

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 of Water
Mr Richard Warner, Program Manager Water Pricing**

**Held at Griffiths Ex-Servicemen's Club
Jondaryan Avenue, Griffith**

**On Monday, 23 November 2009, at 9am
.23/11/09 1**

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1 WELCOME AND INTRODUCTION

2
3 THE ACTING CHAIRMAN: Good morning, ladies and
4 gentlemen. It's nine o'clock, so I think we might make a start.
5 I would like to welcome you to this public hearing. We are
6 inquiring into the maximum prices the State Water
7 Corporation will be permitted to charge for bulk water
8 services in New South Wales for the period commencing on
9 1 July 2010.

10
11 I would like first to introduce ourselves. I am
12 Jim Cox and I am acting Chairman and Chief Executive
13 Officer of the Tribunal and I'm joined on this review by my
14 fellow Tribunal member, Sibylle Krieger, on my left.

15
16 IPART last determined prices for State Water's bulk
17 water services in 2006. That price determination covered a
18 four-year period which is due to expire on 30 June 2010.

19
20 As part of this investigation the tribunal released an
21 issues paper in July 2009 which set out key aspects of the
22 review's process. The issues paper outlines some of the
23 matters which the tribunal considers are important to this
24 review, the matters that the Act says it must take into
25 account when conducting an investigation and also a draft
26 timetable for the review.

27
28 In the issues paper the tribunal called for
29 submissions from State Water, its customers and other
30 interested stakeholders. We are grateful to those who have
31 taken the time and trouble to make a submission. A number
32 of the organisations that made submissions to the review
33 will be presenting their views to this hearing today and
34 all submissions received will be carefully considered by
35 the tribunal in developing its findings and
36 recommendations.

37
38 The tribunal considers this to be a very important
39 investigation. At the last determination IPART determined
40 that State Water required revenue of \$333 million over the
41 term of the last price-path period. Of this total some
42 \$234 million was expected to be recovered from tariffs paid
43 by extractive users and the balance was effectively paid
44 for by the state government on behalf of the broader New
45 South Wales community.

46
47 In its submission State Water Corporation has argued

1 that drought conditions have meant it has not been able to
2 generate the revenue that was forecast at the time of the
3 2006 determination and a deterioration of this low level of
4 revenue will threaten State Water's long-term viability.

5
6 State Water has suggested a range of measures that it
7 would like to see put in place to address the matter of
8 climate induced revenue volatility. These include changing
9 the manner in which future water supply availability is
10 estimated, changing the charging structure and also
11 adjusting the allowed rate of return to reflect the
12 increased risk. We will be exploring these issues more
13 fully over the course of this review and I have no doubt
14 that they will be a key feature of presentations and
15 discussions today.

16
17 State Water is forecasting an increase in operating
18 expenditure of almost 9 per cent in real terms over the
19 next four years. Much of this is due to what it terms
20 thematic expenditure items. We will be seeking to
21 explore the reasons for these additional costs today.

22
23 State Water has also forecast a significant increase
24 in capital expenditure from some \$170 million over the four
25 years to 2009-10 and that's going to increase to
26 \$342 million over the four years 2013-14. That is an
27 increase from \$170 million in the present price-path period
28 to \$342 million in the next price-path period.

29
30 Compliance with pre-1997 dam safety requirements makes
31 up a significant proportion of this expenditure and this
32 expenditure will be met by the government if existing cost
33 shares are maintained. However, significant capital
34 expenditure is forecast on the renewal and replacement of
35 assets and upgrading and modernising water delivery and
36 operational aspects of State Water's business.

37
38 State Water is also proposing that a premium should be
39 introduced on high security entitlements to reflect the
40 value of water under changing seasonal conditions. The
41 scarcity premium would change through time depending on
42 the relative availability of general security water. The
43 changes that are proposed by State Water will impact the
44 prices that it charges for services. However,
45 State Water's proposed charges seem to be less in this part
46 of the State than elsewhere, at least for general security
47 entitlement holders.

1
2 The same could not be said for high security
3 entitlement holders. We estimate that for the Murray-Lower
4 Darling, State Water is proposing to increase the
5 entitlement charges by 68 per cent over four years.
6 For the Murrumbidgee, the increase will be 42 per cent.
7 This increase is largely driven by State Water's proposed
8 scarcity premium.
9
10 The general security entitlement charge is projected
11 to decrease by 15 per cent in the Murray and by 23 per cent
12 in the Murrumbidgee. Water usage charges are predicted to
13 increase by 36 per cent in the Murray and by 1.4 per cent
14 in the Murrumbidgee.
15
16 This hearing is a very important part of the broader
17 price review process. It provides an opportunity for the
18 tribunal to hear in a public forum from State Water and
19 other stakeholders and to question the propositions that
20 they put forward. The submissions made by State Water and
21 stakeholders are available to the public through the
22 Tribunal's website.
23
24 Before we commence proceedings today I would like to
25 say a few words about the process for this hearing. You
26 have available to you a timetable which indicates the order
27 in which organisations will be presenting before the
28 tribunal. For each organisation there is a presentation
29 time that has been allowed and this will be followed by a
30 period for questions by the tribunal.
31
32 Assisting the tribunal today are Tribunal Secretariat
33 members Mr Colin Reid, Director of Water, over on my far
34 left, and Mr Richard Warner, Program Manager Water Pricing,
35 is next to him.
36
37 At the conclusion of all the scheduled presentations
38 I will make time available for members of the public to
39 express their views and opinions on the proposals that have
40 been put forward before us by State Water and other
41 stakeholders. State Water will then be given a short
42 opportunity to respond to matters raised during the day
43 should it so wish.
44
45 The tribunal will consider all the submissions
46 received and all that is said today when it makes its
47 decisions on bulk water prices for State Water. The

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1 tribunal plans to release a draft report and draft
2 determination for public comment in March 2010. Interested
3 parties will have a four to five-week period to make
4 submissions for consideration by the tribunal before it
5 makes its final decisions and a final report and
6 determination will be released in June 2010.
7
8 We commence proceedings today with State Water.
9 I would ask the representatives of State Water to come
10 forward and introduce yourselves. Can you state your names
11 and positions for the record and then commence your
12 presentation.
13 STATE WATER CORPORATION
14
15 MR WARNE: Good morning and welcome. For those of you
16 who don't know me, I am George Warne from the State Water
17 Corporation. In order to keep this thing on time I am
18 going to speak very quickly. Fortunately, Lisa Welsh
19 will be presenting the larger part of our submission -
20 fortunately for you I'd say.
21
22 Could I just very quickly run through the bones of our
23 submission. I intend to outline our achievements during
24 the four-year period in terms of water delivery, opex and
25 capex and some of you might say we haven't done so well in
26 water delivery. We would argue there have been very
27 limited resources. We will talk about the impact of the
28 drought on the State Water business very briefly. We will
29 talk about our financial viability and as you'll be aware,
30 there's a complex balance there between the charges you pay
31 and the contribution the government makes towards its
32 commitments for infrastructure construction.
33
34 We will talk about the changes to prices specifically
35 in the Murray and Murrumbidgee and we will try very briefly
36 to talk about managing the impact on our customers.
37
38 In terms of water sales, interestingly, I was on the
39 other side last time when Abel Immaraj said that perhaps
40 the tribunal should be generous enough to consider a
41 reduction of water availability in the forecasts. We argued
42 that was ridiculous. You should look to 150 years of data
43 and the return to flood conditions at any moment. However,
44 I might have been wrong.
45
46 It is nowhere more starkly shown than in this presentation
47 here. In the regulatory forecast it was agreed that

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1 State Water would sell about 5.5 million megalitres a year
2 based on the historic data from the nine river valleys.
3 The key drivers for State Water are the Murray and the
4 Murrumbidgee where about 65 per cent of our average
5 revenues are derived. That is particularly driven by the
6 Snowy, obviously, so really we're talking about the Snowy
7 and the Murray-Murrumbidgee as being the key drivers of
8 State Water's business outcomes. As you can see, our
9 actual sales are 2.1 million megalitres in 2006-2007,
10 1.1 million in 2007-2008, 1.4 million in 2008-2009 and this
11 year we think we will sell somewhere between 1,500 and
12 maybe 1,700 gigalitres. It has been a very tough period.
13
14 The variance in terms of water sold, you can see there
15 in terms of variances that we've been seeing starting with
16 a 60 per cent variance and in the last few years a 70 and
17 80 per cent variance that is lower than was forecast. It
18 makes it extremely difficult to make much money for a
19 business when you've got those sorts of sales.
20
21 In terms of the operating expenditure, last time IPART
22 determined that State Water could run a more efficient
23 business and they didn't indicate how, but they indicated
24 that they thought it was a reasonable expectation for the
25 business to drop its expenditure by about 18 or 20 per cent
26 and to that end State Water has launched into a
27 restructuring program which I'll go into in a second.
28
29 In terms of our operating expenditure, this is the
30 part of our business that delivers your water and operates
31 the regulated rivers and storages. Using actual figures up
32 until 2009-10, you can see the IPART determination was that
33 we go from \$41 million down to \$36 million and you might
34 say we took a while getting there, but we'll hit the target
35 this year. It looks like we are going to be right on the
36 IPART target expenditure in 2009-10.
37
38 Just in terms of how we might have done that, there
39 are key drivers. We had to meet IPART's determination
40 requirement, which was obviously a key driver. Quite apart
41 from IPART, if you put IPART completely to one side, any
42 business should be attempting to achieve business
43 improvement and efficiency through looking at the way it
44 does business. We would like to think that we'd create a
45 platform for future growth and that there are other
46 opportunities for State Water.
47

1 As an example, it does seem a bit of an opportunity
2 lost when we generate so many water transfers and do so
3 much work in water transfers, but our revenues are
4 relatively tiny compared to the fortunes taken away by a
5 number of operators in the water trading and transfer
6 markets. As an example, it is something as an organisation
7 we should perhaps look at.
8
9 We replaced our geographical structure with a
10 functional structure. Let me say that that's not perfect.
11 It certainly led to a lot of angst in communities out west
12 where you used to have a major service centre in maybe
13 Leeton or Tamworth, but it was really the only model that
14 we struck, according to the target, in terms of the
15 costing. I think after a couple of years it's starting to
16 settle down and show some promise. This obviously resulted
17 in substantial and ongoing efficiency improvements that we
18 are very confident we can hang on to.
19
20 In terms of the new structure, the biggest challenge -
21 this is underway. Some of them are in place and some of
22 them we are starting to see the signs of - we have a new
23 common operating system, operations and procedures.
24 We used to have a different style of system in Leeton than
25 the one that was operating in Tamworth. We had different
26 billing systems in the Fish River than the ones that
27 operated in the rest of the State and as a business we
28 realised that we had to get some common systems in place.
29
30 We have had silos of information. People - either
31 deliberately or because they felt no need - were
32 constrained with the information they held and it was
33 impossible for a river operator who had been trained at
34 Hume Dam to go up to Moree and operate the river there
35 because he didn't understand the methodology and the
36 systems, he didn't understand the releases that were
37 required, the information that was needed, and as a
38 business we have a real vested interest in creating common
39 interests that work right across the State.
40
41 We have had the same task accomplished in multiple
42 valleys. Sometimes now on a Saturday or on a Sunday the
43 sole river operator on duty across the State will be in
44 Goondiwindi and it is his job to field calls, to monitor
45 dams and check regulators right throughout the State.
46
47 With respect to centralised data collection, it is

1 important that all the information we are collecting is
2 collected in a common form and in a common place. Of
3 course that has led to probably some valid criticism that
4 we now have quite a large organisation in Dubbo.
5
6 We have gone through a corporate restructure that's
7 not over yet, but in terms of settling this thing down,
8 we've got an operations group with quite a few senior guys
9 there and we've got a corporate group and I think that
10 we've indicated to IPART in our recommendations further
11 efficiencies need to be gained there over the coming years.
12
13 We are investing in technology and we have some way to
14 go. We now have an IFMS system that provides us with a
15 universal finance system that works across the
16 organisation. We have some work to do on a product called
17 the Facility Maintenance and Management System which is
18 about understanding how we manage our massive
19 infrastructure maintenance program, how we optimise it, how
20 we don't overdo it, but at the same time we have to make
21 sure that we don't have dams that fail and are able to open
22 when they need to.
23
24 Customer service is obviously a key plank where we can
25 save a lot of time, effort and money and provide a better
26 service. We have an IT framework that works for our
27 customers and some of you already are using iWAS and
28 finding it has quite significant potential.
29
30 As an organisation we have indicated to IPART that we
31 believe we can achieve a further 6 per cent saving in the
32 new determination period and we have even given a bit of an
33 outline as to how we might do it. We haven't gone into
34 huge detail because when you start talking about a
35 restructure in future years, you create a number of
36 dead men walking in an organisation which is probably not
37 the ideal thing to do.
38
39 In terms of our achievement, this is about the
40 operating expenditure in some detail. It just shows the
41 operating expenditure. With respect to the capital
42 expenditure program, our performance there has been patchy,
43 but there have been some very spectacular years in terms of
44 expenditure and I guess you might be saying that that's
45 about the extent of the progress we have made. Progress
46 has generally been commensurate with the programs that
47 we've set and it would appear that at the end of the IPART

1 determination period, looking at figures at the end of
2 October, I think we will be about right on the \$117 million
3 for the four-year period in terms of the forecast works
4 that we will be completing during the period.
5
6 In terms of revenue collected, and this is the user
7 share revenue as determined by IPART four years ago, you
8 can see IPART determined that over the period we would
9 collect \$195 million. The actual revenue has been more
10 like \$112 million. There is quite a significant figure
11 that needs to be included in there. There is about
12 \$26 million of operating subsidies that the government
13 allowed during that period that need to be deducted from
14 the shortfall. Our actual shortfall was more like just
15 over \$50 million rather than \$83 million because during
16 that period there were a number of CSOs paid by the
17 government for different activities State Water carries out
18 for some of our sub-economic valleys, particularly those in
19 the far north coast and the far south coast. That gives
20 you sort of a stark view of just how the drought has really
21 impacted State Water.
22
23 That's a graph, and when they set up State Water,
24 they said, "Here is a stable business. It is featured
25 across the entire state of New South Wales. It is very
26 likely to have balanced revenues. When it's wet one year
27 somewhere, it will be dry somewhere else." But I don't
28 think anyone was quite expecting what we have seen. For an
29 organisation that was told, "You will never sell less than
30 2,900 gegalitres as a business", we've grovelled along at
31 1.2 gegalitres during this four-year period. It has been
32 quite a shock to the forecasting people, the statisticians
33 and others and certainly obviously a shock to the farming
34 community depending on the water.
35
36 In terms of financial viability, those losses have
37 exposed us to considerable financial stress. Each year
38 State Water is rated by a credit agency. They come in and
39 say, "If this was commercial entity what sort of credit
40 rating would this organisation have?" Our last rating was
41 triple B minus and with an outlook as stable. If the
42 government attributed the COAG principles of maintaining an
43 organisation that has a financial viability comparable to
44 one of the private sector, if conditions were to continue
45 to worsen, they would either have to give us an equity
46 injection or reconfigure State Water in some other way for
47 us to be able to maintain an investment grade rating.

1
2 That is an issue for everyone because it obviously
3 affects the weighted average cost of capital because of the
4 risk volatility in the finance markets. Organisations that
5 are rated less than triple A pay a significant premium for
6 finance, and with triple B minus you pay the largest
7 premium. We are obviously not yet meeting the obligations
8 of the national water initiative pricing principles,
9 despite the efforts of IPART last time, after four years
10 that has not yet happened.
11
12 Obviously the national water pricing principles
13 include full cost recovery to give a rate of return for
14 shareholders. A lot of irrigators would say, "You've
15 probably got it about it right. In most of those years, if
16 you look at the extraordinary things that have happened to
17 your business and put them aside, you have basically broken
18 even without making any contribution to the government."
19 That's the way it should be in these very tough seasons.
20 But when you consider the massive amount of capital
21 contribution made, it is a pretty poor investment and that
22 certainly is not lost on the treasurer.
23
24 We also have an increased water capital program
25 adding to our financial vulnerability. People say, "Why
26 don't you delay those programs?" I think the simple answer
27 is that they were delayed in the 1980s, they were delayed
28 in the 1990s. It is probably time we met our
29 responsibilities. State Water has nine of the worst
30 15 dams in Australia in terms of dam safety criteria. We
31 really have an obligation in the reasonably short term to
32 meet those requirements and to bring those dams up to a
33 first world standard.
34
35 In terms of our capital expenditure, it is lumpy. We
36 will be very busy next year, particularly with Keepit and a
37 couple of other large projects that come in over the next
38 few years. The important thing about that graph is the
39 darker blue is the government share and the lighter grey is
40 the user share as determined under the sharing principles
41 determined by IPART the last time. That has to do with the
42 irrigators paying 50 per cent of the costs of necessary
43 works related to fish passage and cold water pollution.
44 The key point is although irrigators' contributions towards
45 capital programs increase in real terms, the government
46 contribution increases proportionately a lot more.
47

1 Our proposed prices are obviously driven by a number
2 of things. They are driven by an increase in the weighted
3 average cost of capital. The organisation believes we need
4 a lower gearing to reflect the volatility of our income
5 going forward and in our consumption forecasts. In really
6 simple terms, we are saying there will be less water for
7 State Water to sell and it means higher prices. We also
8 see a reduction in State Water's share of the MDBA
9 contributions. That was a little bit of a surprise to us,
10 but after negotiation with the NSW Office of Water, it was
11 agreed what the ratios would be for the MDBA. The fact
12 that they are not here means that they will appear in
13 another forum. Is that right, Lisa?
14
15 MS WELSH: That's right.
16
17 MR WARNE: I don't think that should be lost on us.
18 Reduced asset lives to increase depreciation is another
19 factor that leads to increases in costs. I think the
20 operating efficiencies we have made are evident. We have
21 indicated there are further operating efficiencies we can
22 make but there obviously is a limit. The firm that did the
23 review were based in the UK. When we took them for a drive
24 along the Lachlan Valley, which is operated by two river
25 operators, we indicated the river miles were basically the
26 length from the south of England to the north of Scotland,
27 to put it in context.
28
29 The capex program is mostly government funded. I
30 think that is an important point, although I know
31 irrigators are concerned about the add-on bits and about
32 our efforts to deliver those pieces like the fish passage
33 or the cold water pollution abatement in the most cost
34 effective manner possible.
35
36 I think you have all seen these water prices. This is about
37 high security and general security. This is looking at the
38 percentage changes we are proposing and I think Jim Cox
39 spoke about these in his introduction. Again I don't think
40 any of those would be a great surprise to you. The fixed
41 charges are obviously where the variation occurs between
42 megalitre users and megalitre use, and we don't colour
43 it so whoever's megalitre is used, you pay the same price.
44
45 One of the other key factors we have noted in the
46 dampening of demand is that we are using 15 years of real
47 data; yet it's only for four or five of those years that

1 carryovers have played a significant part of the water
2 usage factor. I would argue that if you were to apply a
3 carryover factor to some of those better years, water usage
4 may even be lower.

5
6 With regard to managing the impact on our customers,
7 we are determined to retain the 60:40 fixed/variable ratio
8 in response to customer feedback. We have been very keen
9 on that. The flip side of that for you guys is we get a
10 higher weighted average cost of capital. If you were to
11 pay 100 per cent fixed every year, our incomes would become
12 very stable and we would be able to say to the government,
13 "Hey, this business is much more stable", and our cost of
14 borrowings would be slightly lower.

15
16 The alternative is the 90:10 with a lower WACC. I
17 think that in New South Wales 60:40 is what works best.
18 Can I say that we are being harshly being criticised by our
19 interstate colleagues for our pricing policy as not
20 reflecting what they do, therefore being wrong - in fact I
21 think you would all be very happy with the South Australian
22 policy in relation to bulk water.

23
24 We used to use conversion factors for establishing the high
25 security water pricing premiums. We are seeking
26 to increase the high security premium to address the
27 imbalance with general security users during the period.
28 Some general security users will pay less for State Water
29 charges, although when you add State Water charge and the
30 NSW Office of Water charge, there may not be a huge
31 reduction.

32
33 Stakeholder consultation did not provide better
34 alternatives. We sat down with the Irrigators Council and
35 said, "Have you guys got some ideas on how we raise X
36 million in the Murray or the Murrumbidgee?" People were
37 inclined to be very divided depending on the nature of
38 their own business. We had a stab at it, but whether we
39 got that right or wrong, you will obviously inform us
40 today.

41
42 We have included the 6 per cent opex efficiency
43 reduction in our pricing. Another thing we will talk about
44 is the thematic expenditure. I don't know if that's
45 actually the right term, but we have a number of
46 environmental imposts coming into our business, which we
47 have been aware of since the late 1990s. State Water will

1 have to deliver some of those in terms of environmental
2 outcomes in the management of our rivers. They come at a
3 cost. They are largely irrigator costs. To a very large
4 extent, you will see they have completely offset the
5 operating efficiencies we were hoping to achieve in
6 operation our business. That's all I have to say. I'll
7 ask Lisa to complete the presentation

8
9 MS WELSH: For those of you whom I have not already met, I
10 am Lisa Welsh. I am project manager for the State Water
11 pricing submission to IPART. As an overview of the
12 presentation I am going to make this morning, I want to
13 quickly go over State Water's objective with the pricing
14 submission; the sort of consultation that we have
15 undertaken; and what will be our opex and capex
16 particularly in the Murray and Murrumbidgee valleys. I
17 will go into a little bit more detail on some of the
18 financial viability issues that George has already touched
19 on. I will also go into a bit more detail on some of the
20 tariff design issues and touch on a couple of other things
21 that we included in our submission as well.

22
23 Our objective was very clear going into this. Having
24 seen the level of cost recovery that we have achieved over
25 the last few years, it was very clear to State Water that
26 this was our one in four years opportunity to actually
27 secure financial viability. As George said, our credit
28 rating has been deteriorating over the period and there is
29 no further for us to go before we hit junk bond status.
30 That is obviously something that is very important to us as
31 a commercially operated business.

32
33 It is clear to us that this is our opportunity to try
34 to address some of these underlying risks that we don't
35 think are being adequately captured in the determination.
36 Having said that, though, we are aware that our customers
37 are equally going through a tough period, so we are hoping
38 to accommodate their preferences on tariff design as much
39 as possible so that we can try and work on the risks
40 together.

41
42 We have undertaken some extensive consultation in
43 putting together our submission. A lot of you here in the
44 audience would have been included in that. That
45 consultation was extremely important for us, firstly, in
46 terms of confirming our impressions that the current tariff
47 design of 60:40 variable to fixed is valued by our

1 customers. Obviously in considering what other tariff
2 design preferences were possible in this determination,
3 hopefully all of you would agree that we have listened to
4 your preferences and that is directly reflected in our
5 pricing submission.
6
7 That consultation was also used to talk through the
8 level of services State Water is providing at the moment
9 and what are some of the additional services that customers
10 might be interested in State Water providing. In the
11 Murray and the Murrumbidgee that didn't result in any extra
12 services. The message from the customers was that they
13 were happy with State Water's base level of service.
14
15 The third part of that consultation was also about
16 showing our customers, "Here is what our proposed opex and
17 capex budgets are going forward. What do you think?", and
18 then giving our customers an opportunity to interrogate our
19 budgets. That certainly did result in a lot of feedback
20 and some changes in what we were proposing before we put
21 in our final submission to IPART.
22
23 Our forecast operating expenditure going forward: as
24 Jim Cox outlined there is a 9 per cent increase over the
25 four years. We have efficiencies of about 6 per cent which
26 are offset by our thematic expenditure. So by 2013/2014 we
27 have a less than \$3 million increase in our opex. That has
28 been driven by new expenditure pressures on State Water.
29 It has been driven by outside influences for the most part.
30
31 In terms of the works approvals fees, some of you
32 would be aware that State Water now has works approvals in
33 place from the Office of Water and they charge an
34 administration fee every year for those. That is a new
35 expense that is not captured within our current base.
36 Similarly there are a large number of environmental and
37 heritage cost pressures coming through. Some of that
38 includes fish passage monitoring so we can understand better
39 what is working well with our fish passages so we can
40 incorporate that into further designs. It is also
41 important to be able to capture what exactly are the
42 benefits arising from these fish passages? Is it worth it
43 or is it something we want to go back and challenge?
44
45 With regard to dam safety, we need to update our
46 portfolio risk assessment which has not been done since
47 earlier this decade. That is really important because we

1 are about to make some substantial increases in our capital
2 program to address dam safety risks. That is just stage 1.
3 There is a stage 2 coming. We need ensure that we have the
4 best information available so that we don't go too far.
5
6 There are a couple of other smaller items there: land
7 management, emergency and security expenditure to comply
8 with the government's critical infrastructure protection
9 policy, a few corporate expenses and some discretionary
10 services which, as I said before, don't affect the Murray
11 and Murrumbidgee.
12
13 Our capital expenditure program going forward, as you
14 can see there, is dominated by the dam safety, upgrade
15 program. That doesn't affect the Murray Valley. It does
16 affect the Murrumbidgee because Blowering in fact is under
17 construction at the moment.
18
19 Dam safety obviously is associated with quite a number
20 of environmental compliance obligations such as fish
21 passage and cold water pollution. There are some
22 investments in water delivery so that we can be providing
23 the best practice service and facilitating some of the
24 improvements in our reorganisation that George was
25 referring to in maintaining consistency across our river
26 operations so that we can share resources across the
27 valley.
28
29 This is the same slide from George's presentation
30 showing that our total program across the State is quite
31 lumpy. The first three years are dominated by the dam
32 safety upgrade program. As you can see the darker share is
33 the government share. What does that look like in the
34 Murray? Actually it is quite the opposite because in the
35 Murray, first of all, there is no dam safety upgrade
36 program. Also for the size of the valley that it is, it
37 actually looks quite modest. That's because the MDBA
38 controls the bulk of the capital expenditure in the Murray.
39 Aside from what you see there for 2010-2011, it is actually
40 quite a modest capital program.
41
42 For the Murrumbidgee again the calendar has been
43 reversed. So the first year that you see is actually the
44 completion of the Blowering dam upgrade program. That's
45 the first of State Water dam safety upgrade programs and
46 that is currently under construction.
47

1 I wanted to touch on cost shares. In the consultation
2 that we did as part of the IPART determination, it was
3 quite clear to me that there were many, many strong views
4 on cost shares: What should they be? What is appropriate?
5 Is it affordable? Do we really want to pay for that?
6 What's the benefit to users? Why do we have to do this; it
7 has nothing to do with us? Our view is that cost shares
8 are at least partly arbitrary. There is no right and
9 wrong. There are quite a lot of grey areas.
10
11 Under the existing cost shares, when we were
12 completing the submission, one of the things that jumped
13 out to us was that there was about a 150 per cent increase
14 in government revenue requirements - and how much will
15 they be paying us over the next determination period - and
16 only a 22 per cent increase in user shares. That suggests to us
17 that there is a bit of an imbalance. Taking into account
18 the fact that customers are not happy with cost shares and
19 there also seem to us to be some quite perverse outcomes to
20 the current cost shares, we think that it would be
21 appropriate for IPART to keep re-examining how costs are
22 currently shared between government and users.
23
24 Just briefly on financial viability again, not to
25 overemphasise this point, I know you are all going through
26 a tough time with the drought, but our current tariff
27 design does not ensure financial viability. We are lucky
28 in the sense that 100 per cent of our revenues from
29 government are fixed. Not only are they fixed but in the
30 last determination they also paid for some of the user
31 shares via an operating subsidy.
32
33 What concerns us mostly is the share of our revenue
34 requirements that is coming from users. Obviously there
35 was a reduction. We received only 29 per cent of the
36 forecast water deliveries over the last determination
37 period and that had a big impact on our revenues as George
38 said. We aim to recover those user share revenues by
39 \$56 million.
40
41 If that were to continue going forward we would get
42 another downgrade in our credit rating and it would start
43 impacting on how we are able to maintain our assets. We
44 would have to scale back some of our capital program
45 potentially and that could impact service delivery to our
46 customers. I think this is something that interests all
47 our customers; that we can keep maintaining our assets and

1 providing the same level of service we provide today.
2
3 The first thing we looked at in terms of putting our
4 pricing submission together was consumption forecasts. We
5 commissioned a report from the Centre for International
6 Economics. We did that in consultation with the Office of
7 Water. Their report suggested there is a structural break
8 in the past patterns of rainfall. A slide that George
9 showed you earlier with the model of actual water
10 deliveries showed that, in the current drought, the
11 averages have basically fallen to levels never previously
12 experienced. That suggests to us there is a fundamental
13 change in the amount of water available. That is likely to
14 mean that the current level of 100-year averages will not
15 be reflective of what we will see going forward.
16
17 What we are proposing as an alternative is a rolling
18 15-year average based on actual use. I think that there is
19 actually a reasonable argument for us to go to a shorter
20 period, but we are mindful that reducing consumption
21 forecasts at this stage means a direct increase in usage
22 revenue and I think we need to be a bit reasonable about
23 what we can expect from our customers. We think 15 years
24 is about right in terms of smoothing out some of that
25 volatility for State Water but not creating too much of a
26 price shock. An advantage of a rolling 15-year average is
27 also that any further corrections that we don't know about
28 yet - nobody knows exactly what will be the impact of
29 climate change - can be smoothed out and captured in that
30 methodology over the coming years. We like to think this
31 is a methodology which can be used in perpetuity going
32 forward.
33
34 What does that mean for consumption forecasts? You
35 can see on that graph the Murray Lower Darling obviously
36 being heavily impacted by the drought. That would mean a
37 28 per cent reduction in the consumption forecast and a
38 much smaller reduction for the Murrumbidgee of 9.4 per cent
39 but overall in total across State Water about a 20 per cent
40 reduction compared to the 5,500 gigalitres.
41
42 You have heard a little bit about the weighted average
43 cost of capital this morning. We are proposing an increase
44 in the weighted average cost of capital of 1.4 per cent
45 relative to the more recent metropolitan business water
46 determinations. That's on the basis that, as the business
47 stands, the current WACC assumes a 60 per cent gearing. We

1 are not able to sustain that level of financial risk given
2 the volatility in our revenue. We are saying that a more
3 appropriate level of gearing for State Water is 30 per
4 cent, and that results in a WACC of 7.9 per cent. This is
5 the WACC that we are saying will allow us to keep the 60:40
6 variable fixed pricing ratio.
7

8 However we are also saying that if IPART, in its
9 wisdom, doesn't accept that level of higher WACC, then we
10 would be seeking to more directly reduce the risks
11 associated with that revenue of volatility by seeking a
12 higher proportion of fixed revenues. I guess what we are
13 saying is, "We are hearing customers; they want to retain
14 the current ratio of fixed variable charges, so here is the
15 compromise that we are offering."
16

17 State Water also had a look in its pricing submission
18 at the current conversion factors. Over the last four
19 years we have noticed that the impact of the drought has
20 meant that high security users have continued to receive a
21 high proportion of their water, as you would expect to be
22 the case. General security users have been receiving,
23 certainly in some valleys, virtually nothing. We are
24 saying that is creating an inequity. We are saying that in
25 times when water is scarce we think the high security users
26 should be paying for more of the system and that general
27 security users should be paying less.
28

29 It is worth noting that there is no net benefit to
30 State Water of this premium. There is no additional
31 revenue generated. We are saying, "We have noticed this
32 imbalance, here is our suggestion in terms of how it should
33 be fixed", but obviously we look to our customers to inform
34 that as well.
35

36 This is the graph from our pricing submission which
37 many of you will have seen. We are saying that over the
38 current three years of the drought this is a graph which
39 shows the average water market price in both the Murray and
40 the Murrumbidgee compared with the State Water charges.
41 This actually excludes the zero value trades - so all those
42 trades that are between licensed categories owned by the
43 same person with no charge incurred. So what we are saying
44 is that if you have water in a drought, it is extremely
45 valuable.
46

47 This graph is actually from the recent Waterfind

1 annual Murray Darling Basin water market report. This is
2 the one on investment that they have calculated on high
3 security versus general security licences in the New South
4 Wales Murray and Murrumbidgee valleys. This is based on
5 the number of entitlements times the permanent market
6 price. What you can see there is that the return on
7 investment for a high security licence is every year much
8 greater than that of a general security licence. You can
9 also see there that the Murrumbidgee licences are becoming
10 increasingly more valuable than the Murray licences, and I
11 think that tallies with what we have seen in terms of the
12 consumption forecasting where the Murrumbidgee has a
13 much more stable water availability.
14

15 In terms of conversion factors, we are proposing a new
16 formula to calculate the high security premium which
17 incorporates the water sharing plan conversion factor but
18 adjusts that by the inversion of a rolling average of
19 general security allocations. I should stress here that
20 this is one of many options that we came up with, but we
21 discarded all the others. We decided this was the best.
22 It is by no means perfect, it is quite a bit controversial,
23 and we certainly encouraged input from our stakeholders at
24 the time. Obviously it is very difficult for customers to
25 agree on an alternative methodology for this knowing that
26 there are general security licence holders out there as
27 well as high security, so it is a bit controversial.
28

29 Under this methodology we think that the high security
30 premiums should rise only in years where the water
31 availability is reduced and conversely it should fall when
32 there is plenty of water available in the system. As I
33 said, it continues to use the water sharing plan
34 information. It will introduce more variability to
35 pricing, but high security users will pay more only when
36 water availability is reduced and importantly what we have
37 seen over the current drought is that the temporary market
38 price for water will increase.
39

40 Just briefly on customer rebates, I think last time
41 when State Water went into the pricing determination, we
42 tried to get rid of rebates altogether. In reaction to
43 that IPART commissioned a very useful piece of work again
44 from the Centre for International Economics, which actually
45 looked at the basis for these large customer rebates and
46 tried to determine what rationale is there for them and
47 therefore how much they should they be.

1
2 As a starting point we used that same rationale, but
3 knowing what we know about how much it costs to run our
4 business we decided to take each of the perceived benefits
5 of a large customer and put a price against that. The CIE
6 report found that there were economies of scale for billing
7 and metering and there are also system benefits for real-time
8 monitoring and compliance. With some of the larger schemes
9 with 2,000 irrigators, State Water doesn't have to bill
10 them individually, we don't have to meter them and we also
11 get a large degree of security knowing that we know exactly
12 how much will be taken from their uptake rather than trying
13 to calculate bills for 2,000 individual customers.
14
15 We are not disputing that there are some real savings
16 there, but what we have done is try to match that with what
17 we know it costs to run State Water and how much those
18 benefits actually really work. It is also important to
19 note with large customer rebates that the economies of
20 scale in particular only accrue for as long as our large
21 customers continue to represent the current number of
22 customers that they have. If their entitlements decrease,
23 and we all know that the ACCC's water market rules are
24 encouraging customers to do that, we don't know how much
25 that will impact our customers, we are saying that if State
26 Water has to deal with more customers, then the economies
27 of scale associated with our current large customers
28 reduces and therefore so should our rebates.
29
30 What you can see on that graph is the current level of
31 rebates and what that will be in 2011 given our costing
32 methodology. Interestingly, and you may not believe me,
33 but we did this with no particular outcome in mind, when we
34 costed the savings per megalitre and applied that to the
35 number of entitlements held by our large customers compared
36 with 2010, there were some quite large decreases for our
37 large customers and some modest increases for our smaller
38 customers.
39
40 Again, what does all of that mean for water prices?
41 Briefly, it means that high security users, unsurprisingly,
42 will be paying more, but general security users will be
43 paying quite a lot less. That is as a result of the high
44 security/general security premium. You can also see there
45 some of the increases in the usage charges, particularly in
46 the Murray, coming from the consumption conversion factors,
47 but overall the price increases are not as large as you

1 would expect and that's because of the reduction in the
2 contribution to the MDBA.
3
4 This is another slide again from the Water Find Report
5 which shows the growth in the value of entitlements of
6 water users in the Murray and the Murrumbidgee over the
7 last three years. This is both general and high security
8 users and again it takes prices on the permanent market.
9 What we have seen is a 74 per cent increase in the value of
10 Murray entitlements and a 64 percent increase in the value
11 of Murrumbidgee entitlements. We think this is quite
12 relevant information which has come to light only in the
13 last month or so in terms of the affordability of those
14 sorts of price increases that we are proposing.
15
16 What we are saying is that yes, while there has been a
17 drought, a lot of the benefits that the water access
18 licence holders have been accruing are actually on their
19 balance sheets perhaps rather than their ongoing operating
20 profits.
21
22 A couple of other issues briefly. We are not
23 proposing any change to the maximum fee of \$150 for
24 temporary trades. In the last determination IPART held
25 that fixed and it has not escalated for inflation. That
26 has resulted in a real reduction in price. We think that
27 there are some more efficiencies that we can make there
28 too, so we're proposing to keep that fixed at \$150.
29
30 We are also including a new information charge. The
31 intention here is not to charge more to our customers who
32 have reasonable information requests, so what we're saying
33 is that for any request for information that is older than
34 two years you will incur this charge. Similarly, if you're
35 not our customer and you don't contribute to the costs of
36 running State Water, we will charge you for whatever
37 information you require from us.
38
39 Like with any other business we think that customers
40 have a responsibility to keep track of the records that we
41 send out to them, their usage statements and the bills that
42 we do send to them on a regular basis, so we're saying
43 you're responsible and as a part of the costs of running
44 State Water, we know that we have to send you this
45 information and that's not what you will be charged for,
46 but anything over and above reasonable record keeping for
47 our customers is something that we think you should be

1 charged for. The information charge is \$82.50. It is no
2 coincidence that that's exactly the charge that
3 Hunter Water Corporation has for their information
4 requests.

5
6 Finally, the metering service charge was also included
7 in our pricing submission. This is a new charge as a
8 result of the state priority projects under the Australian
9 government's water for the future program. State Water has
10 received \$90 million to install State Water owned meters
11 for our customers. We will obviously incur new costs in
12 operating those metres and maintaining them. What we're
13 saying is that if and when those meters are installed,
14 that's when the charge will be incurred and in the short
15 term that charge is only for minor maintenance and also the
16 cost of data transfer from taking the real-time information
17 from those meters and bringing it back into State Water.

18
19 Obviously, the Commonwealth government is funding the
20 upfront costs of those meters, but within that charge there
21 is no return on capital and there is no depreciation
22 charge. That is something that we anticipate will be
23 incorporated into future charges. That is all from me
24 today. Thank you.

25
26 THE ACTING CHAIRMAN: Thank you very much, George
27 and Lisa, for your very informative presentation. There will
28 now be an opportunity for the tribunal to ask questions of
29 State Water. In the first instance that will be led by
30 Colin Reid and Richard Warner, but Sibylle and I may want
31 to ask supplementary questions. Over to you.

32
33 MR REID: Thank you very much, Jim. First of all, I would
34 like to acknowledge the recent achievements of State Water
35 and indicate that there is general recognition of those
36 achievements in the submissions that we have received.
37 I do say that first up.

38
39 A key issue for the inquiry is who should bear the
40 risk of revenue volatility and the options available to
41 manage that volatility. Decisions on price structure, high
42 and low security price differentials and what sale forecast
43 to use flow from that. Drawing on the National Water
44 Initiative and other sources what is your view on who is
45 best placed to bear the risk of that volatility and why?

46
47 MR WARNE: I think that the last four years have taught us

1 that unlike the people who set up State Water, there is
2 significant volatility that we need to consider. It is not
3 a matter of, "You'll be okay. You've got such a
4 geographical spread that that's not something you should
5 worry about." It is clearly something we do need to worry
6 about. I think there are three or four factors driving
7 that volatility and climate change is one of them.

8
9 In terms of who is responsible, obviously State Water
10 have indicated that it's a shared responsibility between
11 State Water, the government and our customers and to the
12 extent that we've submitted today, we've indicated we think
13 that our customers should pay for some of that volatility.
14 We have indicated that a 15-year time frame much better
15 picks up that volatility than the 113 or the 118-year data
16 set that they've been using in these two southern valleys.

17
18 We believe that the 15-year model does a lot more to
19 recognise the cost of volatility than the previous model
20 and in the event that we run into four wet years coming up,
21 and the sales are very high, the irrigators will receive an
22 almost immediate benefit in the change in the 15-year
23 average of water availability. Do you want to comment on
24 that, Lisa?

25
26 MS WELSH: Yes. We would say that at the moment the
27 government is picking up a large amount of the revenue
28 volatility burden, if you like, simply by the fact that
29 there is one weighted average cost of capital across the
30 whole of State Water. The government contributions are
31 100 per cent fixed whereas our customers obviously aren't
32 and yet, everybody pays a higher WACC.

33
34 In increasing the WACC we're actually saying in a way
35 that because the government has a larger part of the
36 regulatory asset base and they're in fact, if you like,
37 providing an additional subsidy to those users, if you were
38 to say, "Let's target the WACC to the part of State Water's
39 revenues which are variable," I think you would be seeing a
40 reduction in the WACC, perhaps you'd retain that at
41 6.5 per cent for the government share and you'd actually be
42 going for something even higher for users. We don't think
43 that that's appropriate. We don't think it's affordable
44 either. We are saying that in our approach there is some
45 inherent risk sharing there.

46
47 MR REID: With regards to sales forecasts, we have before

1 us the IQQM model, the 15-year moving average and the
2 CSIRO predictions. A number of people have put forward the
3 CSIRO projections in preference to the 15-year moving average.
4 Could you just tell us how practicable it would be to adopt
5 the CSIRO forecast?
6

7 MR WARNE: We made a decision quite early in the piece
8 that if we were going to submit to IPART on time we
9 couldn't wait, because some of the work being done for the
10 Murray-Darling Basin Commission in establishing valley caps
11 is advanced, but it was not at a stage where we could use
12 it. We have tried to use something that was statistically
13 valid and was available and we used actual water use data
14 over the 15-year period.
15

16 Most farmers will tell you that the 15-year period is
17 not going to change our volatility. It just gives us a
18 better measure of what our likely average water sales are
19 going to be going forward. Of course, even then it is not
20 perfect. We are arguing that it's a whole lot better one
21 to use.
22

23 If you were to say that you should use the CSIRO
24 model, I am not sure that given the confidence bands
25 they've got you're going to come up with a different or
26 even a whole lot better result, but Lisa might feel
27 differently.
28

29 MS WELSH: Yes. Certainly the CSIRO yield studies are
30 relevant but only to a certain extent. They were the
31 starting point for CIE's work on consumption forecasting.
32 We explicitly asked them to look at that. The problem with
33 the CSIRO is that aside from up in the north, some of the
34 users up there would say that they just got it wrong, so
35 they are a bit controversial in their own right, but also
36 they look at the next 20 to 30 years and they're also more
37 about resource availability.
38

39 We are about cost recovery in the next four years, so
40 we have to be careful that we don't use them for a purpose
41 for which they were not intended. We think our alternative
42 is better. It is more focused and we are not actually
43 trying to make any comments about ongoing climate change.
44 CIE are economists; they're not hydrologists or scientists.
45 Similarly, we have a very short time frame. We think that
46 the 15 years is much more appropriate for cost recovery.
47

1 MR WARNE: Could I add one other comment? We are using
2 15 years of actual data and we have seen during that period
3 the introduction and use of carryover and it certainly
4 surprised me that in very, very dry years farmers have been
5 carrying over up to a third of the available water. Would
6 farmers use the water that was available in 1996 again if
7 that year repeated? It is very difficult to say, but by
8 their actions they've demonstrated an enormously
9 conservative propensity to carry water to the following
10 season, so that doesn't make any difference. They are just
11 going to use it in the future year.
12

13 Of course they are, but even with our drier scenario
14 there are going to be a number of years when that water
15 spills and is not used. It's not used in the year it's
16 made available. It's carried over and it's not used in the
17 subsequent wetter years. I think that that's one of the
18 inherent conservatisms that's actually not in our model
19 that makes the likely average water use going ahead even a
20 little bit lower.
21

22 MR WARNER: While we are on the issue of carryover water,
23 Western Murray Irrigation has argued that general security
24 carryover entitlements should pay the same premium as high
25 security entitlements, given that carryover entitlements
26 receive more rights than high security. How would you
27 respond to that sort of suggestion?
28

29 MR WARNE: I think that they're wrong. I think they're
30 wrong for two reasons. The way in which the New South
31 Wales Office of Water behaved recently as to the conveyance
32 of water for irrigation corporations with regard to the
33 prior right of carryover is a reflection of the extreme
34 drought and suspended water sharing plans. If the
35 irrigators in the room think that that's the future, we've
36 got a serious problem with our forecasting model because it
37 actually needs to be a lot worse.
38

39 The other point I would make - and I think this is
40 right - is that a general security user who consistently
41 intends to carry over the water made available is going to
42 be paying fixed charges on a whole lot more megalitres than
43 anyone with high security, in that they've really
44 effectively got to pay the fixed charges for the general
45 security for two years to have the water available in one,
46 or they've got to pay the fixed charges for two megalitres
47 or three megalitres to have one megalitre to carry over, so

1 effectively we've got an overload.
2
3 MR WARNER: State Water has forecast an almost 9 per cent
4 increase in operating expenditure over the upcoming
5 determination period. A lot of those are due to thematic
6 expenditure items - your term - and they're the main
7 drivers of the increase. Given that drought conditions are
8 likely to continue, is it possible for State Water to again
9 defer some of those thematic expenditures to alleviate
10 customer impacts?

11
12 MR WARNE: I think that that will be extremely difficult.
13 The 6 per cent efficiency saving is probably achievable.
14 The organisation is just coming off a massive change in the
15 way in which we go about our work. We simply can't avoid
16 some of the costs. The NSW Office of Water finalised our
17 first operating losses last year and it was for works
18 approval and it was for \$98,000. I think they indicated
19 that some of the subsequent ones were going to cost less
20 because there was a lot of development work in that. That
21 is a cost that we're going to incur in every valley. It is
22 not something that can be avoided.
23

24 Likewise, with a lot of the other costs we have
25 indicated, I think that's quite an unfortunate term,
26 "thematic expenditure". These are imposts in the regulated
27 environment we operate in. If we're going to operate a
28 first world water supply company and recognise our
29 environmental and other responsibilities, they're the costs
30 we are going to have to meet and most of those costs relate
31 to the delivery and supply of irrigation water.
32

33 THE ACTING CHAIRMAN: Thank you. I have a couple of
34 supplementary questions, if I may. The first is the
35 15-years rolling average. Obviously there's an element of
36 judgment in that, but could you describe the thinking that
37 went into choosing 15 years and not some other average?
38

39 MR WARNE: I am going to hand over to Lisa here, but
40 initially our view was looking at what had happened to
41 State Water's revenue collection during the IPART
42 determination period. Clearly, there was something broken
43 about the old model, it did not work, so we had to find
44 something that was more robust and more likely to give a
45 result that reflected the sort of water sales. The
46 previous model was out by a factor of four times in some
47 seasons. It was about finding something better.

1
2 We asked people who have statistical expertise and an
3 understanding of the operating environment we work in and
4 we asked for their best judgment. A number of people with
5 a statistics background have looked at it and said, "This
6 is not perfect," but our argument is significantly better
7 than using a 100-year model. Do you want to add to that,
8 Lisa?
9

10 MS WELSH: Yes. The 15 years is definitely a trade off.
11 We had quite a lot of robust discussion internally and with
12 the Office of Water to choose something that was
13 appropriate. The evidence of the structural adjustment in
14 water availability is actually within the last seven years,
15 so you could absolutely justify something between five and
16 10 years, but we're saying that 15 years picks up the
17 structural adjustments and also picks up some of those
18 earlier wetter years, so we're not getting too much of a
19 reduction in consumption forecasts.
20

21 In terms of going further than 15 years, we certainly
22 have a data problem in that that was three or four
23 organisations prior to State Water and it was also back
24 when perhaps the record keeping and the collection of
25 information on the ground for water usage was not as
26 accurate. You are then again having to go back and rely on
27 the IQQM model for some of the modelled outcomes and that
28 is something we're not keen to do. It is also
29 incorporating more years that are not representative of
30 what we think is going to happen going forward. It is
31 definitely a trade off between the two.
32

33 THE ACTING CHAIRMAN: Thank you. Another issue I
34 would just like to pick up on is capital expenditure. As you
35 have shown, much of the capital expenditure is for dam
36 safety purposes. On the slides you showed there also seems
37 to be a fair amount that has been done for renewal and
38 replacement of capital expenditure. I imagine that a lot
39 of that capital expenditure will be paid for by extractive
40 users. Perhaps you can just describe what this renewal and
41 replacement of capital expenditure is and also perhaps
42 discuss why it is not capable of being deferred at this
43 point.
44

45 MR WARNE: Yes. The dams in State Water's portfolio are
46 ranked from 100 years old. It is 100 years since we
47 started construction at Burrinjuck through to about

1 40 years old, with a huge weighting towards that 60 to
2 80-year-old group, and along with those large long-life
3 urban and civil structures are a number of moving parts.
4 Likewise, three hundred significant weirs of regulating
5 structures have a number of moving parts and there's an
6 economic and a useful life attributable to some of those.
7

8 There are occupational health and safety issues with
9 regard to operating some of those and we've tried to
10 stretch their lives out as far as possible. We are not
11 talking about some manic catch-up maintenance. We are just
12 saying in terms of a rational and sensible approach to
13 maintaining long-life infrastructure, like sluice gates,
14 valves and what have you in our infrastructure, they're
15 part of the program that is now being addressed in the next
16 10 to 15 year window, and there's obviously quite an effort
17 in the determination period.
18

19 MS WELSH: I would just add to that that a lot of the
20 renewal and replacement activities are actually associated
21 with a couple of large projects. What comes to mind is, as
22 I said before, the Menindee fuse plug replacement which is
23 obviously in the Murray Valley. The other big project is
24 actually pipeline replacement: \$10 million in the
25 Fish River. That is to replace a piece of ageing pipework
26 that continues to fail.
27

28 Aside from that, as George was saying, a lot of our
29 renewals is actually just quite small projects which we're
30 required to address to maintain our ageing infrastructure.
31 I think it's actually quite a modest program going forward
32 once those are excluded.
33

34 MS KRIEGER: Could I ask you a question following on from
35 that? Generally speaking, you would expect a capital
36 expenditure program to show up ultimately in reduced
37 maintenance expenses. That doesn't seem to be the case.
38 Is that just because the price determination period is too
39 short or is there some other reason for that?
40

41 MR WARNE: I would suggest that with a mirror value or a
42 modern engineering equivalent replacement value
43 infrastructure of \$3 billion, even if you set to one side
44 the urban and very long-life civil elements, there are
45 enough moving parts there to warrant a very significant
46 maintenance program into the generation ahead.
47

1 With that sort of infrastructure involved, I know a
2 lot of it for the purposes of pricing is not part of the
3 pricing determination, but you can't escape the fact that
4 to maintain a reliable and first world water supply we've
5 got to maintain \$3 billion worth of assets and half of
6 1 per cent or 1 per cent a year is not a huge ask given the
7 nature of that infrastructure base.
8

9 MS WELSH: I would add that this has a lot to do with
10 these maintenance management systems. The opex/capex
11 review is quite interested in that system in the fact that
12 it is probably not used to its full potential at the moment
13 and that there are potentially some reduced maintenance
14 costs that we could achieve going forward over and above
15 what we've projected.
16

17 We would tentatively agree with that, except that to
18 accelerate the implementation of that method is going to
19 take extra resources in itself. We would be saying, "Well,
20 yes, if we can have some extra resources for a year to
21 speed that up then perhaps there could be some more savings
22 in maintenance to be attained."
23

24 MR REID: A key component of the expenditure incurred for
25 the Murray and Murrumbidgee relates to the Murray-Darling
26 Basin Authority. Putting aside for the moment the issue of
27 the control of that expenditure, there has been some
28 discussion in some of the submissions about the price
29 comparisons that you've done between what has been charged
30 and what is forecast to be charged and whether they
31 include or exclude the Murray-Darling Basin costs.
32

33 I am just wondering if you can elaborate
34 on those charges and the extent that they will be in future
35 included in State Water's costs as opposed to the Office of
36 Water's costs.
37

38 MR WARNE: I will get Lisa to speak about the future of
39 our charge versus the NOW charge, but in terms of a prime
40 example of that, I think irrigators are quite right to take
41 a long hard look at this Murray-Darling Basin Authority
42 because, as I understand it, the irrigators pay their water
43 charges as determined by IPART and it goes into a big
44 bucket and goes to treasury and treasury sends a cheque off
45 to the Murray-Darling Basin Authority. They operate
46 River Murray Water who then provide shares to the
47 contributing states who manage, operate, maintain and

1 construct works for the Murray-Darling Basin Authority in
2 that rather circular route.

3
4 It was a bit different when it was the Murray-Darling
5 Basin Commission and the States felt genuinely that they
6 were like a co-director of the company, whereas now as an
7 authority they will take the State's cash and they have
8 absolute authority over how it is spent.

9
10 Having said that, as a very live example, we're
11 looking at the works at Hume Dam and we're looking for a
12 special state contribution, which ironically State Water
13 may have to raise, a contribution towards meeting our share
14 of the costs of that dam safety work. When we rate that
15 dam safety work along with our other 14 high priority
16 projects, fortunately it's number one.

17
18 In a discussion with River Murray Water the other day
19 they said they'd like to, for housekeeping sake, complete the
20 dam safety works at Dartmouth Dam too very promptly and
21 I said I would recommend against our state government
22 contributing to that until we finish the other 14 works,
23 because while Hume Dam represents the biggest threat to
24 New South Wales' portfolio, Dartmouth - based on an
25 objective risk criteria - is about number 14.

26
27 That is the sort of say we would have. That is really
28 through our State treasury and that's quite a circuitous
29 route and I think that irrigators quite rightly need to
30 keep an eye on the way in which the authority asserts its
31 power with regard to applying the maintenance, the repairs
32 and the replacement of infrastructure in the Murray Valley
33 particularly.

34
35 MS WELSH: Just to clarify - State Water's submission
36 excludes all costs of the Murray-Darling Basin Authority,
37 just for transparency. State Water is not responsible for
38 any of that expenditure. However, it is relevant to our
39 users in that yes, we do recover a share of that
40 expenditure.

41
42 The extent to which we recover a portion and the
43 Office of Water does is basically an agreement between us,
44 them and also treasury are a party to that. We agreed to
45 split on what that should be just before State Water put in
46 its IPART submission. In terms of that then flowing
47 through to our prices, it's certainly not something that

1 State Water was seeking to camouflage. I know with many of
2 the CSCs that was certainly discussed with them.

3
4 There is not really much we can say aside from the
5 fact that I think it is our observation that it is
6 extremely unfortunate that the ACCC water charge rules
7 haven't allowed any further transparency towards the
8 expenditure of the Murray-Darling Basin Authority and their
9 lack of cost recovery, which I don't think is helping the
10 matter.

11
12 MR WARNER: I have one last question and I don't think
13 this has been asked yet. Large customer rebates - you had
14 a listing up there of all the people who enjoy those. The
15 federal government has been a large purchaser in water. Is
16 it intended to extend the rebates to purchasers of
17 environmental water?

18
19 MR WARNE: We have actually done a bit of thinking on this
20 and the short answer is "no". The short answer is "no"
21 unless they agree to take all their water at one site
22 through one measurement works, then we might be able to
23 talk to them, but the preliminary indications are that in
24 the case of the Murrumbidgee and the northern valleys, the
25 federal government are going to ask DECCW to be their agent
26 for the delivery of environmental outcomes with regard to
27 that water.

28
29 In some of our valleys they are looking at as many as
30 40 delivery sites. Maybe that will be spread spatially
31 over five or six years with a cycle when that water is
32 delivered to the different sites. If they look like a duck
33 and they quack like a duck, we'll treat them like a duck,
34 but at this stage the indications are they're going to be a
35 disparate user and a diffuse water user and quite a complex
36 client. We are not proposing at this stage that they be
37 the beneficiaries of a discount, although you may determine
38 differently.

39
40 We did receive a letter - which you may have got a
41 copy of - on Friday I think about our IPART submission and
42 for the first time we saw in print that they intend to pay
43 water charges, which was quite a significant relief, given
44 that there have been some environmental advocates that say
45 it's an impactor payers model and that the irrigators should
46 pay all the costs of the environmental water deliveries.

47

1 THE ACTING CHAIRMAN: I have just one final question, if
2 I may, and that is on the scarcity premium, the
3 relationship between the prices for general security and
4 high security water. We have received a number of
5 submissions that said we should make that decision on a
6 cost reflective basis, so that, if you like, general
7 security users pay the cost of providing general security
8 water and high security users pay the costs of high
9 security water. I wonder how you respond to that
10 proposition and the extent to which you believe that what
11 you propose is indeed consistent with that philosophy?
12

13 MR WARNE: We have largely been led by IPART's
14 determination in 2006 when you rejected that option and
15 recommended scarcity pricing under water pricing. To that
16 extent, we think we have reflected that. As Lisa was at
17 pains to say, there is never a perfect solution, except
18 that you would argue for a farmer with a thousand general
19 security water entitlements with a zero allocation that he
20 would find paying 40 per cent of those average charges
21 quite a significant burden, in the same year as one of his
22 neighbours with 100 megalitres of high security is enjoying
23 full allocation and a record price for water, or where the
24 South Australian government were paying \$700, \$800 or \$900
25 a megalitre. It just seems that there needs to be some
26 small recognition in the pricing of that whopping anomaly.
27 We hope that in our pricing model, if we go back to years
28 of plenty, when the benefits even out so will the pricing
29 premium.
30

31 THE ACTING CHAIRMAN: Thank you very much for your
32 presentation and for answering the questions. Perhaps we
33 will let you sit in the audience now and we will invite the
34 representatives of Murray Irrigation to come forward.
35

36 MURRAY IRRIGATION

37
38 MS McLEOD: I am Jenny McLeod from Murray Irrigation in
39 Deniliquin. Good morning and thank you for the opportunity
40 to present to you today.
41

42 My presentation is very much focusing on
43 Murray Irrigation's perspective. Murray Irrigation has
44 participated in the New South Wales Irrigators Council
45 submission and Andrew will be speaking later from the New
46 South Wales irrigators' perspective.
47

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1 My presentation focuses very much on State Water's
2 approach to issues that are relevant to the New South Wales
3 Murray and Murray Irrigation. A key concern is the MDBA
4 costs which have also been raised. The other issues for
5 Murray Irrigation are the large customer rebates, the high
6 security premiums and the issue - and I think it was
7 Richard's question that posed it quite well - in terms of
8 who bears the revenue risks associated with volatility in
9 water availability and use.
10

11 This is just a little bit of information about
12 Murray Irrigation today. We are a private irrigation
13 company, an off-river scheme. Our general security licence
14 is 71 per cent of the New South Wales Murray general
15 security water. We have virtually no high security
16 irrigation water. I think we have 119 megalitres and
17 that's actually been sold to an outside party. We do have
18 a conveyance licence which has a component of higher
19 security water and a component of general security water.
20

21 We have two extraction points from the River Murray,
22 so we meet George's objectives in terms of being able to
23 very efficiently deliver water to a large number of
24 customers whilst only having two diversion points which
25 State Water needs to concern itself about.
26

27 We deliver water to nearly 2,400 land holdings and we
28 estimate that they're operated by about 1,300 commercial
29 irrigation businesses. We have a small number of hobby
30 farm or stock and domestic water suppliers as well.
31

32 This is a slide of what has happened to Murray
33 Irrigation and its customers since the last pricing
34 determination. This is a graph of water use on farm inside
35 our business since 2005/2006. On the bottom axis is the
36 water years and it's 2005/2006, going up to 2009/2010,
37 which is obviously an estimate. Megalitres of water use
38 are on the vertical axis. I don't know what the zero is up
39 there.
40

41 This is what the available New South Wales general
42 security announcement was. In 2005/2006 we used nearly
43 a million megalitres on farm and the general security
44 announcement was 56 per cent. We then went into the last
45 four seasons where we have seen the suspended water in
46 2006/2007, a zero allocation, and just over 200,000
47 megalitres of water use. Most of that occurred just prior

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1 to the suspension. 2007/2008 was a zero year with
2 virtually no irrigation program in our region. That is
3 largely stock and domestic use. In 2009, we had an
4 effective allocation inside our business of 11 per cent
5 general security with a small irrigation program in spring
6 and autumn.
7

8 This year, it doesn't look all that great, but we are
9 expecting to deliver about 100,000 megalitres on farm. We
10 have an effective allocation of 14 per cent to our
11 customers, so that's the prediction of water use. It is
12 substantially better but still a long way from where we
13 used to be in terms of water use with obvious implications
14 to our viability and also our customers' viability.
15

16 There has been some discussion about high security and
17 general security premiums. This is the effective price of
18 Murray Irrigation's charge to its customer for megalitres
19 used on their landholdings. It is an average price. It is
20 inclusive of the government charge, so it's dollars per
21 megalitre on the Y axis, and the X axis is just the years.
22 This information is in our annual report.
23

24 You can see we have gone from a relatively low
25 effective price, but still a significant component of
26 irrigators' costs, to dramatic increases in the more recent
27 years when we have delivered virtually no irrigation water,
28 with obvious implications in terms of the impact on
29 farmers' ability to meet their charges to Murray Irrigation
30 and the impact on the ability of Murray Irrigation to
31 recover its charges and then pay those accounts to State
32 Water.
33

34 This is what has been happening with water trade.
35 This is megalitres of annual trade. Water trade has been
36 an important component of irrigators' business in terms of
37 the capacity to sell what little water they may have had
38 available into the market to generate some revenue and also
39 for allowing irrigators who are in a position to continue
40 to operate a water irrigation program to access more water
41 when we have had such small volumes available.
42

43 This graph shows the years once again from 2006. This
44 year is where we are up to now. This is the megalitres of
45 trade into our business and out of our business. In 2006
46 our farmers bought in 90,000 megalitres. They also bought
47 water in - nearly 400,000 - in 2007.

1
2 Since we basically had virtually no water available
3 and had difficulties operating an irrigation program
4 particularly in 2007/2008, we have seen people capitalising
5 on the high annual market, and we have seen water being
6 traded out of our business. This is something, which I
7 think in George's history with our business, had never
8 occurred. We have become a net exporter of water. This
9 has helped our irrigators' financial viability but it
10 certainly has had impacts on our business because that is
11 revenues from water sales we don't recover. Unlike State
12 Water, we have not introduced a usage charge on water
13 leaving our business.
14

15 That was just a little bit of history about where our
16 business sits. Any regulation that results in price
17 increases for our businesses will have impacts on our
18 farmers. I suppose we would look to IPART in this
19 determination to consider those issues when considering its
20 pricing determination. It will take time, even with the
21 improved water availability, for our farmers to improve
22 their financial position.
23

24 In terms of the MDBA, in the New South Wales Murray,
25 the MDBA and costs of River Murray water are really a major
26 driver of bulk water costs. The State Water submission
27 includes just the component that the New South Wales Office
28 of Water has allocated to them to include. The New South
29 Wales Office of Water submission, which is yet to be seen,
30 presumably includes other elements of MDBA costs.
31

32 In terms of the real impact of MDBA on the prices paid
33 by irrigators, you need to put those two costs together.
34 At this stage with the New South Wales Office of Water, it
35 is unclear as to what its costs will include in terms of
36 the MDBA costs, so they need to be considered together in
37 the IPART pricing determination.
38

39 As has been raised, we consider the MDBA disclosure of
40 cost is inadequate. It has actually deteriorated since the
41 formation of the MDBA. If you go trawling around on their
42 website looking for their annual report, you won't find
43 last year's report. If you then look at the year before
44 and you look at the disclosure of River Murray water costs,
45 it is significantly less than when the Murray Darling Basin
46 Commission existed.
47

1 We are reliant on the negotiations with the New South Wales
2 government with the MDBA on what we ultimately end up
3 contributing. From the perspective of customer involvement
4 and users identifying their priorities, we believe that is
5 inadequate. We don't believe we have had any capacity to
6 influence the decisions they make or their ability to
7 assess the efficiency of the MDBA costs.

8
9 I suppose we are looking at IPART to try and improve
10 at least the disclosure of those costs. I have noticed
11 that Rob Freeman, in his submission, has said that he will
12 be providing information to IPART about their costs. We
13 would expect to see some disclosure of those costs through
14 this determination process.

15
16 Just to reiterate we are reliant on New South Wales
17 negotiations, and from where we sit in the Murray, they
18 actually don't speak to us about the machinations of what's
19 happening at an intergovernmental level in terms of the
20 MDBA and the River Murray water costs and the things that
21 drive them.

22
23 The other issue we believe is relevant is that the
24 MDBA costs appear to have escaped regulation under the
25 Water Act because they actually don't strike a charge. My
26 understanding is that they will not be regulated by the
27 ACCC. We don't believe this situation is adequate, if you
28 contrast the Water Act and what the ACCC is doing to
29 businesses like ours. We have an elected board. We pay
30 tax. We are responsible for making sure that we run a
31 viable business and our directors meet their obligations as
32 directors. Whilst the ACCC, with their water charge rules,
33 are not planning to set our charges or determine our
34 charges, it is imposing a very significant level of
35 exposure of our costs to our customers and our services.
36 They also require, if we wish to enhance our services, that
37 we get member approval if we want to then subsequently
38 recover the cost if an irrigator then decides to disconnect
39 from our system.

40
41 We are expected to provide a five-year network service
42 plan that includes our capital and recurrent expenditure.
43 We are expected to provide plans for our financing and
44 capital raising, details of any grants that are given to
45 us, so we avoid any double dipping, and estimates of
46 charges of five years. As well as that, we are expected to
47 consult with our customers.

1
2 Whilst I am not saying we should not have disclosure
3 of our information and we should not operate a robust
4 system of ensuring we are efficient and give our customers
5 a clear understanding of what is driving our costs and our
6 efficiency and we should also talk to our customers, I also
7 think it is ironic that the biggest driver of our costs has
8 totally escaped any ability of customers to even understand
9 what the costs are - what is driving the efficiency? Who
10 is deciding what they actually do? I think it is
11 inadequate and we look to IPART to at least raise those
12 issues for the determination process and to provide some
13 rigour in terms of what they agree to pass on to customers
14 to pay when customers have had no opportunity to
15 understand or influence them.

16
17 In terms of the high security premium, it is obvious
18 Murray Irrigation does support State Water's proposition.
19 A number of submissions have raised the issue of cost
20 reflective pricing. We are not necessarily advocating that
21 IPART move away from the basic principles of cost
22 reflective pricing. The last IPART determination did
23 include a premium for high security licences. We are not
24 advocating that State Water uses scarcity pricing, but we
25 do believe that there is an element of fairness and equity
26 in what State Water is proposing.

27
28 I have tried to demonstrate in our earlier slides that
29 the impact of reduced water availability on our customers
30 and Murray Irrigation's business is very significant. High
31 security licences are well protected through the water
32 sharing plans. They are also well protected through the
33 critical water sharing. So we believe it is reasonable to
34 propose that State Water charge a higher price for high
35 security entitlements, and we are supportive of the
36 methodology that they have used.

37
38 It is also worth noting that the conversion of general
39 security to high security licences is suspended. It may
40 not be reintroduced. For all general security irrigators,
41 apart from going out into the market and purchasing high
42 security entitlements, there really is no opportunity for
43 them to convert to high security licences.

44
45 Large customers rebates: it is refreshing that this
46 State Water submission at least acknowledges that large
47 customer rebates have some legitimacy. State Water is

1 actually proposing quite a significant reduction to Murray
2 Irrigation's large customer rebate. The comment we would
3 make about their proposition is if the water use within a
4 business actually reduces as a result of water being traded
5 to an external water access licence, there is potentially a
6 legitimate argument for a reduction in the rebate.
7

8 The proposition where an irrigator transforms their
9 water entitlement to a separate water access licence and
10 then continues to use water inside Murray Irrigation is
11 less of a justification. You are still getting all the
12 benefits of a single supply point. State Water will
13 actually charge for the annual transfer to that supply
14 point and the additional cost for State Water, effectively,
15 just the cost of sending the bill to that water access
16 licence holder.
17

18 We believe that the avoided cost of Murray
19 Irrigation's business is two supply points. There is a
20 very large number of customers that its services are
21 actually quite significant. Some of the investments that
22 State Water have had to put in in terms of their water
23 systems and their SCADA are not necessarily because of
24 Murray Irrigation but because of a large number of other
25 single licence units.
26

27 The other benefit which needs to be acknowledged is
28 that large irrigation corporations actually pay their water
29 accounts and do not present issues for cost recovery and
30 ongoing recovery of water charges and suspension which in
31 the current environment I would imagine is an issue for
32 State Water.
33

34 Charges structure: we do support State Water's
35 proposition to maintain their current fixed and variable
36 balance. Fixed charges in years of low water availability
37 are a very significant issue for operators and their
38 customers, and I think State Water has listened to
39 customers. It is easier for fixed cost businesses to
40 collect all their money from fixed charges, but having the
41 balance between fixed and variable as proposed by State
42 Water is beneficial to irrigators because it does give them
43 the opportunity to match their costs with income, so we
44 support State Water's approach.
45

46 In terms of consumption forecasts - I think Andrew
47 Gregson will talk about this issue in greater length - from

1 a water user's perspective, we believe State Water has done
2 an excellent job in surviving in the face of very
3 significantly reduced water sales. They have introduced
4 new arrangements for this year to address the leakage out
5 of New South Wales to Victoria and South Australia and to
6 help protect revenue income, and I hope that principle is
7 able to be continued.
8

9 IPART's determination does include a dividend to
10 government. So one of the organisations that has been most
11 significantly impacted by the lower water sales or water
12 usage and reduced revenue for State Water is actually the
13 government. The dividend has not been paid to government.
14 My understanding is that they have received either no
15 dividend or a significantly lower one.
16

17 I suppose the question irrigators would ask is why
18 should government receive a dividend in the face of
19 drought? This is an issue in relation to monopolies and
20 fixed charges and regulations. We don't believe it is
21 appropriate that monopolies should be insulated from the
22 outside effects of things like drought and protected
23 through pricing. In terms of the consumption forecasts, we
24 would argue that the case for significantly reducing the
25 expected consumption at this point should not protect the
26 governments from having a lower revenue from State Water
27 as a result of reduced water sales.
28

29 All businesses have to adjust in the face of changed
30 circumstances and we believe that it is reasonable for
31 government to have a lower return on their asset and not to
32 be fully protected by the pricing determination.
33

34 Looking at user shares, this hasn't really developed;
35 that hasn't been the basis of any discussion so far. We
36 believe the regulated Murray has many beneficiaries and
37 under the current user shares, we believe water users are
38 meeting their fair share. Governments, IPART and
39 irrigators spent a lot of time debating the user shares
40 several years ago, so we are not supportive of reopening
41 the debate on user shares. It was in your issues paper and
42 we are not supportive of reopening the debate.
43

44 Our experience in dealing with governments is they
45 will try and cost shift from government to users and if
46 they are unsuccessful in cost shifting, they actually then
47 stop the program. We are very nervous about the

1 proposition that some of the existing users shares that
2 have been the basis of the more recent determinations will
3 be reopened. If your intention is to reopen them, I
4 suppose we would need to give a lot more thought around
5 what are the issues associated with that.

6
7 In conclusion, I think it is acknowledged in the
8 submissions that State Water's submission and its approach
9 for this determination, apart from also being available on
10 time, is a significant improvement. They have made a
11 really genuine effort to consider the interests of
12 irrigators and they have also made a genuine effort to look
13 at improving their efficiency and reducing the cost impact
14 on irrigators.

15
16 IPART and irrigators have invested significant time
17 historically in establishing some of the pricing principles
18 and we encourage IPART to continue with those pricing
19 principles. We don't believe now is the time to make
20 significant changes to the determination. The irrigation
21 sector is in a period of very significant change. The next
22 determination will have a new basin plan and that will
23 provide more clarity about the future in terms of
24 extractive water use.

25
26 The irrigation sector needs time to recover from the
27 period of drought that it has been in, so we would advocate
28 that now is not the time to introduce significant change.
29 I wish to reinforce the point that the MDBA is a huge issue
30 in terms of the Murray and we look to IPART to try and
31 improve disclosure and rigour around MDBA costs.

32
33 On a final note in terms of where this determination
34 takes us - it is really the State Water and the Office of
35 Water determination - the resilience of Murray Irrigation
36 and of its irrigators' had been significantly challenged in
37 the last few years, so we would ask you to consider that in
38 any price increases that are proposed as a result of the
39 determination.

40
41 THE ACTING CHAIRMAN: Thank you very much for your
42 presentation. We will now have some questions starting
43 with Colin and Richard.

44
45 MR REID: Thanks very much, Jenny. We asked State Water a
46 question on managing revenue volatility. Looking at
47 Murry Irrigation, what action have you taken to

1 manage your revenue volatility? For example what price
2 structure operates within your area and what specific
3 actions have you taken to offset the reduced water sales?

4
5 MS McLEOD: I will make one point initially, which is that
6 Murray Irrigation is a not for profit business, so our
7 price setting doesn't include a profit or a return on
8 capital component. In setting our charges and our
9 assumptions, our aim is effectively to break even;
10 therefore forecasts for consumption are important. We have
11 made a whole multitude of changes to address the situation
12 that I outlined.

13
14 We have slightly altered our fixed and variable
15 components where we have moved to recover 70 per cent of
16 our costs from our fixed charges where previously we were
17 at 60:40, with 60 per cent from fixed and 40 from variable.
18 We have done that for two reasons. One is to recover
19 revenue and also because of the impact of the ACCC's
20 determination which said when you're collecting a
21 termination fee from customers who chose to terminate their
22 delivery entitlements, you can only charge them 10 times
23 your actual fixed charge.

24
25 Previously in the MDBC principles, which were in
26 schedule E, there was the ability to charge a shadow access
27 fee, which is effectively if all your fixed costs were
28 recovered, what would that be? That has now gone. So from
29 1 July we did alter the balance in that respect. We have
30 made some adjustments to our expectations of water sales.
31 That is what we have done from a pricing perspective. On
32 the other side of the ledger, we have made significant
33 changes to reduce our overall costs because obviously any
34 reduction in our costs is a benefit to ourselves and
35 reduces the price impost of our charges on our irrigators.

36
37 MR WARNER: That was very interesting. I also note that
38 you and many others who have put in submissions disagree
39 with the various approaches that State Water has put
40 forward for managing revenue volatility. Do you have any
41 alternative suggestions as to what we might do in that
42 regard?

43
44 MS McLEOD: That is a good question. I suppose the main
45 emphasis that I perhaps clumsily tried to make is that
46 State Water needs to manage their revenue in terms of
47 protecting their income but they should not be immune from

1 a lower revenue that then reduces the dividend that they
2 pay to government. That is our primary issue.

3
4 If, with their consumption forecasts, State Water are
5 going to maintain the expectation of a revenue dividend to
6 government, we don't believe that is appropriate. I
7 suppose I would like to revisit looking at State Water's
8 propositions in terms of their lower consumptions. Does
9 that maintain the revenue dividend to government or is
10 there an alternative? That is our basic proposition.

11
12 MR WARNER: So if we can come up with something that
13 minimises any dividends, we are on the right track?

14
15 MS McLEOD: That's my thinking, yes.

16
17 MR WARNER: One of the other things I would like to
18 mention, and this came up in submissions not from the
19 valleys around here, is that some stakeholders have
20 suggested that we have a common state-based price across
21 all irrigation schemes. What do you think about that?

22
23 MS McLEOD: We don't support that. We support
24 valley-based pricing. We do support cost reflective
25 pricing, although it needs to be acknowledged that cost
26 reflective pricing is actually applied at a really, really
27 coarse level. For example, Murray Irrigation, and
28 Murrumbidgee Irrigation for that matter too, are right in
29 the upstream part of the river valley, but we actually pool
30 the costs for the whole valley in setting prices. So no,
31 we don't support state-wide pricing. If there is
32 subsidisation we support its actually being subsidisation
33 by government and disclosed publicly.

34
35 MR REID: You have been through the issue, as you say,
36 with the ACCC on termination or exit fees. As you
37 indicate, State Water has recently introduced a charge on
38 temporary trades where the water is traded to non-licence
39 holders, and that obviously relates particularly to
40 interstate trade. Some people have indicated that they
41 believe that that charge now imposed by State Water is a
42 restriction on trade. Given the experience that you have
43 had with the termination fees and the exit fees, would you
44 like to comment on that?

45
46 MS McLEOD: My experience is that once somebody makes a
47 decision to take a particular course of action, they just

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1 respond in terms of what is in their best interests for
2 that particular course of action. They are not interested
3 in the larger picture in terms of what is the impact of
4 their action on the costs paid by other people. It is all
5 about what maximises their dollar return, the payment to
6 them.

7
8 I suppose the issue with impacts on trades is that
9 something that actually doesn't stop the trade but alters
10 the net return to the seller seems to be considered an
11 impost; whereas from Murray Irrigation's perspective, we
12 are about managing the third party impacts of that
13 individual's actions, so we support State Water's
14 proposition. I suppose the only reason we haven't
15 introduced it ourselves, apart from being likely to attract
16 more significant attention than State Water's action from
17 government regulators, is the response from our own
18 customers in terms of managing this issue.

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

22
23 We will now take a short break. We are running
24 slightly late, but perhaps we can allow ourselves
25 20 minutes for a cup of tea or coffee and be back here at
26 11.05, thank you.

27
28 SHORT ADJOURNMENT

29
30 MURRUMBIDGEE IRRIGATION

31
32 THE ACTING CHAIRMAN: Ladies and gentlemen, could
33 we now resume. The next presentation will be from
34 Murrumbidgee Irrigation. If their representatives come
35 forward and introduce themselves, we will proceed.
36 Thank you.

37
38 MR TUCKER: Thank you, Jim. My name is Brett Tucker and
39 I am the managing director of Murrumbidgee Irrigation and
40 I have John Howe with me, our policy adviser. I will be
41 doing most of the presentation and then hopefully I'll
42 defer to my brains trust for most of the questions.

43
44 Firstly, a quick overview of our company. I apologise
45 to Jim and others who have probably seen this ad nauseam.
46 We are an unlisted public company, very similar or almost
47 the same structure as Murray Irrigation, with about 3,200

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1 land holdings which used to be our customer base 97 years
2 ago, but like all agricultural areas we've got
3 amalgamations and consolidation of farming businesses, so
4 we suspect somewhere between 1,500 and 1,800 family
5 businesses predominantly, most of which are customer
6 shareholders, although, as I will talk about a little
7 later, there is some pressure on that model at the moment.
8
9 In terms of servicing area, we deal with about
10 \$2.5 billion in water entitlements, most of which belong to
11 our customers, and that means we're about 48 per cent of
12 the Murrumbidgee Valley in terms of entitlement base. That
13 is broken into about 340,000 megalitres of high security
14 and 775,000 of general security and up to 223,000 of
15 conveyance. Obviously in a year like this we don't have
16 that level of conveyance, nor have we for the last few
17 years.
18
19 Our assets under management are about \$500 million
20 replacement value servicing an area of about 660,000
21 hectares with a farm gate or regional value of the order of
22 \$2.5 billion annually to the economy. We are almost 100.
23
24 In terms of the operating environment, like everyone
25 we have had an unprecedented drought, certainly since about
26 2001-2 for the Murrumbidgee Valley. If you look at the
27 last four years, we've averaged 15 per cent general
28 security, albeit we've had near full high security, and
29 over the last eight years only 29 per cent general
30 security. I must say compared to the late '80 and '90s
31 that's just a quantum shift, where for at least two decades
32 general security reliability was the same if not better
33 than high security, given the sort of announcements that
34 were made.
35
36 There have also been significant adjustment pressures
37 from buy back. In last financial year the government
38 substantially was the buyer and they purchased up to the
39 limit of 42,000 megalitres entitlement out of the district.
40 This year to date it's 25,000 megalitres. About the only
41 pattern we can see in the buy back or the sale of water is
42 that there is no pattern. It is quite literally the
43 Swiss-cheese effect we've all been fearing and that's
44 creating significant pressures from an asset management
45 point of view about redundancy of assets.
46
47 There is also a fundamental pressure on our business

1 model from collective governments. The rights of the
2 individual are paramount and the rights and
3 responsibilities of the collective have tended to be pushed
4 behind. As a consequence, we are having to deal with a lot
5 of regional-type issues and collective responsibilities
6 that we would prefer not to have given the other pressures
7 that we're facing, such as the drought and compliance
8 costs.
9
10 The involvement of ACCC and others has substantially
11 increased our compliance costs and I think we've only seen
12 the start of it. Already I suspect it's probably two
13 full-time equivalents in our organisation and given a quick
14 look or a snapshot at things like network service plans
15 that are coming at us, I suspect it will be more like three
16 or four or potentially five full-time equivalents just
17 meeting our new compliance needs with Bureau of Met,
18 ACCC and others.
19
20 There is a continued drive for improved efficiencies,
21 both physical and financial, from our customer base and
22 interestingly, from a physical point of view, that's
23 creating new issues for us. We have quickly come to the
24 realisation in the last five years that you can't divorce
25 carbon energy and water, that as we drive water use
26 efficiency in the district, we are increasing our energy
27 and carbon footprint exponentially and that poses major
28 challenges to us and our customer base going forward.
29
30 I suspect that we are facing the biggest landscape
31 change since the region commenced 97 years ago. We are not
32 quite sure where it is going to lead us at this stage. Can
33 I also say, similar to Jenny's comments, that we
34 acknowledge the efforts made by State Water this time
35 around. There has certainly been a greater focus on the
36 IPART framework. There has been much improvement in
37 supporting information, although we would still argue that
38 more is required. There appears to be less ambit claim in
39 terms of forward cost estimates, greater attention to the
40 role of efficiency improvements and in a capex perspective,
41 less evidence of overstatement of requirements.
42
43 Some concerns. We have a fundamental confusion over
44 the pricing philosophy that is being adopted by State Water
45 in this submission, whether that's cost recovery or
46 capacity to pay. We would argue - similar to our own
47 business - that it ought to be based on true cost recovery

1 wherever that falls. We feel that the high
2 security-general security justification is poor.
3 References to market value of water as a justification for
4 increasing costs to one part of the sector we don't feel is
5 relevant. We are struggling to understand the relevance of
6 a 15-year usage model on fixed charges. If they're fixed,
7 they're fixed, whether it's 15 years. We would prefer a
8 long-term model.
9
10 There is an absence of a comprehensive business
11 strategy to deal with the crisis. We all recognise that
12 the drought and other issues are causing revenue
13 volatility, but the only strategy that we can see in the
14 submission is to raise regulated charges in response and
15 we'll talk a little bit about some of the other responses
16 that we've had later on, particularly given the questions
17 that you asked Jenny before.
18
19 There is less importance given to cost control and
20 efficiency gains. As we found out this morning, 6 per cent
21 over four years we don't feel is adequate. History shows
22 that these issues are critical. Members of the tribunal
23 would have seen this. Maybe last year I think we presented
24 it, but what it demonstrates is since privatisation of our
25 business in 1999 through to last year's financial accounts
26 in 2008, the zero line through the middle, CPI increases of
27 around 35 per cent in that time, you can see the bulk water
28 charges that we paid collectively to government in that
29 time. If not for the dip at the end, which is a direct
30 response to lower usage levels, given the higher usage
31 costs of State Water and the government, or the DWE now,
32 there would have been an 85 per cent increase in those
33 charges over that 10-year period.
34
35 Alternatively, you can see our company controlled
36 costs is the green line, so in that time we've managed to
37 maintain and stabilise our costs. In fact, it represents a
38 43 per cent real reduction in costs in the same period. It
39 is no surprise in the Australian context that productivity
40 improvements mean shedding staff and we've lost about
41 35 per cent of our staff numbers in that period.
42 Originally, we had 450 staff in this district and now over
43 the course of about 20 years we are down to about 170 or
44 165, somewhere of that order.
45
46 We have some concerns over information analysis and
47 transparency and certainly would regard some of it as

1 inadequate. We are not 100 per cent certain from the
2 submission, but it appears to us that there's a possibility
3 of double-counting of inflation in the annual increments of
4 costs and in the calculation of RAB. We seek the
5 Tribunal's support in reviewing that.
6
7 Some of the arbitrary adjustments, as I mentioned
8 before, the general security-high security approach and the
9 reduction of the IC rebates, we'd certainly like to see
10 more information and I note the presentation went into a
11 little bit more detail today on that calculation base, but
12 we would like to work through that.
13
14 The price increases are in our view understated.
15 There is a recommendation for a real increase of
16 Murrumbidgee prices in our view of up to 20 per cent,
17 principally because the MDBA costs were previously included
18 and this time excluded, so we don't believe that that's
19 adequately disclosed in the submission. As Jenny mentioned
20 before, the MDBA costs are at this stage a black box to our
21 organisation. We have no idea what services we get for the
22 price and how they calculate our cost sharing. With
23 respect to the presentation of information, we certainly
24 would have preferred to have balance sheets and trading
25 statements to review.
26
27 In terms of the weighted average cost of capital and
28 the investment grade rating, I am not sure we're any the
29 wiser after this morning's presentation. We really
30 struggle to understand the determination role of the rating
31 and its true relevance to an organisation such as
32 State Water Corporation. Is it an academic exercise to
33 compare yourself to a commercial model or does it have a
34 real cost of the effect of capital for the business?
35
36 We believe that State Water Corporation is overstating
37 the business and climate risks. Revenue is not as volatile
38 as suggested or that comes across in their submission.
39 When you add up the revenues from government and high
40 security and the fixed charges from all, there's something
41 like 70 per cent certainty over revenues.
42
43 What we have witnessed in the last few years from
44 published statements is positive returns and increased net
45 wealth by the organisation. To go through the period that
46 we've been through and still have increased net wealth
47 would suggest to us that it's not as volatile a business as

1 has been made out. In our view, the large capex in 2010 is
2 still forecast and there is a significant risk of
3 overestimating capex in prices.
4
5 Moving through to some key recommendations, at the
6 time of the Murray Darling Basin Commission costs at the
7 last determination, which are now the MDBA costs, there was
8 no justification for the 11th hour inclusion of those
9 costs. We have had no correspondence with the Commission
10 then or the Authority now as to what our cost share ought
11 to be and how we're driving the costs of that business.
12 We consider that a review is required and until such time
13 as a review takes place, the costs should be shifted to the
14 New South Wales Office of Water.
15
16 We would like to see State Water Corporation prepare a
17 more comprehensive business strategy dealing with risks of
18 the drought and other matters before increasing real prices
19 or the weighted average cost of capital or the return to
20 fixed revenue pricing. Baseline opex efficiencies from
21 table 3.3 in the submission should be the starting point
22 for an efficient level of opex. Further reductions should
23 be considered or developed in light of business and drought
24 strategy and we should defer the thematic opex unless
25 customers agree to meet those costs.
26
27 We believe the capex program should be reviewed.
28 We have had little opportunity to review the forward
29 estimates on capex. We should consider the opportunities
30 to defer costs. Further reductions in light of the drought
31 strategy and debt risks should also be reviewed. Along
32 those lines we believe that IPART should review actual
33 capex costs as late as possible in 2010 to avoid potential
34 for overstating the regulatory asset base of the
35 organisation.
36
37 As I mentioned before, we would like IPART to review
38 whether there's a potential double-counting of inflation in
39 the way that it determines costs of capital. We believe
40 that the WACC should remain stable on 6.5 per cent. It
41 shouldn't be used as an incentive to increase revenues.
42 We see no need for a review of the cost shares.
43
44 We don't feel there should be any change in the
45 current consumption forecasts and no increase in ratio of
46 fixed costs without a comprehensive business strategy
47 dealing firstly with the risks and other opportunities that

1 might exist. There should also be a review of the pricing
2 philosophy that is being adopted before changing the high
3 security charge relative to general security charges and
4 particularly that issue I mentioned before about capacity
5 to pay versus cost recovery.
6
7 The methodology used for IC rebates should be
8 revisited and importantly, the cost savings as a result of
9 the irrigation corporations should be assigned to the
10 irrigation corporations and not generally across all users.
11 One particular issue that is coming at us is a replacement
12 program for all of the meters in the valley. It requires
13 careful consideration that the ICs aren't picking up the
14 burden of current capex and future recoveries for those
15 meters when they have no relevance to our businesses.
16
17 One other relevant issue for the Murrumbidgee and not
18 for the other valleys is the Tumut River works. There has
19 been a lack of consideration on the changes that will take
20 place because of releases from Blowering Dam as a result of
21 government buy-back and environmental flows. The pressure
22 on the Tumut River from irrigation demand will diminish
23 significantly over time. As a consequence, we don't feel
24 that irrigators should be meeting any of the costs of the
25 Tumut River upgrades as a result of high flows in that
26 river.
27
28 Finally, the high security premium - again, confirm
29 the philosophy, apply it consistently and if it is about
30 cost recovery that the philosophy is based on then, in our
31 view, market values or commodity prices have absolutely no
32 relevance. If State Water are concerned about the market
33 rents, that is, people making a fortune out of the market
34 and complaining about the cost of delivery of water, then
35 target the market, don't target the cost base of your
36 service.
37
38 We support State Water's trade charge. We have
39 introduced a similar charge this year ourselves. There is
40 a justification for it. We would prefer that approach
41 rather than using market values to drive increases to
42 particular sectors.
43
44 There is just one final point that I have added since
45 this morning's presentation. I noted the comments about
46 the government cross-subsidising the weighted average cost
47 of capital. One might argue also the same for high

1 security users if there is a consistent income coming from
2 them. I would like to leave it there, if I can,
3 Mr Chairman, and answer any questions as you see fit.
4 Thank you.

5
6 THE ACTING CHAIRMAN: Thank you very much. We will
7 start with Richard and Colin.

8
9 MR WARNER: One of the perennials that seems to come up is
10 this opposition to State Water's 15-year rolling average
11 for estimating water use. Nobody seems to like that
12 proposition, yet it seems to be a very poor estimator of
13 water sales. Everybody seems to prefer the IQQM model.
14 Are there any alternatives that you would like to propose
15 as to how State Water can address that revenue volatility
16 issue?
17

18 MR TUCKER: In our own review of pricing we've had to do
19 something similar. We have just gone to a longer-term base
20 to determine the premium between high and general security.
21 We have used water sharing plan data. What we did do
22 though was review that in light of CSIRO reports and also
23 the apparent change in sequence that we are in. We used
24 the worst 50-year sequence of the 100-year data, so the
25 1900s to the 1950s sequence, which was a dryer period than
26 the second half of last century. That has been used in our
27 own pricing calculations. In terms of the high
28 security/general security premium, we've just simply used
29 the relative water sharing plan reliability factors.
30

31 MR WARNER: Would you be happy with us using that 50-
32 year data?
33

34 MR TUCKER: I think it has a stronger basis in fact than
35 the 15 years. The trouble that we have with the 15 years,
36 of course, if you're talking about fixed costs, they're
37 fixed irrespective of the short-term sequence that you're
38 in. Unfortunately, that at times means you've got
39 capacity-to-pay issues amongst some users, but we've taken
40 the view that it is better to get your pricing model
41 consistent and then deal with the issues of capacity to pay
42 separately and we've used other techniques to do that
43 internally.
44

45 MR WARNER: State Water tells us that they've consulted
46 widely on developing expenditure proposals. You seem to
47 dispute much of what they've said in terms of their

1 proposals. Can you tell us what sort of consultation
2 State Water undertook with you?
3

4 MR HOWE: State Water do consult with
5 Murrumbidgee Irrigation and other users via the Customer
6 Services Committee throughout the year. Unfortunately, the
7 IPART framework is dealt with very late in the process and
8 maybe one or two consultations are devoted to that:
9 correct me if I am wrong. This year they did consult with
10 us largely about consumption forecasting along with the New
11 South Wales Irrigators Council. That is the extent of my
12 experience.
13

14 MR TUCKER: I have just one final comment. It is
15 certainly a vast improvement on where it was four years
16 ago.
17

18 MR REID: The issue of high and low security charges is
19 obviously a key issue for yourselves, given the higher
20 proportion of high security water that you take. You
21 reject the idea of the scarcity premium and you say it
22 should be based more on a cost driver approach. Could you
23 just expand a little bit on the cost drivers and how they
24 may bear on the current ratio between low and high security
25 charges?
26

27 MR TUCKER: What we did in our own case was to review
28 each
29 cost line item in the business, identify what drives that
30 cost and then who drives that cost. At the same time
31 you've also got to ask yourself whether it's an efficient
32 cost in the first place or should we do it in some other
33 fashion.

34 Quite literally for us it was a line item by line item
35 review of every cost in the business and then we grouped
36 users into pricing groups according to how they shared or
37 have consistency in the way they drive those costs. We are
38 not confident in the method used of an arbitrary 15 years
39 that it has any relationship to the long-run cost base of
40 providing that service to that individual.
41

42 MR REID: The outcome of your studies?
43

44 MR TUCKER: We had an increase in fixed charges in the
45 business, so we're now talking about a 70:30, similar to
46 Murray Irrigation. In reality it's probably more like
47 about 90:10, but you accept that some of your fixed costs

1 will be recovered in annual revenues. We have dealt with
2 the gap largely through the imposition of a trade charge.
3 Those trading out are still missing paying some of the
4 fixed charges as a result of trade out, so we've captured
5 that.

6
7 We now have about a 70:30 split of fixed charges
8 versus variable and it did result, as I said, in a premium
9 to high security based on a 95:65 ratio, which is the
10 Murrumbidgee water sharing plan long-run reliability
11 factor.

12
13 MR REID: You indicated that for your own internal
14 purposes you've used the 50 years 1900 to 1950 sales
15 data. How do they compare with what State Water is
16 proposing for their 15-year moving average for yourselves?
17

18 MR TUCKER: In our own case the 15 year I suspect would be
19 considerably less than the 50-year data. I don't have the
20 graph with me but - as I said - in the last eight years
21 we've had a 29 per cent average availability. That's off
22 the Richter scale in terms of anything that we've
23 experienced in the last century.

24
25 MR REID: There is a fair amount of argument in your
26 submission about the calculation of the weighted average
27 cost of capital and differentiating for comparing specific risk.
28 How would you propose that be treated as far as
29 State Water is concerned?
30

31 MR HOWE: Basically, the discussion of the weighted
32 average cost of capital for us was a bit confusing in the
33 actual State Water submission. What we have suggested is
34 that if you allow firms' specific risk to change the
35 weighted average cost of capital, which is effectively a
36 State Water argument, that you actually take away one of
37 the major incentives to improve firm performance for
38 State Water.

39
40 I am not sure how that all works, but it appears to be
41 a major discipline on State Water and what we're saying
42 there's no reason to withdraw that discipline by increasing
43 the weighted average cost of capital.
44

45 MR REID: One of the issues you have raised is a lack of
46 comprehensive, detailed and consistent data in total and by
47 valley. Richard has already asked you about the

1 discussions you've had with State Water on the proposed
2 expenditure. Would you like to elaborate on what
3 additional information you were looking for, have sought
4 but have not got?
5

6 MR HOWE: In terms of the discussions with customer
7 service committees on forward capex and opex, we look for a
8 much more evolving process where the capex is reviewed
9 annually, programs are made subject to review by customers
10 and changes are reviewed by customers. On the opex side,
11 things like thematic expenditure should be acceptable to
12 the relevant customers and really we see the Customer
13 Service Committee as the logical place to do that.
14

15 MR TUCKER: Could I add one more comment? Whilst the
16 format and agenda of customer service committees has
17 improved considerably in the last couple of years, from a
18 capex point of view we're still very much into the mode of
19 retrospective analysis. We get to review capex programs
20 post the decision, not pre the decision, in most cases.
21 There is still not a lot of contribution from water users
22 about a forward program for capex.
23

24 MR WARNER: Back to the 70:30 split. You have had to
25 adopt that for your own business purposes given the revenue
26 volatility. Would you accept that sort of split for
27 State Water if we had to introduce it?
28

29 MR TUCKER: I think the split is determined by the cost
30 base. Fundamentally, State Water need to have a look at
31 what are our true fixed costs which can and can't change
32 according to the season and what are our variable costs.
33 In our own case, as I said, there's still a gap. 90:10 is
34 probably more likely the case. We are at 70:30.
35 Recognising that that creates an income gap for our
36 organisation which then leads you to other strategies in
37 your drought mitigation or risk strategy to deal with that,
38 and they include things like reducing your costs in extreme
39 years, to the extent that you can, but in our own case also
40 income diversity.
41

42 In the case of investments, we have taken about
43 \$20 million worth of cash and converted to it about
44 \$50 million worth of water and instead of revenues of
45 \$1 million to \$2 million a year from interest revenues, we
46 are contributing something like \$5 million to \$6 million a
47 year from water sales revenues back into our business

1 model. There are other things that can be implemented in
2 order to address the gap and we don't feel that there's
3 enough focus on those other measures rather than just an
4 increase in revenues from water users.

5
6 MR HOWE: I think the other relevant thing there is even
7 though State Water has a 40:60 ratio, because of the
8 government component of their revenue, that increases the
9 fixed or guaranteed return much higher than the 40:60 might
10 suggest. Plus, as Brett mentioned earlier, the high
11 security is very much a guaranteed form of revenue and so
12 really we estimate that they've roughly got 70 per cent
13 guaranteed revenue from year to year. It is really only
14 30 per cent that's at risk, that 30 per cent arising from
15 the usage charges to users.

16
17 THE ACTING CHAIRMAN: Thank you. Just a couple of
18 questions from me, if I may. The first one, if we can look
19 once again at the 15-year rolling average, as I understand
20 it from State Water and bear in mind that the purpose of
21 making the forecast is to forecast revenue is over a
22 four-year determination period, I think their argument is
23 that the 15-year rolling average is more likely to be
24 representative of sales of water over the determination
25 period, rather than the longer-term average. I wonder if you
26 can tell me why you disagree with this proposition?

27
28 MR TUCKER: I don't think there's any dispute from us that
29 we're in a difficult resource period and that our sales
30 going forward will be lower, but its relevance to fixed
31 cost is what we're questioning. What we would rather see
32 is a more fundamental review of what are the fixed costs
33 irrespective of whether you deliver 1 megalitre or
34 1 million megalitres, or whatever the number may be, and
35 then match that to the users that are demanding that
36 service and in our own case it meant that general security
37 customers, even though they haven't received much
38 allocation in these last few years, are still meeting a
39 reasonably high proportion of fixed costs.

40
41 As I said, we deal with the impacts of that socially
42 at a community level in a different sense, but the pricing
43 model hasn't been corrupted according to the sequence that
44 we're in. Most of the costs are fixed and largely fixed
45 per property, in our case, irrespective of the entitlement,
46 let alone the usage. A lot of our cost in the pricing
47 model is in fact based on property charges. The only

1 reason we've had to review that more recently is to deal
2 with the ACCC pricing changes.

3
4 MR HOWE: Could I add something there, and maybe Andrew,
5 when he comes to speak, will pick this up. One of the big
6 problems with moving away from the IQQM long-term approach
7 is that, whichever way you move, it becomes a bad outcome
8 for some valleys and a good outcome for others. If you
9 look at the data, I think the Murrumbidgee Valley is one of
10 the lowest losers, if you like, in the 15-year moving
11 average approach; but in some valleys it goes to 30 per cent.
12 We have used our 50-year model in our area because it works
13 in our area. State Water has a vast range of customers and
14 regions across the state, but they are all different. If you
15 moved in some cases to a CSIRO approach, you would have
16 a 50 per cent increase in usage price. In another you
17 would have very little impact. It is very difficult for
18 one size fits all to be applied without perhaps unintended
19 outcomes in certain place. So perhaps moving away from a
20 one size fits all approach might be the way to go.

21
22 THE ACTING CHAIRMAN: Thank you for that. The other
23 question I want to ask is about the WACC. You have to bear
24 with me; I'll try to ask it in a useful way. As I
25 understand it, what State Water is saying and what I think
26 you also would agree, is that most of their costs are fixed
27 costs; nevertheless they propose a 60 usage 40 fixed split
28 because that, I guess, is basically what the users want.

29
30 One way to think about that is that what State Water
31 are providing is a type of insurance to users so that when
32 water sales are low, not much would be covered by users;
33 when water sales are higher, more will be. It is the sort
34 of insurance that seems to be valuable for users.
35 Shouldn't State Water be able to charge for that and if the
36 WACC is not the right way perhaps another way might be
37 more appropriate? I'd be interested to hear your thoughts on
38 that.

39
40 MR HOWE: It is a very good question. The simple answer,
41 as far as I would see it, is that, yes, that would be an
42 appropriate way to go if it was made transparent, if it was
43 made clear that, "We think the insurance cost or the
44 insurance service here is being sought by customers" and it is
45 identified, quantified and put a value on it. I guess, once again,
46 what we would say is come back to the IPART framework,
47 which is: identify the costs, identify the efficient part

1 of those costs, then allocate them to who is driving them.
2 If that were done, I think that would be much more
3 acceptable than simply relying on broad-based estimates of,
4 "This is our business risk and therefore we need to
5 increase price effectively as a means of overcoming every
6 threat to the business." If there is an insurance service
7 identified, charge it, and people would be happy to pay, I
8 would imagine.
9
10 THE ACTING CHAIRMAN: Thank you very much for your
11 presentation and for answering the questions.
12
13 We now have a presentation from the Murrumbidgee
14 Private Irrigators and we invite the representatives to
15 come forward
16
17 MURRUMBIDGEE PRIVATE IRRIGATORS
18
19 MS HEHIR: For those who don't know me, my name is Jenny
20 Hehir and I am from Murrumbidgee Private Irrigators. I
21 have my chairman Murray Shaw here to answer questions as
22 we move forward.
23
24 We have kept our presentation fairly simplistic
25 because we are responding under the banner of New South
26 Wales Irrigators Council; however, there are a few points
27 we would like to mention. Murrumbidgee Private Irrigators
28 represents irrigators on the full length of the
29 Murrumbidgee River and the Yanco Creek system. We also
30 have a number of operators amongst our members, although
31 volumes of water are vastly smaller than the irrigation
32 corporations. We are approximately one-third of the
33 diversions on the Murrumbidgee system.
34
35 At this point I would also like to commend Murray
36 Irrigation Limited and Murrumbidgee Irrigation for their
37 excellent submissions and their presentations here this
38 morning. However, I will just follow on with a few points
39 that we would like to reiterate.
40
41 Despite the drought it appears that State Water has
42 still managed to make a profit each year over the last
43 determination period and has shown a positive return on
44 assets. On the contrary, I wish to stress that State
45 Water's customers have been and still remain under enormous
46 financial pressure and, as a result, have been forced to
47 delay any form of capital works or upgrade through this

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1 terrible time. Murrumbidgee Private Irrigators struggle to
2 understand State Water's justification for further capital
3 expenditure during the dry period instead of deferring
4 until the outlook improves.
5
6 We do commend State Water for making inroads into
7 efficiency gains through restructuring; however we believe
8 there is still room for improvement. It appears that the
9 only driver for this improvement has been from the
10 limitation of revenue from customers. It is imperative
11 that IPART continue this pressure until optimum efficiency
12 is reached.
13
14 Murrumbidgee Private Irrigators would like to
15 emphasise that if you compare each of the pricing periods
16 in an open and transparent manner, a four-year period for
17 the next determination is an appropriate length of time.
18 We submit that if State Water were to change its
19 forecasting from the IQQM method, it would be detrimental
20 to all users who have no way of being able to protect
21 themselves from the same dry conditions. It is our view
22 that State Water would be trying to second-guess the future
23 with a model that in fact has no basis.
24
25 MPI supports the continuation of a compulsory levy
26 collection for the Yanco Creek and Tributaries Advisory
27 landholders to build and continue natural resource
28 management. MPI considers that it is essential to co-fund
29 funding that is being provided by government agencies to
30 allow for works that require extra funding to be completed.
31
32 In summary, our organisation's view is that any
33 increase in charges would be a de facto tax increase for
34 irrigators and the revenue would flow back to the state
35 government as dividends.
36
37 We wish to stress to IPART that our irrigators are
38 facing extremely tough financial conditions and are clearly
39 battling to pay current State Water charges. If the
40 charges are raised during these tough conditions, it may
41 render the majority of our businesses unviable. Our
42 members have been borrowing money to fund their operations
43 and are therefore borrowing to pay State Water charges as
44 they currently stand. This has been occurring for the past
45 four-year pricing period.
46
47 There is at this point in time no end in sight to the

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1 current low flow regime and dry weather patterns in the
2 basin. It is high time State Water cut the cloth to fit
3 the garment and if this cannot be done, then its
4 shareholders should make up the deficit.

5
6 In closing, if irrigators do not have the ability to
7 pay their water charges or make a business decision to exit
8 the industry, I pose the question how will State Water
9 survive? Thank you.

10
11 THE ACTING CHAIRMAN: Thank you very much. We will
12 now have some questions.

13
14 MR REID: Thank you very much for your presentation. If I
15 can focus on the Yanco Creek levy firstly, obviously that
16 is included in the current determination and you have
17 proposed to continue that. As a precondition for that to
18 happen, we look for evidence of general support. Do you
19 have that general support and can you demonstrate that to
20 us?

21
22 MS HEHIR: Yes, we do. It was taken to our last general
23 meeting and approved at that meeting.

24
25 MR REID: And not only the continuation of levy but the
26 size of the levy?

27
28 MS HEHIR: Yes. The decision was made that it would
29 remain the same.

30
31 MR REID: Through your customer council or other sources,
32 have you been able to identify the specific actions that
33 you believe State Water should take to reduce its costs?

34
35 MR SHAW: They have already gone down a very extreme
36 path, I suppose, as far as skill shedding or skill sharing.
37 Technological advances must be improved, I would have
38 thought. They are still currently reading meters manually
39 or filling out books and then taking them back to the
40 office. But I know from anecdotal evidence from my
41 customer service officer that they have not been happy with
42 the job shedding and what is happening in the Leeton
43 office. If they can't do it in the low-flow regime then
44 when things return to normal, it should be an opportune
45 time for these changes to take place and play it through
46 the business.
47

1 MR WARNER: One of the things that we have talked about
2 today is how to assist State Water in managing its revenue
3 volatility. I note you favour the continuation of the use
4 of the IQQM model. You don't favour increasing the WACC as
5 a way of overcoming that revenue volatility but you have
6 suggested cost savings in their operating costs. Are there
7 any other possible areas that we could look at as solutions
8 to try and better manage that revenue volatility?
9

10 MS HEHIR: I think we will leave those questions to our
11 capable New South Wales Irrigators Council CEO, thank you.
12

13 THE ACTING CHAIRMAN: Thank you very much for your
14 presentation and for answering the questions.
15

16 The next presentation will be from the New South Wales
17 Irrigators Council. I invite their representatives to come
18 forward and introduce themselves
19

20 NEW SOUTH WALES IRRIGATORS COUNCIL

21
22 MR GREGSON: Thank you very much, ladies and gentlemen.
23 My name is Andrew Gregson. I am chief executive officer of
24 New South Wales Irrigators Council. With me is the council
25 chairman Col Thomson, who has indicated that he is prepared
26 to answer the easy questions, including that last one on
27 notice.
28

29 The State Water Corporation is an excellent business.
30 It is well managed. It is well run. It provides very high
31 level of services in a very difficult sector. In
32 particular the New South Wales Irrigators Council draws
33 attention to the restructure and resultant significant cost
34 savings that State Water has achieved during the course of
35 the current determination. Whilst not achieving everything
36 that IPART set out, State Water has come very close, and we
37 acknowledge that. Moreover they have achieved that
38 restructure and those savings under particularly difficult
39 and challenging circumstances, circumstances that were
40 visited not only on State Water but on all of their
41 customers as well. It is a credit to State Water and to
42 the determination that IPART made in 2006 that the company
43 has achieved what very few others have in this trying
44 period - a profit.
45

46 We have provided IPART with a comprehensive set of
47 submissions in response to the submissions put by State

1 Water. We look forward to any questions that the tribunal
2 might have in respect of our submissions but we don't
3 intend reiterating them now. What we would like to address
4 now are what we believe to be the key issue in this
5 determination process: firstly, the lack of basis for
6 change from the status quo; secondly, the nature of the
7 business risk that State Water faces; and, finally, the
8 appropriate level of return for a regulated business.
9 Let's move to the first of these points, the lack of a
10 basis for change from the status quo.

11
12 During the last determination, IPART peered into State
13 Water in excruciating detail. The level of revenue costs
14 and revenue model to match it were determined at a
15 microscopic level. We now submit that, having undertaken
16 such a process and having provided a determination which
17 clearly worked, the status quo position has been achieved
18 that has suited all the parties. On that basis we submit
19 that no change from the status quo is justified unless it
20 can be demonstrated that such change is fundamentally
21 necessary for the continued operation of the business.

22
23 In short unless there is a demonstrated reason for
24 change, change should not be made. Let's face it,
25 irrigators operate with enough uncertainty; we don't need
26 more of it without an extremely good reason. We therefore
27 submit that State Water must prove a reason to change
28 before IPART would consider the details of any such change.

29
30 Let us now consider the nature of the business risk
31 that State Water faces. This is clearly a critical issue
32 as State Water has requested both an increase in the
33 weighted average cost of capital and a model for
34 forecasting consumption that is significantly beneficial to
35 them. Both of these extraordinary requests are to address
36 the same perceived problem and both will have a significant
37 cost implication for their customers.

38
39 Let us firstly discount the suggestion that State
40 Water has made that they face a demand side risk. Their
41 assertion, as I understand it, is that in years of high
42 rainfall they will face a demand side risk as irrigators
43 will not need to purchase water. This assertion ignores
44 the agricultural base of the state in which they operate.
45 As water availability increases more heavily water
46 dependent crops are planted. As water availability
47 continues to increase the area which is planted to those

1 crops further increases. I am of course referring to rice
2 in the southern part of the state and cotton in the
3 northern part of the state. Whilst it is theoretically
4 possible to grow both those crops on rainfall, that simply
5 is not a commercially viable decision. Even if significant
6 rainfall is available to assist these crops, irrigation
7 water availability is what will drive those planning
8 decisions. The more water that State Water can supply, the
9 more crop that will be planted. Of course this is subject
10 to physical limitations but by the time those limitations
11 are reached, State Water would have reaped sufficient
12 revenue to bring a smile to the face of all but the most
13 dour of treasury officials.

14
15 The business risk that State Water faces is not the
16 demand side, in our submission; it is in fact supply side.
17 Let us turn then to the supply side risk and the manner in
18 which it ought be dealt with. Consumption forecasting is
19 something that IPART are asked to undertake at each
20 determination. Given that a significant portion of State
21 Water's revenue is based on consumer volume, this is
22 obviously a necessary part of the process.

23
24 Australia's hydrography makes consumption forecasting
25 a difficult task. Essentially we live in one of two states
26 out here in the basin - flood or drought. The forecasting
27 process is unable to predict which one will occur in any
28 short term given period and as a result must work on
29 averages. The result is that accuracy in prediction is
30 important.

31
32 Any statistician will tell you that accuracy in
33 prediction with very few exemptions is a direct function of
34 sample size. The larger the sample data set available, the
35 more accurate the outcome will be. In a population of some
36 10,000, sampling 10 people would not give a reliable
37 result. Sampling 100 would give a more reliable result and
38 sampling 1,000 would give greater accuracy. With that in
39 mind, IPART must take into account the data set that is
40 available in New South Wales with respect to water
41 availability.

42
43 The integrated quality and quantity model contains up
44 to 115 years of data. Clearly the use of all that data is
45 the most sensible approach to predicting the future. State
46 Water have argued, based on the work of their consultant,
47 that there has been a statistical break in the IQQM model,

1 that evidences climate change and, as a result, only the
2 past 15 years of data ought be used. We submit that the
3 statistical break is far from evidence of climate change
4 and, more to the point, is simply a statistical reflection
5 of the current drought being the worst on record.
6

7 There is no evidence to reflect that the current drought or
8 the past 15 years is the new normal. In fact the
9 Commonwealth Science and Industry Research Organisation
10 openly stated that the current conditions are not the new
11 normal. Moreover climate change science is not about
12 predicting what will happen in the next four years - the
13 determination period that IPART is considering. Should the
14 more dire predictions of climate change to 2030 and beyond
15 be more accurate, IPART and perhaps the ACCC will have
16 ample opportunity to reset prediction models prior to those
17 events being visited on us.
18

19 Finally we turn to the appropriate level of return for
20 a regulated business. I started this presentation by
21 heaping praise on State Water for the excellent result they
22 have achieved over the past your fears and indeed over the
23 period of the current drought. That phrase is well deserved
24 as State Water has delivered what so many businesses have
25 failed recently to deliver - a profit.
26

27 We recognise that State Water has not been able to
28 return a dividend to its shareholders, but they certainly
29 are not Robinson Crusoe in that. The fact that they have
30 not returned a dividend is not in itself evidence of
31 business risk that warrants a higher charge set by IPART
32 through increased weighted average cost of capital. Indeed
33 we argue that the very basis of the IPART determination
34 mitigates to a very great extent any risk faced.
35

36 We ask you to consider it this way: IPART is in fact
37 setting a floor price. In the current determination State
38 Water has been provided with a revenue stream that has
39 maintained profitability in the most trying of
40 circumstances. There is no upper limit set on revenue in
41 this determination process. In a year of high supply and
42 hence high demand, State Water which will make a
43 significant return. That return will flow to its
44 shareholders.
45

46 Ladies and gentlemen, State Water has done well and,
47 in our submission, the status quo will continue to see it

1 perform well for both its shareholder and its customers.
2 We are happy to take any questions on any part of our
3 submission.
4

5 THE ACTING CHAIRMAN: Thank you very much. Colin
6 and Richard will start the questions.
7

8 MR REID: Thank you very much, Andrew. You talk about
9 retaining the status quo; however, in your submission you
10 have suggested a number of changes to the cost sharing
11 ratios. Other people from your irrigation community have
12 argued against that. I am wondering if you would like to
13 expand on your position there.
14

15 MR GREGSON: You will notice that our submissions in
16 respect to cost sharing ratios are in the alternate; that
17 is, our primary submission is that, with one exception,
18 they don't need to be revisited and they don't need to be
19 recalibrated. However, in the event that IPART disagrees
20 with that, we have argued in the alternate what those cost
21 sharing ratios should be.
22

23 The one exception that we have placed in our
24 submission is in respect of a fish passage that is
25 triggered by dam safety upgrades. We have suggested a
26 method for dealing with those which we consider to be more
27 appropriate. The balance of our submissions with respect
28 to cost sharing are in the alternate arguments and should
29 only be considered in the event that you disagree with our
30 first submission; that is, that there is no need for
31 change.
32

33 MR REID: Thank you for clarifying that. Obviously you
34 represent a broad variety of interests among the irrigation
35 community. If I can just explore a couple of those issues,
36 one is that some irrigators have argued for a uniform price
37 across the state and the other issue, of course, is a
38 question of high and low security. Does the Irrigators
39 Council have a position on either of those matters?
40

41 MR GREGSON: Yes, we do have a position on that and it is
42 a position that reflects what we believe should be the
43 overall approach taken to the IPART determination; that is,
44 assess costs and then attribute those reasonable costs on
45 the basis in which they were approved - on a user pays
46 basis.
47

1 In terms of the differential between valleys,
2 obviously some of them are more expensive to run than
3 others and that ought to be reflected in the reasonable
4 costs that are then passed on to the customers in those
5 valleys. I know that Col Thomson has a few comments to
6 make in respect of high and general security. In our
7 submission, we have suggested that, rather than pick that
8 random number as to what the balance of charges ought be
9 between high and general, we simply take that overall
10 approach that we have suggested to IPART; that is,
11 determine what the costs are and who the impactor was and
12 to then attribute those costs reasonably between them.
13 This has meant we have achieved support for our position
14 both from general and high security irrigators across the
15 state.

16
17 MR THOMSON: On the issue of high and low security, I
18 support the submission. We have made the point that we
19 pretty much have the balance right. It could be well argued,
20 and I have argued with George and his staff on many
21 occasions, that the price of water out in the marketplace has
22 absolutely no relevance to the price of supplying water. If you
23 accept that argument, then it could be argued with high
24 security that supplying a megalitre of water down the river
25 costs no more than it would for low security.

26
27 The other argument is that high security, of course,
28 during this drought have come out of it a lot better than
29 low security. The truth lies in the middle and I think we
30 have gone not far out in getting somewhere in the middle of
31 being accurate.

32
33 It probably costs the same to run a megalitre of
34 water. I think high security irrigators out there have
35 accepted for a long period of time and are quite
36 comfortable paying more for high security. I think that's
37 the politics out there, and I can mention politics; we are
38 a political organisation. I think they are quite happy to
39 pay more. It is the amount that is under debate and they
40 don't want to be fleeced.

41
42 I'll repeat myself, Mr Chairman, I think the last
43 couple of determinations have got it pretty close to being
44 right.

45
46 MR WARNER: I think I will come back to revenue
47 volatility, except a different take on that. You have

1 argued that the status quo should be maintained in relation
2 to a lot of these parameters including the continued use of
3 IQQM, no increase in the WACC to compensate for revenue
4 volatility caused by climate, et cetera. I note that two
5 of your largest members, Murray Irrigation and Murrumbidgee
6 Irrigation, have both confronted the same sort of problem
7 and both of them have adopted strategies, in some cases not
8 dissimilar strategies, to manage that same problem.
9 Shouldn't State Water be allowed to do the same?

10
11 MR GREGSON: State Water have every right and indeed
12 should seek to ensure a reasonable level of return in what
13 they do, but I don't think it is appropriate to
14 characterise them in the same way as those two members of
15 ours, Murray Irrigation and Murrumbidgee Irrigation, given
16 that the revenue for Murray and Murrumbidgee is largely
17 derived from the customer base; whereas there is a great
18 deal more certainty in the revenue for State Water given
19 who its customers are. Its largest contributor, as I
20 understand it, is in fact the state government, and I have
21 a sneaking suspicion there will never be a problem in terms
22 of getting them to pay eventually.

23
24 As Brett from Murrumbidgee said, not long ago some
25 70 per cent of the revenue that State Water collects is
26 indeed pretty much secure, be it from state government
27 contributions, high security and general security fixed
28 charges; so in fact the volatility of revenue that State
29 Water would have you believe is enormous is in fact pretty
30 much 70 per cent secure. I am not entirely sure that we
31 can characterise State Water as being the same as Murray
32 and Murrumbidgee and the other large infrastructure
33 operators when, at the same time, a large portion of their
34 revenue is secure.

35
36 MR THOMSON: I agree with that.

37
38 MR WARNER: I know in your submission that you have
39 challenged several components of State Water's operating
40 expenditure, in particular their thematic expenditure. You
41 proposed that that be deferred pending some certain revenue
42 triggers being met. Could you describe more fully that
43 proposal? How do you think that would work?

44
45 MR GREGSON: We didn't, during the course of preparing
46 this submission, check with our members as to what the
47 trigger would be, so I can't answer that question for you,

1 but I suspect the answer would be a revenue level trigger.
2
3 What we have suggested in our submission is that those
4 thematic expenses couldn't be characterised as urgent in
5 nature. In fact, I suspect State Water would probably
6 agree with that when you look through some of these. We
7 have suggested that that sort of expenditure ought rightly
8 be deferred, as it would be in a normal competitive
9 commercial enterprise, until revenue recovers rather than
10 be visited through a charge to irrigators to increase it as
11 a means of opex.

12
13 THE ACTING CHAIRMAN: I have a few questions. Perhaps
14 we can go back to the high security/low security question.
15 Col Thomson said very kindly that we got it right in the
16 last couple of determinations and therefore, if I
17 understand correctly, the pricing factor we used was based
18 on the conversion factor of the water sharing plans with
19 the general and high security water.

20
21 Col asked what has changed since then. I guess what
22 may well have changed is the likelihood of those people
23 getting water in recent years. I just wonder isn't that a
24 relevant factor that we should look at in deciding the
25 ratio between high and the general security users and
26 whether there is in fact a need to examine this question
27 given the circumstances in recent years?

28
29 MR THOMSON: That's the \$64 question, isn't it? If we are
30 going to make assumptions that every year for the next four
31 years will be the same as the last four years, then maybe
32 we could have that debate. We don't know that. As an
33 irrigator I am saying these last four years will not repeat
34 themselves. I hope I'm right. I'm not very often right
35 but I just hope I'm right.

36
37 The high security irrigators didn't create the
38 drought; it is just a result of what happened. It is a
39 very sad set of circumstances out there at the moment, I
40 can absolutely assure you; no-one is getting any
41 satisfaction out of this. But I think to make long-term
42 determinations on what has happened in the last four years
43 is fraught with danger. We have to be more positive than
44 that and hopefully next year we will start to return to
45 something that is a bit more normal.

46
47 MR GREGSON: I am always interested to get a question

1 which effectively gives me an opportunity to disagree with
2 my chairman. I will decline the opportunity in this
3 instance. I believe what Col was getting at in terms of
4 the current determination and the balance being just about
5 right was in respect of quantum of the premium between high
6 and general security. Our submission doesn't so much go to
7 the quantum as the method by which it ought to be
8 calculated; that is, the cost basis attributed to impact as
9 we proposed in making our submission.

10
11 THE ACTING CHAIRMAN: Thank you for that. I am also
12 struggling a bit with the issue of, if you like,
13 forecasting the amount of water to be delivered, bearing in
14 mind that we're making a four-year determination, and our
15 task really is to work out what is the best way of
16 predicting what water sales are likely to be in the past
17 four years.

18
19 It does seem to me that dry years run together and
20 that it may be more accurate to give greater weight to the
21 more recent years than over the full 115 or 117 years in
22 the IQQM model. I wonder how you would respond to that.
23 It is a fundamentally important issue. I think what we
24 should try to do is to get, if you like, the most accurate
25 forward estimate over the coming four-year period.

26
27 MR GREGSON: In terms of statistical accuracy, you
28 wouldn't ever suggest to make a prediction based on the
29 bottom of a trough nor would you suggest a prediction based
30 on the height of the peak. Obviously, any prediction has
31 to be based somewhere between the trough and the peak.

32
33 If you were to take only the recent past, effectively,
34 what you would be doing is locking in quite a statistically
35 significant trough. In any prediction model that we've
36 studied or that I'm aware of the broadest range of data
37 possible is used to make that prediction and in fact in
38 most of those prediction models the outliers are in fact
39 discounted.

40
41 What the 15-year model suggests should happen is that
42 only the most recent outliers should be counted and I would
43 suggest that that, whilst not necessarily statistically
44 invalid, is obviously far divorced from reality. If indeed
45 the last four years are the new normal and the
46 International Panel on Climate Change and CSIRO have both
47 got it wrong then, in the vernacular, we're all buggered

1 anyway.

2
3 When it comes down to it, to make a prediction you
4 want to look at the greatest range of data that you have
5 available. We are not even suggesting in our submission
6 that you should discount the outliers. In fact, we're
7 content for the outliers of the last eight years of drought
8 to be included, but they should be included along with the
9 balance of the peaks and the troughs that the IQQM model
10 provides.

11
12 MR THOMSON: If you look at the history of drought and we
13 can speculate in this room, can't we, the two periods we go
14 back to look at are the 1900s drought and the 1940s
15 drought. If you look at the 1900s drought, we might have a
16 bit longer to go because it was about 1896 to I think 1916
17 there was a 20-year period there that wasn't all like this,
18 but it was a horrible, horrible 20-year period. If we look
19 at the 1940s then we should just be about out of it. This
20 started in 2002 and I think the 1950's drought wasn't any
21 longer than that, so next year should be a good year. How
22 you sit down - you guys or any of us - and try and plan for
23 the future on that basis I don't have an answer to it.
24 I wish I did.

25
26 MS KRIEGER: I have just one question. In your commentary
27 you said that you didn't think it was a demand side risk,
28 it was a supply side risk, and that basically maybe with a
29 lag of one season people would plant in accordance with
30 their maximum entitlements as quickly as they could. That
31 hasn't actually been the case, has it. Through the drought
32 people have held back and have carried over entitlements.
33 How long do you think it would take for your response to
34 kick in? In other words, how long would it take for people
35 to have the confidence to utilise their full entitlements?

36
37 MR THOMSON: I think with full entitlements it would all
38 happen tomorrow. I think poor Rel's gumboots have just
39 about rotted and his shovel is all rusted. Farmers would
40 react very, very quickly to it. Why a lot of them have
41 carried it over is because the amounts they've had have
42 been too small. It does vary from farm to farm, but I know
43 this year some of the guys down south are saying that while
44 the allocation is so small they'll probably try and
45 accumulate that into next year to make it worthwhile to
46 grow a crop. There are a number of factors out there that
47 influence people to not use it now and to carry it over.

1
2 MR GREGSON: In the context of our submission, I think
3 what Col is getting at is that there is a critical mass
4 issue and I would suggest that that critical mass issue -
5 and it's not a very large number we're talking about - is
6 in fact a supply side rather than a demand side risk.

7
8 THE ACTING CHAIRMAN: Let me try you out on the WACC
9 question that I asked Murrumbidgee Irrigation about.
10 I would be interested in your thoughts on that as well.
11 Let me try and rephrase the question, if I may.
12 As I understand it, State Water are largely a fixed cost
13 business but they are prepared to charge 60 per cent
14 variable, 40 per cent fixed, largely because that is
15 something that their users favour.

16
17 By doing that they're exposing themselves to risk.
18 They are in fact providing water users with a degree of
19 drought insurance because when water sales are low they
20 don't get much revenue, but when water sales are high they
21 get a fair amount of revenue. There is a degree of drought
22 insurance there. This is something that seems to be
23 valuable to farmers themselves. They tell us that.

24
25 Is it not reasonable that State Water should charge
26 for that? You have argued that the WACC is not an
27 appropriate way for them to charge that, but there might be
28 other ways in which they could charge for this service.
29 I am interested in your thoughts on this line of thinking.

30
31 MR GREGSON: Yes, I understand your question and I think
32 you make a reasonable point. It is not accurate to
33 describe State Water's revenue as 60:40, that's not the
34 case, and in fact that's the case from irrigators as
35 customers, but of course there is a different revenue
36 figure across their business. As Brett presented earlier,
37 about 70 per cent of it in fact can effectively be seen as
38 fixed.

39
40 The question of whether State Water is adopting a risk
41 or not in servicing its customers I think comes to the
42 nature of the price determination and we'd suggest the
43 reason that IPART is asked to look at State Water is
44 twofold, first of all, to set a price, but also to consider
45 what that price would look like in a competitive
46 environment, which brings me to a hypothetical question.
47 Should State Water assume some of the risk of the sector

1 that they operate in? Our answer to that is an unequivocal
2 "yes".
3
4 Consider this in a private sector context if there
5 were a competitive environment operating for the delivery
6 of water in the sector that State Water operates. If a
7 customer had a choice between two businesses, one that was
8 prepared to accept some risk of its operations and one that
9 was of a mind to pass all of the risk in that sector on to
10 a customer, it is a pretty simple choice as to which one of
11 those businesses a customer is going to choose.

12
13 In that respect, we would submit that it is reasonable
14 State Water assume some of the risk in the sector that
15 they're operating and that they receive a sufficient reward
16 in return for that risk. We have suggested that the WACC
17 that they have now based on 30 per cent revenue volatility
18 across their entire business operating structure is a
19 reasonable return, has proved to be a reasonable return in
20 the context of the current determination and is therefore
21 appropriate for the new determination.

22
23 THE ACTING CHAIRMAN: Thank you very much for that
24 and for your presentation and for answering questions this
25 morning. We will now break for lunch a little bit ahead of time.
26 I understand, Richard, lunch is to be provided here. We
27 are slightly ahead of time, but let's try and resume at
28 one o'clock in 45 minutes time. Thank you very much.

29
30 LUNCHEON ADJOURNMENT
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47

1 UPON RESUMPTION:

2
3 WESTERN MURRAY IRRIGATION LIMITED

4
5 THE ACTING CHAIRMAN: Ladies and gentlemen, we will
6 resume the session now. The next presentation is from
7 Western Murray Irrigation Limited. Would their
8 representatives introduce themselves for the record and
9 then proceed.

10
11 MS RIX: Good afternoon. I am Cheryl Rix, the General
12 Manager of Western Murray Irrigation, and I have on my
13 right Dennis Mills, who is the Director of the Board of
14 Western Murray Irrigation and he is also actually a private
15 diverter in his own right in the Lower Murray region.

16
17 Thank you for giving me the opportunity to speak and
18 I won't be going over my full submission but just picking
19 up the main points of interest to Western Murray.

20
21 As most of you in the room are very aware, we are a
22 non-profit unlisted public company. Western Murray
23 customers hold high security entitlements of about
24 60,000 megalitres and it is decreasing by the day.
25 We certainly don't have any general security entitlement at
26 all, so we are a little bit of a different voice in the
27 room today. We don't have a conveyance licence either.

28
29 At the moment we manage three irrigation areas, being
30 Buronga, Coomealla and Curlwaa, in the south-west of
31 New South Wales and really are the only people representing
32 that region today. We have permanent plantings in our area
33 and that's the other key difference, we are not rice or
34 cotton growers, and our prevalent crops are grapes and
35 citrus and the two-tiered allocation system in New South
36 Wales of high security and general security was really
37 established to provide a high level of water security to
38 permanent plantings for agricultural production and that's
39 a very historical decision.

40
41 Of course, as a general comment - and I am in line with
42 everyone in the room today - the drought and particularly
43 poor commodity prices have hit our areas very hard
44 We have recently done an on-farm assessment where we
45 have had some mapping done and we've got 20 per cent of the
46 land in Western Murray not being irrigated at all and that
47 has come about due to an initial lack of water in those

1 last couple of years and also those commodity price issues.
2
3 In the year to date we have had inquiries to remove
4 about 4 per cent of our licence and that's permanent water
5 trades, but ours isn't going to the federal government.
6 Given the nature of high security it's actually being
7 picked up by South Australian and Victorian farmers. They
8 are moving that to zero WALs in the New South Wales river
9 system, so quite correctly in that instance George is
10 receiving an extra licence to deal with and we're losing
11 water entitlement off our licence.
12
13 We see that this will be a continuing trend and it has
14 clearly been recognised by State Water as having a negative
15 impact on their variable revenues. I support State Water's
16 recovery of the usage charge when water is traded. I don't
17 believe this is a barrier to trade. It is a due
18 recognition that that water is being used elsewhere and the
19 cost of that needs to be picked up.
20
21 If State Water had done that for the past three years
22 the revenue shortfall - I am guessing - would have been
23 less, but they've really only picked that up in the last
24 few months, so if that's an ongoing decision, hopefully
25 that will help with some of that revenue shortfall.
26
27 I have been interested in the discussion about cost
28 recovery this morning, bearing in mind that's full cost
29 recovery and we do have that combination of fixed and
30 variable pricing, and it has allowed our company to be
31 self-sustaining during the last three years where we've had
32 that reduced allocation and certainly significantly reduced
33 usage as well. We do charge for all services and I'm
34 really pleased to see State Water picking up and charging
35 \$80 for those information requests. All those little
36 things will help.
37
38 Our pricing of course has been driven by the ACCC as
39 well where we had that fair determination price which has
40 to be based on our fixed costs. We will undoubtedly be
41 facing restructure again because we know that our future
42 holds less irrigators and reduced revenues and increasing
43 electricity costs and everything else that's coming out
44 with the carbon tax and things.
45
46 Before I begin on my specific comments I just want to
47 make a couple of general comments. We do not support

1 cross-valley subsidies at all and we do not support the
2 free riders in the system. We know there are a number of
3 beneficiaries in the Murray system that probably aren't
4 paying anything and I think that continually needs to be
5 looked at for the future.
6
7 We don't support that 68 per cent increase in high
8 security charges over the next four years because when you
9 hear that number, 68 per cent, that's a very large number
10 in any consumer terms through increasing a price. We do
11 support cost recovery, however, where the costs are deemed
12 to be reasonable provided all the costs are spread fairly
13 across all entitlement holders and users.
14
15 My next general point really supports metering at all
16 points of supply from the Murray River. Western Murray has
17 actually gone and metered all of our stock and domestic
18 pumping arrangements. There might be small extractions,
19 but we believe any extractions, be they small or large,
20 impact on every other user on the river.
21
22 I note from the State Water presentation this morning
23 that State Water stated they will only be charging marginal
24 costs initially and I recognise they're going to get a
25 large hit from the federal government for metering, but is
26 that a good business strategy? I question marginal costs
27 when I hear it. We have certainly made all our guys pay
28 full tote odds for their metering and so they should. I am
29 probably a lone voice in the support of that type of thing.
30
31 We support State Water's recommendation to maintain
32 the temporary transfer fee at the current levels. We know
33 the water market is a business risk management tool fully
34 accepted and used by all the State Water customers and
35 I have to note that customer service in that area for
36 State Water has been dramatically improved over the last
37 determination period, particularly in the time that they
38 turned those things around, and their costs are very fair
39 and maybe that's one area where they can over time increase
40 their pricing a little bit.
41
42 Listening to this morning and talking about the recent
43 dry sequence, my biggest fear is that we are going to make
44 some short-term decisions based on that last four years
45 rather than thinking about the long-term. I have concerns.
46 Most people were supportive of the determination period
47 being four years and I just questioned in my own mind this

1 morning is that four years too long, based on what we're
2 currently experiencing, in setting down something hard and
3 fast? I am not sure if IPART can consider how they can
4 make that determination period either less or flexible.
5 I really don't know. That is my own little point.
6
7 In particular, in WMI's submission - I would like to
8 get to the specific points now - we specifically commented
9 on those three years of drought and I know Col in the New
10 South Wales Irrigators Council certainly picked up on that
11 too, that we've had those four perhaps exceptional years
12 for the last determination and at the moment I believe
13 State Water has presented a flawed argument that high
14 security entitlements should receive higher fixed charges
15 based on their higher allocations and ability to pay.
16
17 High security entitlements should not be seen to be an
18 easy or a minority voice target to load additional costs on
19 to and I say that because State Water have gone around
20 talking to a lot of customers. There are a lot less high
21 security customers than general security customers, so I'm
22 really just concerned that perhaps the minority voice has
23 not been fairly listened to.
24
25 Of course, since the last determination the severe
26 drought has adversely affected allocations to our
27 irrigators and has forced changes in the way that the whole
28 water system has been managed and that's probably of
29 interest because we have had the water sharing plans turned
30 off and I'm not sure whether that's reflective of how
31 things are going to be in the future. George made the
32 comment today that if that's going to be the future,
33 we should all be very scared.
34
35 We have seen some lessons learnt in the last four
36 years with how they've managed their priorities. The facts
37 are at the moment that high security is already paying a
38 fair and reasonable premium of 1.5 times for the priority
39 and the higher level of service it receives and I note when
40 the determination was completed last time, that the higher
41 level of service was about storage capacity and keeping it in
42 the dam for a bit longer.
43
44 What the drought has highlighted in the last four
45 years is that town water supplies and stock and domestic
46 supplies have been treated a little bit differently from
47 high security irrigation entitlements due to their higher

1 priority and their critical water needs status. I am not
2 sure whether the determination can even look at splitting
3 within high security premiums based on town water supplies
4 and stock and domestic, but I know that in the MDBA's
5 submission by Rob Freeman he picked up on some of those
6 critical human needs and whether that needs to be accounted
7 for at a pricing level.
8
9 Just to put that into some GL actuals, if you look at
10 town water supplies in the Murray - and that includes
11 Murray Irrigation - it's about 37GL, so it's not a big
12 amount of water in the whole scheme of things, but they are
13 achieving that higher level of service. Stock and domestic
14 is only about 14.5GL. Carryover is an absolute unknown
15 quantity and each year it does change, but we have seen
16 that that has received first priority in the last three
17 years, and that carryover has had to be met before high
18 security has been allowed out.
19
20 Also with the conveyance licence - and Jenny mentioned
21 that they do have a conveyance licence - they've had some
22 access to that while high security has been receiving
23 allocations and some of that is equivalent to general
24 security and the conveyance licence is currently charged at
25 the equivalent of a general security licence.
26
27 Just with the comment about high security and how much
28 is actually used for agricultural purposes, the NSW Office
29 of Water has confirmed that 80 per cent of all high
30 security water is actually used in an irrigation season for
31 a productive purpose. In the State Water submission they
32 have noted that we received supernormal gains by trading
33 our entitlements during the dry years, but unfortunately
34 80 per cent use actually refutes that fact.
35
36 That supernormal gains have not been achieved by high
37 security as a significant portion of the traded water in
38 the last three years has actually come from within the
39 Murrumbidgee Valley because they have had better
40 allocations or from the Victorian allocation in those
41 earlier years. It hasn't all been high security users
42 trading their water on the market.
43
44 I note that we have had a couple of slides up about
45 the permanent value of water increasing. It has increased
46 for both general and high security entitlements and
47 predominantly for the real farmer it is an unrealised

1 asset. It is like your house: it might be going up when
2 you're living in Sydney but you're not selling it, so
3 you're not actually realising the value from that
4 entitlement. I think Brett very succinctly alluded to the
5 fact that you can't relate the market price of water to the
6 actual entitlement value and I think the State Water
7 charges have to be separated.

8
9 I like the fact that State Water have tried to come up with
10 some new ideas in their submission and they are trying to
11 come up with a formula for their scarcity pricing is not an
12 un-sensible one, but I'm just concerned about that whole
13 capacity-to-pay argument. Realistically, in those dry
14 years we were buyers of allocation and not sellers in some
15 of those instances and that the water market is so variable
16 that they didn't put market prices up prior to that 2006
17 period.

18
19 It was before my time, but Dennis was telling me on
20 the way over that they were scraping to sell water at \$10 a
21 megalitre at times and probably the average when I got
22 there was \$50 a megalitre, so it is a very variable water
23 market.

24
25 The capacity to pay also does not relate to the cost
26 of the service or the higher standard of service in
27 determining that premium of 1.5 times. What we've seen in
28 the last four years have been some political decisions as
29 well which they've made to allocate water at different
30 times for different users. An example is the running of
31 environmental water down creeks to support fish
32 populations. They have been playing around with
33 traditional allocations.

34
35 High security. Col said that we're happy to pay a
36 higher premium, but if we're going to go much higher we'd
37 want to see the water stored in a dam at 1 July and what
38 we've seen in the last three season is that there hasn't
39 been any water for high security on 1 July. We have
40 started on zero allocations. With that high security
41 premium we are trying to work out what we're actually
42 paying for. Yes, we're getting water, it is coming late in
43 the season, we recognise that, but that is the historical
44 allocation decision of how they've set that up.

45
46 My final point on that whole high security premium is
47 that it has been adhered to from the water sharing plan.

1 You picked up that conversion factor. That water sharing
2 plan is in place until 2014 and I don't think IPART should
3 be messing around in determining a different conversion
4 factor from the water sharing plan. At this stage we don't
5 support that scarcity pricing at all and we don't believe
6 it's a scarcity advantage because basically high security
7 was designed to provide reliability for permanent plantings
8 in the majority of both wet and dry years and I think we
9 should take everything else out of the argument.

10
11 With respect to burden sharing, I noted that
12 State Water wanted to accommodate customer preferences for
13 tariff design, which is great, but as I've said before,
14 there is obviously significantly more general security
15 customers than high security. I note that State Water
16 wants to redistribute the burden of costs faced by
17 high security and general security licence holders and they
18 do believe there is an inequity. I think that that's a
19 lovely noble aim, George, but I don't think it's a good
20 argument.

21
22 George has noted that there's no net benefit or
23 additional revenue to State Water of changes to the
24 high security premium. It might have an individual
25 benefit, of course. We know all those farmers are
26 suffering, but you're not making an extra dollar for
27 State Water out of that decision and you're not dealing
28 with your problems. I would like to see a more effective
29 solution.

30
31 I know that there are some community service
32 obligations to those regions where forecast recovery is a
33 problem and I think that's where we need to keep dealing
34 with that. We have been fully supportive of fixed cost
35 charge relief for all of those people and unfortunately the
36 New South Wales government has never come to the party to
37 give that fixed cost relief, fixed charges, so I don't
38 think we should be penalised or indeed burdened because
39 they were the words that we used.

40
41 I would like to have a brief chat about general
42 security carryover. I know George disagreed with our
43 submission in his presentation today, but when the water
44 sharing plan is transitionally on - and hopefully it will
45 come back on - general security can carry over 50 per cent
46 of their licence entitlements. George noted that a third
47 of available water can be carried over in any one year and

1 it is certainly something that people are using more and
2 more, the carryover, and in those years where they carry
3 they're not collecting the usage charge in that year.
4
5 There is a cost for carrying over. One, they are not
6 collecting their usage, and two, it is actually being
7 stored in the dam for future use, but at what time I'm not
8 sure. It just depends on how the seasons carry out.
9 We have looked at this and said, "Okay. We're going to
10 start messing around with premiums and high security." At
11 the moment that carryover is receiving a higher priority
12 than high security. We know that general security has
13 higher holdings and entitlements, but there are business
14 risks and benefits to carry over. I think it needs to be
15 looked at.
16
17 Of interest this year has been also that they have had
18 a lot of water carried over in the Murrumbidgee that had to
19 be delivered around through the Murray system. I am not
20 sure whether that has cost implications for New South Wales
21 Murray delivery infrastructure, but it is something we
22 would like looked at. I will get off general security and
23 high security.
24
25 With respect to the lowering of the rebates for
26 irrigation corporations, it's great to see that that's
27 still supported. We are only a very small recipient of
28 about \$38,000 at Western Murray. We are certainly not at
29 the \$1 million mark that Murray Irrigation is, but we
30 believe we are receiving or providing benefit back to
31 State Water from that.
32
33 One thing I noted in their submission is that they
34 talked about transformation under the ACCC rules.
35 Western Murray is already allowing transformation. We are
36 in the transition phase and we are having a number of our
37 irrigators who are choosing to either trade their water out
38 to a third party or move water out on to an independent
39 licence, but they are keeping their delivery entitlement
40 within our system, which means they're still a customer
41 that will be potentially pumping water.
42
43 I think I have had one that has totally terminated.
44 I have all these partial people who are receiving water who
45 are still going to be delivery customers even though their
46 water might have all gone. We have to have this little
47 mismatch. State Water is going to have all these

1 customers, new perhaps potentially, but I've also still got
2 them because they haven't terminated their delivery
3 entitlement and I'm still going to be reading their metres.
4
5 If they've transformed it's not correct to say that
6 Western Murray is not actually dealing with those customers
7 any more. Transformation cannot be used as an argument to
8 reduce the rebate, but if someone totally terminates out of
9 my system and I disconnect their outlet and they pay that
10 termination fee, I am very happy to say to George, "You can
11 have that customer and you can pay me less of a rebate
12 because that's really the end point with that customer."
13
14 Transformation is still in its very new stages. We
15 are all not sure exactly how much will happen in that space
16 with the ACCC in the next four years, so I believe that it
17 is too early in this determination to make those changes.
18 I think we should sit on that one for another four years
19 and reflect, yes, if they validly move, but don't do too
20 much more in this determination.
21
22 This is my last wrap-up point: increasing the high
23 security price by 68 per cent, I really do think would have
24 a negative economic impact on our region. Unfortunately we
25 are in a severe wine grape glut because the people in
26 Sydney and all around Australia, are not drinking enough
27 chardonnay. We are all trying but we are in a lot of
28 trouble in some of those areas. Our profitability is at
29 best marginal and a 68 per cent charge is a big increase.
30
31 I noted in the discussions today there was talk about
32 the 60:40 per cent. We concur with why State Water are
33 trying to do that, but if I look at what I have done in my
34 business and similar to the other two, we are on about a
35 70:30 ratio. If I was going to change one thing, if I had
36 to change something with State Water, those percentages are
37 the thing I would be playing around with.
38
39 I trust IPART will develop a fair pricing path and
40 will not let the last four years totally skew its
41 decisions. Those short-term revenue impacts should not
42 result in long-term pricing decisions. Hopefully the
43 drought will break and hopefully you will be accredited
44 under the new ACCC rules because we really don't want to
45 see ACCC running everything and we would really like to
46 have IPART still there in four years time. Thank you.
47

1 THE ACTING CHAIRMAN: Thank you very much for your
2 comments. We will move on to questions from Richard and
3 Colin.

4
5 MR REID: Thanks very much, Cheryl. If I heard you
6 properly, you talked about a fair determination, ACCC,
7 emphasis on fixed costs. Would you like to expand on that
8 for us?

9
10 MS RIX: We set our pricing at the start of each year, but
11 to get our termination fee exactly where we needed it to
12 be, we needed to make sure we had a true fixed cost, and
13 that was our access fee. So we are now getting 100 per
14 cent recovery on fixed costs to give us the true
15 termination fee. So we are certainly fully compliant with
16 how they said their charging would be. Actually for two of
17 our irrigation areas we were already there. There was only
18 one irrigation area where I had to increase their charges.
19 Over the last three years our charging increases have been
20 in line with CPI. We have not had to go up over and above
21 that. Even this year, we were getting the termination fee
22 bands right; we were pretty spot on and we didn't need
23 those large jumps.

24
25 MR REID: Obviously a key issue for you is the
26 relationship between high security and general security. I
27 would just like to take the next step, if we can. I
28 think you have spoken about the carryover entitlement and
29 obviously there is a difference of opinion on that one.
30 Could you just expand on that a bit further so we can
31 understand the issue more?

32
33 MS RIX: Particularly on the carryover one?

34
35 MR REID: Yes.

36
37 MS RIX: It is a little unique at the moment because the
38 water sharing plan is turned off, but I am not sure what we
39 are going to in this determination period. As I said, at
40 the moment up to a third of those licences can be carried
41 over and people make those decisions as to whether they
42 will hold it to run a crop early on in the season. High
43 security has had the benefit of carryover for the first
44 time ever in the last couple of years. We have had that
45 benefit but we forfeit that when we get to our full
46 allocation, so that carryover gets swept out and goes back
47 into pool.

1
2 It has certainly been a benefit for high security, so
3 I really think it has a benefit and a revenue benefit
4 potentially for those farmers as well. If you are using
5 that old argument of capacity to pay and benefits, I think
6 that carryover argument needs to be looked at.

7
8 MR REID: You talked about the partial customers where you
9 were still obviously providing a delivery service for them.
10 Do you charge for that particular service, and presumably
11 that is separate from the normal water usage and fixed
12 charge?

13
14 MS RIX: We used to have what we just called a share and
15 all our charges related to that. When the ACCC rules
16 started to come into play, we separated water entitlements.
17 So effectively the only charge our water entitlement gets
18 now is the fixed government charge from State Water and
19 DWE. That is, in effect, an almost unencumbered amount, a
20 thing that can be moved off the licence very quickly. All
21 our charges are now based on what we call our delivery
22 entitlement, and that is the right to have water delivered
23 to your point of supply being your metered outlet.

24
25 If a person chooses to get rid of his water, which is
26 really easy, that goes, he still has to pay all our access
27 charge, which is our fixed charge, and our usage charge -
28 well, the access charge is very much based on that delivery
29 entitlement, so unless he surrenders that delivery
30 entitlement to us and says, "I don't want water from you
31 again" and terminates it, he continues to pay that
32 regardless of the fact that his water has long gone. But
33 he can, of course, then temporarily trade water in against
34 that delivery entitlement and use water against that. That
35 is one of the business choices people are making, because
36 they realise they have their capital asset and they then
37 temporarily trade water in to keep farming for a bit
38 longer.

39
40 We have really distinguished between the two and all charging
41 is now back at delivery level, which is very much based on
42 the costs of the business. We are a break-even business,
43 so we really have our costs defined very clearly.

44
45 MR WARNER: I appreciate you don't support the 68 per cent
46 increase in high security charges and you seem to be saying
47 that you actually prefer the 1.5 times premium that applies

1 to high security. Are there any other alternative
2 propositions that we might consider to enable State Water
3 to properly recover its costs in relation to high security?
4
5 MS RIX: I am still not clear on what costs are different
6 for high security over general security. I didn't get that
7 out of the submission as to what the clear differences are.
8 I believed it was something to do with storage and holding
9 that water in storage and, yes, delivering it in the real
10 world in these last couple of years. In a more normal
11 scenario and season even this year with general security
12 getting 10 per cent of their allocation out, that is
13 probably equivalent to the volume of water that high
14 security has been given this year, so you are running the
15 same amount down the river. Col Thomson picked up on that
16 very clearly before. One megalitre coming down the river
17 is no different; regardless of whether it's high or low, it
18 is an allocated amount. It is a consistent pricing path.
19 You have that 1.5. I think we are all wanting some sort of
20 certainty in our pricing, so that premium I find is quite
21 solid and consistent; we know what we are dealing with.
22
23 MR MILLS: The thing that needs to be remembered is that,
24 certainly in the last few years, as Cheryl rightly said,
25 high security holders started from a zero allocation and
26 the only water they have had to start the year has been
27 what they have carried over, and that has been at a cost to
28 them. Then the allocation has come. In some years it has
29 come in dribs and drabs.
30
31 This year was a little different; it came a lot
32 quicker. As a result of that, a lot of people actually
33 lost it, as Cheryl said before, and that carryover went
34 back into the system. That was quite a financial loss. It
35 is quite a financial loss for people. They could have sold
36 it on the market or used it in some other way prior to the
37 beginning of June because the cut-off date is 1 May, so you
38 have to make that decision. It was 1 April the year
39 before. A high security water person has a lot of holding
40 costs. He has to try to be the smartest water estimator of
41 all time. I think in the last few years we have all got a
42 bit smarter at it but it still costs a lot of people a lot
43 of money.
44
45 MR WARNER: Just returning to the issue of having
46 carryover entitlements paying the same premium as high
47 security, surely if you have general security and you carry

1 some of that over, all you are doing is deferring when you
2 pay it and you might only defer it to the beginning of the
3 following season anyway? I am not sure whether there is a
4 real big concern or issue there
5
6 MS RIX: I am just talking about costs and storage
7 capacity. What I heard with the 1.5 premium was that we
8 were paying more for storage and we are seeing that the
9 carryover has to be stored at 30 June, so who pays for
10 that?
11
12 MR WARNER: So you are really interested in understanding
13 I guess, the costs - what you are really paying for your
14 high security premium, let's say.
15
16 MS RIX: Exactly. So if we are getting even 1.5, we want
17 to know why we are getting that premium, and if it is
18 just 5, absolutely fine, we recognise receiving that
19 allocation is a very positive thing for our businesses but
20 we want to understand the differences.
21
22 MR WARNER: One of the things we have spoken about at
23 length today is concerns about State Water's revenue
24 volatility and the proposals they have put forward to
25 correct and address that. I was wondering whether you have
26 any alternative ideas as to how we might approach that
27 problem given that some of their ideas don't enjoy a great
28 deal of support
29
30 MS RIX: Their ideas are better than no ideas I guess,
31 aren't they? We have all sat up there and then gone
32 dumb-faced at that question because it is a really
33 difficult question. The problem with people sitting at
34 this table is that we are not State Water. I don't
35 understand their business to the nth degree. I don't
36 understand what things they can manipulate and change, but,
37 yes, that revenue volatility and shortening your
38 determination period might assist with that. If they come
39 back with a strong year next year, that might help with
40 some of that revenue volatility. We don't really know what
41 the rainfall patterns will be.
42
43 I certainly concur with a lot of discussion today.
44 That 15-year old rollover period is really quite,
45 confronting with a lot of the data that is out there and
46 the data that is still to come. It is a bit hard to lock
47 yourself into that type of rollover, their 15-year

1 rollover, with what we know might be coming. I don't think
2 you have an easy job to sort out that revenue volatility.
3
4 MR WARNER: Did you say you have moved to 70 fixed 30
5 variable at the moment?
6
7 MS RIX: We are about on that path; so, yes. That's seems
8 to be what the others are saying as well, which is
9 remarkable that we are all quite consistent.
10
11 MR WARNER: Finally I would like to add that I am trying to
12 help you out. I am drinking as much wine as I can.
13
14 THE ACTING CHAIRMAN: Perhaps it's worth having one more
15 go at the conversion factor if you will bear with me. As I
16 understand it, what State Water are saying is that the
17 conversion factor of 1.5 that we have talked about doesn't
18 represent, if you like, the probability of getting water at
19 high versus general security entitlement holders over the
20 past 15 years. As I understand it that is their
21 proposition. I am wondering why you think that is not a
22 relevant consideration when thinking about this issue
23
24 MS RIX: It is relevant. It is one of the things you have
25 to consider, but you picked up 15. If you go back to the
26 1970s, they were awash with water and they were receiving
27 very high allocations all the time. Dennis will correct me
28 if I'm wrong because I wasn't around then either. The last
29 15 years has probably been a very dry allocation in the
30 sequence for general security and that is what is probably
31 worrying us because, in those wetter years, they do have
32 the opportunity to pour a lot of water and get a lot of
33 things going. I know we haven't seen that, but I am not
34 sure that that is totally reflective of the future either
35 with the dry conditions we are experiencing right now.
36
37 There are a lot of the federal initiatives coming out
38 and which will play out in the next few years with
39 modernisation and water use efficiency. We are only seeing
40 the start of that now. You would hope that some of those
41 delivery systems will improve as well. Entitlements will
42 change quite substantially. You will have environmental
43 water holders sitting there holding quite a bit of water,
44 and they are general security holders as well. I remained
45 concerned that if you decrease the general security charge
46 by 20-something per cent, which you said before, when one
47 of the largest holders may be an environmental water

1 holder, you are actually giving a gift to the government.
2
3 I am sorry, I don't know whether I answered that
4 question at all. I just wandered off on my own thought
5 pattern. You might want to reframe that and I can give it
6 another go. It is relevant, I understand, but I think you
7 have to balance the story and not take the totally dry; you
8 have to have a bit of other analysis in there.
9
10 THE ACTING CHAIRMAN: I understand the point you are
11 making. Thank you very much for your presentation and for
12 answering the questions.
13
14 We now move on to High Security Irrigators -
15 Murrumbidgee. Perhaps they would be kind enough to come
16 forward and introduce themselves for the record.
17
18 HIGH SECURITY IRRIGATORS - MURRUMBIDGEE
19
20 MR HOARE: Roger Hoare, High Security Irrigators -
21 Murrumbidgee. It looks like I am the sole person from my
22 organisation here today. This organisation is a relatively
23 new organisation having its roots in the former
24 Murrumbidgee Horticultural Council. Recently we changed
25 our constitution to allow all high security irrigators
26 within the Murrumbidgee to become members.
27
28 Over the last 10 to 15 years, it has become much more
29 difficult to find out what a high security irrigator is.
30 Some 10 to 15 years ago you would say they were people who
31 solely grew permanent plantings. That has been blurred a
32 lot because, with the advent of the drought and the water
33 market, general security irrigators, large irrigators,
34 whatever you wish to call them, availed themselves of the
35 ability to, I guess, safeguard their operations by buying
36 high security water.
37
38 Also in that period there have been some conversions
39 of general security water to high security. We have an
40 issue with the conversion rate. For the last couple of
41 years, our organisation has been pushing for those
42 conversions to be banned in the future. Indeed the
43 National Irrigators Council and the New South Wales
44 Irrigators Council recently passed motions to see that
45 through.
46
47 We are, of course, opposed to the proposed scarcity

1 charge that State Water has in its submission. We think
2 the premium that is currently being charged is quite
3 sufficient to distinguish between the two security levels.
4 We have heard information from previous speakers that the
5 money received from high security irrigators is partly what
6 is propping up State Water at present. Therefore, why do
7 they need to increase the charge on high security
8 irrigators? It would seem to us that that is just sort of
9 going out and pursuing people who are perceived to be in a
10 position of being able to pay. I will get to that later
11 because I don't think that is quite true.
12
13 Other speakers have also said that the value of
14 irrigators' entitlements is totally irrelevant. That's
15 true because the water market is playing an increasing role
16 in how people operate. This year, for example, water on
17 the temporary market was much lower than in previous years
18 and that is also reflected in the price of permanent water.
19 It has probably dropped by \$2,000 a megalitre compared with
20 earlier times last year.
21
22 Getting to the water market, I think it is interesting
23 to see what's happening in State Water's submission. I
24 think they have been saying in previous years that only
25 high security irrigators have been able to take advantage
26 of the water market. Clearly that is not true because last
27 year out of the 225,000 megalitres transferred in the
28 Murrumbidgee valley by the best of our estimate, and we do
29 run a fairly substantial trading operation, only 25 per
30 cent of that was actually high security water. You would
31 ask yourself where does the rest come from? I think the
32 answer has already been given. It is in part of the
33 carryover water that the general security irrigators have
34 because they are allowed to carry over 30 per cent. What
35 we are seeing is that those people who are clever enough to
36 go out into the market late in the season and pick up cheap
37 water to carry over are then entitled to take part in the
38 early part of the water transfer market in the following
39 season when invariably those prices are much higher.
40
41 Irrigators are becoming very astute business people.
42 Water is becoming another commodity that is traded.
43 We have had the situation this year, and in previous years,
44 where irrigators are making a decision on whether they will
45 actually grow a crop or sell their water. That is what is
46 keeping them afloat financially. We are seeing that the
47 whole market has changed.

1
2 With regard to the ability to pay, I think we have
3 already heard evidence relating to high security irrigators
4 who are generally involved in permanent plantings. One
5 only has to look at what is happening. The wine grape
6 industry is in serious trouble. Recent information is
7 telling us that 20 per cent of the present area of wine
8 grapes in Australia needs to be removed. That is 40,000
9 hectares. A lot of that will obviously be in the
10 irrigated areas, because that's where the cheap commodity
11 is. This had been driven by two things, which are
12 under-consumption, in the first place, and probably the
13 high Australian dollar. The pundits are saying we will get
14 to parity and that will further put the clampers on the
15 wind industry.
16
17 Similarly the citrus industry is struggling. A lot of
18 the earlier varieties that are being exported are having to
19 compete on the world market again against the high
20 Australian dollar, so they are in trouble as well. The
21 only permanent planting or commodity groups that seem to
22 be doing well at present are the nut industry and the olive
23 industry, but we are not sure how long that will continue,
24 because most of those are in their infancy and when you
25 look at the statistics, many of those plantings are
26 non-bearing right now. It will be very interesting to see
27 what happens when they do set to full bearing.
28
29 As far as vegetables and other food crops, one has to
30 look at what is happening with the Australian market,
31 where we are dominated by two supermarket chains. I notice
32 that the ACCC have said a few kind words about the market
33 concentration in Australia of those two groups. They are
34 certainly squeezing vegetable and fruit growers in terms of
35 the market, in terms of trade and actually in how they
36 market their products.
37
38 I don't think I need to say too much more other than
39 the fact that as high security irrigators, I guess we are
40 under the gun like many others and we don't particularly
41 wanted to be targeted by State Water as being the only
42 people who can afford to pay increased charges. Thank you.
43
44 THE ACTING CHAIRMAN: Thank you very much. We will
45 now have some questions and comment starting with Colin
46 and Richard.
47

1 MR WARNER: You did say something that tweaked my
2 interest. You said you have an issue with the conversion
3 rate between high and general security. Would you like to
4 elaborate on that a little?
5
6 MR HOARE: I think it was late last year that 140,000
7 megalitres of general security water was converted to
8 70,000 megalitres of high security water in this valley.
9 It was done without any consultation, and we think that a
10 conversion rate of 2:1 didn't reflect the true value of the
11 water. We think it was done for political reasons rather
12 than good sound business reasons, but it could affect State
13 Water.
14
15 MR WARNER: Just carrying on from that, couldn't there be
16 a link between conversion rates and high security premiums?
17 In other words, if the conversion is 2.5:1, why not have a
18 high security premium for State Water of 2.5:1?
19
20 MR HOARE: I don't quite follow the question; but, no, I
21 don't agree that that would be the case. I have already
22 said that we are opposed to any further conversions.
23 However, if you're going to do the proper rate of
24 conversion you would need many more sound figures than I
25 have seen currently floated around in State Water's
26 submission.
27
28 MR WARNER: One of the things that has come up several
29 times today is this revenue volatility thing and State
30 Water's various ways of addressing that and their 15 year
31 moving average versus IQQM and changes to the WACC, et
32 cetera. Again, do you have any views; if you don't like
33 those, what alternatives might be available?
34
35 MR HOARE: I probably would decline because I think my
36 inferior understanding of the issues would probably not add
37 any greater intelligence to the answers you have already
38 received.
39
40 MR REID: Thanks very much, Roger. You have raised in
41 your submission the issue of the prudence of some of the
42 capital expenditure proposed by State Water. Would you
43 like to elaborate on that for us?
44
45 MR HOARE: Only the fact that in private industry, if one
46 is pushed for finances, one has to look at ways of trimming
47 one's budget to see what one can actually do. We in the

1 private industry have to do that. We can't understand why
2 State Water is not looking at those issues. All right, we
3 understand they have issues with dam safety and what have
4 you, but in terms of operating, we believe they should be a
5 little more prudent in expenditure.
6

7 MR REID: Thanks very much.

8
9 THE ACTING CHAIRMAN: Thank you very much for your
10 presentation and for answering questions.
11

12 QUESTIONS AND STATEMENTS FROM THE PUBLIC

13
14 THE ACTING CHAIRMAN: We now have a session for
15 questions and statements from the public. Perhaps this is the
16 chance to make any additional comments you wish to make or
17 to pose a question. This will be followed by a response from
18 State Water. So if are there any questions or comments we
19 will get a mike to you.
20

21 MR HECKENDORF: Thank you, Mr Chairman. My name is
22 Rel Heckendorf. As chairman of the Customer Service
23 Committee. I am making these comments on comments that
24 have been made today and they are not necessarily the view
25 of the Customer Service Committee.
26

27 I am interested in George Warne's comment about their
28 credit rating. Let's face it, State Water is nothing more
29 than a government department under a different disguise and
30 the state government has a triple A rating, or whatever.
31 If one of its subsidiaries has a poor rating, then maybe
32 the reason behind the poor rating is that the shareholder
33 is not looking after it properly or didn't make a proper
34 contribution in the first place when they started it up.
35

36 I am a bit concerned about depreciation coming into it
37 by arbitrarily reducing the lives of assets. The last time
38 I looked at Berembled Weir, which I guess is 100 years old
39 or pretty close to it, all I could see was a couple of
40 surface cracks in the cement, so there is no reason why its
41 asset life should be reduced for probably another 60 or 70
42 years. I would question this arbitrary reducing of asset
43 life and then increasing depreciation.
44

45 I have an issue with the metering service charge. At
46 this stage the metering project is relying on Commonwealth
47 government money to bring it into place and no irrigators

1 giving up water. The customers at this point in time have
2 not agreed to giving up a certain amount of water to put
3 those meters in. This is a program that has been put
4 together by State Water.
5
6 I have some problem with the thematic costs, if it is
7 discretionary why is it being introduced? There has been
8 no consultation with customers or anybody else about some
9 of those issues, and I will relate to cold water pollution.
10 I was on the River Management Committee when the water
11 sharing plan was put in place, and the issue of cold water
12 pollution was raised. Some numbers were put out and it was
13 deemed that the cost benefit ratio of putting in assets to
14 deal with cold water pollution wouldn't give you the
15 benefits that so many people thought it would. From my
16 understanding, the temperature differential from normal was
17 only 1 or 2 degrees below Wagga. The biggest impact was
18 between the confluence of the Tumut River and Wagga.
19
20 Some of these thematic costs have been foisted upon
21 State Water, obviously. There are plenty of ways of
22 dealing with fish passage other than putting in fish
23 ladders. Berembed Weir, for instance, was an old wicket
24 structure back in the old days when the wickets were left
25 down during the winter period and the waters were supplied
26 by other means. Fish had passage through for six months of
27 a year or more past that structure.
28
29 I think you need to understand that the suspension of
30 the water sharing plan and the issues with carrying forward
31 the high security, et cetera, need to be looked at. That
32 water sharing plan will come back into play when water gets
33 to 20 per cent of general security in the Murrumbidgee and
34 it will be switched back on again. You need to be a bit
35 careful about changing a four-year program because of the
36 water sharing plan being suspended. For the next four
37 years it might be in operation.
38
39 I think you need to be careful in comparing IC's
40 management of risk as far as funding is concerned simply
41 because they manage fish on a year-to-year basis; whereas
42 if you start to give State Water a leg up as far as risk
43 management is concerned, who is to say they won't turn
44 around next year, and then in the next three years the
45 government will get a big windfall - in other words, it
46 will get a big dividend out of it. So if you want to look
47 at something there, then maybe that risk should be tied to

1 allocation and varied accordingly.
2
3 The other issue I wish to bring up is quarterly
4 billing. There has been no mention of that. Quarterly
5 building must have a financial positive for State Water.
6 The final thing is higher price and security conversion.
7 There is no issue for high security conversions. If a
8 security person wants to increase their security, they just
9 go out and buy water. The high security conversions in the
10 past were based on IQQM modelling and had nothing to do
11 with the financial value of high security water compared
12 with general security. Once it got out of kilter with the
13 drought, then everybody wanted to convert. Our view is
14 that if you want high security water, you just go and buy
15 it; there is no need to convert it. The marketplace is
16 alive and well and that's what you can do. Thanks,
17 Mr Chairman.
18
19 THE ACTING CHAIRMAN: Thank you very much. Are
20 there any other questions or comments?
21
22 MS HEHIR: I am interested to know how will you deal with
23 the MDBA costs. I understand only a proportion of those
24 costs have been included in State Waters' submission; the
25 others are to be included in the submission of the Office
26 of Water. Some of those will be water resource management
27 costs which have historically been in the Office of Water
28 or DWE submission, but I presume some of those costs are
29 actually costs that, in other valleys, would appear in the
30 State Water submission, which has different features in
31 terms of how those costs are shared and large customer
32 rebates. I am wondering how IPART will deal with that
33 separation.
34
35 THE ACTING CHAIRMAN: I would imagine it is a matter of
36 waiting for the submission to appear, then adding up the
37 bits and seeing what it means and, if necessary, holding
38 discussions with the MDBA.
39
40 MS RIX: I know we live in New South Wales, but we haven't
41 talked about Victoria and South Australia today. Has IPART
42 gleaned anything from the other two states in that they are
43 facing exactly what we are facing? I refer to Victoria
44 particularly with its drought, the government running of
45 their models and the fact that they have had obviously a
46 large amount of subsidies during this time. South
47 Australia's charging is quite different again. Are you

1 looking at their experiences? I personally believe and I
2 know that we are at a much higher level of cost recovery at
3 our state level than they are. I am concerned once again
4 that we are seen to be the leader and our irrigators are
5 probably being penalised in that marketplace again, and I
6 wanted to get your comments.

7
8 THE ACTING CHAIRMAN: I am sure that you're right to say
9 that New South Wales is achieving a higher level of cost
10 recovery than the other states: I think that is true.
11 We are required to follow the framework set out in our
12 legislation and also in the national water initiative,
13 which does lead us towards full cost recovery. I think
14 that's what we are going to do. I think you made a fair
15 comment that other states have been less conscientious in
16 moving in the same direction.

17
18 MR TIWARI: Arun Tiwari from Coleambally Irrigation.
19 I would just like to seek some clarification on the
20 efficiency improvement by State Water. They expressed
21 that that would be about a 6 per cent improvement in
22 efficiency. My question is where that 6 per cent saving
23 would go. Would it be relevant to all the customers or
24 would it automatically come around to the flows?

25
26 THE ACTING CHAIRMAN: We will ask State Water to
27 respond to that in a moment.

28
29 MR SHAW: Mr Chairman, I was wondering whether State
30 Water could also be asked under the current federal funding
31 regimes where they were wanting to stimulate everything and
32 they've got \$5.8 billion or so for infrastructure funding,
33 whether State Water would qualify or have their hand out or
34 put that in their budget that that sort of funding is now
35 available. Maybe we could get George to enlighten us on
36 that.

37
38 I realise that the \$5.8 billion is dependent on water
39 flowing back to the environmental water part of it, but
40 there might be other projects out there or other funding
41 streams from the Feds. I know that the metering and
42 monitoring project probably comes under what they're
43 talking about. Could you ask them that?

44
45 THE ACTING CHAIRMAN: Thank you. Are there any other
46 questions or comments? Thank you very much. We will now
47 ask State Water to respond.

1 RESPONSE FROM STATE WATER

2
3 MR WARNE: Thank you very much for the opportunity to
4 respond. I am going to run through a few points and then
5 Lisa is going to pick up a little bit of detail. I was
6 interested in the point made by the high security guys
7 about how they're a minority and that can affect them.
8 I am reminded of a meeting at one of the customer service
9 councils and there was one apology for the meeting.
10 I didn't realise until afterwards that it was from the one
11 high security user and there was a unanimous vote
12 supporting our proposal for higher charges for a higher
13 security, except it wasn't high enough.
14 Macquarie Generation wasn't at the meeting that day. No
15 doubt they'll have a different view which they'll express
16 through their Minister, I'm sure.

17
18 Firstly, can I say thank you for the kind words that
19 have been said about State Water. That was entirely
20 unexpected. Yes, there have been some achievements and
21 that's not to say there can't be quite a lot more.
22 I would just like to say that Andrew's submission from the
23 Irrigators' Council, which we are probably going to hear
24 another three times throughout the State, is that the model
25 is not broken. Leave it alone. I think the point we would
26 make is the basis of our entire submission is that the
27 model is broken, something has gone seriously wrong and
28 it's time to address it and we hope we have put forward a
29 proposal as to how you might do that.

30
31 That is the fact that in each valley in the State at
32 some time during the last four years we have fallen off the
33 low record inflows which indicates that we must do
34 something to change the way we share and sell water.

35
36 With respect to the comments made about high security
37 pricing, IPART should do some independent work, but I think
38 you'll find the days of conversion, if that is a proxy that
39 you might consider for pricing premiums, is gone. The
40 ACCC, the independent review by PricewaterhouseCoopers
41 and the view of the irrigation communities is that the time for
42 conversions has gone and there won't be any more
43 conversions. You might carry out your own independent
44 review of that. It wasn't a bad proxy to use in the past,
45 but it was interesting to hear Roger say that if it is a
46 proxy, it's not really good enough. It should be five
47 times the conversion which would be a great indicator for

1 price and we could perhaps support them.
2
3 On the issue of drought, water availability and
4 forecasts, I would take great issue with Andrew's point
5 that the more data you've got the better the model is going
6 to be. I think we're living in unprecedented times. There
7 are a number of factors that relate to the way people use
8 water, the way people carry water over, the way we manage
9 our catchments, the way we manage our river systems, the
10 gross mismanagement of our groundwater system that are
11 telling me personally, State Water collectively, the
12 scientists in our community, the sharers of water in the
13 Murray-Darling Basin, that there is less water and there is
14 going to be less water. That is not to say that there
15 aren't going to be floods ever again. That is not to say
16 there aren't going to be massive events that occur in our
17 rivers in years of plenty, but the trend is obviously in
18 our view downwards and we need to react to that and we
19 need to react appropriately.
20
21 Our decision to go to a 15-year view was not to take a
22 knee-jerk reaction, but to attempt to find a measured
23 solution to addressing this issue before the horse has
24 bolted and State Water is stony broke.
25
26 We have heard a lot of discussion about deferring
27 thematic expenditure, deferring dam safety programs,
28 cutting your cloth to suit your budget, and while I respect
29 that, I think State Water has an absolute responsibility to
30 spend money wisely, I would argue that decisions to defer
31 expenditure in state government owned infrastructure is a
32 road to disaster. You only have to look at the quality of
33 the rural rail services, as an example, where people have
34 deferred expenditure.
35
36 What we have to do is find the right type of
37 expenditure that reflects a first world water supply
38 infrastructure, because you may find that a particularly
39 belligerent treasury might just say, "To achieve your dam
40 safety why don't you run your dams consistently lower?"
41 Just keep in mind that they are paying for this program.
42 I think as a community in the interest of State Water and the
43 irrigators together have got a vested interest in running
44 first world infrastructure that meets our requirements, not
45 stuff that's gold plated, not things that go far beyond
46 what a reasonable expenditure is, but certainly stuff that
47 meets our requirements.

1
2 In terms of how do we deal with this issue of scarcity
3 pricing, we did have an idea at one stage that like stamp
4 duty you could charge a percentage on a water trade. If
5 you think of a house selling at Wakool for \$15,000 in a
6 depressed community or a house selling in Bellevue Hill in
7 Sydney for \$4 million or \$5 million, you would say that the
8 government has a progressive tax there. They charged much,
9 much more stamp duty on the house in Bellevue Hill than the
10 one in Wakool.
11
12 Likewise, during a drought year State Water could pick
13 up its revenues from those trading water by saying,
14 "Well, we're selling water for \$1,000. We're picking up
15 10 per cent. We'll take \$100 a megalitre. If we're
16 selling water for \$10, we'll get \$1." The water trader
17 won't be nearly as valuable in a wet year, but you'll make
18 it up in other revenues. I am here to tell you that that's
19 not going to happen. The ACCC and the interstate trading
20 bodies are not going to let something like that happen.
21 That might have been a more progressive way.
22
23 While I am on that issue, I would take some issue with
24 the figure of 80 per cent used in high security
25 horticultural areas. I think it may have been used for
26 horticulture, but I'm pretty sure, based on the stats we've
27 got about where the water has come from and where it has
28 gone, it wasn't used on horticulture in the Murray or the
29 Murrumbidgee Valley in all but one of those years when
30 obviously we were very, very short of water.
31
32 The comment that water values are not relevant to
33 State Water, I guess that's true, but the value of your
34 water has been again in the capital growth of irrigators,
35 but the comment that was made earlier during an analogy to
36 the value of your house, I would say that you've got a
37 vested interest in making sure that your house is preserved
38 and likewise you've got a vested interest in making sure
39 that State Water has a funding model that's stable and is
40 able to meet the reasonable costs of maintaining
41 infrastructure and the service provision that you need if
42 you like to maintain the value of that asset.
43
44 Comments were made earlier about the 6 per cent
45 reduction in our costs and the efficiency dividend.
46 I would point out that those reductions are in costs of
47 operating and the financial returns will go back to the

1 irrigators in the form of the charges. Any savings we make
2 in water delivery and efficiency will go back to the
3 irrigators in the form of an increased security.
4
5 The strongest argument in trying to compel irrigators
6 to become enthusiastic about the metering project is that
7 most of you will get a benefit in increased security
8 because the small amount of water we have got to give back
9 to the government will be surpassed by the true savings
10 which will be of benefit to all irrigators in the form of
11 greater security.
12
13 A question was asked about the \$5.8 billion in funding
14 available. Roughly \$1.3 billion has been earmarked for
15 New South Wales projects and of that, \$600 million has been
16 reserved within the irrigation districts if the projects go
17 forward. State Water and particularly the NSW Office of
18 Water have got four thematic project lines. The metering
19 is by far the most advanced of those.
20
21 Initially, they are looking at pipelines in the north
22 and south of the state to replace long-term stock and
23 domestic supplies. They are a great idea, they're easy to
24 build and they save water, but they're inherently unpopular
25 amongst people who have a stream in front of their house.
26 In really simple terms, they take years to negotiate and
27 days to build.
28
29 We have a project looking at understanding better,
30 getting a handle on and controlling overland flows and the
31 use of overland flows in the north of New South Wales in
32 the Murray-Darling Basin. That once again is quite easy to
33 say. It will be quite difficult to deliver, I would
34 imagine. The other project is a pre-2007 commitment by the
35 government to spend up to \$400 million in reconfiguring the
36 Menindee Lakes or projects that will lead to increased
37 efficiency in the Menindee Lakes.
38
39 That is really all I wanted to say other than once
40 again thank you for this opportunity to be here and thank
41 you for the kind words that came from many of you about the
42 way State Water is improving its business. We do
43 understand that we have a responsibility to deliver better
44 services, particularly to look at efficiencies and to
45 deliver those capital programs at the lowest possible
46 dollar and some recent very large tender prices that are
47 coming back to us would indicate that we have got every

1 chance of doing that. Could I hand over to Lisa for a few
2 comments.
3
4 MS WELSH: I thought I would like to take the opportunity
5 to correct a couple of misunderstood statements, if you
6 like, particularly within State Water's pricing submission.
7 First of all, there seems to be an emerging perception,
8 particularly within this audience, that State Water is
9 actually taking two separate actions to address the same
10 problem, that problem being revenue volatility, and those
11 two actions being consumption forecasting revisions and
12 also a higher WACC. Our view is that those are actually
13 addressing two separate problems. First of all, our
14 revised consumption forecasts are about getting the right
15 consumption forecast. We have a \$56 million hole in our
16 balance sheet that says that the current IQQM consumption
17 forecasting is just wrong.
18
19 We are saying to IPART now is your chance to get it
20 right. Here is what we think is correct. There have been
21 a range of different views this morning and I've certainly
22 noticed that some of our large customers have taken similar
23 steps to reduce consumption forecasting.
24
25 We are saying that 15 years is a pretty decent
26 approach. On that I would like to emphasise that we're not
27 saying that the next four years are going to continue. If
28 we were going to do that then we would have taken the last
29 rolling average of the last four years. No-one is saying
30 that, but we do think that 15 years is the balance and we
31 think that that is more correct than the current IQQM.
32
33 However, having said that, we think that seeking a
34 higher WACC and in particular the risk premium, that's
35 actually a very separate step which is designed to
36 specifically target the remaining revenue volatility.
37 Step one is getting the right consumption forecast.
38 Step two is dealing with the revenue volatility that
39 State Water faces as a result of retaining the 60:40
40 variable to fixed consumption forecast tariff design.
41
42 I wanted to make sure that people understood exactly
43 why we were going with both of those approaches to avoid
44 any perception by IPART that they should give us one or the
45 other. As far as we're concerned, both are necessary to
46 ensure our ongoing financial viability.
47

1 However, having said that, I notice that a lot of our
2 large customers have chosen a 70:30 fixed variable strategy
3 and that's something that we'd certainly like to run the
4 numbers on with IPART because that may remit the risk
5 premium that we would be seeking through our WACC.
6
7 Some of the other themes that have come out from
8 today's session have been about State Water not just
9 seeking to shift the risk of revenue volatility on its
10 customers, but instead coming up with some alternative
11 business strategies during drought and I would like to deal
12 with each of those individually, because there were quite a
13 few different strategies that were suggested by our
14 stakeholders.
15
16 The first of those was business diversification, so
17 building our unregulated revenue streams, and that is
18 absolutely something that State Water is looking at at the
19 moment, particularly seeing as we have now bedded down
20 our core operations, we've moved a little bit beyond the
21 business basic stage and we're able to now seek other
22 commercial opportunities.
23
24 However, I would like to say that the purpose of that
25 business development is not to cross-subsidise our
26 regulated business and I think that that's something that
27 IPART needs to be aware of. We believe that the regulated
28 business of State Water needs to stand on its own two feet.
29 In the way that we don't expect valleys to cross-subsidise
30 each other, we don't expect that our unregulated business
31 should be cross-subsidising our regulated business either.
32
33 The second of those was the reduction dividends.
34 There is already a natural correction in the amount of
35 dividends that State Water pays to its shareholders and
36 certainly over the last couple of years they have not seen
37 much from us. In fact, the revenue stream has been coming
38 entirely our way, so we would say that that's already
39 happening. We also note that under the IPART legislation
40 you are required to consider a rate of return paid to
41 shareholders. We would say that that strategy is
42 inconsistent with your legislative obligations.
43
44 The third suggestion was some technical improvements.
45 We agree that there are some further productivity
46 improvements that we could be making through the roll-out
47 of best practice for delivery systems: things like

1 increased use of telemetry and taking iWAS a little bit
2 further. In fact, a lot of those improvements have already
3 been included in our 6 per cent productivity savings which
4 is factored into our submission.
5
6 Lastly, I think the final one was a reduced
7 determination period so that we can allow some of the
8 changes that we're seeing currently bedded down, perhaps
9 not make any too hasty decisions. Our view is that the
10 IPART process is quite a resource intensive process not
11 just for ourselves but also our customers. It is not
12 something that I would like to do every year. We are a
13 fairly tightly run business and this is a pretty big impost
14 on our business. It certainly required a huge amount of
15 cooperation right across the business. That is something
16 that we think is a bit unrealistic.
17
18 We would also like to take the next four years to try
19 to suss out exactly what will be the situation with the
20 ACCC which we understand will be undertaking the next
21 determination. We are not anxious to do that any sooner
22 than we absolutely have to.
23
24 The only other thing I wanted to say is that I can
25 confirm that State Water is a largely fixed cost business
26 and that the 60:40 does represent risk sharing. One of the
27 stakeholders here today actually suggested that perhaps
28 they would be happy to pay for that risk sharing if only we
29 could put a price on it. Our view is that we have put a
30 price on it and that's via the higher WACC.
31
32 What we are saying is that if we have a revenue stream
33 that is as stable as say a metropolitan business, if you
34 like, the difference between us is the risk premium. We
35 are saying that if our revenue streams were going to be as
36 stable as theirs then we would be seeking a 90:10 fixed
37 variable tariff design, or alternatively, a level of
38 revenues via the WACC that would allow us to retain the
39 sorts of credit ratings that those businesses achieved.
40
41 Just touching on the large customer rebate, somebody
42 this afternoon made the point that when customers convert,
43 they often will still retain a delivery right within the
44 system; so they are actually not facing reduced customer
45 costs and therefore their rebate should not decrease
46 either. Our point is simply that when water holders
47 convert and they become a stand-alone customer, we get an

1 extra cost. We have a new customer to deal with and
2 therefore the economies of scale associated with that large
3 customer reduce and therefore the rebate should reduce
4 irrespective as to whether their costs have changed or not.
5

6 The only other thing I wanted to say is that there has
7 been a lot of talk today about whether State Water has
8 70 per cent fixed revenues or not. I don't want to confirm
9 that statement without going back and working some figures.
10 Having done a few calculations in terms of what is the
11 proportion of our revenue stream from users, which is
12 associated with high security entitlement holders which
13 can generally be seen to be 100 per cent fixed, based on
14 920 gegalitres of high security entitlements that equates
15 to annually, assuming 100 per cent usage, about 20 per cent
16 of State Water's overall revenues. That is the fixed
17 entitlement. That is assuming the 15-year rolling average.
18 That figure would fall a little bit if we reverted back to
19 the IQQM model.
20

21 In terms of overall revenues from users, that would
22 mean that we would be guaranteed around about 52 to 55 per
23 cent of the revenue requirements from users which, in my
24 mind, still leaves quite a big gap between 100 per cent
25 cost recovery that we are seeking. That is all I wanted to
26 say, thank you.
27

28 CLOSING REMARKS

29
30 THE ACTING CHAIRMAN: Thank you very much, George
31 and Lisa. That brings us to the end of today's proceedings. I
32 think we have had a most interesting discussion which has
33 focused our minds on the key issues - very much so, I
34 think. I appreciate the sympathy expressed by someone who
35 felt for our task in trying to resolve all those issues.
36

37 The next stage in this process is a further public
38 meeting in Dubbo on Wednesday. Thank you very much for
39 attending and thank you for your contributions today.
40

41 AT 2.15PM THE TRIBUNAL ADJOURNED ACCORDINGLY
42
43
44
45
46
47