more vulnerable. That is, State Water has to  
24 borrow money to deliver this capital program and as our  
25 capital program intensifies, as we build more  
26 infrastructure, as we borrow more money, we become  
27 increasingly vulnerable to the vagaries of this drought.

28  
29 For the benefit of irrigators across the state, to  
30 give you an idea of the sort of capital expenditure,  
31 obviously it's quite lumpy. There are a couple of years  
32 with quite a high expenditure over the next few years. The  
33 darker blue there represents the component that the  
34 government is going to be borrowing on behalf of the  
35 government program. The interest payable on the regulatory  
36 asset base will be paid by the government. The lighter  
37 blue or the lighter purple reflects the works that are  
38 being constructed on a cost share basis and will lead to an  
39 increased irrigator contribution.

40  
41 The key point of this graph demonstrates, firstly,  
42 it's lumpy, but for those of you who say we should defer  
43 it, these works were deferred in 1989, they were deferred  
44 in 1996 and they were deferred in 2000. Maybe it's time  
45 the dam safety program was constructed and completed.  
46 Secondly, I would point out that although the irrigator  
47 contribution towards capital works increases, it increases

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1 at a much slower rate than the contribution being made by  
2 the State Government.

3  
4 In terms of our prices, prices are being driven by  
5 State Water's request for an increase in the weighted  
6 average cost of capital and what we are saying to IPART is  
7 please consider us in light of much more stable  
8 organisations, like Sydney Water or Hunter Water, that  
9 despite the drought have been able to maintain very steady  
10 revenues. We are saying, "Look at the volatility in our  
11 income," and we think we need a weighted average cost of  
12 capital that reflects that volatility.

13  
14 We have also asked IPART to consider consumption  
15 forecasts. We had to work out a way to recognise the  
16 science behind the fact that there is going to be less  
17 water in the future. State Water asked the CIE to do some  
18 modelling and to nominate a period. The irrigators have  
19 been reasonably critical. They have said, "How the hell  
20 did you determine that 15 years is the right period to  
21 determine that's what your forecasting should be based  
22 upon?"

23  
24 We could have chosen five years or 10 years, but once  
25 you get to 20, 30 and 40 years you're starting to miss the  
26 very point that we have gone into a period of dramatic  
27 change in terms of water availability. We think that the  
28 15-year model reflects a fair way of understanding that it  
29 will be a dryer future, but in the event that we run into a  
30 very wet period, irrigators will pick under the benefit of  
31 that within the current generation and not some future  
32 generation.

33  
34 State Water has achieved operating efficiencies and we  
35 understand that we have to achieve more. We also have to  
36 achieve the efficient delivery of the capex program.  
37 Despite the fact that it is mostly delivered by government,  
38 we have a vested responsibility to make sure we deliver  
39 that in the most efficient way possible.

40  
41 In terms of the water prices for the community here  
42 today, we are proposing an increase in the high security  
43 price, which is obviously very significant, reflecting the  
44 very high value of that water and to some extent the  
45 primacy that it's held even in these periods of time where  
46 water sharing plans have been suspended. We have  
47 recommended increases in the general security prices. Can

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1 I say that the usage charge reflects the changes in  
2 State Water's expectation as to how much water is going to  
3 be available.  
4  
5 In the Macquarie likewise we felt that the high  
6 security guys have had a very good run, with a massive  
7 increase in their capital values, the ability for those  
8 that have surplus water to achieve massive gains in very  
9 dry years for the water markets which have evolved and led  
10 to some really quite perverse pricing when you cast your  
11 mind back five or 10 years. We have tried to limit the  
12 impact on general security irrigators as far as is  
13 possible. There is a formula that Lisa will run through as  
14 to how we have done that. We have increased usage charges  
15 reflecting how much water we think will be used.  
16  
17 In terms of managing the impact on customers,  
18 State Water's premise in providing a submission to  
19 government is that although we are no longer compelled by  
20 law or by government decree to maintain a fully fixed  
21 60 per cent usage based charge, we are committed to that  
22 because we recognise that for our customers to receive a  
23 very significant bill in a year when there's not much water  
24 available causes significant pain. We are seeing some of  
25 that in the Lachlan Valley right now.  
26  
27 The alternative, if IPART determine that State Water should  
28 have a lower WACC or something more consistent with  
29 Sydney Water, we would argue that that's okay, but we want  
30 income that is also very similar to their steady income and  
31 we would be asking irrigators for a 90 per cent fixed  
32 income, which would I think be quite unpopular.  
33  
34 In terms of conversion factors, conversion factors  
35 mean a lot of things. Conversion factors traditionally  
36 meant what you could convert your general security to high  
37 security for. A recommendation by PricewaterhouseCoopers  
38 to the Federal Government was that the practice of  
39 converting from one security to another should be stopped  
40 and we think it is very unlikely, even when the water  
41 sharing plans are no longer suspended and they come out of  
42 the shadow of this current time, that there will be  
43 conversions allowed and if they are, we think the factors  
44 might be very very different to the ones that apply today.  
45  
46 We are obviously seeking to increase the high security premium  
47 to address the imbalance that occurs when you apply

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1 the 15-year climate model. Some general security users  
2 will pay a bit less. The only thing we would say about  
3 this thing is that it's about tariff design. It is about  
4 who pays what in what valley for a given basket of costs.  
5 We did ask the Irrigators' Council if they had some views,  
6 but obviously users are divided severely into their camps  
7 of interest. They are either high security users or  
8 general security users and they hold a different view  
9 depending upon where they are.  
10  
11 As I said on Monday, the most spectacular example was  
12 we had a unanimous vote at the Hunter Customer Service  
13 Committee in favour of much higher high security charges,  
14 but when I looked at the apologies there was one member  
15 who wasn't there and that was the high security user.  
16  
17 In terms of inclusion of a 6 per cent opex efficiency  
18 reduction, State Water believes that that is achievable.  
19 Despite the fact that the organisation is still very much  
20 settling down from the impact of the restructure we have  
21 just been through, we think we can achieve a 6 per cent  
22 real reduction in our operating costs over the next few  
23 years. That is about all I am going to say. I hope Lisa  
24 can now elaborate on some of those and provide some facts  
25 behind the fiction.  
26  
27 MS WELSH: Thank you, George. My name is Lisa Welsh.  
28 I am State Water's Strategic and Regulatory Manager and  
29 I am also Project Manager for State Water's submission to  
30 IPART. I want to go into a little bit more detail as to  
31 what went into our thinking in putting together our pricing  
32 submission. Just briefly, I want to touch on what we are  
33 trying to achieve with our submission to IPART, the sorts  
34 of consultation that we went through, our forward opex and  
35 capex program, some of the key financial viability issues  
36 which are really driving a lot of what's in our submission  
37 and in particular the tariff design issues and the proposed  
38 prices which come pretty much directly from our financial  
39 viability concerns. I will then touch on a range of other  
40 issues that are also included in our submission.  
41  
42 Coming into this pricing submission our objective was  
43 very clear. George ran through some of the effects of the  
44 unprecedented drought that have characterised the current  
45 determination period. State Water has a deteriorating  
46 credit investment grade rating. Over the last few years an  
47 independent assessment of our financial viability and our

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1 stand alone rating, assuming that we weren't backed by the  
2 government, shows that we are increasingly not a very good  
3 investment risk. That is as a result of the current tariff  
4 design structure.  
5  
6 In having the opportunity to set our prices every four  
7 years, we saw this as an opportunity to try to reverse that  
8 trend and address some of those specific concerns that are  
9 presently being raised.  
10  
11 Having said that, we are not the only ones who have  
12 been through the drought. Our customers have had an  
13 equally tough time, if not more so, particularly in the  
14 Macquarie and Lachlan Valleys who have been extremely  
15 impacted by the drought. We have sought to incorporate our  
16 customers' preferences for tariff design where ever  
17 possible to try to manage some of that impact.  
18  
19 The customer consultation that we undertook was done  
20 in three stages. Firstly, we talked to them about the  
21 IPART process itself. We talked to them about the sorts of  
22 discretionary services that they might be interested in  
23 purchasing from State Water over and above the baseline of  
24 service delivery that State Water now delivers to our  
25 customers in the new world of our streamlined and more  
26 efficient organisation.  
27  
28 The second round of consultation involved talking to  
29 them about what we were thinking in terms of our  
30 consumption forecasts and there were certainly no shocks  
31 for any of our CSC members when they saw our final  
32 submission to IPART. We were able to provide them some  
33 extra information on some of the potential discretionary  
34 services and a little bit more on what we were thinking in  
35 terms of tariff design.  
36  
37 The final round of consultation involved presenting  
38 them with some indicative prices. We also showed them what  
39 we were thinking in terms of the valley specific opex and  
40 capex programs. That provided what I found to be quite a  
41 useful point of discussion in terms of trying to get our  
42 customers' views - and sometimes their views were more  
43 informed than mine because I'm not valley based - in terms  
44 of particularly what we're proposing for capex and I think  
45 that will be evident as I go through the submission.  
46  
47 Finally, that was an opportunity for the CSCs to all

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1 agree on the discretionary services that they wanted  
2 State Water to include in their submission.  
3  
4 Just briefly, as has been pointed out, State Water's  
5 proposed operating expenditure budget going forward is  
6 about a 9 per cent increase by the final year. That is  
7 driven by our baseline opex of 2009-2010 which is of course  
8 the IPART efficient level from this current determination.  
9 We have offset some efficiencies: about 6 per cent on  
10 average. However, we do have some external drivers which  
11 are pushing up our operating expenditure. I will go into  
12 those in a minute. Overall, it's about a \$2.5 million  
13 increase in opex.  
14  
15 Some of the thematic expenditure that is in our  
16 submission involved the works approvals fees. The Office  
17 of Water are just finalising our works approvals conditions  
18 going forward. These are a new regulatory instrument for  
19 State Water and they charge us a management fee to assess  
20 our compliance and reporting requirements with those fees.  
21 That is a new cost for us. It is not in our current  
22 baseline of opex.  
23  
24 There are quite a few environmental and heritage  
25 requirements, specifically fish passage monitoring,  
26 maintenance requirements, water quality monitoring and  
27 assessment procedures. These are new costs for us and not  
28 something that we can accommodate within our baseline.  
29 There is a range of others which I won't go into  
30 individually because that could take a long time, but the  
31 details are in our submission.  
32  
33 What I would want to mention in particular are the  
34 discretionary services which are also classed as this  
35 additional thematic expenditure. After a lot of  
36 discussion, particularly with the Lachlan CSC, they  
37 endorsed an additional \$50,000 a year for discretionary  
38 water efficiency projects. That money will be largely  
39 controlled by the CSC and State Water and the CSC together  
40 will decide where it wants to invest that \$50,000 a year.  
41 That is I think a big win for both State Water and  
42 customers in that we can both share the responsibility for  
43 some of those improvements.  
44  
45 Looking forward, George has already mentioned that the  
46 capital program represents a big increase compared to the  
47 current determination period. I think in this

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1 determination period we were aiming for about \$117 million.  
2 That has gone up to about \$342 million for the next  
3 four-year period. That is dominated again by dam safety  
4 requirements as well as the environmental obligations that  
5 are associated with those works.  
6  
7 What does that look like in terms of the Lachlan?  
8 There are some quite significant capital expenditure  
9 programs for the Lachlan Valley. The majority of that  
10 expenditure is associated with the Wyangala Dam safety  
11 upgrade as well as fish passage offsets and cold water  
12 pollution requirements which are triggered as a result of  
13 those works. In the first two there I think that's a  
14 Lake Cargelligo fish passage as well.  
15  
16 It is a similar story here in the Macquarie. This is  
17 driven very much by the Burrendong Dam safety upgrade and  
18 the cold pollution water offsets that are required. They  
19 dominate the first two years and then there's a big  
20 tapering off of the program.  
21  
22 There is something I wanted to touch on here. There  
23 were some stakeholder concerns about the capital program  
24 that was presented in State Water's submission compared to  
25 what had been shown to the CSCs. I won't go into great  
26 detail here, but this is just a reconciliation of what we  
27 had put in our final submission compared to what had been  
28 put to customers. The changes are largely to do with the  
29 timing of the Burrendong project, but importantly for  
30 customers we actually removed the renewal of Gin Gin Weir.  
31 This is something that State Water was considering, is  
32 Gin Gin Weir a redundant asset, and that was something that  
33 customers were able to confirm with us, so that has been  
34 removed from our program and that had quite a large impact.  
35  
36 You can also see there that the other big mover is the  
37 inclusion of some corporate water to the projects which are  
38 delivered across the program and so weren't included in the  
39 valley specific programs at that time. They are things  
40 like iSMART, which is to help drive our further  
41 efficiencies in terms of how we centralise our water  
42 delivery and improve the use of remote sensing.  
43  
44 Could I comment briefly on cost shares. This is  
45 always quite controversial. State Water is not proposing  
46 any changes to cost shares in its submission. However,  
47 we did notice that in consulting with customers across the

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1 state there were many and varied views on cost shares,  
2 largely of the view that customers should be paying less  
3 and that government should be responsible for a greater  
4 share of State Water's costs. Something that I observed in  
5 putting together this submission is that there is a huge  
6 increase in the revenue requirements from government and a  
7 much more modest increase for customers.  
8  
9 Our view is that cost shares are extremely important.  
10 There is a lot of grey area in how those can be applied and  
11 we think that that's something that IPART should consider  
12 at every determination to make sure that the outcomes are  
13 still consistent with the principles.  
14  
15 As I said before, we don't believe that the current  
16 tariff design allows for our ongoing financial viability.  
17 We have had several credit downgrades to that effect.  
18 In particular, the consumption over the current  
19 determination period was only 29 per cent of the IPART  
20 forecast and that has been driven by the move to a 60:40  
21 variable to fixed pricing ratio and that has resulted in  
22 \$56 million in under-recovery.  
23  
24 Going forward, we think that if that sort of  
25 under-recovery was to continue, we would undoubtedly lose  
26 our investment grade rating and that is eventually going to  
27 impact our ability to maintain our assets, so we think that  
28 IPART needs to seriously consider State Water's financial  
29 viability going forward.  
30  
31 The starting point for State Water in terms of how we  
32 thought that IPART ought to address some of these  
33 structural inadequacies, if you like, in the current  
34 pricing regime was consumption forecasts. Clearly,  
35 recovering only 29 per cent of usage revenue  
36 shows that there is a big problem, that there's something  
37 wrong with the current forecasts. With the Office of Water  
38 we commissioned some work to present an alternative  
39 methodology that we could use in our submission to IPART.  
40  
41 We commissioned the Centre for International  
42 Economics. As you have already heard so far, they have  
43 come up with a recommendation to change from the 100-year  
44 IQQM model average to a rolling 15-year average. The  
45 15 years is absolutely a discretionary call. There are  
46 certainly arguments both for a longer period and a shorter  
47 period. We thought that represented the best trade off, if

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1 you like. The CIE modelling showed that there had been a  
2 structural break in water availability that had occurred in  
3 the last seven years, at the start of this current  
4 drought. This means that choosing a longer period than  
5 15 years you're going to incorporate more and more years  
6 that aren't reflective of what we think is going to happen  
7 going forward. However, having something shorter than that  
8 is going to lead to some huge price shocks, particularly in  
9 the usage charges paid by our customers.

10  
11 The other advantage to this methodology is that it  
12 self corrects. We are not trying to make a comment on  
13 climate change, we're not scientists, and we certainly hope  
14 that the current drought does not continue. What we've  
15 come up with is a methodology that we can keep rolling  
16 forward and it will self correct. If we have it wrong and  
17 this regulatory period does turn out to be a lot wetter,  
18 that will continue to be incorporated into consumption  
19 forecasts going forward and we will fully recover our costs  
20 over a shorter term than 100 years, but certainly more of a  
21 15-year period, so we will neither over-recover nor  
22 under-recover in that time.

23  
24 What does that look like for our valleys? Overall, it  
25 means a 20 per cent reduction in consumption forecasting  
26 compared to the 5,500 gegalitres. It also means some quite  
27 large reductions for the Lachlan and Macquarie Valleys that  
28 have been hit extremely hard by the current drought.

29  
30 However, just putting that into perspective, the top  
31 graph there shows the level of under-recovery given the  
32 current 5,500 gegalitres and the bottom graph shows how  
33 much we would have under-recovered given the actual water  
34 deliveries over the current period had we been using the  
35 4,400. You can see that we under-recovered by 29 per cent,  
36 but had IPART been using what is now our 15-year average,  
37 we still would have significantly under-recovered by  
38 36 per cent.

39  
40 What we are saying is that we don't think that the  
41 last four years are representative of what's going to go  
42 forward. If that was the case, we should all pack up and  
43 go home because there's no future for irrigation or for  
44 State Water in New South Wales. What we are saying is that  
45 there does need to be a big reduction and that going  
46 forward this is what we believe is the best option.

47  
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1 That was step one which is getting the right  
2 consumption forecasts. Step two is how do we deal with the  
3 fact that State Water has 40 per cent fixed revenues from  
4 users and 60 variable? What we looked at was some of the  
5 outcomes from other metropolitan water businesses who we  
6 knew had the same WACC as us. Four years ago when IPART  
7 was determining our WACC they said, "You're a water  
8 business. We know water businesses. You can have a WACC  
9 the same as everybody else." However, when we went back  
10 and looked at some of the outcomes for in particular  
11 Sydney Water's determination, we found that despite the  
12 fact that they'd been through a drought, which is granted  
13 not nearly as severe as ours, and they do have some  
14 variable water charges, they still managed to recover  
15 95 per cent of their revenue.

16  
17 Our modelling showed that if we were similarly to have  
18 had that level of cost recovery, we would need 90 per cent  
19 fixed charges. 90 per cent fixed charges as a proposition  
20 for our customers is extremely unpopular and not something  
21 that we wanted to go to IPART and recommend as our best  
22 option. Instead, we tried to come up with something that  
23 would accommodate the current 60:40 split. However, that  
24 says to us that we have a significant revenue volatility  
25 risk in our business and it's not something that we're  
26 being compensated for with the current WACC.

27  
28 Our calculations show that, if you like, the risk  
29 premium that we should be compensated for for taking on  
30 that risk of our users is about a 1.4 per cent premium and  
31 that has resulted in us seeking a 7.9 per cent WACC in the  
32 determination. We think that this will be sufficient for  
33 us to retain our credit rating and it also means that we  
34 can accommodate our customer's preferences in retaining a  
35 large percentage of variable revenues.

36  
37 In particular, our operating licence no longer  
38 requires us to seek the 60:40 fixed variable ratio and that  
39 is something that we didn't have an option for last time  
40 around. As I said, again, 60:40 is our preference, but if  
41 IPART doesn't see fit to compensate us for that risk of  
42 revenue volatility then we will be directly seeking to  
43 reduce that risk not by our revenues but actually by  
44 changing the pricing structure.

45  
46 The final issue on tariff design was that the other  
47 thing that struck us as we were going into the preparation

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1 for our submission is that there has been a real inequity  
2 in terms of the impacts of the current drought on the water  
3 availability to high security and general security users  
4 and who is bearing the costs of running the system.  
5  
6 Obviously, during the current drought high security  
7 users have continued to get close to 100 per cent of their  
8 entitlement which is exactly the way the rules are written  
9 and what is intended. However, what we're seeing is that  
10 general security users in some valleys, and in particular  
11 the Macquarie and the Lachlan, are getting very little  
12 allocation, virtually zero. Despite this they have still  
13 been paying significant fixed charges and that has  
14 certainly put a lot of our customers under a lot of  
15 pressure and I think that that has been quite evident with  
16 government policy in regards to the Lachlan Valley during  
17 this determination period.  
18  
19 We went back and had another look at how the high  
20 security premium was calculated. What we have seen is that  
21 the current premium is based on the water sharing plan  
22 conversion factors which is in terms of how many units of  
23 the general security licence do I have to give up in order  
24 to get a high security licence. The Office of Water have  
25 actually now suspended those conversions because they don't  
26 think it is possible to use those conversion rates to  
27 convert from general security to high security without  
28 causing third-party impacts. They are basically saying  
29 they're wrong.  
30  
31 If the conversion factors are suspended and yet  
32 they're still being used to determine the premium, we're  
33 saying now the premium itself is also wrong.  
34  
35 In terms of coming up with an alternative methodology,  
36 we believe that our first best scenario would be for the  
37 Office of Water to actually correct those water sharing  
38 plan conversion factors, but they're still in place until  
39 2014, I believe, so we think that's pretty unlikely.  
40  
41 The alternative that we came up with was retaining  
42 those conversion factors but adding a scarcity premium to  
43 them which would be the inverse of the rolling average of  
44 the general security allocation for the last 15 years.  
45 It is also no coincidence that we chose the same 15-year  
46 period for the high security premium as we have for the  
47 consumption forecasting. We thought that the consistency

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1 there was quite useful.  
2  
3 What that means for high security premiums is that in  
4 years where the resource is restricted, we think high  
5 security users should pay more. They should pay more of  
6 the cost of running the system. When water is more freely  
7 available that premium should fall.  
8  
9 It is worth pointing out here that at the end of the  
10 day for State Water this is a zero sum game. We are not  
11 expecting to raise any more revenue out of this, but we do  
12 think that a change to the high security premium is  
13 required to address some of the inequities that have  
14 appeared during the current drought.  
15  
16 Just as a final point, one of the things that we did  
17 have another look at was the large customer rebates. Back  
18 in the 2006 determination State Water argued unsuccessfully  
19 for the removal of these rebates. IPART commissioned some  
20 very useful work by CIE into the reasons behind the large  
21 customer rebates and they came up with a number of reasons  
22 as to why they should be retained, including things like  
23 economies of scale. What we did was take the principles  
24 that were endorsed by IPART at that time, but we applied  
25 them to what we now understand to be State Water's costs.  
26  
27 They resulted in some quite large changes to some of  
28 the existing rebates. They obviously don't affect  
29 Macquarie at all. They will affect one of the larger users  
30 in the Lachlan, but it's not a huge impact there. However,  
31 one of the things that we are seeing is that with the ACCC  
32 water market rules which allow individual customers within  
33 the irrigation corporation to transform, which means that the  
34 State Water gets an extra customer, we're saying that the  
35 rebate should decrease because those economies of scale  
36 that are associated with that large customer are decreasing  
37 as well.  
38  
39 What does all of that mean for prices? It means that  
40 there are some quite significant price increases,  
41 in particular in the Lachlan, as a result of the high  
42 security premium. There is quite a significant increase  
43 proposed in the high security charge for the Lachlan of  
44 152 per cent. However, there is only a modest increase in  
45 the general security charge, but again a big increase in  
46 the usage charge driven partly by consumption forecasting  
47 but also by the capital expenditure program and some of the

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1 increased opex in that valley; similarly, quite a big  
2 increase in the high security premium in Macquarie,  
3 actually a small reduction in the general security  
4 entitlement, but again a sizeable increase in the usage  
5 charge.  
6  
7 We are not proposing any changes to the maximum fee of  
8 \$150 for the temporary trades. We have managed to achieve  
9 some efficiency savings in the way we conduct our trading  
10 over the last couple of years and we think that we can  
11 continue those going forward. We are saying that that  
12 should remain fixed which translates to an efficiency gain  
13 of around about 10 per cent over the next four years.  
14  
15 We are also proposing a new information charge that  
16 will be levied on all of those requests for information from  
17 people who are not our customers and they are many and  
18 varied and often very time consuming. We are also  
19 proposing to apply this charge to information requests from  
20 people who are our customers but who want information that  
21 is not current.  
22  
23 What we are saying to our customers is, "We want you  
24 to take responsibility for keeping your own information,  
25 customer accounts, water accounts, statements, bills,  
26 that's your responsibility, as it is with any other  
27 business, but if it's a reasonable request for something  
28 that's current then we're happy to provide that to you."  
29  
30 Finally, we are also proposing a new metering service  
31 charge as a result of the metering project under the  
32 Australian Water for the Future Program. Obviously, that  
33 program has not yet received formal government approval.  
34 What we are saying is that there will be charges for only  
35 the marginal costs associated with those meters if and when  
36 that metering project is rolled out. The  
37 Commonwealth Government at this stage is looking at  
38 funding the up-front capital cost, so the metering service  
39 charge at this stage will not include any return on capital or  
40 depreciation. That is all I wanted to say. Thank you.  
41  
42 THE ACTING CHAIRMAN: Thank you very much. We will  
43 now have a period of questions. We will start off with the  
44 Secretariat, Colin and Richard, but Sibylle and I may also  
45 wish to add questions as well.  
46  
47 MR REID: Thank you very much, Jim, and thanks George and

1 Lisa for your presentation. My first question relates to  
2 managing revenue volatility. As part of the 2006  
3 determination, IPART had State Water review the  
4 availability and cost of insurance and other market  
5 mechanisms to manage variations in sales volumes.  
6  
7 It was thought that this may provide a market derived  
8 independent valuation that could be explicitly recognised  
9 in State Water's costs. For the purpose of this  
10 determination has State Water re-looked at these options in  
11 preference to an in-house calculated adjustment to the rate  
12 of return?  
13  
14 MR WARNE: On the specific issue of insurance,  
15 when I first started at State Water we started a series of  
16 discussions with a British firm called MF Global about  
17 whether they might consider that, because at the time they  
18 were very interested in the index, we had started on dam  
19 levels and what have you, as to whether they could create a  
20 product to offset some of their commodities markets.  
21  
22 Interestingly, some of the preliminary work done  
23 through New South Wales Farmers and National Farmers  
24 indicated a premium of 30 or 40 per cent of average charges  
25 that might provide some insurance for volatility risk in  
26 water.  
27  
28 The initial observations were that that was an  
29 extremely expensive product and we consider if we are  
30 committed to the low fixed charge high variable charge -  
31 and we are. We think that meets our customers'  
32 requirements to a very large extent - then really the most  
33 efficient way of recognising that volatility is through the  
34 WACC.  
35  
36 MR REID: Irrigator groups have queried State Water's  
37 demand-side risk. This is a common theme in the  
38 submissions. Lachlan Valley has stated in 1999-2000, when  
39 there was widespread flooding in New South Wales, demand  
40 only fell by 15 per cent from the long-term average and  
41 Lachlan Valley further state that State Water has more  
42 upside demand opportunity than metropolitan water  
43 businesses that you looked at in comparing risk. What is  
44 your response to these comments?  
45  
46 MR WARNE: I think it is a valid comment. I think that in  
47 some of the southern irrigation areas in Victoria and even

1 in their Riverland a wet summer can dramatically reduce  
2 water sales. In the case of State Water and our customers,  
3 our customers are not limited by land that can be  
4 irrigated. Typically, they are limited by the amount of  
5 water available and in wetter years they simply grow more  
6 crop.

8 In establishing our 15-year model and our likely sales  
9 we are recognising the fact that we think there will be  
10 good years in future, but the trend will be generally  
11 lower. The other point that I would make that I don't  
12 think has been taken into account by CIE is the propensity  
13 of our irrigators during the last 10 years, particularly in  
14 the last five years, to carry over water is unbelievable.  
15 In the Murray when they announced an 8 per cent allocation  
16 one year, more than a third of that water was carried into  
17 the final season.

18  
19 Farmers are inherently conservative when they're  
20 thinking about water use in future, particularly now that  
21 they've been given the right to carry over unused water  
22 into a future season, and we think that will act as a  
23 considerable dampener on those wet year usage extremes that  
24 we may have seen in 1991-92 or even in 1996. It is the  
25 changing face of agriculture, as they start to think about  
26 next year, given that it's an individual decision and no  
27 longer a collective decision about how much water is made  
28 available and that "The water I don't use is going to be  
29 given to someone else." Actually, we have seen a glimpse  
30 of that in the Peel Valley where they're coming to grips  
31 with that very issue.

32  
33 MR REID: Lisa spoke about the reconciliation between what  
34 has been presented to the customer committees and what's in  
35 the submission on capex. However, both Lachlan and  
36 Macquarie claim that there are significant discrepancies  
37 between the opex figures provided by State Water to  
38 customer service committees and what is included in  
39 State Water's submission to IPART for the 2009-10 year.  
40 In fact, Macquarie have indicated that what was shown to  
41 the customer services committee for operating expense was  
42 3.9 million in 2009-10 and what is included in the  
43 submission is 4.3 million, which is a variance of  
44 8 per cent. I am wondering whether you have any  
45 reconciliation of those differences?

46  
47 MS WELSH: My reading of that was that I think the

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1 8 per cent from memory referred to the capex which is why  
2 I did the reconciliation there. Obviously, we are happy to  
3 go back and provide a reconciliation to the Macquarie CSC,  
4 that's not a problem, but one thing I would say is that  
5 something we noticed as we were going around and presenting  
6 to the CSCs was that at that stage of the development of  
7 our total asset management plan, which is where all those  
8 figures came from, what was picked up in the CSC reports  
9 were those which were valley specific activities and there  
10 were a number of corporate expenses that have not been  
11 allocated and a number of those were also these thematic  
12 plans. It involved things like, for example, iSMART and  
13 some of the environmental heritage assessments had not yet  
14 been allocated to valleys and therefore weren't showing in  
15 those opex figures.

16  
17 MR REID: George indicated that you will meet your 2009-10  
18 capex figures. It was pointed out by Lachlan that  
19 60 per cent of the capex provided for in the 2006  
20 determination is forecast by State Water to be spent in the  
21 current year. It does raise issues about the reliability  
22 of the figure for the current year and whether it can be  
23 reasonably expected that you will meet it.

24  
25 MR WARNE: State wide - as Lisa pointed out - our capex is  
26 heavily weighted towards the dam safety program. The major  
27 projects in this area are keystone projects at Blowring  
28 and particularly at Keepit and these projects have very  
29 long lead times to do with environmental approvals and  
30 others. Blowring's construction is well under way and  
31 Keepit is at Budget Committee or Cabinet on 3 December,  
32 having received a favourable tender which your independent  
33 review is privy to.

34  
35 We are well under way to delivering those projects.  
36 Once the projects actually start on site, our experience  
37 has been that they start to drive State Water. That is,  
38 the constructor is very keen to get in there and get out of  
39 there and the expenditure accelerates quite dramatically.  
40 I think that their criticism of our projected expenditure  
41 at Wyangala may be valid given the very significant number  
42 of community concerns that have been raised there with  
43 regard to our proposed construction and the long-term  
44 future of the dam wall.

45  
46 MR REID: The land management thematic expenditure is an  
47 area of contention. That has been mentioned in a number of

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1 submissions, obviously including Lachlan's. Irrigator  
2 groups have indicated that they believe that such  
3 expenditure was for development of business opportunities  
4 outside of State Water's river operations activities and  
5 therefore should not be recovered through regulated  
6 charges. Would you like to comment on that?  
7  
8 MR WARNE: Lisa may wish to correct me, but the area we're  
9 seeking recovery from the irrigators on are those lands  
10 that are directly related to the operation of our  
11 infrastructure that provides a regulated water supply.  
12 There are types of land State Water controls. There are  
13 those we own directly under the first vesting schedule and  
14 they relate to the lands required to actually sit a dam  
15 upon the immediate foreshore and the road into the sites  
16 that the buildings are on.  
17  
18 There is a second vesting schedule of far more lands  
19 that we actually control and we lease out and they are  
20 subject to a review of whether we should own them, whether  
21 we should give them back or what their future may be. I  
22 think it's fair to say that we're asking irrigators to  
23 recognise the value of the land that the infrastructure  
24 directly related to supplying their water sits upon.  
25  
26 MR REID: Obviously, another contentious issue is the size  
27 of the forward capex program, recognising that the dam  
28 safety expenditure needs to be paid by government, but  
29 flowing from that dam safety expenditure are the fish  
30 passage activities under which the cost sharing ratio is  
31 50 per cent paid by irrigators.  
32  
33 You mentioned that some of these programs have been  
34 delayed a number of times. What are the legal imperatives  
35 for State Water to incur this cost at this time when we are  
36 in the midst of a severe drought and both State Water and  
37 customer revenues have substantially reduced?  
38  
39 MR WARNE: State Water recognises - obviously with some  
40 compassion - the terrible time that our farming communities  
41 have been through, but we're really charged with the  
42 responsibility of delivering a First World infrastructure  
43 and if irrigators want to see their dams go the way of our  
44 rail infrastructure in much of rural New South Wales then  
45 to delay essential expenditure is a recipe for exactly  
46 that.  
47

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1 For example, at Hume Dam the engineers have indicated  
2 that they think we should effectively lower the operating  
3 level of the dam until the works are completed and that  
4 would effectively take 400,000 megalitres of storage out of  
5 circulation. I think, as a community of interest,  
6 irrigators have a vested interest in seeing the money spent  
7 and seeing the ancillary money spent that leads to  
8 recognising our environmental responsibilities also being  
9 spent, albeit spent wisely.  
10  
11 I am, as is State Water, quite concerned about the  
12 escalating cost of fish ladders at a rate far greater than  
13 the rate of inflation. We believe that we have a  
14 responsibility to try and wind back some of those costs to  
15 a more reasonable expense per site. Some of the very  
16 clever negotiation we have done has led to a much lower  
17 liability, albeit a significant liability, for a more  
18 effective fish passage in the right place rather than  
19 necessarily a fish ladder that is triggered by the  
20 construction of dam safety works.  
21  
22 We have done quite a bit of work there. We can do  
23 better in terms of efficiency and delivery, but I think to  
24 cause delay, postpone or to even cancel some of those works  
25 is quite irresponsible given our place in the ecological  
26 society that we live and work with.  
27  
28 MS WELSH: I would just add to that that the fish passages  
29 are a legislative requirement that is triggered by  
30 section 218 of the Fisheries Management Act as a result of  
31 those dam safety upgrade programs. Cold water pollution is  
32 not a legislative obligation. However, it did originate as  
33 part of the government policy on cold water pollution  
34 mitigation. That is where it started. However, it is in  
35 the process if you like of becoming a regulatory obligation  
36 on State Water via the works approvals. Those requirements  
37 are being written into the works approvals as we speak and  
38 I think that the Office of Water is halfway through  
39 finalising those. We have a limited capacity to defer or  
40 even discontinue those works at this stage, if you like.  
41  
42 MR REID: Finally from me, the high security premium - and  
43 this may be a terminology issue - submissions, including from  
44 the Lachlan and Macquarie, have queried the inclusion of a  
45 scarcity premium in proposed charges to high security  
46 customers. It is suggested by irrigator groups that the  
47 difference between high and general security charges should

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1 be cost based and not include some sort of scarcity  
2 premium.

3  
4 I just wonder whether you've looked more at the  
5 effective charge that has been applied because of the lower  
6 availability of water to general security customers and  
7 compared that to the higher security effective price, if  
8 you like, and that's what you're referring to and the use  
9 of the term "scarcity premium" may have created some  
10 misconceptions in that regard.

11  
12 MR WARNE: I think you're right. I think it's an attempt  
13 by State Water to try to find a fairness factor. It seems  
14 hugely anomalous that someone who has had a zero  
15 allocation and in this community of interest all the other  
16 people have had a zero allocation, have been paying more  
17 than half the costs of running State Water in a particular valley  
18 and these who have had 100 per cent allocation have been  
19 paying a lot less. We had to develop a mechanism that was  
20 based on our forecast model for 15 years of inflows that  
21 recognised that one product was far more likely to be  
22 delivered than the other and shared the costs fairly  
23 between the communities of interest.

24  
25 That is what we have attempted to do. If irrigators  
26 have a smarter model and it's one they don't think they  
27 will complain about now or later and claim that the  
28 government should forego all charges in that area, we are  
29 happy to talk to them. We tried to find something that  
30 married that apparent anomaly where there was a disparity  
31 between the fairness of someone getting all their water and  
32 paying such a small proportion of the total costs derived  
33 in a particular year.

34  
35 MS WELSH: Could I just add that when we were starting to  
36 investigate some of the potential options, one of the things  
37 we did look at was saying if you take, for example, the  
38 Murrumbidgee Valley where we know how many megalitres  
39 have been allocated to general security as compared to high  
40 security, it is actually possible to work out what the  
41 effective price per megalitre is and that's where a lot of  
42 discrepancies are found and that's what we think is  
43 inherently unfair with the current high security premium.  
44 It is possible to do that analysis.

45  
46 MR REID: It is also stated by the irrigator groups that  
47 stock and domestic customers and town water supply are

1 given a greater assurance on security of supply than the  
2 other high security irrigator users and therefore should  
3 pay a higher premium. I wondered if you wanted to comment  
4 on that.

5  
6 MR WARNE: I think you're right. There's another group  
7 called basic landholder rights who are basically beyond the  
8 law, as far as I can see, despite the best efforts of  
9 State Water and others to try to rein them in over the  
10 years. You have these categories of basic landholder  
11 rights, stock and domestic suppliers, urban water suppliers  
12 and high security and we think that they've all been  
13 prejudiced in favour of, probably with good cause,  
14 certainly during this last five-year period.

15  
16 MR WARNER: A couple of questions from me. In Griffith  
17 we explored quite extensively the issue of revenue volatility,  
18 including your 15 year moving average for consumption  
19 forecasting which doesn't seem to enjoy a great deal of  
20 support. I think at that venue one of the irrigation  
21 companies suggested that they had moved to a 50-year  
22 average. You were a bit dismissive of that today in your  
23 talk, George. Is there some halfway house between 50 and  
24 15 that would moderate the volatility we are going to see  
25 in a move to 15, because we're looking at 150 per cent  
26 increases in some charges in some valleys, I would suggest.  
27 I put that to you.

28  
29 MR WARNE: Can I just correct you? The 50-year period  
30 they were looking at was the first 50 years of the last  
31 century. If you look at the Lachlan Valley in particular,  
32 the most volatile rainfall in the state, I think Condobolin  
33 or one of those rainfall stations recorded literally half  
34 as much rain in the first 50 years than in the second  
35 50 years, so it's a particular 50-year period they chose,  
36 and if you follow their logical extension then maybe they  
37 should choose one from 1607 to 1657. We are trying to talk  
38 about the here and now and recognising what's going on in  
39 our catchments today and to try to reflect that in a  
40 pricing model.

41  
42 It is not perfect, but we are saying it's a whole lot  
43 better than the 115-year model, the 89-year model or  
44 whatever we're using in each of the valleys. I think that  
45 while there was some credibility in their model, the  
46 extension of their sentence to say, "We've largely  
47 insulated ourselves by reducing operating costs and

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1 increasing fixed charges," which was a universal catchcry  
2 of each of the schemes we spoke to last week, is a  
3 reflection of something that we find politically very  
4 difficult to deliver.

5  
6 We have argued that 15 years is not a perfect model.

7 Probably a more perfect statistical model is a seven-year  
8 model, but we think that would be so extreme in terms of  
9 the effect on prices that we've opted for a 15-year model.

10 Lisa's point about it being gently self correcting over the  
11 period of determinations will bear fruit for customers.

12  
13 MR WARNER: Let's go back to the main point. Is there a  
14 halfway house? What does 25 years do for you?

15  
16 MR WARNE: We haven't run the model on 25 years, but  
17 I would point out that throughout south-eastern Australia,  
18 the period from 1970 to 1990 was one of the wettest  
19 20 years on record. You have to decide what it is we're  
20 trying to achieve. I think we're trying to recognise the  
21 fact that our catchments are less likely to collect as much  
22 water in future and we need to reflect that in our  
23 availability models and in our usage models. I don't know  
24 that a 30-year model or a 50-year model does that.

25  
26 MR WARNER: As you have previously mentioned - you  
27 brought it up - some of the irrigation companies had already  
28 adjusted their shares of fixed to variable charges: up to  
29 70 per cent fixed, 30 per cent variable. Is there also  
30 movement available to you that doesn't go from 40 per cent  
31 fixed up to 90 per cent fixed but is somewhere in the  
32 middle?

33  
34 MR WARNE: There are a couple of issues there. Part of  
35 State Water's revenue is received from the State Government  
36 as a reflection of the growing capital base that we are  
37 actually constructing. To some extent we have a bit of  
38 creep there in our fixed income anyway. In may not be the  
39 70:30 that some were advocating the other day, but  
40 certainly more than 40 per cent of our income is fixed.

41  
42 There may be some room to move, but I think that once  
43 again irrigation communities would argue their preferred  
44 model would be a 100 per cent usage based model rather than  
45 the 40:60, even though a 90:10 should theoretically lead to  
46 slightly lower water charges for everyone.

47

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1 MS WELSH: I would also like to add that I personally  
2 modelled the difference in charges that users would be  
3 paying with the 60:40 and a 7.9 per cent WACC as compared  
4 to a 90:10 and a 6.5 per cent WACC, and in particular I was  
5 able to show them what exactly you're paying in addition on  
6 your return on capital, noting that a large part of  
7 State Water's regulatory asset base is actually allocated  
8 to the government, and generally customers at those CSCs  
9 were relatively comfortable - I wouldn't say that they were  
10 necessarily endorsing State Water's WACC. I don't want to  
11 misrepresent those comments - with the fact that they  
12 understood exactly how much they were paying for this  
13 service, if you like, and to them that seemed to be a  
14 smaller amount than they had perhaps anticipated.

15  
16 MR WARNER: It has been suggested in one of the  
17 submissions we are going to consider today that price  
18 increases should be limited to 20 per cent for individual  
19 irrigators. What is your response to that?

20  
21 MR WARNE: We have actually lived through this because  
22 we administer the cap that was applied to groundwater users.  
23 We strongly discourage such a measure. I will give you an  
24 example. In the event you were to do that and we were to  
25 introduce the metering charge, for example, State Water  
26 might abandon the metering program because we just simply  
27 wouldn't be recovering any of the costs associated with  
28 owning and operating them because we would be constrained  
29 by the cap.

30  
31 I think that nothing has constrained the massive  
32 capital growth in the value of the underlying water  
33 entitlements and I think that likewise we should be talking  
34 about the fair and reasonable actual costs of delivering  
35 the service and caps are an administrative nightmare in  
36 terms of their application.

37  
38 MS WELSH: I would just add, however, we are in favour of  
39 a smooth price path as long as there's no NPV shortfall.  
40 The prices that we presented in our submission represented  
41 full cost recovery in every year and that was partly  
42 because that was the output of our model, but we do  
43 recognise that IPART like to avoid price shocks and that is  
44 something that we support as well; as long as there's no  
45 NPV shortfall, as I said.

46  
47 MR WARNER: I think Macquarie River Food & Fibre will be

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1 arguing that in their view you're double dipping on your  
2 15-year consumption forecasting as well as increasing the  
3 WACC. How would you respond to that?

4  
5 MR WARNE: We basically think that they're separate  
6 issues. The 15-year forecasting is trying to get a grip of  
7 the changing world of water given what we've been through  
8 in the last four years and recognising that in terms of our  
9 long-term expectation of much lower average water sales per  
10 year, and the other one is simply reflecting the  
11 volatility.

12  
13 We went back to the Dam Safety Committee and said,  
14 "Would you review these maximum events that are likely to  
15 occur so that maybe we can modify the expenditure on dam  
16 safety, because obviously we're not going to have quite as  
17 much water in future?" and their argument was,  
18 "You're going to have less water but it's going to be more  
19 volatile."

20  
21 In answer to the question "Will there be floods in  
22 future?", the answer is "Yes", "Will there be droughts?",  
23 "Yes", but it would appear that the volatility is going to  
24 be greater rather than less than it has been and in the  
25 Australian context that's really saying something. We see  
26 them as quite separate issues. One is about volatility and  
27 the other one is about a recognition that there will be  
28 less water to sell.

29  
30 MR WARNER: Another issue that has been raised by  
31 stakeholders is the suggestion that thematic expenditures  
32 should be delayed until there's some sort of trigger event  
33 based on revenue; in other words, they're basically saying  
34 until the rain returns.

35  
36 MR WARNE: I thought Lisa explained the key ones there.  
37 There's not much room to move. I think our first charge  
38 was \$94,000 for the works approval and we are going to have  
39 one of those in each valley. It is a requirement of  
40 State Water to receive those works approvals. That is  
41 something we pay to the New South Wales Office of Water.  
42 It is not negotiable. It is a cost of doing business.

43  
44 Likewise, a number of these environmental  
45 responsibilities which are coming upon us are part of  
46 running a First World industry in the 21st century.  
47 Irrigators have to recognise that running a regulated

1 river, a man-made operation, you have to recognise your  
2 environmental responsibilities. We have to try to deliver  
3 that as efficiently as we can, but I don't think we can  
4 hide from the fact that we are operating in an environment  
5 that is under increasing environmental scrutiny and some of  
6 those costs reflect that.

7  
8 MS KRIEGER: I have a relatively minor question.  
9 You spoke before about the adjustment you made to corporate  
10 expenses in their allocation and that that resulted in  
11 slightly different figures from the ones discussed with the  
12 CSCs. Can you say that the methodology used to allocate  
13 those corporate expenses was the same as it had been in the  
14 past?

15  
16 MS WELSH: I can answer part of your question. The short  
17 answer is I wasn't here four years ago and I can't speak  
18 about the allocation of those costs at that time. However,  
19 what I can say is that the allocation of those corporate  
20 overheads for this pricing determination is based on our  
21 direct costs in our valleys and in particular, EFT costs.  
22 That is general corporate overheads.

23  
24 However, having said that, I think what I was  
25 referring to more particularly was the discretionary  
26 expenditure and that is something that the opex/capex  
27 consultants did raise some concerns about in terms of can  
28 we better direct that discretionary expenditure to those  
29 valleys where there will be perceived benefits.

30  
31 We went back and did a bit of a review as to how we've  
32 done that and we found that for two of the most expensive  
33 areas we think that yes, perhaps there is a better way and  
34 that we could have taken a little bit more time and  
35 consideration in terms of how we allocate fish passage  
36 monitoring and fish passage maintenance to those valleys  
37 where we actually have an increasing number of fish  
38 passages. We have provided some revised figures on those  
39 numbers which will result in a reallocation of that  
40 discretionary expenditure.

41  
42 THE ACTING CHAIRMAN: I have just a couple of final  
43 questions, if I may. Compared to where we were in Griffith  
44 on Monday, we now seem to be expecting much larger price  
45 increases in these valleys based on expected lower water  
46 availability in future. What issues of capacity to pay do  
47 you think will this raise for your customers and bearing in

1 mind that we at IPART are required to set prices based on  
2 full cost recovery, what account should we take of those or  
3 are those issues that are better handled outside of the  
4 IPART process?

5  
6 MR WARNE: The State Government introduced a number of  
7 initiatives to assist farmers during this extremely  
8 difficult time, but you would be pretty foolish to consider  
9 that the drought hasn't impacted irrigators' ability to pay  
10 bills in the past years. The important thing is that  
11 State Water operates a key structure item that provides  
12 them, if you like, with an important element of their farm  
13 business's asset base and I think that they and us together  
14 have to recognise its importance in terms of the future  
15 viability of their farm business.

16  
17 To shy away from the responsibilities to continue  
18 funding that, maintaining it and enhancing it to meet  
19 current standards is pretty foolish when you consider some  
20 of the decisions that have been made in other state  
21 infrastructure in past years and I particularly pointed to  
22 some rural rail services and what have you where they're  
23 now really past repair and the concept of reviving those to  
24 reinstate the value of that transport infrastructure is  
25 long gone.

26  
27 I would encourage irrigators, despite the extreme  
28 difficulty they're going through, to recognise that a key  
29 part of their farm asset is their water entitlement and  
30 their regulated water entitlement is worth a whole lot more  
31 if they have sound infrastructure to deliver that water and  
32 use it when the water is available.

33  
34 THE ACTING CHAIRMAN: I wanted to ask a final question  
35 on the WACC issue. As I understand the argument, what  
36 you're suggesting is that by moving to a 60 variable/40 fixed  
37 pricing split you are in fact providing a degree of  
38 insurance to farmers, if you like. That is, in years when  
39 there's not much water available they don't pay very much  
40 and in years where there's a lot of water available they  
41 pay more. That is the service that you're offering and  
42 it's valuable and it might well be reasonable that farmers  
43 should pay for that. The issue is is the WACC the only or  
44 the best way for you to recover those charges?

45  
46 The difficulty I have with WACC - in terms of the  
47 theory of WACC - is that what it rewards is what is called

1 systematic risk, which is risk that varies with economic  
2 conditions. Your revenue is variable, but it varies with  
3 natural conditions which may not be strongly related to  
4 economic conditions. I would be interested in your  
5 thoughts on these issues and whether the WACC is the only  
6 way of calculating what is in effect an insurance premium  
7 that you're proposing to charge.

8  
9 MR WARNE: It is interesting that you and the Treasurer  
10 seem to think very alike. The Treasurer is also extremely  
11 concerned about any contribution by government, let alone a  
12 higher one. I think the point you raise is very valid.  
13 State Water did investigate a number of other ways we might  
14 address this volatility risk because we simply think to go  
15 to our community and say, "You're going to pay 100 per cent  
16 fixed charges and you're going to have to trust us to  
17 deliver an efficient service" is too much to ask.

18  
19 We have actually supported right through our  
20 submission maintenance of the 40 per cent fixed/60 per cent  
21 usage based charging. Is the WACC the perfect mechanism to  
22 recognise that volatility of income? Probably it's not,  
23 but it's one that is available to us. In terms of these  
24 hearings and this community of interests, the irrigators  
25 have a very strong vested interest to make sure that is the  
26 method we use because a huge proportion of that increased  
27 WACC is paid by the State Government.

28  
29 THE ACTING CHAIRMAN: Thank you very much for your  
30 submission and for answering questions.

1 THE ACTING CHAIRMAN: We will now have a presentation  
2 from Lachlan Valley Water. Could the representatives come  
3 forward and introduce themselves, please, and then we will  
4 proceed with their presentation. Thank you.

5  
6 LACHLAN VALLEY WATER

7  
8 MS EWING: Thank you. I am Mary Ewing, the  
9 Executive Officer of Lachlan Valley Water. I don't have a  
10 presentation on the board, but I want to speak to four main  
11 topics in our submission and reflect on some of what  
12 State Water said. I also want to address the opex and  
13 capex issues, the volatility risk and strategies to manage  
14 that, the cost shares and the consumption forecast.  
15 Thank you for the opportunity to speak here.

16  
17 In terms of the opex and capex, we do recognise the  
18 improvement that State Water has made both in the  
19 information that they have provided in support of their  
20 submission and in their operating expenditure and the  
21 reductions they have achieved. However, as we said in our  
22 submission, I think State Water was a little misleading in  
23 comparing the revenue shortfall between notional revenue  
24 that State Water nominated at the last IPART hearing, which  
25 was effectively IPART decided that was an inefficient cost,  
26 and so in fact the correct comparison should have been with  
27 the efficient revenue as determined by IPART, in which case  
28 the shortfall over the four years is \$56 million.

29  
30 In fact, the table that George put up showed that over  
31 the last four years, as State Water has got down to its  
32 efficient level of expenditure, there has still been that  
33 \$10 million accumulated deficit. State Water has certainly  
34 made progress in improving the efficiency of their  
35 operation and in the restructuring. However, it has taken  
36 a while to get to that point and the risk and the costs  
37 associated with that we feel should be borne by the  
38 shareholders and not by the customers.

39  
40 On the opex, State Water said there was a theoretical  
41 lag in the ability of their systems to support the  
42 operation in view of reduced staff numbers and therefore  
43 they expect only 6 per cent efficiency gains over the next  
44 four years, whereas we believe that there's actually the  
45 capacity to achieve an efficiency gain equivalent to the  
46 CPI over the full four years of the next determination  
47 period.

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1  
2 One of the things that supports our view of that is  
3 the reduction in staff numbers. In fact, State Water now,  
4 at around 300-305, is back to the 2005 level of staffing  
5 which was just after corporatisation. From our point of  
6 view, it looks like there was a significant increase in  
7 staff numbers in the two or three years following  
8 corporatisation that possibly indicates a corporatisation  
9 process that wasn't as efficiently handled as it could have  
10 been, or an organisation that at the time it was  
11 corporatised didn't have systems in place and structures  
12 that enabled the corporatisation to move as smoothly as it  
13 could.

14  
15 In terms of capex, I appreciate your confidence,  
16 George, in the ability of State Water to meet your capex  
17 targets. I am sure you won't be offended if we say we  
18 think that should have some independent verification and we  
19 suggested in our submission that IPART should review  
20 State Water's progress with capex in say the third quarter  
21 to see if you are on budget.

22  
23 We think that that would provide a good guide as to  
24 whether the current period capex can be achieved and is  
25 therefore also a good guide as to the future capex which is  
26 projected for the next period and particularly that capex  
27 that is going to be over the three years 2009-10, 2010-11  
28 and 2011-12, which is a very significant jump compared to  
29 what has been achieved in the past. We would urge that the  
30 best information that you could get on the ability of  
31 State Water to achieve that capex should be factored into  
32 the determination.

33  
34 We did have some queries about duplication of capex in  
35 State Water's projections for the Lachlan Valley. The  
36 capex projections we looked at were fairly late in the  
37 process and there were some questions about duplication.  
38 I think that fish passages had been included twice. Those  
39 were the types of issues that we queried. I didn't have an  
40 opportunity to determine whether or not they were  
41 duplicated, but I expect that during the determination  
42 process State Water would provide advice on that.

43  
44 The second issue we wanted to address was the  
45 volatility risk and the strategies to manage that.  
46 State Water has actually done very well over the last four  
47 years in managing the volatility considering the conditions

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1 that we have been in and the reduced water sales. As  
2 I think George and Lisa both acknowledged, State Water has  
3 a significant proportion of fixed income anyway. If you  
4 look at table 2.3 in State Water's submission, they're very  
5 small, but a return on RAB. We believe that the volatility  
6 risk has been overstated.

7  
8 We also found it difficult to sort out the  
9 relationship between the theoretical construct of  
10 State Water's structure for pricing purposes and the actual  
11 infrastructure that State Water has and therefore the risk  
12 that is being experienced in the real world as to their  
13 pricing structure.

14  
15 State Water in their submission has a 10.5 per cent  
16 debt gearing ratio and when I actually looked at  
17 State Water's annual financial reports, State Water  
18 actually broke even in two of the last three years and made  
19 a small loss in one of the last three years that was  
20 available. I am questioning whether State Water is  
21 overstating the volatility risk given the strategies that  
22 State Water already appear to have put in place to manage  
23 that.

24  
25 In terms of managing that volatility risk, State Water  
26 has suggested two strategies, being the reduced consumption  
27 forecasts and the increased WACC. We suggest one of the  
28 other measures that should be used is an obvious one which  
29 is to spread the user base. George acknowledged that basic  
30 landholder rights are a very significant user of  
31 State Water services and therefore they're a driver of  
32 costs, an impacter. I read State Water's submission where  
33 it says that it's a very difficult thing to recover costs  
34 from people where there is no formal relationship with  
35 State Water. However, clearly, they are a driver and  
36 we believe that is a very obvious method of assisting and  
37 managing risk.

38  
39 One of the other options or things that could be  
40 considered is potentially the ability for State Water to  
41 retain retained earnings as a sinking fund to help smooth  
42 the volatility of revenue. In terms of commenting on the  
43 overall volatility in the last four years, we have all been  
44 through a very difficult period. State Water has in fact  
45 had similar returns on capital, according to table 2.3,  
46 that the RNCG report indicates that its customers have  
47 received over the last four years. We think that it's a

1 little bit difficult that State Water is not looking at  
2 sharing the risks that its customers have been experiencing  
3 over the last four years as a result of reduced water  
4 availability. State Water is seeking through this  
5 determination to insulate itself from those risks and  
6 effectively move a lot of the risk to its customers.

7  
8 The third point I wanted to talk about is the  
9 consumption forecast and as you noted we are not in favour  
10 of the 15-year rolling average. The Sustainable Yield  
11 Report for the Lachlan indicated that over the last 10  
12 years both the run-off and the diversions were reduced,  
13 were below average. They indicated it was not  
14 statistically significant because of the high variability  
15 and intra-year volatility. Our preference would be to  
16 adjust the long-run average consumption by bringing it  
17 right up to date and including the last eight years in it.  
18 Again, we come back to spreading the user base as another  
19 mechanism for managing the risk of revenue volatility.

20  
21 In terms of cost shares, I was surprised at  
22 State Water's submission and again Lisa today noted that  
23 the government share of revenue for State Water is  
24 increasing 149 per cent compared to users 22 per cent, but  
25 that's totally expected. It entirely reflects the dam  
26 safety upgrades and the legacy costs that are borne by  
27 government and therefore we don't see a need to revisit  
28 that aspect of the cost shares.

29  
30 We do suggest that one aspect of the cost shares that  
31 should be looked at is fish passage that arises from dam  
32 safety upgrades. Clearly, the driver for the fish passage  
33 is the dam safety upgrade. It is not other issues.  
34 Therefore, our strong view is that fish passage arising out  
35 of dam safety upgrades should actually be considered and  
36 treated the same as the underlying dam safety upgrade.

37  
38 It is good to hear George's comments about the costs  
39 of fish passage because certainly it is a major issue and  
40 an increasing issue and I don't know if there are better,  
41 more innovative ways out there to provide fish passage.  
42 I think certainly our valley would be very much in support  
43 of investigation and implementation of that.

44  
45 With respect to cost sharing, again, I keep coming  
46 back to the same issue about spreading the user base, using  
47 other methods apart from consumption and increasing the

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1 rate of return to underpin State Water's viability. It is  
2 clear that as the availability of water for consumptive use  
3 reduces that more and more of State Water's effort and work  
4 goes into providing services for other types of users or  
5 basic landholder rights and we think a transparent and fair  
6 method of dealing with that would be to reflect that in the  
7 cost shares.

8  
9 High security versus general security, again,  
10 we believe that the scarcity issue is really reflected in  
11 the market price. We certainly support a security premium  
12 that reflects the relative security of the two types of  
13 water, but the additional scarcity premium we suggest is  
14 already reflected in the market price of the underlying  
15 asset and should not also be reflected in the market price  
16 of providing the water. That was what I wanted to say.

17  
18 THE ACTING CHAIRMAN: Thank you very much. We will  
19 now have some questions.

20  
21 MR REID: Thank you very much for your presentation,  
22 Mary. I just wanted to elaborate on the issue of the customer  
23 base and the broadening of that. As you correctly pointed  
24 out, there are a number of users of State Water services  
25 who in some cases do not directly pay for those services  
26 and George elaborated on that a little bit as well.

27  
28 Given the diverse nature of these other users and in  
29 some cases fairly high transaction costs if there was an  
30 attempt to get revenue from them, as a consequence of that  
31 IPART has developed cost sharing ratios such that taxpayers  
32 more broadly funded some of these activities of  
33 State Water. I am just wondering if you can tell me how  
34 practical you think it would be to directly charge these  
35 other groups that you have identified and in what regard do  
36 the cost sharing ratios not reflect the costs that are  
37 incurred by those people?

38  
39 MS EWING: Clearly, if it was easy to make the links they  
40 would already have been done. Probably the one that  
41 springs to mind earliest is rating because that would be  
42 location based, so that you are able to identify  
43 landholders that do have frontage to a river or a lake or a  
44 body of water. Potentially, there's a link there with the  
45 rating base. I recognise that many people who have  
46 landholder rights may also hold other licences as well, so  
47 there is already some overlap there.

1  
2 In terms of the other part of your question about the  
3 cost shares, the Lachlan over the last few years when there  
4 has been no general security water available, general  
5 security users have been paying roughly 80 per cent of the  
6 operating costs of the river and in the last three years  
7 they have received virtually none of the water, but even if  
8 you take it over the last seven or eight years, they  
9 received only about 10 per cent of the flow down the river.

10  
11 I realise that is an extreme situation. It would not  
12 be possible to actually ascribe 80 per cent of the costs,  
13 for example, to basic landholder rights, but we think it's  
14 worthy of additional work to try to come up with some  
15 measure in there that reflects the work that is done by  
16 State Water to meet requirements for basic landholder  
17 rights, base flow in the river, and in these situations  
18 where there is very little water available, we believe they  
19 are not just the beneficiaries but impacters. They are  
20 actually driving the requirement for that service.

21  
22 MR REID: Thank you, Mary. In your submission you  
23 suggest that the high security premium should be linked to  
24 more recent sales data, but yet you oppose the 15-year average  
25 that State Water is proposing more broadly for sales  
26 forecasts. I am wondering whether you can reconcile those  
27 two positions for me.

28  
29 MS EWING: Even if you put high security in there for  
30 15 years, it would provide I think a more realistic  
31 representation. I think what we suggested in our  
32 submission was that - and I know there are difficulties  
33 referred to by State Water - if the long run average was  
34 re-run incorporating the most recent data into the  
35 110 years for high security availability and general  
36 security availability, as well as for the consumption  
37 forecasts, that would provide a fairer reflection of the  
38 relative water available.

39  
40 MR REID: Turning to the issue of rebates to the  
41 irrigation corporations, you have indicated that you agree  
42 that the rebate to the irrigation corporations should  
43 reduce as a result of transformation. At the Griffith  
44 hearing I think Western Murray raised the issue that even  
45 under transformation they were still incurring delivery  
46 costs in that situation, presumably for maintaining  
47 channels and whatever else for you. I am wondering whether

1 you have any contrary view or agree with that perception?

2  
3 MS EWING: I don't really have a view on that. I haven't  
4 looked at it closely enough. Broadly stated, our view is  
5 that the question of rebates and any reduction in rebates  
6 should be entirely transparent. If there is a reduction in  
7 costs to State Water that should be reflected in the  
8 rebate. As the reduction in costs to State Water declines,  
9 equally that should be reflected in a decline in the  
10 rebate.

11  
12 MR REID: Lisa referred to the introduction of the  
13 metering charge and in your submission you have expressed  
14 some concerns about implementation of the New South Wales  
15 metering scheme, but you haven't elaborated on that. I am  
16 wondering if you could expand on your concerns there,  
17 please, Mary.

18  
19 MS EWING: These state priority projects don't seem to be  
20 moving very quickly. I understand that State Water and the  
21 New South Wales Office of Water have to make a business  
22 case to actually be able to spend the money that has been  
23 approved in principle. It seems to me quite a large task  
24 to complete making that business case and actually roll out  
25 the meters over the next four years. That is where our  
26 doubt about the speed of implementing the measuring  
27 program comes from.

28  
29 However, if the metering program is implemented, we do  
30 actually support the metering charge being imposed from  
31 whenever some meters are replaced. We don't actually  
32 diverge from State Water's position on that.

33  
34 MR WARNER: I have just a couple of questions, Mary.  
35 I note that you favour the IQQM model updated to reflect  
36 recent usage as a better estimate for water sales or water  
37 supply. As a layperson I have a little bit of difficulty  
38 in having something that happened in say 1890 or 1910  
39 having the same weight as something that might have  
40 happened in 2005. What would you say to the proposition  
41 that some sort of weighting be applied to the various  
42 components of that, such that the more distant something is  
43 from the present the less of a weighting it has applied to  
44 it?

45  
46 MS EWING: I would want to have a look at it.  
47 Potentially, there is some logic to that argument.

1 However, I would also say that 110 years is not a  
2 particularly long period of time in terms of climatic  
3 variability and climate cycles. In fact, we are not that  
4 different perhaps to where we were in 1895 to 1910. It  
5 would depend on the weighting. What information do we  
6 have that in fact current conditions are more valid than what  
7 happened in 1895?

8  
9 MR WARNER: Yes, I appreciate the point, but what we're  
10 trying to capture is if there is a cycle there somewhere,  
11 that that cycle is somehow reflected.

12  
13 MS EWING: Yes, I agree, and I am asking are we at the  
14 same point in the cycle in 2005 as we were in 1895.

15  
16 MR WARNER: State Water suggested that if we didn't accept  
17 their approach to the high security versus general security  
18 premiums, that the most appropriate mechanism for dealing  
19 with that would be through the water sharing plan  
20 conversion factors which have been suspended. What do you  
21 have to say to that? Is that an appropriate vehicle to  
22 have that reopened or dealt with?

23  
24 MS EWING: I think it is. I realise the difficulties in  
25 developing the conversion factors now, but we would support  
26 a revision of the conversion factors. It doesn't  
27 necessarily mean that we would support a reopening of  
28 conversion, but the conversion factors are designed to  
29 reflect that conversion should not have third party impacts  
30 on remaining licence holder. It should adequately reflect  
31 the relative securities of the different classes of  
32 licence.

33  
34 MR WARNER: In your submission you also argued that a  
35 target for efficiency gains in operating expenditure for  
36 State Water should be equal to the inflation for each year.  
37 On what basis do you believe that that target should be  
38 somehow set equal to the inflation rate?

39  
40 MS EWING: We would say that 2.5 per cent is a reasonable  
41 surrogate for the inflation rate. Many other outside  
42 regulated businesses are aiming to match CPI increases each  
43 year. That is simply a part of doing business, to continue  
44 to make your systems and your operations more efficient,  
45 and our view is that State Water should equally be seeking  
46 to achieve those efficiencies.

47

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1 As we said in our submission, we think State Water has  
2 done a good job getting to here, but we don't think it's  
3 the end. We think that State Water are still operating  
4 with significantly more staff than they had  
5 pre-corporatisation. They had 250-260 staff  
6 pre-corporatisation, so clearly there are increased costs  
7 and increased services required as a result of  
8 corporatisation.

9  
10 However, the implementation of improved systems and  
11 additional technology should in the end enable those staff  
12 numbers to decline. We know that State Water is a business  
13 where a large proportion of their costs is directly or  
14 indirectly associated with staff. Therefore, we believe  
15 that if staff numbers are reduced through the introduction  
16 of approved systems, that efficiency gains can be achieved.

17  
18 MR WARNER: Thank you.

19  
20 THE ACTING CHAIRMAN: Thank you very much for your  
21 presentation and for answering questions.

22  
23 MS EWING: Thank you.

24  
25  
26  
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1 THE ACTING CHAIRMAN: The next presenters are from  
2 Macquarie River Food & Fibre. Could you come forward and  
3 identify yourselves and then commence your presentation.

4  
5 MACQUARIE RIVER FOOD & FIBRE

6  
7 MS MADDEN: Thank you very much. My name is Susan  
8 Madden. I am the Executive Officer of Macquarie River Food &  
9 Fibre. I would also like to acknowledge that we have some  
10 members of our executive committee here today, including  
11 our current Chairman, Tony Wass.

12  
13 As most of you should be aware, Macquarie River Food &  
14 Fibre is the representative irrigator organisation for the  
15 Macquarie Valley in the regulated section of the  
16 Macquarie River downstream of Burrendong Dam and we  
17 represent riparian irrigators, groundwater irrigators, as  
18 well as members of the Valley Severn off-river irrigation  
19 schemes.

20  
21 I think it is worth noting that MRFF has been a strong  
22 supporter of the IPART process over time and we have a lot  
23 of confidence in the process. We are grateful for the  
24 opportunity to be able to present here today. MRFF's  
25 submission this time is built on a number of previous  
26 submissions that we have provided to IPART on State Water  
27 pricing.

28  
29 We are here in basic support of our written submission  
30 and I am happy to take questions on any aspect of that  
31 during question time. I would like to use the time in my  
32 presentation to focus on some of the key issues of concern  
33 that we have in the Macquarie Valley with State Water's  
34 pricing proposal. In particular, Lisa has already looked  
35 at a couple of these issues in relation to capex, but we  
36 would like to see reconciled differences that we have  
37 looked at in terms of opex and capex forecasts for the  
38 valley, in terms of figures that we have previously been  
39 aware of through the customer service committee compared to  
40 those in State Water Corp's submission.

41  
42 We would also like to re-raise the issue of flood  
43 mitigation and the role that the flood mitigation zone in  
44 Burrendong Dam has. We would ask that that be recognised  
45 and that costs be allocated accordingly.

46  
47 The third point that I will speak about in some detail

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1 today is that it's no surprise that MRFF, along with a  
2 number of other irrigator groups, or all of the irrigator  
3 groups, reject the 15-year rolling average as put forward  
4 by the CIE and by State Water Corp. We reject both the  
5 underlying basis that has been argued for a required change  
6 as well as the method that has been put forward as the  
7 proposed change.  
8  
9 Just to recap, these are the price increases that we  
10 are looking at for the Macquarie Valley. The high security  
11 entitlement. Again, it's a matter of how we present  
12 numbers, isn't it, because we are looking at an increase  
13 over the four-year period and we are looking at  
14 185 per cent on the high security entitlement. The general  
15 security entitlement is obviously less of an increase, but  
16 over a four-year period it's 4.2 per cent, and then we're  
17 looking at what we would consider to be a significant  
18 increase in the fixed charge, which we understand to be  
19 mainly driven by the consumption forecast, and approaching  
20 that 79 per cent.  
21  
22 Irrigators in this valley have a lot of difficulty in  
23 digesting these kinds of significant price increases and  
24 they appear to be an ongoing feature of these pricing  
25 determinations.  
26  
27 Mary has spoken about - and no doubt the New South  
28 Wales Irrigators' Council and others would have spoken  
29 about - whether or not these costs can be justified and  
30 whether or not things such as the WACC and consumption  
31 forecasting is really just another means of passing on  
32 State Water Corp's natural business risk to its customer  
33 base instead of in fact sharing some of that with its  
34 shareholders.  
35  
36 Looking at our first issue, which is the  
37 reconciliation of the opex and capex figures for the  
38 Macquarie Valley, we certainly advocate the provision of  
39 valley based reports through the CSC process. We have  
40 raised some concerns in relation to some differences here.  
41 It is worth saying that we acknowledge that State Water  
42 provided the information to us in good faith and that they  
43 were preparing for the submission process and some of the  
44 final figures may not have been available in earlier  
45 meetings of the CSC. We appreciate Lisa coming back today  
46 and we understand that there will be further review of  
47 these figures throughout the determination process.

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1  
2 However, it's probably worth noting that when we see  
3 differences like this there is obviously some erosion of  
4 stakeholder confidence in the systems that State Water have  
5 in place for their financial management, as well as erosion  
6 of the actual instruments of the valley based reports.  
7  
8 Looking at the impact for the opex figures, there was  
9 in fact an 8 per cent variance in the 2009-10 opex budget  
10 that we have previously seen compared to the 4.254  
11 presented to IPART. I think it's worth noting that  
12 I haven't time to review in any real detail the  
13 Atkins Cardno review report, but they also raised some  
14 issues - from skimming that document - with the variation  
15 in the figures for the Macquarie, as well as a couple of  
16 other valleys, that they considered to be material  
17 increases. I understand that there will be some further  
18 review as to what makes up those variances.  
19  
20 It is also worth raising at this point that thematic  
21 expenditure is one thing that we're seeing that's causing  
22 some overall increase in opex for State Water. When we  
23 previously looked at how thematic expenditure might apply  
24 to the Macquarie, it didn't look to have such a material  
25 influence on our valley figures, so we would be interested  
26 to see whether that has changed and if it hasn't changed,  
27 what impact it is that's driving a variance of 8 per cent  
28 in opex figures.  
29  
30 We also saw variance in the capex forecast program.  
31 Lisa has provided a reconciliation of that today for which  
32 we're grateful and we'll obviously digest that in more  
33 detail. She did mention that the Gin Gin Weir upgrade had  
34 been taken out of the figures, which accounted for some of  
35 the difference. There were also some fish-way expenses  
36 that we felt should have been included in operating  
37 expenditure rather than capex, so we would also need to  
38 check that that has in fact been done and I trust it  
39 probably has.  
40  
41 Again, there are probably differences relating to  
42 timing. However, obviously considering the impacts of the  
43 RAB and these issues, it's important that stakeholders have  
44 a clear understanding of what constitutes efficient and  
45 prudent capex.  
46  
47 Just to close on that issue, we would obviously like

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1 to see some further review of those figures and we would  
2 probably support the recommendations from the Atkins  
3 Cardno report in that respect.  
4  
5 The second issue that I would like to go through is  
6 the flood mitigation role of Burrendong Dam. This is an  
7 issue that MRFF has raised in previous submissions. There  
8 is certainly a recognised official role of flood mitigation  
9 in the dam and therefore we would question why this isn't  
10 recognised under the IPART impacter-pays approach.  
11  
12 I have with me a letter from State Water which relates  
13 to the re-formation of the Flood Mitigation Zone Reference  
14 Group, which is a subcommittee of stakeholders, and in this  
15 letter it very clearly acknowledged that Burrendong Dam  
16 does have a flood mitigation zone which is a specific area  
17 designed to store additional water in the case of flooding.  
18 The letter goes on to encourage participation from a wide  
19 stakeholder group which is representative of the diverse  
20 views of the river valley and the diverse range of  
21 stakeholders who would be affected by flood issues and who  
22 therefore drive the cost for the flood mitigation zone.  
23  
24 To quantify this impact, Burrendong Dam has a total  
25 storage capacity of 1.678 million megalitres and of that,  
26 489,000 megalitres is in fact a designated flood mitigation  
27 area and that was officially recognised with the  
28 construction of the Burrendong Dam. That accounts for  
29 about 29 per cent of the total storage capacity.  
30  
31 This is a table that has been previously presented by  
32 MRFF to IPART as to how you might allocate the costs. This  
33 may be more along the lines of the beneficiary pays  
34 approach, but it does I think highlight very clearly those  
35 members of the community who are getting benefit from the  
36 flood mitigation role of Burrendong Dam in terms of avoided  
37 impact if there was dam failure, but I think that could  
38 also be used as potentially a way of how costs may be  
39 allocated in that the official purpose of it was for flood  
40 mitigation.  
41  
42 Going on from that, our recommendation in this respect  
43 would be that the flood mitigation role of Burrendong Dam  
44 must be recognised and that the associated infrastructure  
45 and storage costs be allocated to groups in line with the  
46 impacter pays approach. Going on from that, the important  
47 point there is that it's in proportion to the contribution

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1 that each individual or group makes to creating the cost.  
2  
3 The third point that I am going to speak about in some  
4 detail is of course the consumption forecasting approach.  
5 We have issue with the 15-year rolling average approach in  
6 terms of both the case that State Water through their  
7 consultants, CIE, have put forward for change and also an  
8 issue with the methodology that they've been proposing to  
9 address that change.  
10  
11 We feel that the case is flawed and that in effect the  
12 15-year rolling average is an ineffective means of  
13 addressing what may be an issue with water availability due  
14 to climate change. To recap what this means for the  
15 Macquarie Valley, it is quite a significant impact.  
16 We will look at a table in a minute, but I think we are  
17 facing the largest change in consumption forecasts of all  
18 the valleys from the proposed approach. We therefore take  
19 significant issue with it.  
20  
21 We are looking at a reduction in the consumption  
22 forecast figures from the current determination of  
23 30.1 per cent and as a result of this, we think it would be  
24 the primary driver for the significant increase that we're  
25 looking at for usage charges.  
26  
27 Our argument is really not around whether or not  
28 climate change may or may not be happening. It is more  
29 about how you might recognise changes in water  
30 availability. I think it is fair to say that there is  
31 still a large degree of uncertainty in the science around  
32 this and it is a forecasting and a predicting approach, so  
33 obviously that's something that we're not going to be able  
34 to get 100 per cent right.  
35  
36 We hear a lot about the CSIRO report on the  
37 sustainable yields project being the best available science  
38 that we have on this matter at the moment. If we look at  
39 what the findings from CSIRO are for the Macquarie Valley,  
40 we are looking at a wet extreme of a possible 25 per cent  
41 increase in water availability and then a dry extreme of a  
42 negative 25 per cent change in water availability. We are  
43 looking at volatility, but it could be up and it could be  
44 down. Their best estimate for water availability is a  
45 reduction of 8 per cent. We are talking about a period out  
46 to 2030, so we're talking about a long-range projection.  
47 Their best estimate for surface water diversions is a

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1 reduction of 4 per cent. Even if we look at these figures,  
2 they're well within what the 15-year average would do for  
3 the Macquarie which is a minus 30.1 per cent change.  
4  
5 On that basis, the CIE - who in the last determination  
6 were actually commissioned by IPART - also considered the  
7 impacts of climate change at that time and rejected  
8 State Water's proposal at that stage, which was I believe  
9 IQQM minus a standard deviation. They couldn't see the  
10 basis at that point for a change in using IQQM. Given that  
11 we are looking at a forecast tool, we are still trying to  
12 rely on average figures, so why not use the best available  
13 information that we have, the information that is available  
14 over the longest time set, which we believe to be IQQM. As  
15 Mary previously submitted, that IQQM could be upgraded to  
16 include the recent drought years.  
17  
18 The CIE has acknowledged in their current report for  
19 State Water Corporation that climate change is a long-run  
20 proposition, so I think it is fair that a long-run average  
21 approach be maintained for determining possible water  
22 availability.  
23  
24 The second issue that we had with the consumption  
25 forecasting approach - and I have already touched on this -  
26 is that even if there was a basis for change, that the  
27 long-run average, the 15-year average, is probably an  
28 ineffective way of doing this. Again, just to draw on  
29 comments made in the CIE report, they noted that through  
30 their statistical analysis relating to what they determined  
31 to be a structural break in water availability, that there  
32 was at least evidence of a structural break in the northern  
33 and central valleys and greatest evidence of a structural  
34 break in terms of potentially reduced water availability in  
35 the southern valleys.  
36  
37 If we look at the model that they proposed to use for  
38 consumption forecast and then the 15-year average, the  
39 greatest impact is in fact happening in the northern  
40 valleys, so obviously the Macquarie and also border rivers  
41 and the Namoi River take a fair WACC under this approach as  
42 well. On that basis it's fair to say that we think that  
43 the model that they've put forward is an ineffective means  
44 of addressing the problem that they have identified.  
45  
46 On that basis, we would urge IPART to reject the basis  
47 and the method for change in the consumption forecasting

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1 approach. We would submit that we retain the long-run  
2 average approach based on IQQM, as has been used in  
3 previous determinations and updated to include the most  
4 recent data.  
5  
6 To go on from this - and Mary has touched on this in  
7 quite a bit more detail - we think that with State Water  
8 Corp, particularly in trying to drive a frontier company  
9 and seek further efficiencies, there are probably other  
10 avenues that should be looked at for trying to manage some  
11 of their risk. We have listed debt funding, shortfalls and  
12 investment services previously as a means of doing this.  
13 We would also support the idea of widening the customer  
14 base.  
15  
16 In our submission we have talked in a little bit more  
17 detail about that. We heard very clearly from both George  
18 and Lisa this morning that the people who rely on  
19 State Water are many and numerous and are quite time  
20 consuming in their demands. We also heard from George that  
21 State Water would be very comfortable with widening the  
22 customer base, the stock and domestic and basic landholder  
23 rights.  
24  
25 I will wrap up in terms of what we are presenting  
26 today by saying that State Water have very clearly painted  
27 a picture of the very dire financial situation that they  
28 face. As representatives of an irrigator group, we find it  
29 a little bit unpalatable and hard to digest that they would  
30 then propose to put a significant shift in their business  
31 risk which would be felt by their customer base, which we  
32 feel at this stage is quite a narrow customer base and who  
33 are also going to be subject to much the same financial  
34 pressures during these times of reduced water availability.  
35  
36 Some of the means that we have seen of them trying to  
37 shift this risk have included an increased WACC, changes to  
38 consumption forecasts and then failing that, perhaps we may  
39 need to look at changes to the ratio of fixed and variable  
40 usage charges. We don't feel that any of these methods are  
41 palatable to irrigators.  
42  
43 We would like to see State Water Corp as a frontier  
44 business seeking further efficiencies as well as looking at  
45 implementing other risk management approaches and one of  
46 those might be to include a widening of the user base in  
47 the Macquarie Valley. We have also clearly demonstrated

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1 that we think that the flood mitigation role is another  
2 cost that needs to be more broadly shared than to just put  
3 it on the customer base.

4  
5 Having focused on just a few of the key points from  
6 today, we would like throughout the course of this  
7 determination a further opportunity to see the  
8 reconciliation of the opex and capex figures. We would  
9 like to see the flood mitigation role recognised. We would  
10 like to see a wider user base recognised and have costs  
11 allocated accordingly. It is fair to say I think that we  
12 would like to see the 15-year rolling average rejected by  
13 IPART as well. Thank you very much and I am happy to take  
14 some questions.

15  
16 THE ACTING CHAIRMAN: Thank you. We will take  
17 questions now starting with Colin and Richard.

18  
19 MR REID: Thank you, Jim. Thanks very much, Susan, for  
20 your presentation and elaborating on those points in your  
21 submission. There are a couple of other issues that you  
22 have raised in your submission. One of them is the  
23 allocation of MDBA costs to Macquarie and what you're  
24 indicating is that Macquarie is a terminal system. I was  
25 just wondering with the increased broadened role of the  
26 MDBA whether there are some costs that they will be  
27 incurring in future which may directly relate to Macquarie?

28  
29 MS MADDEN: Yes. I think in terms of the costs that have  
30 arisen from the previous Murray-Darling Basin Commission,  
31 we don't see that Macquarie Valley should be subject to  
32 those costs. The MDBA certainly will have a role going  
33 forward in basin-wide management and which of those costs  
34 will be through State Water and which of those will be  
35 through the determination process from the Office of Water,  
36 I'm not sure.

37  
38 MR REID: Thank you for that. Obviously, the increases  
39 proposed for Macquarie are much higher than some of the  
40 other valleys. State Water did commission a study looking  
41 at customer impacts. I am just wondering if you can  
42 elaborate on your views as to the adequacy of that study  
43 and give us some more information on, for example, the  
44 share of on-farm costs that are represented by water  
45 charges in a normal year?

46  
47 MS MADDEN: To be perfectly honest, I actually found the

1 RMCG consultancy fairly inadequate and I probably didn't  
2 give it that much weight in our submission either.  
3 It seemed to me that they focused on a couple of years of  
4 ABARE and ABS stats which were static in time and may not  
5 be representative of normal years in irrigation.

6  
7 Water charges may be a small percentage of overall  
8 costs of production. Having said that, there are many and  
9 varied costs of production. Given that there is limited  
10 ability to be able to pass on any costs, when we're looking  
11 at well above CPI increases in book costs, then we're going  
12 to have to look at that regardless of what component they  
13 may cover in the overall cost base.

14  
15 MR WARNER: I would firstly like to thank you for your  
16 presentation. I particularly found your critique of the  
17 15-year average most useful. Thank you. I note that you  
18 favour the IQQM model provided it is updated to reflect  
19 recent usage. I will put the same question to you that  
20 I put to Lachlan. I have a little difficulty giving same  
21 weightings to each year. What would you say to us applying  
22 some sort of weighting over time to that series?

23  
24 MS MADDEN: Yes. As much as I thought that you would  
25 probably ask me that question, I wasn't quite sure how to  
26 respond, because I'm not really clear why you do have  
27 trouble with not being able to give the same recognition to  
28 something that as you said may be in the 1890s. As  
29 I understand it, the IQQM is under the current management  
30 rules and that kind of thing is a simulation over time and  
31 represents variation and climatic variability.

32  
33 I understand that we may now be looking at climate  
34 change and what might happen over a period of time, but  
35 looking at the CSIRO report which says maybe under a best  
36 estimate we might be getting a 4 per cent change out to  
37 2030 - okay, that's only 20 years away, but we're getting  
38 closer - I think if we keep it up to date and we put in  
39 recent years, IQQM still has the ability to adjust going  
40 forward and that adjustment is going to be over the longer  
41 term, which is I think when we would expect climate change  
42 to occur.

43  
44 MR WARNER: Yes. It wasn't directly related to climate  
45 change. We sometimes hear stories of very long cycles in  
46 water of 30 to 50 years, but anyway, thank you for that.  
47 I have one other question. It has been put to us by the

1 Peel Valley Water Users Association that they think there  
2 should be a common price across all valleys. They are in  
3 favour of getting away from valley based charging. Do you  
4 have a view on valley based charging?  
5  
6 MS MADDEN: We would say that we would not be in favour  
7 of that and we are not in favour of the cross-subsidisation  
8 across the valleys which that would obviously imply.  
9  
10 MR WARNER: Thank you very much.  
11  
12 THE ACTING CHAIRMAN: Perhaps one further question on  
13 the 15-years thing which has been so contentious. From our  
14 point of view, we are trying to produce a forecast over a  
15 fairly short period of time, the next four years over which  
16 the next determination will run. One thought about the  
17 15 years is that recent years may be more reflective of  
18 what is likely to happen over the next few years than say  
19 the full 100 or 115 years of data and because we're looking  
20 at a short-term forecast, perhaps the longer term forecast  
21 produced by the CSIRO is less relevant for our purposes.  
22 I would be interested in your thoughts on those issues.  
23  
24 MS MADDEN: I suppose my thought on those issues is that  
25 we are not really sure what the short-term outlook may look  
26 like, obviously, which is why we need to go for a  
27 forecasting approach, but I'm not convinced that just  
28 because we've seen what we've seen in the short term, why  
29 that is going to impact on the longer term.  
30  
31 Maybe the other issue that we have here with  
32 consumption forecasting, which I didn't talk about so much  
33 today but I go into a little bit more in the submission -  
34 and Mary did touch on it - is the whole situation with  
35 State Water Corp's financial situation. Yes, we have been  
36 through extreme conditions in the last four years and yet  
37 operating costs have still been covered and there has been  
38 a very small return on assets.  
39  
40 I think we need to think about why do we consider that  
41 the current model is broken as such and that even though we  
42 are well below where we expected consumption to be over the  
43 past determination period, I don't think that the impact on  
44 State Water has been quite as severe as they've portrayed.  
45 I don't think we'd be having the same discussion if we'd  
46 had four abnormally high years of rainfall and high water  
47 availability and I don't think State Water have addressed

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1 how they would have dealt with that situation.  
2  
3 THE ACTING CHAIRMAN: Thank you very much for your  
4 presentation and for answering questions. We will now have  
5 a session in which we will take questions and comments from  
6 people sitting in the audience. That will be followed by  
7 an opportunity for response by State Water. If you would  
8 like to ask a question or make a comment, please do so,  
9 just indicate, and we'll try to get a microphone to you.  
10 Please introduce yourself for the benefit of the  
11 transcriber. Are there any questions?  
12  
13 MR WARNER: I have a question. George, very quickly, the  
14 issue of flood mitigation in Burrendong Dam was raised and  
15 how do we treat that. How would you like to respond to  
16 that issue? Do you have a response to that issue?  
17  
18 MR WARNE: We have actually done a little bit of research  
19 on this and Lisa has the answer. The point I'd make is  
20 that a lot of the dam safety work is about preparing these  
21 dams for exactly that flood and it has been heavily  
22 sponsored by our shareholders and I think we always ought  
23 to recognise that. We have to encourage them to keep going  
24 with this dam safety work rather than choose some other  
25 more passive methodology, like dismantling the dam or  
26 something like that.  
27  
28 MS WELSH: My understanding of the situation is that IPART  
29 has previously considered this issue, particularly in terms  
30 of how they allocated the regulatory asset base for  
31 Burrendong and the Macquarie River. I have some updated  
32 figures just to put this into perspective.  
33  
34 I noticed that Susan presented a number of figures  
35 about the overall capacity of Burrendong being 29 per cent  
36 for flood mitigation. The government's share of the  
37 regulatory asset base, the closing value as at 2009-10 and  
38 assuming that State Water does fully deliver on its capital  
39 program, will be 58 per cent, but I think that that  
40 regulatory asset base share already means that the  
41 government is paying a large part of the costs of that  
42 asset and that in fact that share is going to increase even  
43 further to 67 per cent over the next four years as a result  
44 of the dam safety upgrade program.  
45  
46 Yes, we look to IPART if they want to go back and  
47 revisit those numbers, because there is a lot of grey area

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1 in determining those cost shares, but I would like to make  
2 the point that the government already does fund the bulk of  
3 the cost of assets in the Macquarie Valley.

4  
5 THE ACTING CHAIRMAN: Are there any other questions or  
6 comments?

7  
8 MR WASS: Tony Wass from Macquarie River Food & Fibre.  
9 I would like to address the issue of the questioning of the  
10 IQQM model and suggesting that there might be some  
11 weighting against the earlier figures. I think that's  
12 really questioning the statistics. I think the IQQM model  
13 uses hard figures over the 110 years and I think that if  
14 that is updated to alter the weightings of those figures,  
15 that is simply fiddling with statistics and where do you  
16 stop.

17  
18 We are simply indulging in the same argument about  
19 whether we have a 15-year rolling average or whether we  
20 have 110 years. I think that if you're going to reject the  
21 15 years process, as we do, you have to go and accept the  
22 hard figures of the IQQM model and update it to the present  
23 day and leave it at that.

24  
25 THE ACTING CHAIRMAN: Thank you. Are there any other  
26 questions or comments?

27  
28 MS MADDEN: Just to go back to Lisa's response about the  
29 government's shares, isn't it fair to say that those shares  
30 are based on the IPART government user defined shares  
31 which are applicable across all dams and based on the table  
32 that we see in the issues paper and therefore, I don't actually  
33 think that that addresses the issue of the flood mitigation  
34 of Burrendong Dam.

35  
36 THE ACTING CHAIRMAN: Lisa, we will let you respond at  
37 the end perhaps. We will see if there are any others first.  
38 We will ask State Water if they want to respond to what has  
39 been said during the day, including Burrendong Dam.  
40 Thank you.

41  
42 MR WARNE: Thank you very much for the opportunity to  
43 respond. We will just run through a few issues. Clearly,  
44 there are discussions about the dam safety issue and as  
45 I said earlier in response to a comment, I think we ought  
46 to be very grateful that our shareholders are taking so  
47 seriously their responsibilities for the pre-1997 works.

1 There is of course an efficient economic argument that it  
2 is a modern requirement to have a safe dam and that the  
3 principal beneficiary should pay. That is not one that  
4 State Water has supported, but certainly I think we ought  
5 to take the opportunity that the state has offered us to  
6 complete this dam safety program and get cracking and  
7 that's obviously our responsibility.

8  
9 We heard Mary's comment earlier about basic landholder  
10 rights and how there are large numbers of beneficiaries  
11 along our regulated river system that enjoy the benefit of  
12 river frontage but pay nothing. They cause us a lot of  
13 anxiety. They ring our organisation. They ask us about  
14 changes in river height. They get annoyed when we kill the  
15 lilies in their ponds at the front of their billabongs.

16  
17 I think there is a real opportunity here, but to the  
18 farming community I'd say you need to bring the New South  
19 Wales and the National Farmers along because traditionally  
20 farmers have bitterly opposed any landholder based charge  
21 for the benefits provided by a regulated river. I think  
22 that it's something that's actually worthy of some merit as  
23 we see increasing numbers of lifestyle and other users  
24 taking enormous benefit from their basic landholder rights.

25  
26 The comment was made earlier that the state priority  
27 projects do not seem to get moving very quickly. These are  
28 priority projects with regard to the Murray-Darling Basin,  
29 \$13.8 billion, \$1.4 billion of which has been attributed to  
30 New South Wales. I would say you are spot on, they don't  
31 seem to get moving very quickly, despite our enormous  
32 enthusiasm for one or two of those projects. We would like  
33 to think that during this period we do get cracking on  
34 those projects and that there are some spin-off benefits  
35 for the irrigation community.

36  
37 I just want to spend a minute on your comments about  
38 the IQQM model and how wonderful it is. The IQQM model  
39 has failed. It has failed State Water big time. We got  
40 29 per cent of the water that we thought we would get  
41 during the four-year period. We need to do something else.  
42 For those who think that the IQQM picks up all of the  
43 related issues and for those who don't even believe in  
44 climate change, I think we have to deal with the issue that  
45 the farm dams policy has failed us and in the recovery from  
46 drought stream flows simply don't occur to replenish even  
47 small quantities of water in the bottom of our dams.

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1  
2 We have significant changed land use upstream of the  
3 dam sites which is not picked up in the IQQM model and  
4 I think we've also failed in terms of our groundwater  
5 monitoring and use and groundwater use and abuse has led to  
6 significant changes in the commencement of flows for a lot  
7 of the streams, particularly streams that are recovering  
8 from drought.  
9  
10 When you add to that the issue of climate change and  
11 you look at the experience of the last four years, we are  
12 requesting that IPART seriously consider a changed look at  
13 what model is going to work to determine what the likely  
14 water sales for this organisation are going to be during  
15 the next four or five years.  
16  
17 The comment was made that when State Water's  
18 organisation was a ring-fenced part of the greater  
19 Department of Water and Energy some years ago, it had about  
20 260 people. I think that is probably worthy of some  
21 further review because I would imagine that there was a  
22 cost of \$5 million to \$7 million in corporate overheads  
23 being paid to government to reflect the benefits of  
24 insurance policies, personnel departments,  
25 payroll departments and even things as simple as billing  
26 and otherwise. I think you may find that full-time  
27 equivalent staff members, who were people providing  
28 services that today relate to the services provided by  
29 State Water, might be a figure more like 400. I think that  
30 would require some further careful thought.  
31  
32 The point about low sales is no longer theoretical.  
33 If IPART chose some model other than the 15 years that we  
34 have proposed then the irrigators are really saying the  
35 last four years are such a huge anomaly that they'll never  
36 happen again and that they would really be much happier to  
37 pay much higher fixed charges because they're so likely to  
38 get all their water. I think we have to follow that to its  
39 logical conclusion. We have two issues. State Water are  
40 saying that based on the modelling we think there will be  
41 significantly less water. We think that the volatility we  
42 have experienced in the last 15 years is going to be  
43 ongoing - less water and a more volatile availability of  
44 the water.  
45  
46 I think that the higher fixed charges for high  
47 security users is an issue that requires some thought.

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1 Irrigators need to be aware when they're advocating a  
2 reduction in those proposals that they're actually  
3 advocating a much higher charge for general security users;  
4 as long as they fully understand what they're saying when  
5 they advocate that.  
6  
7 We have seen what we believe was a windfall gain to  
8 high security users in some valleys during some of the  
9 recent years and we think that the cost of water is so much  
10 a small part of their business compared to the costs  
11 imposed on irrigators with very little water. As long as  
12 the advocates of lower fixed charges for high security  
13 users recognise what they're doing, they're actually  
14 advocating higher charges for general security users, but  
15 I guess they would be reluctant to say that out loud. They  
16 are the only points I wanted to make.  
17  
18 MS WELSH: I have a couple of supplementary points. First  
19 of all, just picking up on Mary's point, the fact that we  
20 achieved an infinitesimal positive return on assets over  
21 the current drought and holding that up as a sign that  
22 there is nothing wrong with the current system, I would  
23 totally disagree that the fact that we narrowly avoided  
24 borrowing to have to pay for our operating expenses and our  
25 wages bill, that that is a sign that there's not something  
26 broken at the moment.  
27  
28 As a regulated monopoly it's extraordinarily difficult  
29 to almost completely fail to make a rate of return on your  
30 assets. I think that that is a sign in itself that again,  
31 as George said, there is something wrong.  
32  
33 Also, the suggestion that perhaps we could somehow  
34 retain some of our revenues as a buffer against times of  
35 drought, this is something that was raised quite a lot  
36 during our discussions with the CSCs. In one way it's  
37 actually tantamount to not paying dividends which, again,  
38 State Water does not support as a commercial enterprise.  
39 We are required to pay a reasonable rate of return to our  
40 shareholders and that's something that we stand by.  
41  
42 Also, I would argue that the Commonwealth Government's  
43 Farm Deposit Scheme is a much surer and safer way for  
44 irrigators to insulate themselves against periods of  
45 drought and that allowing State Water to effectively  
46 in-source that service for them is a highly risky one,  
47 especially when we are a corporation wholly owned by the

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1 government who does enjoy their rate of return from us.

2

3 I am also concerned about what is emerging as an  
4 apparently contradictory view in the sense that on the one  
5 hand we should be diversifying our customer base, in  
6 particular to encompass stock and domestic uses because as  
7 we become dryer they are going to be an increasing  
8 percentage of our costs, and yet on the other hand we are  
9 all going to return to normal conditions under the IQQM.

10

11 I would argue that you can't actually have it both  
12 ways. Either we're going to have less water and therefore  
13 stock and domestic users are going to bear a higher  
14 percentage of the cost of running the system, or it's going  
15 to be the same as always where they don't pay very much  
16 because they're receiving hardly any of the water anyway  
17 relative to everybody else.

18

19 My last point would be just on the question that you  
20 asked Susan about, whether users in the Macquarie Valley  
21 ought to be facing some of the costs associated with the  
22 Murray-Darling Basin Authority's broader basin  
23 requirements. My understanding is that all of those costs  
24 are actually directly funded from the Commonwealth, so  
25 certainly within the amount that State Water reflected in  
26 its IPART submission, it only included the previous costs  
27 of the Murray-Darling Basin Commission and excluded all the  
28 basin plans. My understanding is that none of those costs  
29 should be passed on to users in the Macquarie.

30

31 THE ACTING CHAIRMAN: Thank you very much. I think  
32 that brings us to the end of our Dubbo public hearing. We  
33 have had a very good discussion of issues that are particularly  
34 relevant to water users in this part of the state and  
35 I think we have learned a lot about the circumstances of  
36 the state and the issues being faced by State Water and by  
37 their customers. Thank you very much for your assistance.

38

39 We move to Moree next week, that will be the next  
40 public hearing, and then we will consider everything that  
41 has been said at all the public hearings and produce a  
42 draft report in the new year. Once again, thank you very  
43 much for your attention and participation.

44

45 AT 1PM THE TRIBUNAL ADJOURNED ACCORDINGLY

46

47

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